



Cost Allocations - Apportioning Environmental Response Costs Among Multiple Parties for the Cleanup of Contaminated Property

What is a cost allocation?

A cost allocation is a process by which the past and/or future costs for investigation and remediation activities (i.e., the response costs) for a contaminated property requiring cleanup are apportioned among two or more parties.

When are cost allocations needed?

Property that is contaminated with hazardous or toxic waste from historical or current activities will, in all likelihood, have to be investigated and cleaned up at some point. These investigation and remediation activities might be triggered by the off-property discovery of contamination in potable residential or municipal groundwater wells, or by the on-property discovery (during construction-related excavation activities) of buried leaking drums or residual wastes from, for example, a former manufactured gas plant.

The cleanup of the property may be conducted involuntarily, driven by a regulatory agency order to comply with existing environmental laws, or voluntarily, based on a business decision to improve or expand existing facilities, re-develop the property for new use, or to facilitate a real estate transaction. In either case, significant response costs may be incurred by the current property owner(s).

The parties initially incurring these costs will often seek to obtain cost recovery or contribution from those parties who were believed to be responsible for the contamination. In many cases, the plaintiff parties who incur the response costs file a lawsuit to recover these costs from the other defendant parties. As part of this litigation, a cost allocation might be conducted (by the courts or by others) to apportion the response costs among the parties. In other cases, the parties may forego or postpone a lawsuit and participate in a voluntary cost allocation to apportion the response costs among themselves.

Who are the parties that participate in a cost allocation?

Individuals, businesses, public entities (including municipalities, and state and federal government agencies), and other parties participate in cost allocations. Depending on, among other things, the historical and current use of the property and the availability of information necessary to identify the responsible parties, cost allocations may involve as few as two parties or as many as dozens or even hundreds of parties.

Are there standard methods for conducting cost allocations?

There are no standard methods and there is little guidance for conducting cost allocations. Most of the information accessible in the public domain, such as case law reviews and articles in the legal literature, and a limited number of U.S. regulatory agency policy and guidance documents, relates to cost allocations conducted under U.S. federal environmental legislation known as CERCLA. Nonetheless, the fundamental principles originating from CERCLA cost allocations provide a general framework that is applicable for *any* environmentally-contaminated property where apportionment of the response costs is an issue.

Who conducts cost allocations?

Many cost allocations are performed by the courts in the litigation of cost recovery or contribution actions. Plaintiff and defendant parties may also conduct cost allocations. For properties where a large number of parties have been identified, an allocation committee may be established to allocate the response costs among all of the parties. An allocation committee may also opt to engage the services of an outside private allocator to perform the allocation task, in whole or in part. More often than not, a private allocator will be engaged by parties too few to form a viable committee but too numerous to do the allocation among themselves. Private allocations are performed by attorneys and former judges, accountants and economists, technical consultants, and alternative dispute resolution firms.

There are no standard methods, however, case law, and policy and guidance arising out of U.S. environmental legislation provides an excellent framework for any environmental cost allocation



How are cost allocations used?

In addition to the courts' use of cost allocations to derive binding apportionments of costs for parties litigating cost recovery and contribution actions, cost allocations may also be used in binding processes such as arbitration and in non-binding processes such as settlement negotiations and mediation.

Combining a cost allocation with mediation can be an effective way for the parties to reach a settlement among themselves or with a regulatory agency. However, the skills necessary to conduct an allocation are not necessarily the same skills required to mediate a settlement. Allocations tend to be provocative and often generate criticism from some or all of the parties. Accordingly, the individual who conducts the allocation may meet serious obstacles in attempting to mediate a settlement. A mediated settlement of an allocation is more likely to be successful if the allocator and the mediator are completely independent, albeit there are some arguable advantages of having them part of the same team.

What are the steps in a cost allocation?

Cost allocations can be divided into three major phases: (1) scoping and initiation, (2) information collection and database development, and (3) preliminary and final allocations. Each phase consists of numerous steps which are not necessarily the same for any two allocations. **Figure 1** illustrates the phases and specific steps in a generic allocation process.

The specific steps in each phase of an allocation will depend, among other things, on the scope of work agreed to by the allocator and the parties, the quantity and quality of the information available, and the intended use of the allocation. In some cases the parties may engage an allocator to simply prepare and administer questionnaires for information discovery, or to compile and manage a database of waste-related information. In other cases, the allocator may be retained to design and implement the entire allocation process, subject to review and approval of the parties.

How long does a cost allocation take?

The length of time required for a cost allocation (exclusive of the time spent selecting the allocator) depends on numerous factors including: the number of parties, the degree of cooperation among the parties and between the parties and the allocator, the complexity of the property and the anticipated remediation, the amount and quality of existing documentation, and the scope of additional discovery activities.

For less complex properties with adequate documentation (e.g., a current industrial or commercial property involving only a few parties), a cost allocation may take as little as 1 to 2 months to complete. For more complex properties with limited documentation (e.g., a former municipal landfill involving fifty to one hundred parties), a cost allocation may take as long as 12 to 18 months.

Many of the steps in an allocation process (Figure 1) may be conducted currently or at least with some degree of overlap. This may be necessary (even desirable) in order to allow sufficient time for individual steps to be completed within a desired timeframe. Concurrent or overlapping steps will also help to maximize the cost- and time-efficiency of the allocation process overall. **Figure 2** illustrates the sequence of steps for a generic allocation process.

What criteria or factors are considered in a cost allocation?

The apportionment of response costs among parties is accomplished through the use of allocation criteria or "equitable factors" which are used to evaluate the information collected on the property. Current U.S. environmental legislation does not prescribe the equitable factors to be used. Instead, the selection of these equitable factors is left to the discretion of the courts and private allocators.

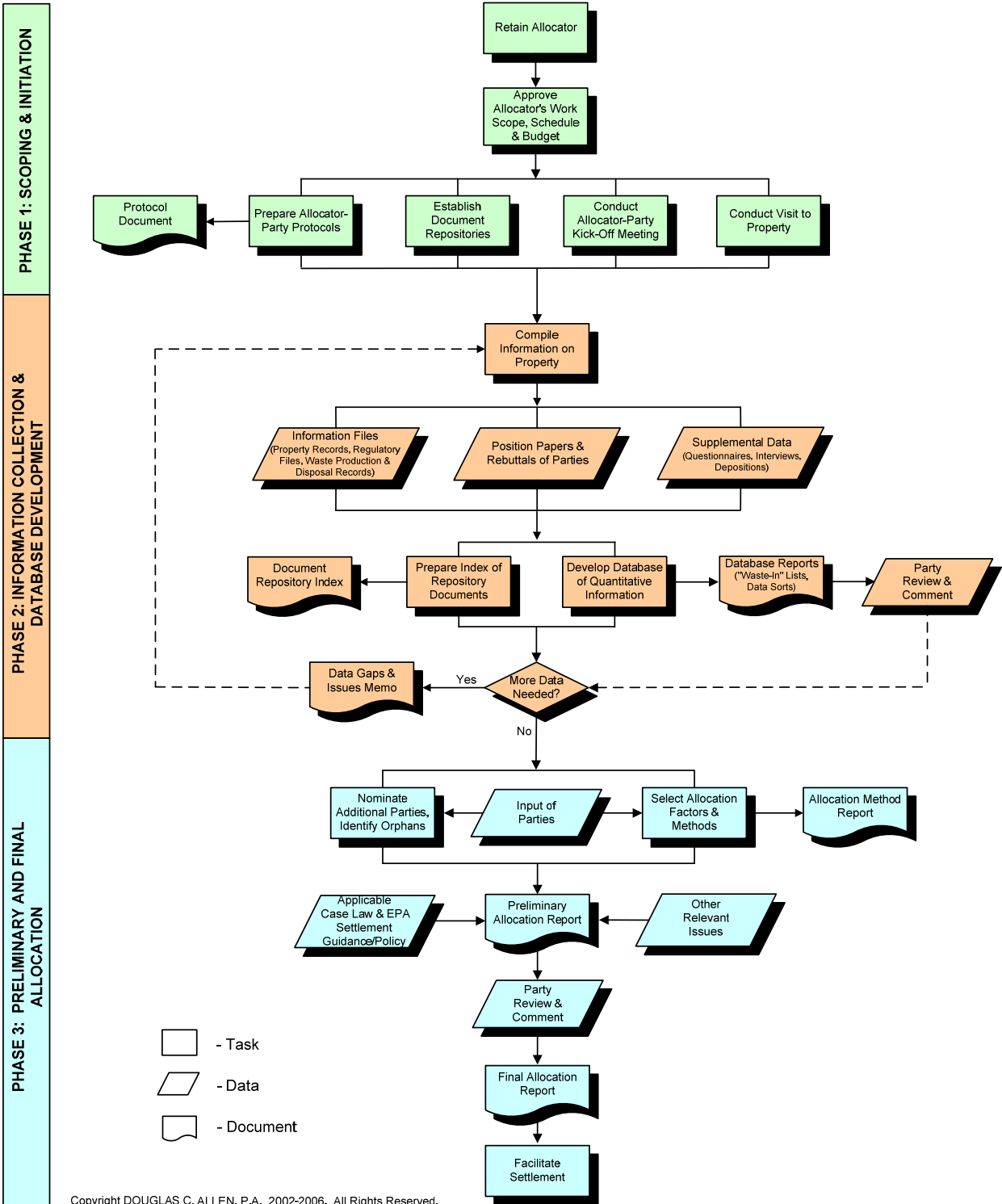


Figure 1 – Overview of a generic allocation process. The generic process illustrated here is based on numerous allocations conducted by the author for cost recovery and contribution actions under the U.S. Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA, a/k/a "Superfund"; 42 U.S.C. §§ 9601-9675). However, the general framework is applicable for any environmentally-contaminated property where an allocation of response costs is needed. The specific steps in a cost allocation will depend on many factors including: the needs and desires of the parties, the quantity and quality of the information available, and the intended use of the allocation.

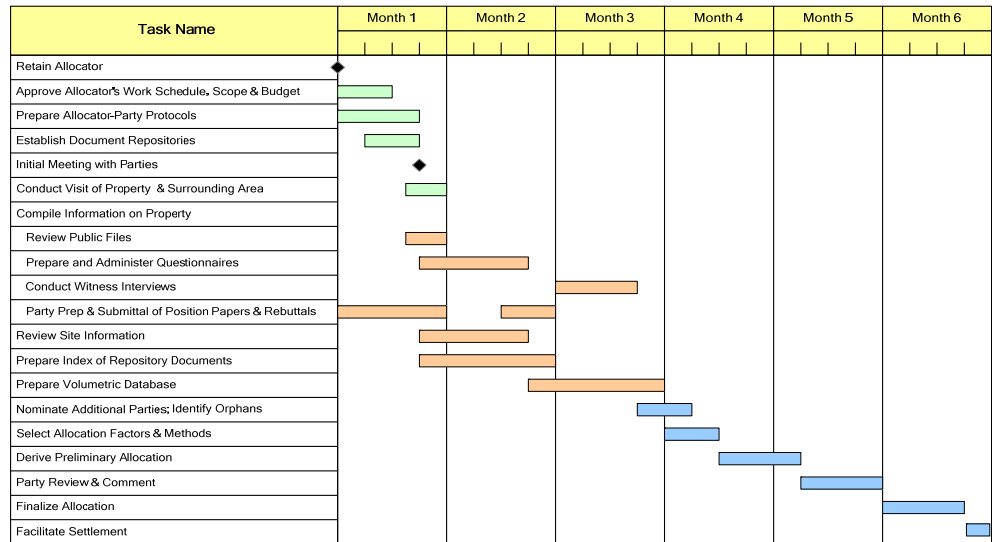


Figure 2. Generic Gantt Chart of the allocation process. The allocation process shown here is conducted over a 6 month timeframe. Conducting tasks concurrently or with at least some degree of overlap can maximize the cost- and time-efficiency of the process.

The factors often cited in CERCLA-type cost allocations, individually and collectively, are the so-called "Gore Factors". During debate of the original Superfund legislation, the "Gore Amendment", introduced by then-representative Albert Gore, proposed six factors to be considered when allocating site costs among PRPs (H.R. 7020, 96th Cong., 2d Sess. (1980)):

1. The ability of the parties to demonstrate that their contributions to a discharge, release, or disposal of a hazardous waste can be distinguished;
2. The amount of the hazardous waste involved;
3. The degree of toxicity of the hazardous waste involved;
4. The degree of involvement by the parties in the generation, transportation, treatment, storage or disposal of the hazardous waste;
5. The degree of care exercised by the parties with respect to the hazardous wastes concerned, taking into account the characteristics of such hazardous wastes; and
6. The degree of cooperation by the parties with federal, state, or local officials to prevent any harm to public health or to the environment.

Although the Gore factors were not included in the final Superfund legislation, they were endorsed in the 1986 Superfund Amendments and Reauthorization Act (SARA) and cited in the proposed revisions of the 1994 Superfund Reform Act (SRA). The Gore factors have been and continue to be used by the courts and by private allocators.

In addition to the Gore Factors, numerous other factors have been used by the courts, in private allocations, or suggested in allocating costs. These factors include:

- Contractual provisions (e.g., indemnification clauses)
- Innocent landowner
- Years of ownership/operation
- Economic benefits from ownership/operation
- Knowledge of waste handling and disposal practices



- Degree of control over waste handling and disposal practices
- Public interest considerations
- Ability to pay
- Litigation risk
- Strength of evidence tracing wastes to the parties

What are some of the issues that may arise in conducting a cost allocation?

There are a number of issues that may arise in an allocation that may need to be explicitly addressed by the allocator at least qualitatively if not quantitatively. Some of these issues may be procedural in nature and readily resolvable. Other issues may be more substantive and require considerable discussion among the parties and the allocator. These issues may include:

- Gaps and inaccuracies in the record of evidence
- Interpretation of the available record of evidence
- Confidentiality of information submitted during an allocation
- Selection and application of equitable factors and allocation methods
- Nomination of additional parties during the allocation
- Orphan shares
- *de minimis* parties
- Non-participating, financially solvent parties
- Transshipment allegations
- Spoliation of evidence
- Relevance of case law, standards of evidence, & regulatory policy
- Counterclaims

What are the key factors to a successful cost allocation?

A successful allocation is the product of the combined efforts of the parties and the allocator. Parties who provide complete and accurate information, meet allocation schedule deadlines, and participate fully in the allocation proceedings will help to ensure the success of the allocation. An allocator who can implement and manage a well defined, equitable and fair allocation process, facilitate clear communications among the parties, and provide ample opportunities for allocator-party interaction will also maximize the chances for a successful allocation.

What key factors should be considered in selecting an allocator?

The parties who engage the services of an allocator will be in the best position to determine the qualifications of an allocator that will meet their needs. However, some general factors to consider in selecting the allocator may include:

- **Neutrality** - The ability of the allocator to be neutral and objective throughout the process is critical for maintaining the level of trust between the allocator and the



parties if the allocation is to be successful. Proper disclosure and resolution of potential conflicts of interest by the allocator should be an important consideration to the parties during the selection process. Equally important is the willingness and ability of the allocator to deal with parties' perceptions of the allocator's bias or fairness during the allocation process.

- **Approach** – The use of “off the shelf” or recycled solutions in developing an allocation may not only be inappropriate for the conditions of a specific property but it may also compromise the parties' perception of the allocator's neutrality. An allocator should conduct an objective and thorough review and evaluation of all of the information and use maximum creativity in considering and evaluating the property- and party-specific factors of the case, generally-accepted evaluation criteria and allocation methods, and the current landscape in regulatory policy and guidance.
- **Flexibility** - An allocator should be flexible to accommodate legitimate changes in the work scope and in the schedule of an allocation. The necessity for additional information gathering (including questionnaires, witness interviews, etc.), nomination of additional parties during the allocation process, and the filing of position papers and briefs could all adversely impact both the scope and the schedule of an allocation. The allocator should be able to respond to these changes by analyzing the impacts on the allocation in terms of time and cost, recommend appropriate solutions, and work with the parties to keep the process moving towards settlement.
- **Experience with legal and technical issues** – Environmental cases are inherently complex both legally and technically. Ideally, an allocator should possess a thorough knowledge of and have hands on experience with the legal framework for conducting allocations (e.g., legislation, case law, policy and guidance) and with the specific legal and technical issues underlying a given case.
- **Management of multiple parties** – Allocations involving multiple parties can present an allocator with formidable time and resource management challenges. Allocators involved in multi-party allocations should possess adequate management skills to deal with the potentially large volumes of information, the logistics of meetings and teleconferences, and the dissemination of allocator work product and associated correspondence.
- **Personal Qualities** - Personal chemistry between the allocator and the parties can make a significant difference in the outcome of an allocation and subsequent settlement. Strong interpersonal and communication skills will help an allocator to interact with the parties in a professional, impartial manner yet with a thorough and genuine understanding of the positions of all parties.

Summary

A carefully constructed cost allocation can be an effective process for apportioning among two or more parties the past and future investigation and remediation costs necessary to address environmentally-contaminated property. Although there are no standard methods and there is very little guidance for conducting cost allocations, the fundamental principles of cost allocation developed for CERCLA-type cost recovery and cost contribution actions provide a general framework that is applicable for *any* environmentally-contaminated property where apportionment of response costs is an issue. The success of any cost allocation will ultimately depend on a clearly defined scope of work to be done by a qualified allocator and the full participation of the responsible parties.



About the Firm:

DOUGLAS C. ALLEN, P.A. provides strategic consulting services to businesses, their legal counsel, insurers and investors to help them define, quantify and manage their high risk exposures so they may mitigate adverse and material consequences to their operations and financial strategies.

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