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April 27, 2006

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# Environment

Use of Environmental Insurance by  
the Military Departments  
(D-2006-080)

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### **Acronyms**

AFCEE	Air Force Center for Environmental Excellence
ADUSD(ESOH)	Assistant Deputy Under Secretary of Defense (Environment, Safety, and Occupational Health)
EI	Environmental Insurance
GAO	Government Accountability Office
ODUSD(I&E)	Office of the Deputy Under Secretary of Defense for Installations and Environment
PBC	Performance-Based Contracting
NAVFAC	Naval Facilities Command
USACE	United States Army Corps of Engineers



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April 27, 2006

MEMORANDUM FOR DEPUTY UNDER SECRETARY OF DEFENSE FOR  
INSTALLATIONS AND ENVIRONMENT  
ASSISTANT SECRETARY OF THE AIR FORCE  
(FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Report on the Use of Environmental Insurance by the Military Departments  
(Report No. D2006-080)

We are providing this report for review and comment. We considered management comments on a draft of this report from the Deputy Under Secretary of Defense for Installations and Environment and the Air Force Center for Environmental Excellence when preparing the final report.

DoD Directive 7650.3 requires that all issues be resolved promptly. Comments from the Deputy Under Secretary for Defense for Installations and Environment and the Air Force Center for Environmental Excellence were partially responsive. We request additional comments on all recommendations by May 26, 2006.

If possible please provide management comments in electronic format (Adobe Acrobat file only) to [Audacm@dodig.mil](mailto:Audacm@dodig.mil). Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Questions should be directed to Ms. Kimberley A. Caprio at (703) 604-9202 (DSN 664-9202) or Ms. Rhonda L. Ragsdale at (703) 604-9347 (DSN 664-9347). See Appendix B for the report distribution. The team members are listed inside the back cover.

A handwritten signature in black ink, reading "Richard B. Jolliffe".

Richard B. Jolliffe  
Assistant Inspector General  
Acquisition and Contract Management

## Department of Defense Office of Inspector General

Report No. D2006-080

April 27, 2006

(Project No. D2004-D000CB-0216.000)

### Use of Environmental Insurance by the Military Departments

#### Executive Summary

**Who Should Read This Report and Why?** DoD contracting and environmental program management personnel responsible for contracting for environmental cleanups on active and closed DoD installations and sites should read this report. The report discusses the use of environmental insurance when contracting for environmental cleanup services.

**Background.** Environmental insurance is a tool used to transfer the risk of potential cost overruns and legal liability from the property owner to the contractor and the insurance provider when performing environmental cleanups. This allows the owner and the contractor to achieve greater certainty of their financial obligations in environmental cleanups. In April 2001, the Office of the Deputy Under Secretary of Defense for Environmental Security issued a memorandum encouraging the use of environmental insurance to manage potential legal, financial, and environmental risks associated with the cleanup of closed DoD properties. Currently, the Military Departments are the primary users of environmental insurance for both active and closed installations. Using environmental insurance allows DoD to transfer portions of the risk of cost overruns and unexpected schedule changes to the contractor and the insurance provider. By DoD shifting the risk, the contractor is strongly motivated to complete the environmental cleanups in a timely and cost-efficient manner. When the Military Departments use environmental insurance, the contractor rather than DoD is the insured party. However, environmental insurance policies can be structured to allow DoD to have additional insured status and assignability privileges that give DoD some of the same protections as the insured contractor.

As early as February 2000, the Navy incorporated the use of environmental insurance with firm-fixed-price contracts awarded for environmental cleanups to encourage the application of performance-based contracting principles. Performance-based contracting is a contracting method that defines a service requirement in terms of performance objectives and provides the contractor with the latitude to determine how to meet those objectives. Using environmental insurance provided maximum opportunities for the contractor to enter into the firm-fixed-price performance-based contracting method. Since 2001, the Army and Air Force have issued 40 performance-based contracts with environmental insurance. The environmental insurance cost \$39 million, or 7.9 percent, of the total contract costs of \$491.5 million. The Navy performed one firm-fixed-price contract using environmental insurance in February 2000, at a cost of \$28.8 million at the Charleston Naval Complex.

**Results.** The use of environmental insurance is relatively new and is not being used on a consistent basis throughout DoD. Specifically, the Army and Air Force have increased environmental insurance use, while the Navy originally used environmental insurance but has chosen to limit its use to early transfers of sites closed because of Base Realignment

and Closure efforts. The varied use of environmental insurance is attributed to the lack of DoD level guidance to identify the appropriateness and use of environmental insurance and lessons learned based on environmental insurance use to date. Without guidelines at the DoD level, DoD may miss opportunities to reduce risk through the use of environmental insurance for environmental cleanups or may incur additional cost for environmental insurance not needed. DoD contracting officers took steps to evaluate and obtain a fair and reasonable price on the total contract price when contracting for environmental cleanup services with environmental insurance. However, we were unable to entirely determine whether DoD received a fair and reasonable price for the environmental insurance portion of the contracts because the contracting officers did not evaluate the price of environmental insurance separately, but as part of the total contract price. We also reviewed the manager's internal control program as it relates to the Military Departments' controls over evaluating whether to use environmental insurance.

**Management Comments and Audit Response.** The Assistant Deputy Under Secretary of Defense (Environment, Safety, and Occupational Health) provided comments for the Deputy Under Secretary of Defense for Installations and Environment. He partially concurred with the recommendation to perform a survey of lessons learned for effective use of environmental insurance, stating that a survey will be conducted once additional environmental insurance experience was obtained. He partially concurred with the recommendation to establish milestones for issuing guidance on environmental insurance use, stating that the Assistant Deputy Under Secretary of Defense (Environment, Safety, and Occupational Health) was in the process of developing a handbook on performance-based contracting for environmental cleanup projects, which would include key provisions for using environmental insurance. Finally, he stated that the report did not sufficiently support the need to include monitoring the contractors' adherence to the provisions of the environmental insurance policy. We acknowledge the Assistant Deputy Under Secretary of Defense (Environment, Safety, and Occupational Health) efforts to develop a handbook to include direction on environmental insurance use; however, his comments were partially responsive because he failed to provide estimated timeframes for the completion of the survey and issuance dates for the handbook. We request the Assistant Deputy Under Secretary of Defense (Environment, Safety and Occupational Health) provide comments on the final to provide the milestones.

The Acting Chief, Environmental Division, DCS/Installation, Logistics and Mission Support (the Acting Chief), providing comments for the Director, Air Force Center for Environmental Excellence, partially concurred with the recommendation to monitor contractors' adherence to environmental insurance provisions to preclude voiding the policy. The comments were partially responsive. We request the Acting Chief provide comments to the final report outlining how the Air Force will monitor contractors' adherence to environmental insurance provisions and timeframes for completing the action.

We request that both the Assistant Deputy Under Secretary of Defense (Environment, Safety, and Occupational Health) and the Acting Chief provide comments on the final report by May 26, 2006. A discussion of the management comments is in the Finding section of the report and the complete text is in the Management Comments section.

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## Background

**Environmental Insurance.** Environmental insurance (EI) is a tool used to transfer the risk of potential cost overruns and legal liability from the property owner to the contractor and the insurance provider when performing environmental cleanups. By transferring risk to the contractor and the insurance provider, the property owner can achieve greater certainty of the financial obligations in environmental cleanups. Although EI transfers risk of cost overruns and legal liability to the insurance provider, the contractor still retains some level of risk because each insurance policy requires the contractor to pay a deductible, referred to as “self-insured retention,” and a co-insurance<sup>1</sup> payment before the insurance provider pays any claims.

During the early 1980s, when EI was initially offered by insurance providers, the number of insurance providers and the market for EI were limited. Since then, the market for EI has expanded rapidly to include both the private and public sectors; however, the number of insurance carriers remains limited. Currently, there are only three major insurance providers that offer EI for significant environmental cleanup projects that exceed \$10 million in estimated costs. The insurance providers offer the following EI coverage:

- Cleanup cost cap insurance<sup>2</sup> covers instances where the actual cleanup cost exceeds the estimated cost and will cover up to an agreed-upon amount once the cleanup cost exceeds the estimated cost.
- Pollution legal liability insurance covers claims against the current or previous property owner arising from cleanup, bodily injury, or property damage resulting from contamination.
- Insurance that covers claims arising from pre-existing known and unknown contamination below reportable levels. All parties with interest in the property can be named insured parties on the property transfer insurance policy.
- Insurance that covers sites with known environmental contamination for which cleanup and development activities are planned.

**DoD Use of EI.** In April 2001, the Office of the Deputy Under Secretary of Defense for Environmental Security issued a memorandum encouraging the use of EI to manage potential legal, financial, and environmental risks associated with cleanup of closed DoD properties. Currently, DoD components use EI for both active and closed installations. Within DoD, the Military Departments are the primary users of EI. Using EI allows DoD to transfer portions of the risk of cost overruns and unexpected schedule changes to the contractor and the insurance provider when contracting for environmental cleanups. By DoD shifting the risk,

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<sup>1</sup> Co-insurance is a percentage of the cost overrun paid by the contractor (named insured).

<sup>2</sup> Cleanup cost cap insurance is also known as stop gap loss insurance.

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the contractor is strongly motivated to complete environmental cleanups in a timely and cost-efficient manner. In addition the contractor has an incentive to use innovative methods for the cleanup, and by purchasing EI, the contractor can limit its risk. The contractor limits its risk because when unexpected conditions occur during the cleanup causing cost overruns and schedule changes, the contractor can file a claim with the insurance provider, seeking reimbursement for the unexpected expenses. When DoD components use EI, the contractor rather than DoD is the insured party. However, environmental insurance policies can be structured to allow DoD to have additional insured status and assignability privileges that give DoD some of the same protections as the insured contractor.

As early as February 2000, the Navy included EI with firm-fixed-price contracts awarded for environmental cleanups. The motivation of using EI within the firm-fixed-price contracts was to apply performance-based contracting (PBC) principals within the environmental cleanup arena. PBC is a contracting method that defines a service requirement in terms of performance objectives and provides the contractor with the latitude to determine how to meet those objectives. Using the firm-fixed-price PBC method allows DoD to:

- place maximum risk and full responsibility for cost and resulting profit or loss upon the contractor,
- provide maximum incentive for the contractor to control cost and perform effectively, and
- promote maximum innovation in cleanup technologies and strategies by the contractor.

The Army and Air Force contracting and environmental cleanup program management personnel stated that using EI, where appropriate, provided opportunities for the contractor to enter into the firm-fixed-price PBC and transfer potential risk of cost overruns and unexpected schedule changes from DoD to the contractor and insurance provider. When choosing to use EI, DoD provides the funding to the contractor to pay the nonrefundable premium up front. According to the U.S. Army Environmental Center (Army Environmental Center), the industry standard for the cost of EI is approximately 6 to 15 percent of the total environmental cleanup cost.

**DoD Components Involved in Environmental Cleanups.** Within DoD, the primary organizations responsible for management or contracting for environmental cleanups are the Office of the Deputy Under Secretary of Defense for Installations and Environment (ODUSD[I&E]), the U.S. Army Corps of Engineers (USACE), the Army Environmental Center, the Naval Facilities Command (NAVFAC), and the Air Force Center for Environmental Excellence (AFCEE).<sup>3</sup> The primary users of EI, within the Military Departments, are

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<sup>3</sup> The Air Force Major Commands also award their own contracts for environmental cleanup services at the Air Force installations; however, as of July 2005, none had issued environmental cleanup services contracts with EI.

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essentially the contracting officers and environmental cleanup program manager personnel who are responsible for the requiring, procuring, and monitoring of environmental cleanup and EI.

**ODUSD(I&E).** ODUSD(I&E) provides, operates, and maintains the installation assets and services necessary to support the military forces. Specifically, ODUSD(I&E) manages the DoD Installation Restoration Program and the Military Munitions Response Program. Both programs focus on ensuring the environmental cleanup of active DoD installations and closed DoD properties. As such, ODUSD(I&E) is responsible for issuing guidance to include direction on both the Department's use of PBC for environmental cleanup services and the Department's use of EI.

**USACE.** USACE provides DoD and other Government agencies, as well as foreign governments, with critical engineering, construction, and environmental management services. USACE plays a major role in managing numerous environmental programs that includes cleaning up areas on former military installations contaminated by hazardous waste for DoD Components, as well as for other Federal organizations. USACE began using EI, with firm-fixed-price PBC environmental cleanup contracts, in March 2002.

**Army Environmental Center.** The Army Environmental Center implements the Army's environmental program by providing services such as site studies, investigations, design and technical assistance, remedial action activities, and long-term operations and monitoring. As part of implementing the Army's environmental program, the Army Environmental Center manages the environmental cleanup of active and excess Army installations, as well as provides technical support regarding environmental cleanup of active, excess, and closed Army installations. The Army Environmental Center began using EI in September 2001, when contracting for environmental cleanup services with firm-fixed-price PBC.

**NAVFAC.** NAVFAC manages the environmental cleanup for the Navy shore installations. In February 2000, the Navy initiated the use of EI on a test basis using a firm-fixed-price contract for the environmental cleanup of the Charleston Naval Base Complex (Charleston Project) following the 1995 Base Realignment and Closure recommendation to close the Charleston Naval Base Complex. NAVFAC did not receive its desired cost savings and has not used EI since when contracting for environmental cleanup services for either active or closed installations. Currently, NAVFAC uses EI for the early transfer of closed shore installations to local governments or commercial developers through grants. DoD accomplishes this by negotiating a price for the environmental cleanup with the local government or commercial developer and providing a grant for the negotiated amount. DoD includes the cost of EI in the total grant amount. Using the grants allows the Navy to transfer the closed installation earlier and transfer responsibility for management of site cleanup to the local government or commercial developer.

**AFCEE.** AFCEE provides environmental and engineering services associated with both active and closed DoD installations to Air Force and other

DoD organizations. AFCEE began using EI, with firm-fixed-price PBC environmental cleanup contracts, in September 2002.

**Dollars Expended on EI.** When contracting for environmental cleanups using EI, the Army and Air Force use a firm-fixed-price PBC contracting method. Over the last 4 years the Army and Air Force awarded 40 PBC contracts using EI for a total of \$491.5 million. Of the \$491.5 million, a total of \$39 million, or 7.9 percent of total contract costs was attributable to EI. For this audit, we reviewed 11 of the 40 contracts. The table below outlines the total contract value and the value of the EI associated with the Army and Air Force contracts awarded over the last 4 years.

	<u>Number of Contracts</u>	<u>Total Contract Cost (millions)</u>	<u>Insurance Premium (millions)</u>	<u>Insurance as Percent of Contract Price</u>
<b>Army Cleanup Sites</b>				
Active	25	\$374.1	\$29.6	7.9
Closed	11	99.6	7.9	8.0
<b>Air Force Cleanup Sites</b>				
Active	1	8.2	0.7	8.4
Closed	<u>3</u>	<u>9.6</u>	<u>0.8</u>	<u>8.6</u>
<b>Totals</b>	<b>40</b>	<b>\$491.5</b>	<b>\$39.0</b>	<b>7.9</b>

The Navy awarded one firm-fixed-price contract using EI in February 2000, at a cost of \$28.8 million at the Charleston Project.

## Objectives

The overall audit objective was to determine the overall use within DoD of insurance for environmental contracts. Specifically, we determined whether DoD effectively used insurance when contracting for environmental services and whether DoD received a fair and reasonable price when using EI. We also reviewed the management control program as it related to the overall objective. See Appendix A for a discussion of the scope and methodology and prior audit coverage.

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## Managers' Internal Control Program

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

**Scope of the Review of the Management Control Program.** We reviewed the adequacy of USACE and AFCEE management controls over contract management and administration for 11 contracts with EI. Specifically, we reviewed USACE and AFCEE controls over evaluating whether to use EI, ensuring EI policies contained the appropriate provisions to benefit DoD, and overseeing the administration of the contract as it relates to the EI policy. Because we did not identify a material weakness, we did not assess management's self-evaluation. We did not review the management controls at ODUSD(I&E) and Navy because we did not review any individual contracts with EI.

**Adequacy of Management Controls.** The USACE and AFCEE management controls over contract management and administration were adequate; we identified no material control weaknesses.

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## **Use of Environmental Insurance Within DoD**

The use of EI is relatively new and is not being used on a consistent basis throughout DoD. Specifically, the Army and Air Force have increased EI use, while the Navy originally used EI but has chosen to limit its use to early transfers of sites closed because of Base Realignment and Closure efforts.

The varied use of EI is attributable to the ODUSD(I&E) not issuing overarching DoD guidance to identify the appropriateness and use of EI and lessons learned based on EI use to date.

Without guidelines at the DoD level, DoD may miss opportunities to reduce risks through the use of EI for environmental cleanups or may be incurring additional costs for EI when not needed.

## **DoD Goals for Environmental Cleanup**

In the 2004 Defense Installation Strategic Plan, ODUSD(I&E) outlines the Department's goals for the environmental cleanup of DoD installations contaminated by hazardous substances, pollutants, and military munitions. One primary goal of the Plan is for DoD to identify, track, and report on the environmental conditions at each DoD active and closed installation. In its efforts to identify the environmental condition of each active and closed installation, DoD categorized each installation and site as having high, medium, or low risk. These categories of risk define the severity of the contaminant levels, the chance of the contaminant traveling outside the current affected area, and the exposure of the contaminant on an installation or site. The DoD goal is to have the environmental cleanup solution for active sites designated as high-risk in place by 2007, medium-risk sites by 2011, and low-risk sites by 2014. For closed sites, the DoD goal is to have the environmental cleanup solution in place for high- and medium-risk sites by 2007 and 2011 respectively, and cleanup solutions for low-risk sites by 2020. The goals established by DoD to complete the environmental cleanup solutions, as well as the actual environmental cleanups, drive the Military Departments decision on whether to use firm-fixed-price PBC with EI.

## **DoD Use of EI**

While the environmental industry has used EI since 1979, the Military Departments did not initiate the use of EI until 2000, as a part of environmental cleanup of closed installations. Since then the Military Departments have also begun to incorporate the use of EI when contracting for active installations cleanup. Over the last 5 years, both the Army and Air Force have increased their use of EI for cleanups of active installations. Specifically, the Army and Air Force have used EI on contracts for the environmental cleanup of groundwater

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contaminated with various hazardous materials, landfill closures, cleanup of drinking water, and other types of environmental cleanups. The Navy has chosen to limit its use of EI to early transfers of closed sites as part of the Base Realignment and Closure efforts. Because the Military Departments have taken different positions on what is the most beneficial use of EI, there is inconsistent use of EI throughout DoD.

**Army Use of EI.** Based on the Army's experience in using EI since 2001, on 36 contracts, the Army has realized lessons learned and identified processes, practices, and strategies for requiring, procuring, and monitoring EI that appear to be working well. In addition, both USACE and the Army Environmental Center have developed guidance to address the use of EI. Specifically, USACE issued, "Fixed-Price Remediation with Insurance," dated October 1, 2003, and the Army Environmental Center issued, "Performance-Based Contracting Guidebook," dated June 10, 2005.

According to both of the published Army guidances for using EI, the Army applied the following steps to evaluate the viability of using EI. First, Army contracting officers, in cooperation with the program management personnel, as part of an evaluation of the appropriateness of EI, assessed the need for EI based on the following factors:

- Is there a significant potential for cost uncertainties?
- Is there a significant potential for cost or schedule overruns?
- Is the estimated contract award price more than \$2 million?
- What type of competitive process will be used to award the contract?
- Will the contractor be encouraged to use innovative cleanup approaches?
- What is the financial risk to the contractor for completing the proposed cleanup?
- Are State and local regulatory standards for closure mandatory?
- What type(s) of contaminant(s) are being disposed of and what methods of cleanup are being used?
- How well has the proposed cleanup site been defined and characterized?

The Army guidance does not specify in which cases EI should be used based on the results of the evaluation, but leaves the decision to the discretion of the contracting officer and program manager. Thus the Army uses the results of this evaluation to define whether a significant level of risk for cost overruns

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and unexpected schedule changes exists and can be transferred from DoD to the contractor. If the risk level is significant enough, then the contracting officer and project manager would consider using EI.

Second, once the contracting and program management personnel make the decision to use EI, the requirements for EI, to include the type and amount of insurance, are incorporated in the solicitation. According to USACE and Army Environmental Center officials, when EI is not required, it is acceptable for a contractor to include EI in its proposal.

Regardless of whether EI is required or not, the source selection board evaluates each proposal on its technical merit, price, and past performance, at a minimum. In addition, as part of the source selection process, Army contracting personnel evaluate proposed EI policies for compliance with requirements outlined in the solicitation and for key provisions. For example, two key provisions are “additional insured” and “assignability,” which provide DoD protection if the contractor is unable to fulfill the requirements of the contract.

- The additional insured provision allows the insurance provider to transfer the rights and obligations of the EI policy to the Army in the event the original contractor (the named insured) is unable to complete the contract requirements.
- The assignability provision allows the Army to reassign the EI policy to a replacement contractor should the original contractor fail to perform in accordance with the contract. This allows DoD to continue to have the cleanup insured and avoid a costly replacement or loss of premiums paid.

Finally, the Army monitors contractors’ adherence to provisions of the EI policy to preclude voiding the policy. For example, the EI policy for the barracks at Hunter Army Airfield, Georgia, requires the contractor (the named insured) to periodically provide all cleanup cost data to the insurance provider. The USACE, Omaha District contracting officer requires that he also receives copies of these reports to ensure the contractor meets the provisions of the insurance policy. If a contractor fails to adhere to the provisions of the EI policy, DoD would no longer have the insurance coverage it paid for. Furthermore, DoD will most likely have to expend additional funds to purchase another EI policy or for the actual environmental cleanup cost resulting from cost overruns or unexpected schedule changes. Thus, monitoring by the contracting officer should allow for early detection of any possible noncompliance of EI policy provisions.

**Air Force Use of EI.** The Air Force has been using EI since 2002 and also issued guidance. Specifically, AFCEE issued, “Environmental Restoration Performance-Based Contracting Concept of Operations,” dated November 16, 2005, that is similar to Army guidance, and identifies Air Force processes, practices, and strategies used to solicit and award firm-fixed-price PBC contracts that include EI. The AFCEE Concepts of Operations states that before deciding to use EI an evaluation should be conducted to determine whether the cost of EI warrants the benefits to be gained. The one difference between the Army and Air Force practices is that Air Force does not monitor contractor adherence to EI

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policy provisions. According to an Air Force contracting officer, monitoring for adherence to EI policy provisions should not be necessary because the contractor has a vested interest in keeping the policy valid. However, it is in the best interest of the Air Force to monitor the contractor because, should the contractor not comply with the EI policy provisions, the EI policy could be voided which could impact both the Air Force and the contractor.

**Review of Army and Air Force Contracts With EI.** Based upon our review of 11 firm-fixed-price PBC contracts for environmental cleanup services that included EI, the Army and Air Force were diligent, and in all cases complied with the requirements identified in their guidance. See Appendix B for a listing of the 11 contracts reviewed at USACE and AFCEE.

**Use of Consultant.** Both the Army and Air Force used EI consultants to assist them in assessing their use of EI for environmental cleanup projects, as well as evaluating the language in solicitations and proposals that include EI. The EI consultants had experience in underwriting, environmental cleanup, and EI. According to Army and Air Force officials, the use of EI consultants helped considerably in identifying clauses needed in solicitations requiring EI and ensuring EI policies contain provisions to protect DoD.

**Army and Air Force Assessment of Advantages of EI Use.** According to Army and Air Force officials who use EI, the monetary benefits of using EI are not yet fully realized. Even though there are benefits from the use of EI, both the Army and the Air Force stated that an evaluation should be conducted before deciding to use EI to determine whether the cost of EI warrants the benefits to be gained. The majority of environmental cleanup contracts are awarded for a period of 5 to 10 years. Of the 40 contracts awarded by USACE, the Army Environmental Center, and AFCEE since 2001, 23 were awarded within the last 2 years. According to Army and Air Force officials, since many of the contracts are still in the early stages of environmental cleanup, it is too early to anticipate that claims would have been filed. However, according to contracting officers and insurance providers, because DoD is not the named insured on the EI policy, they may not be notified of claims filed by contractors (the named insured).

However, Army and Air Force contracting officials using EI stated that there are clear benefits to using EI that allow DoD to better manage and control the cost of environmental cleanups. These benefits include:

- reducing risk to DoD of potential cost overruns and unexpected schedule changes, by transferring the risk to the contractor and insurance provider; and
- enhancing the likelihood of a contractor entering into firm-fixed-price PBC contracts and using innovative technologies and strategies for environmental cleanup services.

**Navy Use of EI.** In 2000, as a test model, the Navy issued a firm-fixed-price contract using EI as part of the acquisition strategy. This was for the cleanup of the Charleston Project prior to its closing as part of the 1995 Base Realignment

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and Closure. According to Navy officials, the results of the Charleston Project were less than favorable, because the Navy had unrealistic expectations of potential cost savings and expected to transfer the entire risk associated with the cleanup to the contractor. To better understand why the expected results were not realized, the Navy contracted with the Center for Naval Analysis to conduct two studies to determine how well the Charleston Project worked and to identify lessons learned on the use of firm-fixed-price contracts for environmental cleanups. The Center for Naval Analysis reports, "Insured Fixed-Price Contracts: Capping the Cost of BRAC Environmental Cleanup," dated February 2000, and "Fixed Price Insured Environmental Contracts: Lessons Learned," dated October 2001, concluded that the Navy did not obtain its desired results because the Navy expected to transfer full responsibility and risk for completing the Charleston Project cleanup. Specifically, as related to EI, the cost of the insurance and other measures of indemnity were far more expensive than the Navy expected and the use of EI did not directly result in a cost saving. The Center for Naval Analysis reports finally concluded that the Navy could in the future achieve more favorable results, if it limited the use of EI to smaller-scale cleanup projects.

According to the Acting Director of Environmental Programs, NAVFAC Headquarters, due in part to the Center for Naval Analysis studies, the Navy does not use EI with contracts for active installation environmental cleanup. Instead, the Navy uses EI in conjunction with grants it makes to local governments or commercial developers to transfer closed Navy installations. Under the grant the local government or commercial developer is responsible for managing the cleanup and is required to purchase EI. The estimated cost of the EI is included in the amount of the grant which the Navy pays to the local government or commercial developer. By using this method, the Navy is able to transfer the property prior to cleanup earlier than expected. According to the Acting Director of Environmental Programs, NAVFAC Headquarters

"NAVFAC Headquarters, the Navy is not completely opposed to using EI for future cleanup projects on active or closed installations; however, the Navy would only consider using EI after carefully weighing the specific project risks and cost. The Navy's priority for environmental cleanups, in accordance with the Defense Installation Strategic Plan, is the cleanup of sites declared as high risk. This is a significant consideration in the use of insurance for two reasons. First, unlike the earlier DoD Guaranteed Fixed-Price Remediation contracts, the Navy does not contract for cleanup of entire installations with insurance because funds earmarked for high risk sites would have to be spent on lower risk sites that are included in the installation. This would severely impact Navy's ability to maximize completion of high risk sites by the end of FY 2007 per the DoD guidance. Secondly, high risk sites are typically, more complex and carry greater uncertainty. Contracting for sites with a high degree of unknown site conditions are generally not done under fixed price contracts because the savings that may be associated with fixed-price contracts are outweighed by the cost the Government would end of paying for insurance of higher risk. The Navy heavily uses fixed-price contracts, including, performance-based, for sites that have been well characterized and therefore do not require insurance to mitigate risk to the contractors."

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**Fair and Reasonable Price for EI.** When making a source selection decision, the Military Departments' contracting officers have to consider the fairness and reasonableness of the proposed contract price. Federal Acquisition Regulation 15.305(a)(1), "Proposal Evaluation," states that normally competition establishes a fair and reasonable price; therefore, when contracting for a firm-fixed price, a comparison of proposed contractor prices would satisfy the requirements to perform a price or cost analysis. The Army and Air Force contracting officers used full and open competition to award the 11 firm-fixed-price PBCs for environmental cleanup services with EI. By comparing the total proposed contract prices, Army and Air Force personnel gained a reasonable assurance that the contract prices received on the 11 firm-fixed-price PBCs were fair and reasonable. Because the contracting officers evaluated the total contract price for fairness and reasonableness, the EI price would also be considered fair and reasonable. In addition to the full and open competition and price comparisons, the EI price on 9 of the 11 contracts reviewed was within the industry standard of 6 to 15 percent of the total environmental cleanup services contract price. Because the Army and Air Force contracting officers did not evaluate the price of EI separately, we were unable to determine whether DoD received a fair and reasonable price for the EI portion of the contracts. Since the Navy does not use EI in contracting for environmental cleanup services, we did not evaluate any practices in place to evaluate the fair and reasonableness of contract prices or prices for EI.

## **Guidance on EI Within DoD**

The use of EI among the Military Departments is varied. This is due in part to the limited use of EI to date, as well as the lack of overarching guidance at the DoD level. According to an ODUSD(I&E) official, ODUSD(I&E) has not issued overarching guidance because EI is a new tool within DoD. The official further stated that ODUSD(I&E) is in the process of developing a guidebook on PBC. The guidebook will also include direction on the use of EI when contracting for environmental cleanups and will define how best to use EI as a tool to share risk. The estimated completion date of the ODUSD(I&E) guidebook is the summer of 2006.

**Military Service-Level Guidance on EI.** While the DoD level guidance is not yet available, the Army and Air Force have issued guidance as previously discussed. The overall intent of the Military Service-level policies is to provide the Army and Air Force contracting and program management personnel with direction on how to implement a PBC approach for environmental cleanups. In addition, each policy provides guidelines for requiring, procuring, and monitoring EI when it is used as part of the PBC approach. According to USACE, Army Environmental Center, and AFCEE personnel, both the Army and Air Force used lessons learned and obtained assistance from EI consultants in developing the guidance.

**Planned Office of Secretary of Defense Guidebook.** As stated previously, ODUSD(I&E) is drafting a guidebook on PBC that will include direction on the

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use of EI when contracting for environmental cleanups. However, as of April 2006, specifics on the type and extent of detail regarding the use of EI were not available. However, the guidebook should be an excellent tool to address the DoD level position on the use of EI, as well as draw from the experience, lessons learned, and guidance already available at the Military Service level. The ODUSD(I&E) guidebook can incorporate this as appropriate.

At a minimum ODUSD(I&E) should ensure the guidebook includes the following key factors relating to EI:

- criteria for determining when to use EI on environmental cleanup projects,
- designation of key provisions (such as assignability and additional insured) should be included in all EI policies, and
- need for contractor monitoring for adherence to key provisions of the EI policy.

## **Benefits of Using EI**

The Army and Air Force contracting and environmental cleanup management personnel see major benefits to using EI and have encouraged its use as an opportunity to transfer risks associated with potential cost overruns and unexpected schedule changes from DoD to the contractor and the insurance provider. Further, the Army and Air Force contracting and environmental cleanup management personnel believe EI enhances the opportunities to use firm-fixed-price PBC for environmental cleanup services because much of the risk can be transferred from the contractor to the insurance provider. The Air Force believes a business case analysis should be performed to evaluate whether the cost of EI warrants the benefits to be gained. By comparison, the Navy has not ruled out future use of EI, nor has it encouraged the use of EI for environmental cleanup projects. The Navy's past use of EI did not realize the desired benefits; therefore, the Navy does not consider EI an incentive to contractors to compete for firm-fixed-price PBC when contracting for environmental cleanup services.

**Value of Overarching Guidance.** ODUSD(I&E) has not yet issued overarching guidance to address the use and benefits of EI. Without guidance at the DoD level, DoD may miss opportunities to reduce risks through the use of EI for environmental cleanups or may be incurring additional cost for EI when not needed. Establishing an overarching DoD position on the purpose and benefits of using EI will provide the umbrella under which the Military Departments have to operate and implement using EI. In addition to the overarching DoD position, guidance that highlights specifics based on lessons learned from USACE, the Army Environmental Center, and AFCEE that have been successful in using EI will also provide the Military Departments with a better understanding of the benefits from using EI and best practices to follow.

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**Opportunity to Identify EI Benefits.** As indicated by both Army and Air Force officials using EI, many of the benefits of EI are yet to be realized because the environmental cleanup projects and contracts are in the early stages. As the DoD focal point for policy and environmental issues, ODUSD(I&E) should take the lead in conducting a survey to identify lessons learned for practices, processes, and strategies for the effective use of EI. Results of the survey should be used to update the guidebook and improve opportunities for EI use.

## **Management Comments on the Finding and Audit Response**

**The Air Force, Acting Chief, Environmental Division, DCS/Installations, Logistics, and Mission Support Comments.** The Acting Chief Environmental Division, DCS/Installations, Logistics, and Mission (the Acting Chief) provided comments for the Director, Air Force Center for Environmental Excellence. The Acting Chief partially concurred with the finding, stating the Air Force was making considerable progress in using performance-based contracting for environmental cleanup contracts, with or without environmental insurance. Furthermore, the Acting Chief stated that the overall Air Force position is that EI is a tool that can be used in some cases to transfer risk; however, an evaluation of the appropriateness of EI should be conducted to determine whether the cost of EI warrants the benefits to be gained.

**Audit Response.** We acknowledge the progress being made, not only by the Air Force, but the Army and the Navy, in using performance-based contracting for environmental cleanup contracts. We agree that EI is a tool to transfer risk and an evaluation should be conducted to determine the appropriateness of EI for specific environmental cleanup projects.

**Deputy Assistant Secretary of the Army (Environment, Safety, and Occupational Health) Comments.** Although not required to comment, the Office Assistant Secretary of the Army (Environment, Safety, and Occupational Health) provided comments on the finding. The Office Assistant Secretary of the Army (Environment, Safety, and Occupational Health) comments were clarifying in nature and we considered them and made appropriate changes as deemed necessary.

## **Recommendations, Management Comments, and Audit Response**

The Assistant Deputy Under Secretary Defense (Environment, Safety, and Occupational Health) [ADUSD(ESOH)] provided comments for the Deputy Under Secretary of Defense for Installations and Environment and the Acting Chief, Environmental Division, DCS/Installations, Logistics, and Mission Support provided comments for the Director, Air Force Center for Environmental Excellence.

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**Revised Recommendation.** As a result of management comments, we revised draft recommendation 1.c. to clarify the intent of the recommendation.

**1. We recommend the Deputy Under Secretary of Defense for Installations and Environment:**

**a. Survey the Army, Navy, and Air Force for lessons learned and results achieved on the use of environmental insurance to identify practices, processes, and strategies for effectively using environmental insurance when contracting for environmental cleanup services.**

**Management Comments.** The ADUSD(ESOH) partially concurred, agreeing that a survey of the Army, Navy, and Air Force experiences with environmental insurance will be useful once they have gained more experience in using environmental insurance to formulate lessons learned and make recommendations on specific practices

**Audit Response.** Management comments were partially responsive. The ADUSD(ESOH) did not provide an estimated completion date for the survey; therefore, we request the ADUSD(ESOH) provide comments addressing when it expects to conduct and complete the survey of the Army, Navy, and Air Force for lessons learned on the use of environmental insurance.

**b. Establish milestones for issuing overarching guidance on the Department's position on the use of environmental insurance when contracting for environmental services. The guidance should include the following, at a minimum:**

**(1) criteria for determining when to use environmental insurance,**

**(2) key provisions (such as additional insured and assignability) that should be included in all environmental insurance policies,**

**Management Comments.** The ADUSD(ESOH) partially concurred and stated, as discussed in the report, ADUSD(ESOH) was finalizing a handbook on performance-based contracting in environmental restoration that will address the use of environmental insurance. The handbook will address the "criteria" and "key provisions" discussed in the recommendation.

**Audit Response.** Management comments were partially responsive. As acknowledged in the report, we recognize the ADUSD(ESOH) efforts in the development of a handbook on performance-based contracting in environmental restoration that will include "criteria" and "key provisions" for the implementation and use of environmental insurance. However, the initial date for issuing the handbook was Fall 2005; therefore, we request the ADUSD(ESOH) provide a response to the final report on the estimated completion and issuance dates for the handbook.

**(3) need for contractor monitoring for adherence to key provisions of the environmental insurance policy, and**

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**Management Comments.** The ADUSD(ESOH) partially concurred and stated the report does not sufficiently support the need for contractor monitoring for adherence to key provisions.

**Audit Response.** Based on the management comments, we reconsidered the sufficiency of the support for the recommendation and found that additional data was needed. We provided additional support outlining the need for contracting officer monitoring the contractors' adherence to the provisions of the environmental insurance policy. Specifically, contracting officers monitoring the contractors' adherence to the environmental insurance policy is needed to prevent voiding the policy, which could result in DoD losing the insurance coverage it purchased. We request that ADUSD(ESOH) consider the additional information, reconsider the recommendation, and provide comments on the final report.

**(4) lessons learned based upon results of Recommendation 1.a.**

**Management Comments.** The ADUSD(ESOH) partially concurred, stating the Army, Navy, and Air Force representatives had already contributed lessons learned from using environmental insurance in the development of the handbook on performance-based contracting for environmental restoration. The ADUSD(ESOH) stated they will survey for additional lessons learned when the Army, Navy, and Air Force gain more experience.

**Audit Response.** See the audit response for Recommendation 1.b.1 and 1.b.2.

**c. Establish a process to evaluate whether DoD is achieving the anticipated benefits of risk reduction, cost savings, timely completion of cleanup projects, and increased use of performance-based contracting for environmental cleanup services, as it relates to environmental insurance.**

**Management Comments.** The ADUSD(ESOH) partially concurred, stating that DoD currently had a process in place that tracks cleanup progress made on all DoD sites on an annual basis. DoD extracts data from this process and uses it to assess whether DoD is achieving the benefits of risk reduction, cost savings, timely completion of projects, and increased use of performance-based contracting. In addition to this data, the examination of lessons learned, as discussed in Recommendation 1.b.4. will also assist in the assessment of whether DoD is achieving the anticipated benefits from using environmental insurance.

**Audit Response.** Based on management comments, we revised the recommendation to clarify the intent of the draft recommendation to specifically address the evaluation of the benefits received from using environmental insurance. If the current process used by DoD to annually track the progress of site environmental cleanups can account for benefits achieved from the use of environmental insurance, then this process would meet the intent of the recommendation. Accordingly, we request the ADUSD(ESOH) provide comments outlining the process and showing how DoD is achieving the anticipated benefits from using environmental insurance.

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**2. We recommend that the Director, Air Force Center for Environmental Excellence incorporate procedures to monitor for contractor adherence to environmental insurance provisions to preclude voiding the policy.**

**Management Comments.** The Air Force, Acting Chief, Environmental Division, DCS/Installations, Logistics, and Mission Support partially concurred. However, the Acting Chief, Environmental Division, DCS/Installations, Logistics, and Mission Support did not provide specifics on how he intends to implement the recommendation and the estimated completion date of the corrective action.

Although not required to comment, the ADUSD(ESOH) agreed with the recommendation but questioned why it addressed only the Air Force because DoD will direct all the Military Departments to incorporate procedures to monitor for contractor adherence to environmental insurance provisions.

**Audit Response.** The Acting Chief comments were partially responsive. Because the Acting Chief did not provide specifics on how he intends to implement the recommendation and the estimated completion date of the corrective action, we request that he provide comments in response to the final report.

The recommendation is addressed only to the Air Force because the Air Force criteria did not include the requirement to monitor the contractors' adherence to provisions of the insurance policies. While on the other hand, the Army does perform monitoring of contractors to ensure contractors' adhere to provisions of the insurance policy. Finally, the Navy is not addressed because currently, the Navy does not use environmental insurance when contracting of environmental cleanups on active installations.

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## Appendix A. Scope and Methodology

We evaluated the DoD methodology for using EI and DoD policies and regulations on the use of EI in contracting for environmental cleanups. We obtained four separate spreadsheets from USACE, the Army Environmental Center, and AFCEE that included a universe of 40 firm-fixed-price PBC environmental cleanup contracts from FY 2001 through FY 2005, with EI. The table below shows the contract universe and the number of contracts reviewed, per component.

<b>Universe and Sample of Firm-Fixed-Price Environmental Contracts With Environmental Insurance</b>		
<u>Component</u>	<u>Universe</u>	<u>Sample reviewed</u>
USACE	10	7
Army Environmental Center	26	0
AFCEE	<u>4</u>	<u>4</u>
<b>Total</b>	<b>40</b>	<b>11</b>

We limited our scope to USACE and AFCEE environmental cleanup contracts with EI. We did not review Army Environmental Center environmental cleanup contracts with EI because Army Audit Agency had already performed an audit of the Army Environmental Center's performance-based contracts that included a review of its use of EI.\* In addition, we did not review Navy contracts because the Navy does not procure EI for environmental cleanup services; instead, the local government or commercial developer conducting the environmental services procures the EI.

We collected, reviewed, and analyzed documents dated from April 2001 through January 2006. Specifically, we evaluated contracts, requests for proposals, solicitations, statements of objectives, source selection criteria, EI policies, and other contract documentation related to 11 firm-fixed-price contracts with EI, totaling \$79.5 million, with an EI value of \$7.65 million. We also reviewed policies, processes, and guidelines governing the requirements and procurement of EI.

We interviewed ODUSD(I&E), USACE, Army Environmental Center, AFCEE, Air Combat Command, Air Force Real Property Agency, Naval Facilities Command, and Naval Base Realignment and Closure and Office personnel to gain a better understanding of the history, purpose, processes, and benefits of using and procuring EI. We also interviewed two EI providers to gain an understanding of

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\* As of April 2006 Army Audit Agency had not issued its report.

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the EI industry's position on DoD use of EI for environmental cleanup services. In addition, we obtained an understanding of the underwriting procedures for an EI policy.

We performed this audit from May 2005 through January 2006 in accordance with generally accepted government auditing standards.

**Use of Computer-Processed Data.** We did not use computer-processed data to perform this audit.

**Use of Technical Assistance.** We did not use technical assistance to perform this audit.

**Government Accountability Office High-Risk Area.** The Government Accountability Office (GAO) has identified several high-risk areas in DoD. This report provides coverage of the DoD Contract Management high-risk area.

## Prior Coverage

During the last 6 years, GAO issued two reports discussing environmental insurance. Unrestricted GAO reports can be accessed over the Internet at <http://www.gao.gov>.

## GAO

GAO Report No. GAO-05-94, "Brownfield Redevelopment: Stakeholders Report That EPA's Program Helps to Redevelop Sites, but Additional Measures Could Complement Agency Efforts," December 2, 2004

GAO Report No. GAO-01-52, "Brownfields: Information on the Programs of EPA and Selected States," December 15, 2000

## Appendix B. Contracts Reviewed

The table below shows the 11 firm-fixed-price PBC contracts with EI that we reviewed at USACE, Omaha District and AFCEE.

<b>Firm-Fixed-Price PBC with Insurance</b>			
<b>Army</b>			
<b>Contract Award Date</b>	<b>Project Name</b>	<b>Contract Number</b>	<b>Contract Amount</b>
March 25, 2002	Fort Leavenworth, Kansas	DACA45-02-C-0011	\$19,871,134
June 30, 2004	Atlas Site 10; York, Nebraska	W9128F-04-0019-0001	4,260,075
September 24, 2004	MCA Barracks; Hunter Army Airfield, Georgia	DACA45-03-D-0029-0001	2,219,946
September 30, 2004	Omaha Lead Site; Omaha, Nebraska	DACA45-03-D-0029-0002	2,273,446
April 15, 2005	Seymour Johnson Air Force Base	W9128F-04-D-0018-0002	12,389,145
May 13, 2005	Shaw Air Force Base	DACA45-03-D-0026-0002	7,786,024
May 27, 2005	Fort Gillem, Georgia	DACA45-03-D-0029-0003	12,784,227
<b>Air Force</b>			
September 23, 2002	Charleston Air Force Base	F41624-01-8552-0022	3,999,863
March 5, 2003	Former Grissom Air Force Base	F41624-01-D-8544-0020	2,492,103
December 28, 2004	Davis Site, McClellan Air Force Base	FA8903-04-D-8670-0158	3,108,225
June 13, 2005	Langley Air Force Base	FA8903-04-D-8688-0014	8,198,215

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## **Appendix C. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense for Acquisition, Technology, and Logistics  
Deputy Under Secretary of Defense for Installations and Environment  
Director, Acquisition Resources and Analysis  
Under Secretary of Defense (Comptroller)/Chief Financial Officer  
Deputy Chief Financial Officer  
Deputy Comptroller (Program/Budget)

### **Department of the Army**

Assistant, Secretary of the Army (Installations and Environment)  
Auditor General, Department of the Army  
Commander, U.S. Army Corps of Engineers  
Commander, U.S. Army Corps of Engineers - Omaha District  
Commander, Army Environmental Center

### **Department of the Navy**

Assistant, Secretary of the Navy (Installations and Environment)  
Naval Inspector General  
Auditor General, Department of the Navy  
Commander, Naval Facilities Command

### **Department of the Air Force**

Assistant Secretary of the Air Force (Financial Management and Comptroller)  
Assistant, Secretary of the Air Force (Installations and Environment)  
Auditor General, Department of the Air Force  
Commander, Air Combat Command  
Commander, Air Force Center of Environmental Excellence  
Director, Air Force Real Property Agency

### **Combatant Command**

Inspector General, U.S. Joint Forces Command

### **Other Defense Organizations**

Director, Defense Logistics Agency

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## **Non-Defense Federal Organization**

Office of Management and Budget

## **Congressional Committees and Subcommittees, Chairman and Ranking Minority Member**

Senate Committee on Appropriations

Senate Subcommittee on Defense, Committee on Appropriations

Senate Committee on Armed Services

Senate Committee on Homeland Security and Governmental Affairs

House Committee on Appropriations

House Subcommittee on Defense, Committee on Appropriations

House Committee on Armed Services

House Committee on Government Reform

House Subcommittee on Government Management, Finance, and Accountability,  
Committee on Government Reform

House Subcommittee on National Security, Emerging Threats, and International  
Relations, Committee on Government Reform



# Assistant Deputy Under Secretary of Defense (Environment, Safety, and Occupational Health) Comments



ACQUISITION,  
TECHNOLOGY  
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE  
3000 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3000

MAR 30 2006

MEMORANDUM FOR KIMBERLY CAPRIO, PROGRAM DIRECTOR, CONTRACT  
MANAGEMENT, DEPARTMENT OF DEFENSE INSPECTOR  
GENERAL

THROUGH: DIRECTOR, ACQUISITION, RESOURCES, AND ANALYSIS

SUBJECT: Report on the Use of Environmental Insurance by the Military Departments  
(Project No. D2004-D000CB-0216)

Thank you for the opportunity to review and comment on this draft report. We are somewhat disappointed that many of our comments expressed in previous discussions with Inspector General auditors were not considered in this draft document. We still support those comments and strongly suggest your reconsideration. We also suggest your consideration of additional recommendations (attached) for clarity on certain revised portions of the report.

Concerning the report's recommendations, our comments are as follows.

Recommendation 1 to Deputy Under Secretary of Defense for Installations and Environment. Partially concur.

- Recommendation 1.a: *Survey the Army, Navy, and Air Force for lessons learned and results on the use of environmental insurance to identify practices, processes, and strategies for effectively using environmental insurance when contracting for environmental cleanup services.* We agree that a survey of Army, Navy, and Air Force experiences with environmental insurance will be useful when the Services have garnered sufficient experience to formulate "lessons learned" and recommend certain practices.
- Recommendations 1.b.(1) and 1.b.(2): *Establish milestones for the guidance and issue overarching guidance on the Department's position on the use of environmental insurance when contracting for environmental services. The guidance should include the following at a minimum: (1) criteria for determining when to use environmental insurance; (2) key provisions (such as additional insured and assignability) that should be included in all environmental insurance policies.* As acknowledged in the draft report, OSD is finalizing a handbook on performance-based contracting in environmental restoration that will address the use of environmental insurance. This document will provide the "criteria" and "key provisions" discussed in this recommendation.



- Recommendation 1.b. (3): *need for contractor monitoring for adherence to key provisions of the environmental insurance policy.* The report should provide sufficient support for its recommendation for monitoring for contractor adherence to policy terms. Currently, it does not.
- Recommendation 1.b.(4): *lessons learned based upon results of Recommendation 1.a.* Representatives of the Military Services participated in the development of the performance-based contracting handbook discussed above by sharing their experiences with environmental insurance thus far. An additional survey of experiences will be beneficial when more experience with environmental insurance is obtained.
- Recommendation 1.c: *Establish a process to evaluate whether DoD is achieving the anticipated benefits of risk reduction, cost savings, timely completion of cleanup projects, and increased use of performance-based contracting for environmental cleanup services.* This recommendation is beyond the scope of this report. DoD currently has a process in place to track cleanup progress made at all sites on an annual basis. From these data we can assess whether we are achieving the benefits of risk reduction, cost savings, timely completion of projects, and increased use of performance-based contracting. An examination of lessons learned, as discussed above, will fulfill the objective of determining the effectiveness of environmental insurance and performance-based contracting.

Recommendation 2. *We recommend that the Director, Air Force Center for Environmental Excellence incorporate procedures to monitor for contractor adherence to environmental insurance provisions to preclude voiding the policy.* Concur With Comment. The report does not explain why it recommends only the Air Force to require additional contractor adherence monitoring. The report states that the Army does perform contractor monitoring but does not discuss Navy use of same. After describing the need for consistent use of environmental insurance across the Services, the report appears to single out the Air Force for this recommendation. DoD will direct all Services to incorporate procedures to monitor for contractor adherence to environmental insurance provisions.

If you have questions or require further information, my staff contact on this issue is Mr. Vic Wieszek, available at (703) 571-9061 and [victor.wieszek@osd.mil](mailto:victor.wieszek@osd.mil).

  
Alex A. Beehler

Assistant Deputy Under Secretary of Defense  
(Environment, Safety, and Occupational Health)

Attachment:  
As stated.

Revised  
Page 15

**Detailed Comments on  
Department of Defense Inspector General  
Draft Report: "Use of Environmental Insurance by the Military Departments"**

- The term "risk assessment" is misleading because the term has a specific meaning in environmental cleanup that is not intended in this report. Recommend replacing this term with "evaluation of appropriateness of environmental insurance" or something similar.
- The terminology for the different types of insurance, specifically "property transfer insurance" and "Brownfields restoration and redevelopment insurance" are not industry terms, they are vendor-specific terms. Recommend not using this terms as they are not universally understood.
- The number of insurers willing to offer environmental insurance is shrinking. Recommend mentioning in the report what companies offer which type of environmental insurance.
- The discussions addressing Navy's use of environmental insurance are unclear.
  - On page 3, the report states that the Navy currently uses environmental insurance only with early transfer of closed shore installations; however, on pages 9-10, in the section entitled "Navy Use of Environmental Insurance," the report fails to mention that the Navy is using environmental insurance for early transfer of closed shore installations.
  - The report states that, based on experience at Charleston, the Navy has determined that it should use environmental insurance only for "smaller scale cleanup projects." The report then states that the Navy currently uses environmental insurance "in conjunction with grants it makes to local governments or commercial developers to transfer closed Navy installations." Does this current use involve only smaller scale cleanup projects?
- Navy Use of EI, page 12. Replace the second paragraph with "According to the Acting Director of Environmental Programs, NAVFAC Headquarters, the Navy is not completely opposed to using EI for future cleanup projects on active or closed installations; however, the Navy would only consider using EI after carefully weighing the specific project risks and cost. The Acting Director further stated that the Navy's priority for environmental cleanups, in accordance with the Defense Installation Strategic Plan, is the cleanup of sites declared as high risk. This is a significant consideration in the use of insurance for two reasons. First, unlike with earlier DoD Guaranteed Fixed-Price Remediation contracts, the Navy does not contract for cleanup of entire installations with insurance because funds

earmarked for high risk sites would have to be spent on lower risk sites that are included in the installation. This would severely impact Navy's ability to maximize completion of high risk sites by the end of FY07 per the DOD guidance. Secondly, high risk sites are typically more complex and carry greater uncertainty. Contracting for sites with a high degree of unknown site conditions are generally not done under fixed price contracts because the savings that may be associated with fixed price contracts are outweighed by the cost the Government would end up paying for insurance of the higher risk. The Navy heavily uses fixed price contracts, including, performance based, for sites that have been well characterized and therefore do not require insurance to mitigate risk to the contractors."

- Executive Summary:

- Background, 1<sup>st</sup> paragraph, last sentence, Change "However, DoD can be listed as an additional insured party on the insurance policy, and thus have the same insurance coverage as the contractor." To "However, environmental insurance policies can be structured to allow the DoD to have additional insured status and assignability privileges which gives the DoD some of the same protections as the insured contractor." [NOTE: The area of environmental insurance is a complex one and the statement as written is not correct. The Army worked closely with insurance consultants to structure the specifications to ensure that the Army's interests were protected such that if a contractor were to become insolvent, the Army would be able to assign the insurance policy to a replacement contractor. This is called "assignability" and is not related to the "additional insured" status that is another area of concern to the Army. Being an additional insured is relevant on liability policies such as Pollution Legal Liability policies (which are not normally purchased for active installation cleanups).]
- Background, It is unknown which specific contracts went into the total figures shown in the 2<sup>nd</sup> paragraph (i.e., "Since 2001, the Army and Air Force have issued 40 performance-based contracts with environmental insurance. The environmental insurance cost \$39 million, or 7.9 percent, of the total contract costs of \$491.5 million."). Though the validity of the numbers is not being questioned, it would be helpful if the report included (as an appendix) the list of all the contracts included to make up these numbers.
- Results: In this section, and throughout the report, the DoD IG refers to Base Realignment and Closure installations and sites as "Base Closure and Realignment" efforts. It is recommended that all instances of "Base Closure and Realignment" be changed to "Base Realignment and Closure"
- Summary of Recommendations: Sentence "We also recommended that the Deputy Under Secretary of Defense for Installations and Environment establish milestones for issuing guidance and issue overarching guidance on the Department's position...." appears to have redundant language

inserted. Recommend deleting the words “guidance and issue” from the middle of the sentence.

- Background:
  - DoD Use of EI, last 2 sentences of page 2: “However, DoD can be listed as an additional insured party on the insurance policy. When DoD is listed as an additional insured party, DoD then has the same insurance coverage as the contractor.” See comment on this same language in the Executive Summary.
  - DoD Use of EI, 3<sup>rd</sup> paragraph, page 2: “When choosing to use EI, the contractor requires DoD to pay the non-refundable insurance premium up front.” It is recommended that the sentence be changed to read, “When choosing to use EI, the DoD provides the funding to the contractor to pay the non-refundable insurance premium up front.”
  - DoD Components Involved in Environmental Cleanups, page 3, Army Environmental Center: Sentence which starts with “As part of implementing the Army’s environmental program,…” It is recommended that the phrase “manages the environmental cleanup of active and closed Army installations” be changed to “manages the environmental cleanup of active and excess Army installations and provides technical support regarding environmental cleanup of closed Army installations.”
  - Table “The Army and Air Force Use of Environmental Insurance – FY 2001 Through FY 2005”, page 4. Though the validity of the numbers is not being questioned, it would be helpful if the report included (as an appendix) the list of all the contracts included to make up these numbers.
- Finding:
  - Army Use of EI, page 7, 4<sup>th</sup> bullet: “What type of competitive process will the contract be awarded?” Recommend changing this bullet to “What type of competitive process will be used to award the contract?”
  - Army Use of EI, page 7, 8<sup>th</sup> bullet: “What type(s) of contaminate(s) are being disposed of and what methods of cleanup are being used? Recommend changing the word “contaminate(s)” to “contaminant(s).”
- Appendix A. Scope and Methodology:
  - Page 14, paragraph following table: “We did not review Army Environmental Center environmental cleanup contracts with EI because Army Audit Agency had already performed an audit of the Army Environmental Center’s performance-based contracts that included a review of its use of EI.” As of March 2006 the Army Audit Agency has not issued a report. What happens if the AAA never issues their final report? Was the In Process Review briefing information sufficient for the DoD IG or will there be a need to revisit the USAEC contracts?

# Department of the Air Force Comments



DEPARTMENT OF THE AIR FORCE  
HEADQUARTERS UNITED STATES AIR FORCE  
WASHINGTON DC

11 April 2006

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDITING  
OFFICE OF THE INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE

FROM: HQ AF/A7CV  
1260 Air Force Pentagon  
Washington DC 20330-1260

SUBJECT: Draft Report on Use of Environmental Insurance by the Military Departments  
(Project No. D2004-D000CB-0216, 17 February 2006)

This is in reply to your memorandum requesting AF/A4-7's OPR to provide comments on the subject report.

In general, we partly concur with your report, and the recommendations. However, we are pleased to determine that Air Force is making a considerable progress on the Performance Based Contracting initiatives with or without the concept of environmental insurance towards our specific cleanup goals. Attached are our specific comments for your consideration.

If you have any questions, please contact Mr. Singh Gill, P. E., AF/A7CVR, DSN 327-0225 for further information.

  
Jamee Sue Plockmeyer, P.E.  
Acting Chief, Environmental Division  
DCS/Installations, Logistics & Mission Support

Attachment:  
AF/A7CV comments on draft DoD IG report

cc:  
SAF/IEE  
AF/A4-7 Audit POC  
A7CPP  
AFRPA/COO

*America's Air Force -- No One Comes Close*

**Air Force Review Comments  
Draft Report dated 17 Feb 2006  
Use of Environmental Insurance by the Military Departments  
DoD IG**

1. Pg 2, 3<sup>rd</sup> paragraph states "The Army and Air Force contracting and environmental cleanup program management personnel stated that using EI provided maximum opportunities for the contractor to enter into the firm-fixed price PBC and transfer risk..."

The Air Force position is that EI is a useful tool that can be used in some cases to transfer risk; however, an appropriate business case analysis should be conducted to determine if the cost of the insurance warrants the benefit to be gained. In most cases, AFCEE believes that the cost of the EI is not sufficiently offset by the potential benefits gained. This is consistent with the HQ AFCEE PBC CONOPS, which was provided to the inspection team (see pg 18; final version attached).

2. Pg 2, 4<sup>th</sup> paragraph. HQ AFCEE is a service center that provides environmental services to the Air Force Major Commands and Installations. However, some MAJCOMS (and indeed some Installations) procure their own contracts for environmental cleanup.
3. Pg 3, paragraph 5. See comment #2.
4. Pg 9, paragraph 3. See comment #1.
5. Pg 11, paragraph 5. See comment #1.
6. Pg 12, paragraph 1. See comment #1.

Revised

Revised  
Page 12

Revised

Tgc/10 Apr 2006

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# Office of the Assistant Secretary of the Army (Installations and Environment Comments)



DEPARTMENT OF THE ARMY  
OFFICE OF THE ASSISTANT SECRETARY OF THE ARMY  
INSTALLATIONS AND ENVIRONMENT  
110 ARMY PENTAGON  
WASHINGTON DC 20310-0110  
MAR 29 2006

SAIE-ESOH

MEMORANDUM FOR The Deputy Auditor General for Force and Financial Audits, US Army Audit Agency Operations Center, 3101 Park Center Drive, Alexandria, VA 22302

SUBJECT: Comments for DoDIG Draft Report – "Use of Environmental Insurance by the Military Departments", Project No. D2004-D000CB-0216

1. Attached are the Army's comments for transmittal to the Deputy Under Secretary of Defense for Installations and Environment concerning the DoDIG Draft Report found in the subject heading.
2. My point of contact for this action is Mr. Rick Newsome at (703) 697-1987.

*Tad Davis*

Addison D. Davis, IV  
Deputy Assistant Secretary of the Army  
(Environment, Safety, and Occupational Health)  
OASA(I&E)

US Army Comments  
on DoD IG Report on the Use of  
Environmental Insurance by the Military Departments  
(Project No. D2004-D000CB-0216)

**Executive Summary**

1. Background, 1<sup>st</sup> paragraph, last sentence: "However, DoD can be listed as an additional insured party on the insurance policy, and thus have the same insurance coverage as the contractor."

Revised

Recommended Change: Change to "However, environmental insurance policies can be structured to allow the DoD to have additional insured status and assignability privileges which gives the DoD some of the same protections as the insured contractor."

NOTE: The area of environmental insurance is a complex one and the statement as written is not correct. The Army worked closely with insurance consultants to structure the specifications to ensure that the Army's interests were protected such that if a contractor were to become insolvent, the Army would be able to assign the insurance policy to a replacement contractor. This is called "assignability" and is not related to the "additional insured" status that is another area of concern to the Army. Being an additional insured is relevant on liability policies such as Pollution Legal Liability policies (which are not normally purchased for active installation cleanups).

2. Background, 2<sup>nd</sup> paragraph: Sentences, "Since 2001, the Army and Air Force have issued 40 performance-based contracts with environmental insurance. The environmental insurance cost \$39 million, or 7.9 percent, of the total contract costs of \$491.5 million."

Recommended Change: It is unknown which specific contracts went into these total figures. While I do not question the validity of the numbers it would be helpful if the report included (as an appendix) the list of all the contracts included to make up these numbers.

3. Results: In this section, and throughout the report, the DoD IG refers to Base Realignment and Closure installations and sites as "Base Closure and Realignment" efforts.

Revised

Recommended Change: Recommend that all instances of "Base Closure and Realignment" be changed to "Base Realignment and Closure"

4. Summary of Recommendations: Sentence “We also recommended that the Deputy Under Secretary of Defense for Installations and Environment establish milestones for issuing guidance and issue overarching guidance on the Department’s position....” appears to have redundant language inserted

Recommended Change: Recommend deleting the words “guidance and issue” from the middle of the sentence.

Deleted

**Background**

1. DoD Use of EI, last 2 sentences of first paragraph: “However, DoD can be listed as an additional insured party on the insurance policy. When DoD is listed as an additional insured party, DoD then has the same insurance coverage as the contractor.”

Recommended Change: See Comment #1 on Executive Summary

Revised

2. DoD Use of EI, 3<sup>rd</sup> paragraph, page 2: “When choosing to use EI, the contractor requires DoD to pay the non-refundable insurance premium up front.”

Recommended Change: Change sentence to read, “When choosing to use EI, the DoD provides the funding to the contractor to pay the non-refundable insurance premium up front.”

Revised

3. DoD Components Involved in Environmental Cleanups, page 3, Army Environmental Center: Sentence which starts with “As part of implementing the Army’s environmental program,....”

Recommended Change: Change phrase “manages the environmental cleanup of active and closed Army installations” to “manages the environmental cleanup of active and excess Army installations and provides technical support regarding environmental cleanup of closed Army installations.”

Revised

4. Table “The Army and Air Force Use of Environmental Insurance – FY 2001 Through FY 2005”, page 4

Recommended Change: See Comment #2 on Executive Summary

**Findings**

1. Army Use of EI, page 7, 4<sup>th</sup> bullet: “What type of competitive process will the contract be awarded?”

Recommended Change: Change to “What type of competitive process will be used to award the contract?”

Revised

Revised

2. Army Use of EI, page 7, 8<sup>th</sup> bullet: "What type(s) of contaminate(s) are being disposed of and what methods of cleanup are being used?"

**Recommended Change:** Change the word "contaminate(s)" to "contaminant(s)."

3. Guidance on EI Within DoD, Planned Office of Secretary of Defense Guidebook, page 11, 1<sup>st</sup> bullet: "use of risk assessments of environmental cleanup projects in determining EI use"

**Comment:** Statement as written is unclear. Standard risk assessments that are prepared as part of the cleanup process will not necessarily provide direct information regarding whether or not to use EI. What was the intent of this bullet? Needs to be more explicit. **Recommended Change:** Change to "criteria for determining when to use EI on environmental cleanup projects."

Revised  
Page 12

#### **Appendix A. Scope and Methodology**

1. Page 14, paragraph following table: "We did not review Army Environmental Center environmental cleanup contracts with EI because Army Audit Agency had already performed an audit of the Army Environmental Center's performance-based contracts that included a review of its use of EI."

**Comment:** As of March 2006 the Army Audit Agency has not issued a report. What happens if the AAA never issues their final report? Was the In Process Review briefing information sufficient for the DoD IG or will there be a need to revisit the USAEC contracts?

## **Team Members**

The Department of Defense Office of the Deputy Inspector General for Auditing, Acquisition and Contract Management prepared this report. Personnel of the Department of Defense Office of Inspector General who contributed to the report are listed below.

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