DEFENSE BASE ACT INSURANCE: ARE TAXPAYERS PAYING TOO MUCH?

HEARING

BEFORE THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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DEFENSE BASE ACT INSURANCE: ARE TAXPAYERS PAYING TOO MUCH?

THURSDAY, MAY 15, 2008

HOUSE OF REPRESENTATIVES,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The committee met, pursuant to notice, at 10 a.m., in room 2154, Rayburn House Office Building, Hon. Henry A. Waxman (chairman of the committee) presiding.

Present: Representatives Waxman, Tierney, Watson, Cooper, Sarbanes, Davis of Virginia, Duncan, and Issa.

Staff present: Phil Barnett, staff director and chief counsel; Karen Lightfoot, communications director and senior policy advisor; David Rapallo, chief investigative counsel; Brian Cohen, senior investigator and policy advisor; Margaret Daum, counsel; Mark Stephenson and Denise Wilson, professional staff members; Earley Green, chief clerk; Jen Berenho Iz, deputy clerk; Caren Auchman and Ella Hoffman, press assistants; Leneal Scott, information systems manager; Sam Buffone, William Ragland, Lauren Belive, and Miriam Edelman, staff assistants; Larry Halloran, minority staff director; Jennifer Safavian, minority chief counsel for oversight and investigations; Mason Alinger, minority legislative director; John Brosman, minority senior procurement counsel; Ashley Callen, minority counsel; Emile Monette and Benjamin Chance, minority professional staff members; Patrick Lyden, minority parliamentarian and member services coordinator; and Ali Ahmad, minority deputy press secretary.

Chairman WAXMAN. The meeting of the committee will come to order.

One of the primary issues this committee has tackled, this Congress, has been the waste and abuse of taxpayers' dollars from crop insurance in Kansas to an Air Force base on Ramstein, Germany. We have held over a dozen hearings into Federal programs that don't seem to be using taxpayer money wisely.

Today and next week we turn back to Iraq. Our subject today may seem obscure, insurance payments under the Defense Base Act of 1941, but the costs to the taxpayers are high.

The Defense Base Act requires contractors operating in Iraq and Afghanistan to purchase Workers' Compensation insurance for their employees. Three agencies—the State Department, USAID, and the Corps of Engineers—have approached this requirement responsibly. They conducted a competition to select an insurance carrier to offer this insurance at low rates to their contractors.

The Defense Department has taken a completely different approach. It allows contractors to negotiate their own individual insurance contracts. This approach has produced a boondoggle for the insurance companies and the private contractors and saddled the taxpayer with enormous costs.

Typically, insurers offering Workers' Compensation pay out as much in claims and expenses as they take in through premiums. The carriers make their real money off of investment returns they earn during the interval between when they receive premiums and pay claims and expenses.

This has been the experience of the State Department, USAID, the Corps of Engineers. In fact, the company that won these contracts, CNA, has actually paid out 8 percent more in claims and expenses than it has received in premiums.

But these contracts represent only 10 percent of the insurance market in Iraq and Afghanistan. Ninety percent of the DBA market is controlled by the Defense Department, and the experience in the DOD market has been completely different.

Under the DOD approach, private contractors negotiate with private insurers, but bill the taxpayers for the costs. This arrangement has been exceptionally lucrative for the private insurers and the contractors. Over the last 5 years, the four largest private insurers have made underwriting profits of nearly 40 percent. That is almost $600 million in profits.

The LOGCAP troop support contract—the largest single contract in Iraq—illustrates what is going on. As a series of charts will illustrate—and we will have them on the screen to the right and the left—KBR paid an insurance company, AIG, $284 million for Workers' Compensation coverage. Since KBR's contract is a cost-plus contract, this $284 million premium plus a markup for KBR of up to $8 million gets billed to the taxpayers bringing the total costs to the taxpayers of $292 million.

Out of this amount, just $73 million actually goes to injured contractors, and AIG and KBR pocket over $100 million as profit.

Well, this is really disgraceful. The taxpayer is paying nearly $300 million to deliver less than $75 million in benefits to injured contractors. Rube Goldberg could not design a more inefficient way to help employees wounded or injured in Iraq.

The Defense Department has argued that the fact that Iraq is a war zone justified the high costs of the insurance program, but under the Defense Base Act, the taxpayer, not the insurance company, has to pay the costs when a contractor is wounded in action. The insurance companies only pay for the types of injuries that could occur at any work site.

What makes the situation even worse is the people this program is supposed to benefit—the insured employees working for contractors. They have to fight the insurance company to get their benefits. Delays and denials in paying claims are the rule. Audit after audit has said that the Defense Department model doesn't work, but still the Defense Department won't change.

When Congress passed a law in 2006 requiring the Defense Department to rethink its approach, the Department reported that it would be too expensive to collect the necessary data and "there are no compelling procurement reasons for DOD to initiate any efforts."

My staff prepared an analysis of the Defense Base Act, which has been distributed to the Members as a supplemental memo, and based on new data from the insurers, it identified 600 million reasons why the Defense Department should care. That is the amount of the excessive profits that insurance companies have earned at taxpayer expense in just 5 years.

I would ask that this memorandum and the documents it cites to be made part of today's record. Without objection that will be the order.

[The information referred to follows:]

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MEMORANDUM

May 15, 2008

To: **Members of the Committee on Oversight and Government Reform**

Fr: **Majority Staff, Committee on Oversight and Government Reform**

Re: **Supplemental Information on Defense Base Act Insurance Costs**

On Thursday, May 15, 2008, at 10 a.m., in room 2154 of the Rayburn House Office Building, the full Committee will hold a hearing entitled, "Defense Base Act Insurance: Are Taxpayers Paying Too Much?" This memo provides supplemental information obtained during the Committee's investigation.

Federal law requires that all federal contractors working overseas obtain workers' compensation insurance known as Defense Base Act (DBA) insurance. For 90% of the DBA insurance required in Iraq and Afghanistan, the premiums and other terms are negotiated between the private contractors and the insurance companies while the costs are paid by the federal government. The information provided to the Committee shows that this arrangement has been extremely profitable for both the insurance companies and the private contractors.

In preparation for today's hearing, the Committee obtained profit and payment data from the four major insurance companies participating in the DBA program, as well as program information and evaluations from the Department of Labor, the Department of Defense, and congressional auditors. This information shows:

- **Insurance companies have made underwriting profits of nearly $600 million in Iraq and Afghanistan.** The top four DBA insurance companies received $1.5 billion in premiums from 2002 through 2007 from contracts negotiated with private contractors. They will pay out $928 million in claims and expenses for injuries incurred under these policies and earn net underwriting gains of $585 million.

- **The DBA program is significantly more lucrative for the insurance companies than other workers' compensation insurance.** The four top DBA insurance companies

earned underwriting gains of 39% on these policies from 2002 through 2007. In comparison, the same four companies have had a net underwriting loss on the other lines of workers' compensation insurance they offered during the same period. Outside of the DBA program, insurers offering workers' compensation typically earn their profits through investment returns, not underwriting gains.

- **The high costs of workers' compensation insurance under the DBA program inflate: the fees paid to private contractors in Iraq.** Contractors operating under cost-plus contracts in Iraq are allowed to bill the taxpayer for the costs of the workers' compensation premiums they pay plus a mark-up for contractor profits. The largest private contractor in Iraq, KBR, paid its workers' compensation insurer, AIG, $284 million in premiums through 2005 under its contract to provide logistical support to the troops. In addition to receiving reimbursement for these expenses, KBR will receive an additional payment of $2.8 million to $8.4 million in profits for incurring these expenses. The insurer, AIG, will pay out $73 million in claims and incur around $114 million in expenses, earning almost $100 million in profits.

- **Other features of the DBA program increase costs to taxpayers.** Under the DBA program, the maximum workers' compensation payments are capped based on the average compensation of U.S. workers, but there are no corresponding caps on the maximum premiums that insurers can charge per worker. The federal government reimburses insurers for payments resulting from "a war-risk hazard," but it appears that the DBA insurers are charging extra premiums based on the "danger pay" workers receive for being exposed to these risks.

- **The DBA insurers frequently delay or deny payment on claims from injured employees.** Despite the high profits realized by the insurers, the Department of Labor told Committee staff that the DBA insurers delay or deny payments on almost all claims submitted by injured contractor employees. The insurers lose over 95% of the disputed claims that are brought before administrative judges.

The high costs to the taxpayers of DBA insurance are avoidable. The Department of State, USAID, and the Army Corps of Engineers have negotiated DBA insurance rates for their contractors using a "risk-pool" approach. This approach has resulted in substantial savings by reducing premiums and eliminating underwriting profits. The Defense Department has been repeatedly urged by congressional and Army auditors to consider the use of a single insurer risk-pool for the entire Army or Department of Defense. According to the Congressional Budget Office, this change could save taxpayers as much as $362 million over the next decade. The Defense Department has consistently resisted these calls for change.

I. Background

The Defense Base Act of 1941 required contractors to purchase workers' compensation insurance for workers on overseas military bases. The law has since been expanded to require

coverage of contractors and subcontractors under almost any overseas contract with any government agency.[1]

DBA workers' compensation benefits include disability, medical, and death benefits for injury or death in the course of employment.[2] Disability payments for injuries that cause a loss of work time are set at two-thirds of an employee's average weekly wage, with maximum payments set at twice the national average weekly wage.[3] For workers who are killed, death benefits for a spouse or one child are equal to one half an employee's average weekly wage, payable for the life of a spouse or until a child turns 18.[4] Permanent disability benefits may be payable for life and subject to an annual cost of living adjustment.[5] Injured employees are entitled to receive coverage for medical costs and to treatment by a physician of their own choice.[6]

The Department of Labor is responsible for administering and overseeing DBA insurance. DBA regulations require that in the event of injury or death, the insurer must notify the Department of Labor within ten days.[7] The insurance company must then begin payments or file a "notice of controversion," indicating that it is contesting the validity of the claim.[8] These

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[1] 42 U.S.C. § 1651 *et seq.*

[2] 33 U.S.C. § 901 *et seq.* Benefits are based on those required under the 1927 Longshore and Harbor Workers' Compensation Act.

[3] *Id.* (setting the maximum payment at 66 2/3% of the employee's average weekly wage, subject to a maximum compensation rate, which is adjusted annually); Department of Labor, *National Average Weekly Wages (NAWW), Minimum and Maximum Compensation Rates, and Annual October Increases (Section 10(f))* (online at www.dol.gov/esa/owcp/dlhwc/NAWWinfo.htm) (accessed May 9, 2008). The "Maximum Compensation Rate" is presently $1,160.36 per week, based on a national average weekly wage of $580.18 per week. *Id.*

[4] 33 U.S.C. § 909. If the employee has more than one survivor (*e.g.*, two children or a spouse and a child), the benefits are one half the employee's average weekly wage, plus an additional 16 2/3% of the employee's average weekly wage, up to a maximum benefit of two-thirds of the employee's average weekly wage. These payments are also capped based upon the maximum compensation rate. *Id.*; Department of Labor, *National Average Weekly Wages (NAWW), Minimum and Maximum Compensation Rates, supra* note 3.

[5] 33 U.S.C. § 908; Department of Labor, *Defense Base Act: Workers' Compensation for Employees of U.S. Government Contractors Working Overseas* (online at www.dol.gov/esa/owcp/dlhwc/ExplainingDBA.htm) (accessed May 9, 2008).

[6] Department of Labor, *Defense Base Act: Workers' Compensation for Employees of U.S. Government Contractors Working Overseas* (online at www.dol.gov/esa/owcp/dlhwc/ExplainingDBA.htm) (accessed May 9, 2008).

[7] *Id.*

[8] Department of Labor, *Defense Base Act Insurance and Claims Administration* (Feb. 22, 2006).

disputed claims can be settled informally or in a formal hearing before an administrative law judge.[9]

Under the DBA program, insurance companies and federal taxpayers share the risks of contractor injuries and deaths that occur overseas. Insurers pay the costs of injuries or deaths that occur in the normal course of employment. However, under the War Hazards Compensation Act of 1942, the federal government covers the costs of any injury or death that "proximately results from a war-risk hazard."[10] For injuries caused by "bombs or bullets" — such as security guards injured in a firefight — insurance carriers are reimbursed by the Department of Labor, which determines whether an injury is due to a war hazard, and receive an additional 15% to cover administrative expenses.[11] In disputed cases, the insurers also receive reimbursement for their costs in contesting claims.[12] The effect of the War Hazards Compensation Act is to reduce significantly the risk to insurers of offering workers' compensation in a combat zone because it transfers the risk of injury during an attack to the federal government.

The premiums and terms of 90% of the DBA insurance market are set through negotiations between the insurance companies and individual contractors. For a small portion of the DBA insurance market (approximately 10%) — the insurance purchased by contractors for the State Department, the U.S. Agency for International Development (USAID), or the Army Corps of Engineers — the premiums and terms are set through negotiations between these agencies and insurers. These agencies combine their contracts into a risk-pool and negotiate with a single insurer to offer DBA insurance to their contractors.

The most recent data from the Department of Labor, which tracks injuries and fatalities payable under the Defense Base Act and War Hazard Compensation Act, indicates that 1,292 contractors have been killed and 9,610 wounded in Iraq and Afghanistan.[13]

II. Insurance Company Profits under the Defense Base Act

Since the wars in Iraq and Afghanistan began, insurance companies participating in the Defense Base Act program have made record profits, receiving premium payments from the federal government in much larger amounts than the claims they are paying out.

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[9] Department of Labor, *Defense Base Act: Workers' Compensation for Employees of U.S. Government Contractors Working Overseas* (online at www.dol.gov/esa/owcp/dlhwc/ExplainingDBA.htm) (accessed May 9, 2008). If an employee wins a claim, the insurance company must reimburse reasonable attorney fees. *Id.*

[10] 42 U.S.C. § 1701 *et seq.*

[11] 20 C.F.R. § 61.104.

[12] 20 C.F.R. § 61.104 *et seq.*

[13] Department of Labor, *Defense Base/War Hazards Act Summary by Nation for Afghanistan* (Apr. 2, 2008); Department of Labor, *Defense Base/War Hazards Act Summary by Nation for Iraq* (Apr. 2, 2008).

As part of the Committee's investigation into the DBA program, the Committee sought profit and loss information from the four insurance companies that participate most actively in the DBA program in Iraq and Afghanistan: American International Group (AIG), CNA, ACE USA, and the Chubb Corporation. Together, these four insurance companies control over 99% of the DBA market in Iraq and Afghanistan.[14] In fact, AIG alone controls approximately 80% of this market.[15]

Data provided to the Committee by these four insurance companies indicates that DBA payments have grown from $18.1 million in 2002 to a high of $462 million in 2005, a twenty-five fold increase. Since 2005, annual premiums have remained over $400 million each year. Overall, these four insurance companies have received approximately $1.7 billion in Defense Base Act insurance premiums since 2002. Table 1 sets forth payments to the top four DBA insurance companies for each year from 2002 to 2007.

Table 1: Total Spending on Defense Base Act Insurance

Year	Total DBA Premiums
2002	$18,078,902
2003	$74,452,255
2004	$272,181,736
2005	$462,560,542
2006	$427,580,701
2007	$440,687,778
Total	**$1,695,541,914**

Ninety percent of the $1.7 billion in premiums received by the four insurance companies were negotiated between the insurance companies and the private contractors.[16] This market has been extremely profitable for the four companies. From 2002 through 2007, they received premiums of $1.5 billion, paid out claims and expenses of $928 million, and retained $585 million as underwriting gain.[17] Table 2 shows that the overall profits earned by these four insurance companies equaled 39% of the premiums they received.

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[14] Department of Labor, *Defense Base/War Hazards Act Summary by Carrier for Afghanistan* (Apr. 2, 2008); Department of Labor, *Defense Base/War Hazards Act Summary by Carrier for Iraq* (Apr. 2, 2008).

[15] *Id.*

[16] The remaining DBA premiums, approximately $180 million, were negotiated directly by the State Department, USAID, and the Army Corps of Engineers through their single risk-pool programs.

[17] Estimates of underwriting gains were reported to the Committee by the four primary DBA insurers, and are expressed as a percentage of earned premiums, net expenses, and War Hazard Compensation Act payments received or expected to be received by the insurers. CNA provided a range of profit estimates, and the Committee used the average of this range to estimate profits.

Table 2: Underwriting Profits for Defense Base Act Insurers Contracting with Private Contractors (2002-2007)			
Company	**Net Earned Premium**	**Underwriting Gains**	**% Gain**
AIG	$1,305,827,000	$500,087,000	38%
ACE	$88,608,000	$24,121,000	27%
CNA	$110,722,000	$58,000,000	53%
Chubb	$7,940,000	$3,038,000	38%
Total	**$1,513,097,000**	**$585,246,000**	**39%**

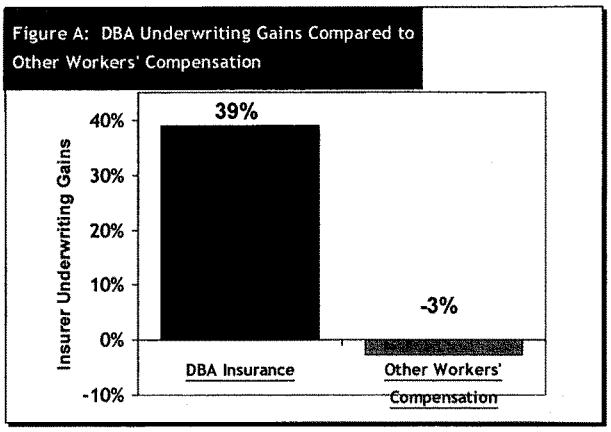
The four insurance companies participating in the DBA program have regularly reported profits under the program. Last year, the four companies reported total underwriting gains of $93 million on the DBA premiums they negotiated with private contractors.

The profits earned by the four insurance companies under the Defense Base Act program in Iraq and Afghanistan far outpaced profits made by insurance companies under other workers' compensation plans. According to *A.M. Best*, a leading source of insurance industry analysis and data, insurance companies typically suffer small underwriting losses under workers' compensation plans because the claims paid out, combined with their administrative and operating expenses, exceed the premiums they receive.[18] In these cases, the insurance companies make their profits by investing the premiums they hold in reserve.

From 2002 through 2006, insurance companies reported net underwriting losses of 2.6% under workers' compensation programs, excluding any dividends paid or interest and investment income. In fact, insurance companies that provide workers' compensation insurance have reported underwriting losses in this line of business in eight of ten years between 1997 and 2006. Figure A shows the wide disparity in profits earned by insurance companies under normal workers' compensation plans compared to those earned under the DBA insurance program in Iraq and Afghanistan.

This overall trend is also true for the top four insurance companies providing DBA insurance. Collectively, the four companies reported underwriting losses of 1% since 2002 on workers' compensation insurance other than DBA insurance. According to *A.M. Best*, the largest DBA insurer, AIG, has retained underwriting gains of just 1% since 2002 from its workers' compensation insurance. In comparison, AIG reported underwriting gains under the DBA program of 38% since 2002.

[18] A.M. Best, 2007 Best's Aggregates & Averages, *Workers' Compensation* (2007) (2006 is the most recent year for which A.M. Best data is available).



III. Defense Base Act Insurance under the LOGCAP Contract

On September 28, 2007, the Army Audit Agency issued a report examining DBA payments under the single largest contract in Iraq, KBR's $27 billion contract to provide meals, housing, laundry, and other logistical support to the troops, also knows as the Logistics Civil Augmentation Program (LOGCAP).[19] The findings in this audit provide an illustration of the waste in the DBA program.

In its audit, the Army Audit Agency reported that the Army had reimbursed KBR for DBA charges of $284 million made by its insurance company AIG through fiscal year 2005. Of this amount, the auditors reported that AIG would be required to pay out only $73 million in actual claims. The auditors observed that "the cost of DBA insurance substantially exceeded the losses experienced by the LOGCAP contractor."[20]

The data the Committee received from AIG indicates that expenses in providing DBA insurance are typically 40% of premiums. Using this estimate, AIG's expenses under the LOGCAP contract would be $114 million, and its underwriting profit would be $97 million.

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[19] Army Audit Agency, *Audit of Defense Base Act Insurance for the Logistics Civil Augmentation Program, Audit of Logistics Civil Augmentation Program Operations in Support of Operation Iraqi Freedom* (Sept. 28, 2007) (A-2007-0204-ALL). *See also* Army Sustainment Command, *Quarterly Media Spreadsheet with Disbursements* (Mar. 28, 2008) (reporting total current obligations to KBR of $27.2 billion under the LOGCAP contract).

[20] *Id.*

The Army Audit Agency concluded that AIG's rates appear "unreasonably high" and "excessive," warning of an "increased risk that the Army could be overcharged."[21] The audit report found that there is "a high risk that the contractor may have been paying more than necessary for this insurance" and that "[s]ignificant annual increases insurance companies made to DBA insurance rates don't appear to be consistent with the risk."[22]

Army auditors also raised concerns about the cost-plus nature of these charges. As the auditors stated, "because the LOGCAP contract is primarily a cost-reimbursable contract, the cost of this insurance is ultimately passed on to the government."[23] As a result, there is little incentive for KBR to control its costs for DBA insurance. To the contrary, under the LOGCAP contract, KBR itself is paid its fee as a percentage of these DBA costs, ranging from 1% to 3%, meaning that KBR may have received between $2.8 million and $8.4 million on top of AIG's profits.

Although the Army auditors found that "Army personnel at all levels appear to be aware of and concerned with the high cost of DBA insurance," they concluded that "sufficient action hadn't been taken to scrutinize these costs."[24] The auditors also warned that "we believe similar problems could exist on other contracts outside the LOGCAP arena."[25]

IV. The Use of "Risk-Pools" to Lower Government Costs

The data provided to the Committee indicates that federal agencies significantly reduce the costs associated with DBA insurance when they negotiate a single "risk-pool" contract with an insurance company to cover all of the agency's contractors rather than allowing individual contractors to negotiate with insurance companies separately.

CNA is the insurance company that provides the risk-pool coverage for the State Department, USAID, and the Corps of Engineers. It has had net underwriting losses of approximately $15 million under these contracts, 8% of the $180 million in premiums it received.[26] This underwriting loss is in line with losses typically experienced by workers' compensation insurers.

Table 3 sets forth the premiums and estimated underwriting gains and losses of insurance companies participating in the risk-pool approach compared to those contracting directly with private contractors.

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[21] *Id.* at 2, 9.

[22] *Id.* at 2.

[23] *Id.*

[24] *Id.*

[25] *Id.*

[26] Because CNA only provided ranges of underwriting gains and losses under its at large and risk-pool contracts, these estimates cannot be calculated with precision and instead represent the closest possible approximations.

Table 3: Underwriting Profits for Defense Base Act Insurers under Risk-Pool and Privately Negotiated Contracts (2002-2007)			
	Net Earned Premiums	**Underwriting Gain/Loss**	**Percent Gained/Lost**
Risk-Pool Contracts at State, USAID, and USACE	$182,445,000	$15,000,000 losses	8% losses
Privately Negotiated Contracts	$1,514,000,000	$585,000,000 gains	39% gains

V. The Recommendations of Independent Auditors and the DOD Response

Every year since 2005, Congress and independent auditors have recommended that the Defense Department consider a risk-pool arrangement to lower costs to the taxpayer. To date, however, the Defense Department has refused to examine this possibility at the Army or Department level.

A. The 2005 GAO Report

On April 29, 2005, the Government Accountability Office (GAO) issued a report entitled "Defense Base Act Insurance: Review Needed of Cost and Implementation Issues." Specifically, the report examined "the cost of workers' compensation insurance provided to contractor employees in Iraq under the Defense Base Act."[27]

GAO's report concluded that DBA insurance rates "are higher for DOD than for other agencies." GAO reported that the single risk-pool programs administered by the State Department and USAID resulted in lower rates to the taxpayer than the Defense Department's approach of allowing contractors to "independently acquire their own insurance." GAO reported that the State Department and USAID "paid approximately $2 to $5 for every $100 of salary cost for DBA insurance," while the Defense Department contractors "were paying DBA insurance rates between $10 and $21 per $100 of salary cost." GAO explained that the State Department and USAID were able to get lower prices in part because of "the pooling of work."[28]

[27] U.S. Government Accountability Office, *Defense Base Act Insurance: Review Needed of Cost and Implementation Issues* (Apr. 29, 2005) (GAO-05-280R).

[28] *Id.*

GAO recommended that the Director of the Office of Management and Budget within the White House coordinate with USAID and the Departments of Defense, Labor, and State in "identifying cost-effective options for acquiring DBA insurance."[29]

In response to GAO's report, both the White House and Defense Department disagreed and refused to implement the recommendation. On April 6, 2005, the Office of Management and Budget within the Executive Office of the President sent a letter to GAO stating that "we do not concur with GAO's recommendation" because it was "overly broad." Instead, the White House argued that "a targeted approach to DBA issues would be preferable" and stated that it would "work to solve specific issues as they arise."[30]

Similarly, on March 15, 2005, the Defense Department sent a letter to GAO stating that "[w]hile we take no exception to the factual information" contained in the GAO report, the recommendation to consider a risk-pool arrangement to lower costs "is not necessary." In addition, the Defense Department argued that "the costs of undertaking such a substantial interagency effort to address the issues listed with this recommendation will outweigh any potential benefits."[31] According to GAO, "DOD officials told us, however, that they do not have cost estimates or other data to support their statement."[32]

B. The 2006 Congressional Requirement

In 2006, Congress ordered a full review of DBA insurance payments, as GAO recommended a year earlier. Section 1041 of the National Defense Authorization Act for Fiscal Year 2006, signed into law on January 6, 2006, required the Secretary of Defense to "review current and future needs, options, and risks associated with Defense Base Act insurance."[33] Congress ordered the Defense Secretary to conduct this review "in coordination with" the White House Office of Management and Budget, USAID, and the Departments of State and Labor.

In particular, Congress ordered the Defense Secretary to examine "cost-effective options for acquiring Defense Base Act insurance."[34] Congress also directed the Secretary to issue a

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[29] *Id.*

[30] Dean F. Clancy, Associate Director of Human Resource Programs, Office of Management and Budget, Executive Office of the President, to David E. Cooper, Director of Acquisition and Sourcing Management, U.S. Government Accountability Office (Apr. 6, 2005).

[31] Deidre A. Lee, Director, Defense Procurement and Acquisition Policy, Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics, to David E. Cooper, Director of Acquisition and Sourcing Management, U.S. Government Accountability Office (Mar. 15, 2005).

[32] U.S. Government Accountability Office, *Defense Base Act Insurance: Review Needed of Cost and Implementation Issues* (Apr. 29, 2005) (GAO-05-280R).

[33] National Defense Authorization Act for Fiscal Year 2006 (Public Law 109-163), sec. 1041(a) (Jan. 6, 2006).

[34] *Id.* at sec. 1041(b).

report to Congress within one year that would "set forth the findings of the Secretary as a result of the review and such recommendations, including recommendations for legislative or administrative actions, as the Secretary considers appropriate."[35]

On February 27, 2007, the Under Secretary for Acquisition, Technology, and Logistics for the Department of Defense issued a five-page paper responding to the requirement. DOD explained that its review was limited because the agency did not "collect specific DBA data from their overseas contractors, such as the number of covered employees working on a given contract."[36] DOD explained that "[s]uch data collection efforts would be expensive and would divert already limited resources" and that "there are no compelling procurement reasons for DoD to initiate any DBA data collection efforts of its own."[37]

The agency did point to one concrete initiative to address this problem, which was a pilot program already underway at the Army Corps of Engineers that saved millions of dollars in a matter of months by utilizing a single insurance company for its entire contractor risk-pool. The paper noted that the Army Corps of Engineers "has reported significant DBA cost savings over the first six months of its pilot program and is currently taking steps to extend that pilot program for a second year."[38] In particular, DOD reported that the Army Corps of Engineers "estimated savings to the Government on DBA insurance costs of more than $19 million after the first six months of its pilot program."[39]

Despite these clear and immediate savings, DOD gave little indication that any consideration was being given to using a single insurance company for the entire contractor risk-pool at the Army or Defense Department level. The paper stated that the Defense Department had postponed consideration of expanding the program until the pilot program's end, which was not until March 2008. The Department stated:

> We shall continue to monitor closely this [Army Corps] initiative, which may ultimately prove to be a better way for DoD to ensure that all of its overseas contractors can readily secure DBA insurance at reasonable rates world-wide than having such contractors individually purchase DBA insurance on the open market.[40]

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[35] *Id.* at sec. 1041(c).

[36] Kenneth J. Krieg, Under Secretary of Defense for Acquisition, Technology, and Logistics, *Report to Congress on NDAA FY 06 Section 1041 Review of DBA Insurance* (Feb. 27, 2007).

[37] *Id.* at 3.

[38] *Id.* at 5.

[39] *Id.* at 2.

[40] *Id.*

C. The 2007 Congressional Budget Office Analysis

The same month that the Defense Department issued its paper to Congress, the Congressional Budget Office issued its own analysis concluding that utilizing an insurance risk-pool approach across the entire Department could lower costs to the taxpayer by as much as $362 million.[41]

In February 2007, CBO issued a report to Congress that included an analysis of the amount of savings that would result if the Bush Administration would "create a Defense Base Act insurance pool for Department of Defense contractors deployed overseas."[42] CBO noted that "there is evidence that insurance premiums, commonly listed as a rate per $100 in direct labor cost, are higher than historical trends would predict."[43] According to CBO:

> Creating a larger DBA insurance pool would lower risk premiums and strengthen the buyer's negotiating position. The Department of State and the U.S. Agency for International Development (USAID) secure blanket coverage now, and their contractors pay lower DBA insurance premiums than DoD contractors.[44]

Although CBO expressed some qualifications about its predictions, it concluded overall that "pooling risk is an effective way to lower insurance costs."[45] CBO estimated that U.S. taxpayers could save up to $362 million from 2008 through 2017 if this approach was adopted, beginning with an immediate savings of $33 million in 2008 alone.

D. The 2007 Army Audit Agency Report

The Army Audit Agency conducted an audit in 2007 of DBA insurance under the LOGCAP contract. As described in part III, this audit found extensive problems in the DBA program. The auditors included in their report a recommendation that the Army consider a "risk-pooling arrangement to minimize cost to the government of purchasing liability insurance."[46]

In response to this recommendation, the Deputy Assistant Secretary of the Army for Policy and Procurement wrote to the Army Audit Agency on August 16, 2007.[47] In the letter, the

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[41] Congressional Budget Office, *Budget Options,* at 35 (Feb. 2007).

[42] *Id.*

[43] *Id.*

[44] *Id.*

[45] *Id.*

[46] Army Audit Agency, *Audit of Defense Base Act Insurance for the Logistics Civil Augmentation Program, Audit of Logistics Civil Augmentation Program Operations in Support of Operation Iraqi Freedom* (Sept. 28, 2007) (A-2007-0204-ALL)..

[47] Letter from E. Ballard, Deputy Assistant Secretary of the Army for Policy and Procurement, to Deputy Auditor General, Army Audit Agency (Aug. 16, 2007).

Deputy Assistant Secretary explained that the Army was waiting to make any decisions about a risk-pool program for the Army or Defense Department until March 2008, when the pilot program administered by Army Corps of Engineers "will end its two-year trial."[48] The Army letter stated, "[g]iven the success of the USACE pilot program, the Department of the Army will consider developing an Army-wide program."[49]

E. Current Status

Despite recommendations made every year since 2005 by GAO, Congress, and the Army's own auditors, the Defense Department has failed to implement an agency-wide single insurer risk-pool program for DBA insurance. At the conclusion of the Army Corps of Engineers' pilot program in March of this year, neither the Army nor the Defense Department took action to expand the single insurer risk-pool approach to the service or department level.

In written testimony provided for today's hearing, Richard Ginman, the Deputy Director for Defense Procurement and Acquisition Policy, stated that the Defense Department still has made no decision on whether to utilize a risk-pool approach for DBA insurance. Instead, the Department has apparently delayed this decision again while it orders yet another review. As Mr. Ginman states in his written testimony:

> A goal of the pilot program was to provide data to build and present to our office and the Army, a formal business case to determine if the pilot should be expanded Army or DoD-wide. To help USACE develop such a case, the Army Audit Agency recently agreed to the Army's (Deputy Assistant Secretary of the Army, Policy and Procurement) request to review the results of the two year pilot program to determine if it warranted permanent placement at the USACE and warrant further extension in the Army. Once Army Audit's review is complete, USACE will develop the business case and we will review the results to determine the Department's next steps.[50]

Mr. Ginman's written testimony provides no timeline for this new analysis, for the development of a "business case," or for the Department to make any final decisions regarding this matter.[51]

VI. Other Problems in the DBA Program

The information received by the Committee also reveals a number of other problems with costs and care provided under the DBA program. DBA insurers may charge minimum

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[48] *Id.*

[49] *Id.*

[50] House Committee on Oversight and Government Reform, Hearing on Defense Base Act Insurance: Are Taxpayers Paying Too Much?, Written Testimony of Richard Ginman, Deputy Director for Defense Procurement and Acquisition Policy, Office of the Deputy Under Secretary of Defense for Acquisition and Technology (May 15, 2008).

[51] *Id.*

premiums, which can result in extraordinarily high costs to the taxpayer. While DBA insurers collect unlimited premiums based on covered workers' salaries, benefits paid out under the policies are capped based on average worker salaries. DBA insurers also collect premiums based on "danger pay," which may be an illegal "premium loading" charge under the War Hazards Compensation Act. In addition, DBA insurers challenge an unreasonably high number of claims, resulting in additional costs to the taxpayer and unjustified delays in benefits to injured and killed workers.

A. Minimum Premiums

DBA insurance rates are typically expressed as a percentage of total payroll. For example, the insurance contract may require premiums of $10 per $100 of payroll. In cases where contractors have only a few employees and a limited payroll, DBA insurers may charge a minimum premium in addition to, or instead of, a flat percentage of payroll. In cases where contractors have only a few employees, these minimum premiums result in premiums that are extraordinarily high as a percentage of total salary. In some cases, these minimum premiums result in contractors paying more for workers' compensation insurance than they pay in salary. Information provided to the Committee indicated that in at least 47 contracts, contractors were forced to pay more in insurance premiums than they paid in salary. Overall, minimum premiums have been applied to over 700 contracts and have cost $8.5 million since 2002.

B. Unlimited Premiums and Capped Benefits

Under the insurance contracts negotiated by Defense Department contractors, DBA insurance premiums are usually based on the salaries paid by the contractors to their employees. If a contractor pays a premium of $4 per $100 of pay, the contractor will pay the insurance company $4,000 for coverage for an employee making $100,000 per year and $8,000 for a worker making $200,000 per year. There is no cap on the premiums paid to the insurer.

Under the DBA program, however, there is a cap on the benefits payable by insurers. In 2008, payments for death and missed work time due to disability cannot exceed $1,160.36 per week. Under the formulas used to determine benefits, benefits are capped for employees who make over $90,000 per year. The insurance premiums for an employee who earns $180,000 per year are twice as high as those for an employee who earns $90,000 per year. But in the event of injury and death, the two employees will receive the same benefit due to the applicable caps on benefits. The effect is to produce an apparent windfall for insurers when employees earn over $90,000 per year.

C. "Premium Loading"

Under the War Hazards Compensation Act, insurers are reimbursed by the federal government for injuries that are caused by "a war-risk hazard." Under the implementing regulations, insurers are supposed to be ineligible for these reimbursements if they charge

insurance premiums that include the costs of these war risks — an action known as "premium loading."[52]

It does not appear that this prohibition is being enforced. According to the Army Audit Agency, many workers under KBR's LOGCAP contract receive pay bonuses that are based on the fact that they are in a dangerous war zone, and this danger pay is taken into account in determining the size of the DBA premiums paid by KBR. The Army auditors determined that this constituted inappropriate premium loading, writing: "we believe that the premium paid on danger pay was also the 'premium' for war risk hazards."[53]

In a separate opinion, however, the Department of Labor concluded that the agency "does not equate danger pay as premium loading."[54]

D. Delays in Caring for Injured Contractors

The high profits received by the DBA insurers do not appear to result in expeditious coverage for injured contractor employees. Department of Labor officials informed Committee staff that the DBA insurers initially delay or deny payments on almost all claims from injured employees. They also said that the insurers require 30% to 40% of claimants to proceed through an administrative dispute process. The high dispute rate is in part a result of perverse incentives in the War Hazard Compensation Act that encourage insurers to fight and delay claims. If an insurance company disputes a claim and wins, they do not have to pay the claim. If the company disputes the claim and loses, they are reimbursed by the Department of Labor for the costs of disputing the claim, plus an additional 15% to cover administrative costs.

The Committee received data from the Department of Labor on the number of disputed claims that have been resolved through the Department of Labor Office of Administrative Law Judge (the final step in the dispute process) in 2008. This data indicates that of 108 disputed claims that have appeared before this Department of Labor office, there were only five cases where the injured contractors claim was denied. [55]

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[52] Army Audit Agency, *Audit of Defense Base Act Insurance for the Logistics Civil Augmentation Program, Audit of Logistics Civil Augmentation Program Operations in Support of Operation Iraqi Freedom* (Sept. 28, 2007) (A-2007-0204-ALL).

[53] *Id.*

[54] *Id.*

[55] Cases can be viewed at www.oalj.dol.gov/ by selecting LDA in the middle search field.

Chairman WAXMAN. In the course of our hearings into Government waste, fraud, and abuse, we have learned to recognize the recipe for wasteful government spending, and all the key ingredients are here: an obscure Federal program, a procurement approach that leaves Federal taxpayers, not private contractors, liable for the biggest risks, and officials who ignore warning after warning.

We need to stop this flagrant abuse of taxpayers' dollars, and this hearing is an important step in this process.

[The prepared statement of Chairman Henry A. Waxman follows:]

Opening Statement of Rep. Henry A. Waxman
Chairman, Committee on Oversight and Government Reform
Defense Base Act Insurance: Are Taxpayers Paying Too Much?
May 15, 2008

One of the primary issues this Committee has tackled this Congress has been the waste and abuse of taxpayer dollars. From crop insurance in Kansas to an Air Force base in Ramstein, Germany, we've held over a dozen hearings into federal programs that don't seem to be using taxpayer money wisely.

Today and next week, we turn back to Iraq. Our subject today may seem obscure: insurance payments under the Defense Base Act of 1941. But the costs to the taxpayer are high.

The Defense Base Act requires contractors operating in Iraq and Afghanistan to purchase workers' compensation insurance for their employees. Three agencies — the State Department, USAID, and the Corps of Engineers — have approached this requirement responsibly. They conducted a competition to select an insurance carrier to offer this insurance at low rates to their contractors.

The Defense Department has taken a completely different approach: it allows contractors to negotiate their own individual insurance contracts. This approach has produced a boondoggle for the insurance companies and the private contractors — and saddled the taxpayer with enormous costs.

Typically, insurers offering workers' compensation pay out as much in claims and expenses as they take in through premiums. The carriers make their real money off of investment returns they earn during the interval between when they receive premiums and pay claims and expenses.

This has been the experience of the State Department, USAID, and the Corps of Engineers. In fact, the company that won these contracts, CNA, has actually paid out 8% more in claims and expenses than it has received in premiums.

But these contracts represent only 10% of the insurance market in Iraq and Afghanistan. Ninety percent of the DBA market is controlled by the Defense Department. And the experience in the DOD market has been completely different.

Under the DOD approach, private contractors negotiate with private insurers, but bill the taxpayer for the costs. This arrangement has been exceptionally lucrative for the private insurers and the contractors. Over the last five years, the four largest private insurers have made underwriting profits of nearly 40%. That's almost $600 million in profits.

The LOGCAP troop support contract — the largest single contract in Iraq —illustrates what's going wrong. As a series of charts will illustrate, KBR paid an insurance company, AIG, $284 million for worker's compensation coverage. Since KBR's contract is a cost-plus contact, this $284 million premium plus a mark-up for KBR of up to $8 million gets billed to the taxpayer, bringing the total costs to the taxpayer to $292 million.

Out of this amount, just $73 million actually goes to injured contractors, and AIG and KBR pocket over $100 million as profit.

This is disgraceful. The taxpayer is paying nearly $300 million to deliver less than $75 million in benefits to injured contractors. Rube Goldberg could not design a more inefficient way to help employees wounded or injured in Iraq.

The Defense Department has argued that the fact that Iraq is a war zone justifies the high costs of the insurance program. But under the Defense Base Act, the taxpayer — not the insurance companies — has to pay the costs when a contractor is wounded in action. The insurance companies only pay for the types of injuries that could occur at any worksite.

What makes the situation even worse is the people this program is supposed to benefit — the injured employees working for contractors — have to fight the insurance companies to get their benefits. Delays and denials in paying claims are the rule.

Audit after audit has said the Defense Department model doesn't work, but still the Department won't change. When Congress passed a law in 2006 requiring the Defense Department to rethink its approach, the Department reported that it would be too expensive to collect the necessary data and "there are no compelling procurement reasons for DoD to initiate any … efforts."

My staff prepared an analysis of the Defense Base Act, which has been distributed to the members as a supplemental memo. Based on new data from the insurers, it identifies 600 million reasons why the Defense Department should care. That's the amount of the excessive profits that insurance companies have earned at taxpayer expense in just five years.

I ask that this memorandum and the documents it cites be made part of today's record.

In the course of our hearings into government waste, fraud, and abuse, we've learned to recognize the recipe for wasteful government spending. And all the key ingredients are here: an obscure federal program … a procurement approach that leaves federal taxpayers, not private contractors, liable for the biggest risks … and officials who ignore warning after warning.

We need to stop this flagrant abuse of taxpayer dollars. And this hearing is an important step in this process.

Chairman WAXMAN. Mr. Davis, I want to recognize you for an opening statement.

Mr. DAVIS OF VIRGINIA. Thank you, Mr. Chairman, for holding this hearing on the Defense Base Act Insurance Program. The DBA provides vital insurance coverage for the brave men and woman employed by the companies performing critical parts of our Government's overseas operations around the globe.

This once obscure program has dramatically expanded since 2003 with an unprecedented number of contractors working under wartime conditions supporting our efforts in both Iraq and Afghanistan. Thousands of contracts and subcontracts throughout the world are subject to DBA insurance requirements.

Agencies and the contractors use several models to acquire the mandatory coverage. In general, Defense Department contractors purchase DBA insurance on their own and recover their costs under the terms of the contract. In contrast, the Department of State preselects one primary insurance carrier to provide the DBA insurance at a fixed rate for all of its various covered contracts.

A few years ago the Army Corps of Engineers launched a pilot program based on the State Department model, and the Corps is here today to discuss that trial effort. Recently, the Congressional Budget Office suggested DOD adopt that single source method, but that approach may not be a panacea.

Efficiencies and cost controls possible at lesser levels of operations may be overwhelmed by the vastly increased scale of the Pentagon's DBA responsibilities, which dwarf those of the State and the Corps both in size and the diversity of requirements. The CBO acknowledged such in an arrangement that presents a number of challenges.

It is not clear that any insurance provider would be willing to underwrite DBA insurance for all DOD contractors, or the contractors who would be willing to participate on those terms. Concentrating so large a portion of current DBA coverage in the hands of one carrier could have the perverse effect of driving carriers out of the market, the resulting loss of competition risks making it easier to raise rates. The cost of initiating and administering such a centralized DOD-run program could further endanger any savings for any preselected master contract.

Mandating a single source for all DOD contractors to obtain this insurance may in fact result in economies of scale and lower cost for the insurance in Iraq and Afghanistan where risks are higher, but it doesn't take into account the myriad places around the globe where Federal contracts are performed, and the risks are much lower.

In those places where operational risks are lower, the cost of DBA insurance will almost certainly go up under a single-source contract. The effect is like pushing on an inflated balloon. If you squeeze the balloon in one place, a bulge has to pop out somewhere else.

This is a good opportunity for us to conduct some real oversight into whether we are spending the taxpayers' dollars in the most costs-effective manner. If there is a better, cheaper way to obtain DBA insurance, we need to pursue that route.

However, Mr. Chairman, I think it is important we conduct balanced oversight, and that means bearing in mind this program covers thousands of contractors performing work in almost every country in the world. Viewing the entire DBA program through the lens of one audit of one contractors, even if the contractor is KBR, a former Halliburton subsidiary, risks missing the larger picture.

The problem appears to be as much with Government controls and oversight of this increasingly expensive program as it does with any alleged contractor overcharges. Oversight focused on the general case, not the outlier, is far more likely to yield reforms that lead to meaningful savings.

Thank you again, and we look forward to today's testimony.

[The prepared statement of Hon. Tom Davis follows:]

HENRY A. WAXMAN, CALIFORNIA
CHAIRMAN

TOM DAVIS, VIRGINIA
RANKING MINORITY MEMBER

ONE HUNDRED TENTH CONGRESS

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Statement of Rep. Tom Davis
Ranking Republican Member
Committee on Oversight and Government Reform
"Defense Base Act Insurance: Are Taxpayers Paying Too Much?"
May 15, 2008

Thank you, Chairman Waxman, for holding this hearing on the Defense Base Act (DBA) insurance program. The DBA provides vital insurance coverage for the brave men and women employed by the companies performing critical parts of our government's overseas operations around the globe. This once obscure program has dramatically expanded since 2003 with an unprecedented number of contractors working under wartime conditions supporting our efforts in both Iraq and Afghanistan. Thousands of contracts and subcontracts throughout the world are subject to DBA insurance requirements.

Agencies and their contractors use several models to acquire the mandatory coverage. In general, Defense Department contractors purchase DBA insurance on their own and recover their cost under the contract terms. In contrast, the Department of State pre-selects one primary insurance carrier to provide the DBA insurance at a fixed rate for all its various covered contracts. A few years ago, the Army Corps of Engineers launched a pilot program based on the State Department model, and the Corps is here today to discuss that trial effort.

Recently, the Congressional Budget Office suggested DOD adopt that single-source method. But that approach may not be a panacea. Efficiencies and cost controls possible at lesser levels of operations may be overwhelmed by the vastly increased scale of the Pentagon's DBA responsibilities, which dwarf those of State and the Corps both in size and diversity of requirements.

The CBO acknowledged such an arrangement presents a number of challenges. It's not clear that any insurance provider would be willing to underwrite DBA insurance for all DOD contractors, or that contractors would be willing to participate on those terms. Concentrating so large a portion of current DBA coverage in the hands of one carrier could have the perverse effect of driving carriers out of the market. The resulting loss of competition risks making it easier to raise rates. And the cost of initiating and administering such a centralized DOD-run program could further endanger any savings from a pre-selected master contract.

Mandating a single source for all DOD contractors to obtain this insurance may in fact result in economies of scale and lower costs for the insurance in Iraq and Afghanistan where risks are higher, but it does not take into account the myriad places around the globe where federal contracts are performed and the risks are lower. In those places where operational risks are lower, the costs of DBA insurance will almost certainly go up under a single-source contract. The effect is like pushing on an inflated balloon – if you squeeze the balloon in one place, a bulge has to pop out someplace else.

This is a good opportunity for us to conduct some real oversight into whether we are spending the taxpayers' dollars in the most cost effective manner. If there is a better, cheaper way to obtain DBA insurance, we need to pursue that route.

However, Mr. Chairman, I think it's important we conduct balanced oversight, and that means bearing in mind this program covers thousands of contractors performing work in almost every country in the world. Viewing the entire DBA program through the lens of one audit of one contractor – even if the contractor is KBR, a former Halliburton subsidiary – risks missing the larger picture. The problem appears to be as much with government controls and oversight of this increasingly expensive program as it does with any alleged contractor overcharges. Oversight focused on the general case, not the outlier, is far more likely to yield reforms that lead to meaningful savings.

Thank you again. We look forward to today's testimony.

Chairman WAXMAN. Thank you very much, Mr. Davis.

Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman. I want to congratulate you and the committee for the latest in the remarkable series of hearings that really benefit the taxpayer.

Taxpayers are really upset that they don't feel that they are getting more value for their taxpayer dollars. The latest book reviewed in the Wall Street Journal said that, on average, taxpayers get about 24 cents of value for every dollar they pay in taxes. That obviously means 76 cents in something else, and a lot of that is waste, fraud, and abuse.

So I appreciate your looking into this little known area of the law. I think that if this were used as a case study in business school in pretty much any business school in America, the students would be appalled.

I have been teaching at Vanderbilt Business School now for over a decade, and I think the students at the ON School of Management in Nashville, TN, would be able to craft a much better system than the one we have today.

So let's get the facts out, and let's see how we can help the taxpayer. Thank you, Mr. Chairman.

Chairman WAXMAN. Thank you, Mr. Cooper.

Ms. Watson.

Ms. WATSON. Thank you, Mr. Chairman, for holding today's hearing concerning the importance of safeguarding taxpayers from incurring the costs of high insurance premiums related to the Defense Base Act.

As you all know, DBA insurance is required for all private contractors and subcontractors who do business overseas with any Government agency currently. Our Nation's state of affairs has us occupying Iraq and Afghanistan where we rely heavily on large numbers of Government contractors which, consequently, has increased the amount spent on DBA insurance by the hundred millions of dollars.

However, both the Federal Government and insurers do accept the risk of injury or death to contractors, but the Government absorbed the entire cost of injury or death if it is related to war risk hazards.

Since the start of the wars in Afghanistan and Iraq, there have been 1,292 contractors killed and another 9,610 wounded as a result of their employment with various Government agencies, although DBA insurance is meant to protect contractors and their families by providing death, disability, and medical benefits for injuries sustained during the course of employment. This committee has found that adequate controls weren't in place to ensure the cost of DBA insurance were minimized.

In order to make sure that the taxpayer dollar is used wisely and effectively, potential cost-saving measures should be explored to relieve the burden on the taxpayer from paying unusually high and unfair insurance premiums.

Thank you, Mr. Chairman. I yield back.

Chairman WAXMAN. Thank you very much, Ms. Watson.

Mr. Sarbanes, do you want to pass on the opening statement?

Mr. SARBANES. Yes.

Chairman WAXMAN. We will get to the witnesses. Thank you.

We are pleased to have the following people here to testify before us: Mr. Richard Ginman, Deputy Director of Defense Procurement and Acquisition Policy, U.S. Department of Defense; Mr. Shelby Hallmark, Director of Workers' Compensation Programs, U.S. Department of Labor; Mr. William H. Moser, Deputy Assistant Secretary of Bureau for Administration Logistics Management, U.S. Department of State; Mr. James Dalton, P.E., Chief, Engineering and Construction, U.S. Corps of Engineers; Mr. Joseph P. Mizzoni, Deputy Auditor General for Acquisition and Logistics, U.S. Army Audit Agency; and Mr. John K. Needham, Director, Acquisition and Sourcing Management Issues, Government Accountability Office.

We are pleased to welcome all of you to our hearing today. It is the practice of this committee that all witnesses that testify before us do so under oath, so if you have no objections, I would like to ask you to please stand and raise your right hands.

[Witnesses sworn.]

Chairman WAXMAN. Thank you. The record will indicate that each of the witnesses has answered in the affirmative.

Your prepared statements that have been submitted to us will be in the record in full. We would like to ask, if you would, to try to limit the oral presentation to around 5 minutes. We have a clock. When it is turned on, it will be green for 4 minutes, and then turn yellow for 1 minute, and after 5 minutes will be red. When you see the red light, it would be a good time to summarize and conclude.

Mr. Ginman, we are pleased to have you, and there is a button on the base of the mic, be sure it is on. We are looking forward to hearing from you.

STATEMENTS OF RICHARD GINMAN, DEPUTY DIRECTOR FOR DEFENSE PROCUREMENT AND ACQUISITION POLICY, OFFICE OF THE DEPUTY UNDER SECRETARY OF DEFENSE; SHELBY HALLMARK, DIRECTOR, OFFICE OF WORKERS' COMPENSATION PROGRAMS, U.S. DEPARTMENT OF LABOR; WILLIAM H. MOSER, DEPUTY ASSISTANT SECRETARY OF STATE FOR LOGISTICS MANAGEMENT, U.S. DEPARTMENT OF STATE; JAMES C. DALTON, CHIEF OF ENGINEERING AND CONSTRUCTION, U.S. ARMY CORPS OF ENGINEERS, DEPARTMENT OF THE ARMY; JOSEPH P. MIZZONI, DEPUTY AUDITOR GENERAL FOR ACQUISITION AND LOGISTICS, U.S. ARMY AUDIT AGENCY; AND JOHN K. NEEDHAM, DIRECTOR, ACQUISITION AND SOURCING MANAGEMENT ISSUES, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

STATEMENT OF RICHARD GINMAN

Admiral GINMAN. Chairman Waxman, Ranking Member Davis, distinguished members of the committee, thank you for the opportunity to appear before you today to discuss Defense Base Act insurance. I am Dick Ginman, and I serve as Deputy Director, Defense Procurement of Acquisition Policy in the Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics. I have more than 37 years in government and commercial business in a variety of acquisition positions.

Before assuming this job, I held several private sector positions, including vice president of a line of business at General Dynamics. I also served in the U.S. Navy for 30 years, retiring as a Rear Admiral, Supply Corps.

In the past, DOD permitted its overseas contractors to purchase the required DBA insurance from any insurance company approved for this purpose by the Department of Labor. In our April 1996 Report to Congress, we compared the State Department's and USAID's DBA rates to a sampling of rates paid by DOD contractors. We found that in most cases our rates were lower than those paid by State and USAID, sometimes significantly lower.

We found that many firms purchased DBA insurance at very favorable rates, as riders to their regular State-side Workers' Compensation insurance programs. In addition, except for a few isolated instances DOD contractors were not having problems obtaining DBA coverage.

We were concerned that the umbrella contracting approach did not provide an incentive for improving a company's safety record. Since all companies pay the same rate, there is no incentive for a company to be proactive about keeping rates down through better safety records, and thus be more competitive in the marketplace.

Further, with a single contract with one rate, we would not be able to take advantage to the lower premiums available to industry for the majority of areas to which we were sending contractors at the time. After 9/11 and during the beginning of the Iraq War, however, we received complaints from companies doing business in Iraq concerning DBA insurance. They complained that the rates for the insurance had increased significantly going from $4 to over $20 per $100 of employee's salary, and in some cases they could not obtain DBA insurance at all.

Also, minimum premium payments of $15,000 to $25,000 dollars hit small businesses particularly hard. To determine if a single mandatory contract approach for DBA would provide cost savings for DOD, we sponsored a pilot program with the U.S. Army Corps of Engineers. Although the Corps' pilot program was competed, only CNA International submitted an offer. CNA's initial contract established worldwide DBA insurance rates of $5 to $8.50 per employee salary for services and construction, respectively. which were below the range of $10 to $21 GAO cited for contract workers in Iraq in their 2005 Report.

While the Corps found that several small and local businesses were now able to obtain lower DBA insurance rates for Iraq and obtained insurance where they were previously denied, the Corps also discovered that in certain non-war zone areas, the umbrella DBA rates were sometimes higher than what individual contractors were previously obtaining. This is expected under the concept of risk-pooling where lower risk areas would pay a higher premium than the higher risk areas.

In April 2008, CNA and the Corps agreed to a contract modification setting up two additional labor categories for security and for aviation with materially higher rates. This occurred because CNA was incurring significant losses in the war zone such as Iraq and that it could no longer continue contract performance at the current rates. They agreed to a $10.30 and a $17.50 rate per $100 of

employee's salary for security in aviation, respectively, which are similar to the same rates at State.

A pilot program goal is to provide data to build and to present to our office in the Army a formal business case to determine if the Pilot should be expanded Army or DOD-wide. To help the Corps develop such a case, the Army Audit Agency recently agreed to review the results of the pilot program to determine if it warranted permanent placement at the Corps and warrant further extension into the Army.

To build this business case, the Department will pursue collecting DBA data from the top 50 defense contractors. Once Army's audit review is complete and we have collected the additional data, the Corps will develop the business case, and we will review the results to determine the Department's next steps.

Mr. Chairman, I thank the committee for your interest in our efforts, and we would be happy to address any questions.

[The prepared statement of Admiral Ginman follows:]

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TESTIMONY OF

RICHARD GINMAN

DEPUTY DIRECTOR FOR

DEFENSE PROCUREMENT AND ACQUISITION POLICY,

OFFICE OF THE DEPUTY UNDER SECRETARY OF DEFENSE

(ACQUISITION AND TECHNOLOGY)

BEFORE THE UNITED STATES

HOUSE OVERSIGHT AND

GOVERNMENT REFORM COMMITTEE

May 15, 2008

FOR OFFICIAL USE ONLY
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HOUSE COMMITTEE

Chairman Waxman, Representative Davis, and distinguished members of the Committee, thank you for the opportunity to appear before you today on behalf of Dr. Finley, the Deputy Under Secretary of Defense for Acquisition and Technology, to discuss Defense Base Act (DBA) insurance and the War Hazards Compensation Act (WHCA) programs. In particular, I will address some of the Department of Defense's (DoD's) efforts to determine the cost effectiveness of these programs and our experiences with DBA rates on our contracts before and during the Iraq war.

But first let me introduce myself. I am Dick Ginman and I serve as the Deputy Director, Defense Procurement and Acquisition Policy and Strategic Sourcing (DPAP), in the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics. I have more than 38 years experience in government and commercial business in the fields of contracting, acquisition and financial management. Before assuming this position in October 2006, I held several private sector positions including Vice President of General Dynamics Maritime Information Systems and Director of Contracts for Digital System Resources. I served in the United States Navy for 30 years retiring as a Rear Admiral, Supply Corps. In addition to three tours afloat, I served in a variety of contracting and acquisition positions that included Commander, Navy Exchange Service Command; Deputy for Acquisition and Business Management in the office of the Assistant Secretary of the Navy, Research Development and Acquisition; and Deputy Commander for Contracts, Naval Sea Systems Command.

DBA and WHCA Overview

The DBA (42 U.S.C. 1651-1654), which was enacted in 1941, requires Federal contractors to provide specified levels of workers' compensation insurance for their overseas employees who may be injured or killed on the job. In administering the DBA, the Department of Labor (DOL) ensures that the required workers' compensation benefits are provided for covered contractor employees. The requirement to obtain DBA insurance flows down from the prime contractor to all subcontractors and covers all employees working overseas, including foreign nationals (unless DOL grants a waiver for a country which would normally only apply to foreign nationals). The cost of DBA insurance is generally passed on to the Government within the cost of the contract.

The compensation benefits paid due to injuries and death for DBA-covered contractor employees caused by war risk hazards may be reimbursed to the self-insured employer and insurance carrier by the United States, as it has assumed liability for these under the WHCA (42 U.S.C. 1701-1717). The WHCA, administered by DOL's Office of Workers' Compensation Programs, provides for reimbursement from the Employees Compensation Fund (established by section 8147 of the Federal Employees' Compensation Act, 5 U.S.C. 8147) to self-insured employers and insurance carriers for DBA benefits where the injury or death arose from a war-risk hazard, as defined by the WHCA. This reimbursement includes acts of terrorism that meet the definition of a war-risk hazard. However, a WHCA reimbursement will not be made where the insurance carrier has charged an additional premium for war-risk hazards (see 42 U.S.C. 1704(b); 20 C.F.R. 61.1 OO(b)).

Cost Effectiveness of DBA Prior to 9-11 and the Iraq War

In the past, DoD permitted its overseas contractors to purchase the required DBA insurance from any insurance company approved for this purpose by DOL. In 1996, we compared the cost-effectiveness of this approach to the agency-wide DBA programs at the Department of State (DOS) and the United States Agency for International Development (USAID). USAID is the older of the two existing programs, having been initiated in the late 1970s, whereas the DOS program is more recent, awarding their first contract in 1992.

We compared the DOS's and USAID's DBA rates to a representative sampling of rates paid by DoD in our April 1996 report to the Committee on Armed Services (which was requested by the Conference Report accompanying the Fiscal Year 1996 Defense Authorization Act). We found that in most cases, our rates were lower than those paid by DOS and USAID, sometimes significantly lower. We found that many firms purchased DBA insurance at very favorable rates as riders to their regular stateside worker's compensation. In addition, except for a few isolated instances, DoD contractors were not having problems obtaining DBA coverage.

Also, we were concerned that the umbrella contracting approach did not provide an incentive for improving a company's safety record. There was no incentive for companies to be proactive about keeping rates down through better safety practices, as there are when high rates make a firm less competitive. Although DoD would not pay higher premiums in high-risk areas, we were additionally concerned in 1996 that if a single contract with one rate was issued, that we would also not be able to take advantage

of the low premiums for the majority of areas to which we were sending contractors at that time.

Cost Effectiveness of DBA During Iraq War

After 9-11 and during the beginning of the Iraq war, however, we received several complaints from companies doing business in Iraq concerning the cost and availability of DBA insurance. Specifically, they complained that: (1) the rates for this mandatory insurance had increased significantly - going from $4 to over $20 per $100 of employee salary, and (2) in some cases, they could not obtain DBA insurance. This difficult DBA market hit small businesses particularly hard because there was often a minimum premium of $15,000 to $25,000, regardless of how few contractor employees were overseas or how short a time period they were there. In short, DoD started to experience in Iraq, DBA situations similar to what had occurred at USAID and DOS, before they commenced their umbrella contracts.

Therefore, to determine if a single mandatory contract approach for DBA would provide cost-savings for DoD, we sponsored a pilot program at the U.S. Army Corps of Engineers (USACE). The USACE pilot program is based on the programs at USAID and DOS. Although the USACE pilot contract was competed on a full and open basis, only CNA International submitted an offer. After contract award in November 2005, all requirements for DBA insurance on USACE contracts world-wide were to be placed with CNA for an initial period of one year.

CNA's initial contract established DBA insurance rates of $5 per $100 of employee salary for services and $8.50 per $100 of employee salary for construction. These rates were

significantly below the range of $10 to $21 per $100 of salary cited for contract workers in Iraq by the GAO in an April 2005 report on this subject. Also, no minimum payments were required by the contractors for DBA insurance.

Based on these positive early results, USACE continued with the second year of its pilot program. For the subsequent contract, awarded in March 2007, CNA again, was the only offeror. Nonetheless, the rates were materially reduced from the previous contract, from $5 per $100 of employee salary for services to $3.50 , and from $8.50 per $100 of employee salary for construction to $7.25.

While USACE found that several small and local business were now able to obtain lower DBA insurance rates for Iraq and obtain insurance where they were previously denied, USACE also discovered that in certain non-war zone areas, their umbrella DBA rates were sometimes higher than what individual contractors were previously obtaining. Of course, this is expected under the concept of risk-pooling, where lower risk areas would pay a higher premium than higher risk areas.

Similar to the first year of the contract, the USACE extended the second performance period of the pilot contract for an additional six months, through September 2008, to develop a follow-on solicitation. In April 2008, CNA and the USACE agreed to a contract modification, setting up two additional labor categories for security and for aviation with materially higher rates. This occurred because CNA was incurring such significant losses in war zones such as Iraq, that it could no longer continue contract performance at the current rates. USACE and CNA agreed to a $10.30 rate per $100 of

employee salary for security, and a $17.50 rate per $100 of employee salary for aviation, which are similar to the rates DOS has for this two categories.

Although the contract for the pilot program is continuing, the USACE in February 2008 decided to make the program permanent. A goal of the pilot program was to provide data to build and present to our office and the Army, a formal business case to determine if the pilot should be expanded Army or DoD-wide. To help USACE develop such a case, the Army Audit Agency recently agreed to the Army's (Deputy Assistant Secretary of the Army, Policy and Procurement) request to review the results of the two year pilot program to determine if it warranted permanent placement at the USACE and warrant further extension in the Army. Once Army Audit's review is complete, USACE will develop the business case and we will review the results to determine the Department's next steps.

The Department's goal is to continuously strive for improvement in all that we do. We will not lose sight of the tenet that while we endeavor to provide our warfighters the very best, we must also ensure that we do so while being good stewards of taxpayer funds. Our warfighters deserve nothing less and our taxpayers, rightfully, should insist on nothing less.

Mr. Chairman, I thank you and the members of the committee for your interest in our efforts, and would be happy to address any questions that you may have for me.

Chairman WAXMAN. Thank you very much. We have questions, but we will wait until all the witnesses have testified first.

Mr. Hallmark.

STATEMENT OF SHELBY HALLMARK

Mr. HALLMARK. Good morning, Mr. Chairman, and Ranking Member Davis and other Members. I am Shelby Hallmark. I am the Director of OWCP, the Office of Workers' Compensation Programs at the Department of Labor. I have served in that position, or its Deputy, since 1990.

The Longshore and Harbor Workers' Compensation Program is the smallest of OWCP's programs. Our Longshore Division oversees the Defense Base Act enacted, as we know, in 1941 to provide Workers' Compensation protections for employees of Federal contractors overseas. Our Federal Employees' Compensation Division runs the War Hazards Compensation Act, providing Federal reinsurance for DBA losses incurred as a result of war.

The DBA is a private sector insurance driven Workers' Compensation system similar to those run by each State. DOL's role is oversight. We assure that Federal contractors overseas procure the necessary DBA insurance coverage. We oversee insurers' handling of claims activities and issuance of payments, and we resolve disputes between insurers and employees when they arise.

DOL has no authority to regulate insurance premiums under the Longshore and DBA statutes. In effect, the system is self-regulating. The market determines premiums, and purchasers, contractors, or Federal contracting agencies can negotiate for better prices. Most claims are resolved without Federal intervention.

In 2003, contracting subject to DBA rose dramatically. DOL launched a major effort to educate the many players in the system, insurers, contracting agencies, contractors, and attorneys, defense and plaintiff, on their roles and responsibilities. We sponsored numerous seminars and round tables aimed at clarifying requirements, addressing the special problems arising in the Middle East environment, and sharing best practices.

Although all participants in the DBA system were challenged by the unique difficulties presented in Iraq and Afghanistan, we believe compliance assistance effort and the efforts of our stakeholders have improved the extension of DBA coverage and the delivery of services to workers.

Two of the three major insurers have opened claims processing offices in the Middle East to over come distance, language, and cultural barriers, and have translated forms and brochures into Arabic. While claims processing is elongated due to distance and war zone conditions, overall outcomes are improving. Contracting agencies have acted to ensure that contractors and subcontractors have DBA coverage, and claims filing compliance has risen.

The volume of DBA claims from Iraq and Afghanistan rose quickly from 2003 through 2007. DOL staff are acutely aware of the significant numbers of both American and foreign citizens injured or killed in the course of DBA employment, and our staff have worked extremely hard to ensure that the program functions as intended for these workers.

While it appears that Iraq/Afghanistan claimants are somewhat less successful in obtaining benefits than domestic claimants in the Longshore program, we believe this discrepancy is largely explained by the unique circumstances involved in implementing an insurance program in a conflict zone where just finding and communicating with injured workers can be a huge challenge.

I am proud to note, however, that Iraq/Afghanistan cases that do enter DOL's dispute resolution system receive very comparable outcomes, indicating that our efforts to reach out to these claimants are working.

My written testimony provides examples of complex cases involving multiple vests of foreign nationals in which DOL was able to achieve relatively rapid payment of the large majority of the families involved, despite significant obstacles. Our New York office worked very hard to get benefits to scores of Nepalese, Iraqi, and Turkish families in just these three cases.

Mr. Chairman, you voiced a specific interest in post-traumatic stress disorder, PTSD cases. While the major insurers have generally handled DBA claims the same way they do domestic Workers' Compensation claims, PTSD presents challenges that are not normally faced in Workers' Compensation.

In 2006, we determined that additional focus was needed in this area, specifically in DBA community. Relatively clear-cut PTSD cases were being reported but not getting appropriate resolutions swiftly enough. Employers were not providing counseling services that military members get, and, of course, these workers did not receive VA services.

We, of course, push for proper resolutions in the individual cases we became aware of, but we also took action systemically working closely with insurers to raise awareness of PTSD issues and encourage best practices.

My written testimony outlines OWCP's implementation of the War Hazards Compensation Act. This reinsurance program, paid from Federal entitlement funds, is being administered effectively. We have received less than 300 claims for reimbursement from insurers so far. We expect many more to be filed in the coming years.

Thank you for this opportunity, and I will be glad to answer questions.

[The prepared statement of Mr. Hallmark follows:]

STATEMENT OF SHELBY HALLMARK
DIRECTOR
OFFICE OF WORKERS' COMPENSATION PROGRAMS
U.S. DEPARTMENT OF LABOR

BEFORE THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
U.S. HOUSE OF REPRESENTATIVES

May 15, 2008

Thank you Mr. Chairman.

My name is Shelby Hallmark and I am the Director of the Office of Workers' Compensation Programs (OWCP), a component of the Employment Standards Administration at the United States Department of Labor (DOL). OWCP is responsible for overseeing, among other workers' compensation activities, the provisions of the Defense Base Act (DBA) and the War Hazards Compensation Act (WHCA). I appreciate this opportunity to appear before you today to discuss the Department's responsibilities under these two statutes.

DEFENSE BASE ACT OVERVIEW

The 1941 Defense Base Act (DBA) (42 U.S.C. § 1651 et seq.) is an extension of the Longshore and Harbor Workers' Compensation Act (Longshore Act) (33 U.S.C. § 901 et seq.). Since 1950, this program has been administered by DOL. Unlike other programs OWCP administers, but similar to state workers' compensation systems, benefits under the Longshore Act and DBA are provided by private insurance companies to injured workers and survivors of workers whose death is related to their employment while under contract overseas to federal agencies. The Department oversees this benefit delivery by receiving and monitoring reports of injury and of benefit payment, and providing informal but critical dispute resolution services. We also educate the various parties to the program about their rights and responsibilities under the DBA, and provide technical and compliance assistance whenever necessary.

Following the inception of the Iraq conflict in 2003, we quickly became aware that the level of contract activities there and in Afghanistan required a major enhancement in our compliance assistance with regard to the DBA. While the program had been in existence for six decades, contract employment covered by the DBA had been relatively restricted. Thus, DBA claims activity had been a trickle compared to the basic Longshore program. Federal contracting agency staff, insurers, contract employers, and the plaintiff and defense bars all needed to be fully informed of the DBA's requirements to ensure that the insurance coverage required under the statute was put in place via the contracting process, that subcontractors were informed of their responsibilities, that claims services

were extended appropriately, and that all parties to DBA cases better understood the process and their rights and responsibilities within it.

DOL held seven DBA training seminars from 2003 to 2006, each of which attracted hundreds of participants. In addition, we held smaller round-table discussions with key stakeholders to address special problem areas of program implementation as they were encountered. Since conducting those major seminars, OWCP's Longshore Division actively participated in industry events whenever possible, including participation in full-day DBA seminars and symposiums sponsored by ACE-USA and AIG in 2007 and again this month. Our district directors participate in this assistance effort as well, speaking at an AIG-sponsored DBA event last November, the Loyola Law Conferences in March 2007 and 2008, a half day workshop for KBR and its subcontractors in Houston last month, and regularly holding telephonic training sessions with the insurance claims managers.

The DBA assigns oversight, but not benefits administration responsibilities to DOL. Thus, our role is limited to overseeing employer/carrier responsibilities that are spelled out in the statute and to resolving disputes that may arise. This places a premium on technical assistance of the kind we emphasized in the early years of the Iraq conflict. Through our seminars, round-tables and other communication channels, we assisted the dissemination of best practices and helped to resolve operational challenges as they were identified.

For example, when we were informed that mail from the Federal government or the insurance companies was being used by insurgents to identify and target surviving family members as "collaborators," we immediately notified the insurers of this serious problem. Our Longshore staff worked with the insurers to have all mail sent to the local employer who would then deliver it directly to the claimants. This and similar precautions helped to avoid public identification of the surviving claimants. The experienced and dedicated Longshore/DBA claims staff in our New York office has continued to provide detailed and ongoing assistance of this kind, helping to identify unique and unforeseen problems and develop successful strategies to overcome them on a daily basis.

In addition, we have continued to encounter problems associated with ensuring coverage in the Middle East. Recently, the Joint Contracting Command Iraq (JCCI), the military agency responsible for contracting with local companies in Iraq and Afghanistan, contacted OWCP seeking help in obtaining DBA insurance. Because of the large number of contracts in Iraq and because no insurance companies or brokers have sales offices there, the JCCI and its contractors were having trouble locating DBA coverage. By contacting the insurance industry representatives with whom OWCP has been working for years on DBA education, regulation, and compliance assistance, we were able to arrange for both brokerage and insurance company staff to directly contact the JCCI leadership in Iraq.

The procurement of DBA coverage for overseas contracts remains complicated, but we are continuing to facilitate communication among the contracting and insurance organizations to address and resolve problems as they arise.

We believe that our compliance assistance efforts, and the efforts of the major insurers and other parties within the Longshore/DBA community, have improved the system's provision of DBA medical and compensation benefits to the employees of U.S. contractors in Iraq and Afghanistan. The delivery of an insurance-based program of this kind is a challenge in any war zone, particularly one at great distance, with a different language, and within a society with different legal and civil structures.

For example, filing timeframes are inevitably elongated for Iraq and Afghanistan claims, ensuring that host country nationals are fully apprised of and encouraged to exercise their rights is difficult. Moreover, the cultural barriers and economic system shortcomings may make delivery of benefits, especially to widows, extremely difficult. At least in part as a result of our focus on these challenges, we believe that the outcomes under DBA in Iraq and Afghanistan are becoming more comparable to those under the Longshore program here at home. We also believe that where there are differences in outcomes, they derive in large part from the difficulties in dealing with the foreign national claims just mentioned.

DBA CLAIMS AND PAYMENT STATISTICS

Table 1 displays the number of claims arising from Iraq and Afghanistan since 2003. The particularly steep increase in Calendar Year 2007 likely resulted in large part from improved reporting by contractors and their subcontractors, and some late reporting from previous periods.

Although the increased claims volume placed a strain on DOL capacity, we have made significant adjustments, including spreading the caseload throughout our ten Longshore district offices, and have generally kept our processing of cases timely. While this is not meant to demonstrate a trend, there has been a decline in the claims volume in the first quarter of 2008, especially for disabling injuries and deaths.

Table 1
DBA Claim Totals for Iraq & Afghanistan
(Calendar Years)

	2003	2004	2005	2006	2007	2008 to 3/31
Iraq	157	1,684	3,113	3,581	12,007	2,110
Afghanistan	13	150	526	1,036	2,413	269
Total	170	1,834	3,639	4,617	14,420	2,379

Table 2 shows the amount of payments made in Calendar Years 1997 to 2007, as reported to the OWCP by self-insured employers and insurance carriers under the DBA throughout the world. We are unable to segregate the payment data for claims arising from Iraq or Afghanistan from other Defense Base claims. However, it appears that the increase in the number of claims paid and in the amount of payments can be attributed in large part to increased DBA covered employment and related deaths and injuries in the Middle East conflicts. As compliance among subcontractors improved, there was an increase in no-time-loss injuries reported by covered employers, resulting in an over 100 percent rise in cases paid in 2007.

Table 2
DBA* Payments Reported by Self-Insured Employers and Insurance Carriers
(Calendar Year 1997 to 2007)

Year	Cases Paid	Compensation	Medical	Total	Average Per Claim
1997	432	$4,905,081	$1,203,217	$6,108,298	$14,140
1998	423	$5,497,439	$2,194,012	$7,691,451	$18,183
1999	269	$3,724,290	$1,727,703	$5,451,993	$20,268
2000	309	$6,268,112	$2,314,654	$8,582,766	$27,776
2001	516	$7,212,869	$2,198,061	$9,410,930	$18,238
2002	430	$5,480,592	$2,101,403	$7,581,995	$17,633
2003	688	$7,885,666	$3,452,728	$11,338,394	$16,480
2004	1,592	$19,432,369	$10,647,020	$30,079,389	$18,894
2005	3,080	$36,140,994	$23,656,467	$59,797,461	$19,415
2006	5,039	$66,973,732	$48,781,929	$115,755,661	$22,972
2007	11,887	$100,319,949	$69,815,704	$170,135,653	$14,313
Totals	**24,665**	**$263,841,093**	**$168,092,898**	**$431,933,991**	**$17,512**

*For all DBA cases; Iraq/Afghanistan cases represent the great majority but payment information is not separately available.

DBA MEDICAL AND CLAIMS SERVICES

Claimants under the DBA are entitled to prompt, appropriate medical care for their injuries. In the majority of trauma cases in Iraq and Afghanistan, contract employees who are American citizens receive immediate care at military Combat Support Hospitals (CSH). The military also sends the most severely injured to facilities in Germany, and then to civilian medical care in the United States. Less severely injured workers may be treated locally by the military, and then be flown by the contractor directly back to the United States if additional medical services are required. Except for treatment provided by the military, the DBA insurance companies pay for this healthcare and submit reports to our district offices that oversee the claims. Our district directors are responsible under the DBA for supervising the provision of these services, monitoring the reports from the insurance companies, and responding to questions from claimants.

The DBA also covers foreign nationals, including Iraqis and Afghans, for medical care. In severe cases the employee may receive initial care by a U.S. military CSH, and then be transferred to either Northern Iraq or a neighboring country such as Jordan or the United Arab Emirates for further medical care. Again, the insurance company is responsible for paying for these services, including medical evacuations and transportation expenses.

Monitoring medical care services provided to foreign nationals in other countries is challenging. Departmental staff must rely on reports from the insurance companies, in some cases generated by the Middle Eastern representatives hired by some of these companies. In an effort to make the program as accessible to claimants as possible, we urged insurers to translate into Arabic and other local languages the forms and instructions for filing claims and submitting information to us, and we require contractors and their subcontractors to provide information about their rights under the statute to their employees. The DOL Web site now contains detailed information about the DBA, the forms, instructions, contact information, Q&A, and many links to other available resources. We frequently conduct informal conferences via telephone for foreign national claimants in need of dispute resolution services.

INSURERS IMPROVING DBA CLAIMS SERVICE

We are pleased that two of the three largest DBA insurers have opened claims centers in the Middle East to assist claimants. AIG has had an operation in Dubai and Istanbul, employing trained staff members who speak Arabic and other local dialects. ACE-USA just announced the opening of their claims center in Bahrain, providing similar services for its clientele. The ability of these offices to communicate with claimants directly and in their own language should enhance the quality and timeliness of support to Iraqi and third country national claimants. It is likely that communications will accelerate and our ability to ensure that appropriate services are in fact delivered to host country nationals will improve.

DEPARTMENT OF LABOR DBA DISPUTE RESOLUTION SERVICES

When disputes arise over the provision of any benefit, whether weekly indemnity payment or medical services, our district office staff receive a report of the dispute and attempt to resolve it by telephonic or written communications (often requiring the receipt of additional documentation). In cases where the dispute cannot be resolved in this way, the district office staff convenes an informal conference, allowing the parties to communicate directly with each other under the mediation of our specialists. If this dispute resolution is unsuccessful, the parties can request a formal hearing before the Department's Office of Administrative Law Judges (OALJ) whose decisions can be appealed to the Department's Benefits Review Board and then to federal court.

Although the majority of DBA cases are handled by the insurance carriers without dispute, disagreements sometimes arise between the employer/carrier and the claimant. Our records show that among all Iraq/Afghanistan cases reported between Calendar Years 2001 to 2005, only 8.2 percent have genuine, two-party claim disputes, compared to 13.4 percent for non-DBA cases for the same period.

Another way of assessing the responsiveness of the system is to look at the percent of time loss (disability and death) cases which receive an indemnity payment. Our data show that 70.3 percent of Iraq/Afghanistan DBA time loss (disability and death) cases reported between Calendar Years 2001 and 2005 were paid, compared with 87.7 percent for non-DBA cases during the same period. Undoubtedly this disparity can be attributed in part to obstacles in war-zone claim investigation and benefit delivery. Of the paid Iraq/Afghanistan cases noted in this period, 20.2 percent involved bona-fide disputes between the two parties, whereas 16.5 percent of non-DBA paid cases were disputed. Put another way, about 80 percent of Iraq and Afghanistan paid claims were paid without any dispute, compared to 83.6 percent for non-DBA cases. This is not a significant difference and suggests that while DBA claims arising in Iraq and Afghanistan have a lower rate of participation in the claim dispute process, once the dispute arises, the claim is given the same level of dispute resolution services from the OWCP and the OALJ, and the outcomes are similar to non-DBA claims.

Our efforts to expedite dispute resolution have also proven effective overall. The following data illustrate how our district offices have worked to help both workers and insurers reach fair and prompt resolution to complex dispute issues. Comparable data for both DBA cases and the larger Longshore program again indicate that outcomes are roughly similar, and our efforts to overcome the logistical and other challenges of the DBA have been relatively successful.

Table 3
DBA* v. Longshore Dispute Resolution Performance
(FY 08 through March)

	NUMBER OF RESOLUTIONS	AVERAGE # OF DAYS	PERCENT OF RESOLUTIONS BY THE LONGSHORE DISTRICT OFFICE
DBA Claims	197	171	60.1
LS Claims	1,558	141	60.5

* All DBA cases; Iraq/Afghanistan cases represent the great majority but are not separately available.

DEPARTMENT OF LABOR OVERSIGHT

The Department of Labor, in addition to its compliance assistance efforts, works diligently to ensure that the obligations of all contractors and the rights of all workers are protected, regardless of nationality or claim complexity. For example, in August 2004, while en route to their place of employment, 11 Nepalese laborers were abducted by Iraqi insurgents and killed. At the end of 2006, a District of Columbia law firm filed claims on behalf of the workers' families. Through the efforts of the New York Longshore district office, OWCP determined that the employer was insured. In early 2007, OWCP conducted informal conferences and then referred the cases to the OALJ for formal hearing because the employer denied that the workers were covered under the DBA. In March and April 2008, the DOL administrative law judge issued orders awarding death benefits to the widows and children of three workers followed by awards to dependent parents of six other workers. The remaining two workers left no survivors eligible for DBA benefits.

In December 2004, a bus carrying Iraqi workers to a job site was ambushed and 40 were injured or killed. The employer was an insured Iraqi subcontractor. The insurer initially refused to file injury reports because the incident occurred en route to, but not at the job site, and disputed the identity of some of the workers and their eligible survivors. None of the claimants was represented by counsel. Through the efforts of the New York district office, the insurer eventually filed injury reports on all workers injured or killed and paid benefits to disabled workers and to those survivors who could be identified. Thirty of the 39 claims have been paid to date. The remaining nine claims, all for non-fatal injuries, were not pursued by the worker or were not paid due to lack of medical or other evidence.

In January 2007, a plane carrying 31 passengers from Turkey crashed near Baghdad. All but one on board were killed. Thirty of them were employees of a Turkish construction contractor. As soon as OWCP learned of the accident, the New York district director confirmed DBA coverage. The company was working under contracts for different agencies, and complications arose because the employees were covered by different insurance companies. To facilitate resolution of various insurance coverage and

entitlement issues, the OWCP held an informal conference with ten participants including lawyers representing the employer, the two insurance carriers, and the claimants, and at least one contract employer representative, in April 2007. All but three of the 27 claims were voluntarily paid, the majority within two months of the incident. The three remaining claims are currently in process for payment.

Our experienced staff in the New York district office continues to receive new DBA claims from Iraq and Afghanistan, creates and reviews those cases, and distributes the files to the district office closest to the (U.S. citizen's) residence for ongoing monitoring and service. This distribution allows for dispute resolution to occur at a closer Longshore office for U.S. citizens, while allowing our New York office to maintain oversight of all foreign national claims and serve as our center of expertise for new issues and for communications with the insurers and contractors.

POST TRAUMATIC STRESS DISORDER

Mr. Chairman, you expressed a particular interest in the handling of Post-traumatic Stress Disorder (PTSD) claims in the context of the DBA. Stress claims are perhaps the most complex of all in any workers' compensation system. The key factor – work-relatedness – is often very difficult to discern in such cases, given the lack of clarity with regard to specific causative events, the frequent ambiguity of medical diagnoses, temporal delays between events and the onset of symptoms, and the personal and subjective nature of the medical condition itself. PTSD, although somewhat less difficult to diagnose than other stress conditions, may be clouded by employees' reluctance to report the condition or seek help out of concern for being stigmatized or barred from future employment.

In 2006, the Department determined that additional focus was needed in the DBA community on PTSD cases coming from Iraq. Relatively clear-cut PTSD situations were being reported by DBA contract employees – such as individuals who witnessed bombing attacks which killed several co-workers – and claim resolutions were not being obtained swiftly enough. Media reports also indicated that contract workers were not always receiving the kind of de-briefing and counseling following such traumatic events that uniformed military personnel receive, and of course it was understood that these DBA-covered employees do not have recourse to Department of Veterans Affairs psychological services upon their return to the United States.

The Department has worked closely with the insurance industry, questioning what appeared to be inappropriate denials of benefits for PTSD treatment, and providing venues for the claims management leadership to share best practices, approaches, and insight about PTSD. The insurance companies are now paying significantly more attention to PTSD. They are training their claims management staff how to identify PTSD and make appropriate referrals for treatment, and identifying healthcare specialists to help treat it and promptly report it to the Longshore Division. We have also urged insurers to work with contract employers to provide pre-deployment training and counseling regarding potential traumatic stress, as well as post-event and post-employment counseling and services to help employees transition successfully.

INSURANCE PREMIUMS

Mr. Chairman, you raised questions about the Department of Labor's role in overseeing the cost of the DBA program.

Three major insurance companies, AIG, ACE-USA, and CNA, provide the majority of DBA insurance coverage in Iraq and Afghanistan.

There is no standard premium for DBA insurance. Whereas Longshore insurance activities are subject to regulation by state insurance commissioners, because DBA coverage is provided overseas for companies and workers from around the globe, insuring all ranges of industries and occupations inside a war zone, U.S. regulators play little, if any, role in the premium setting for DBA coverage. Rather, as in the Federal Employers Liability Act (FELA) covering railroads, and the Jones Act covering seamen, premiums are based on payrolls but are a product of market-driven forces and negotiations between the insurance companies and the employers or contracting agencies.

The DOL does not have the authority to regulate premiums, either for domestic Longshore policies or for DBA policies. The Longshore Division of OWCP collects documentation that the required DBA policies are in effect for extant contracts. The Federal Employees' Compensation Division of OWCP receives copies of the complete DBA policy for each claim filed under the WHCA, and determines whether a war risk premium has been included in the DBA policy. If it had been included, the Department would deny WHCA reimbursement, as the war risk premium had already provided coverage. However, OWCP staff has uncovered no instance in which any premium, additional charge, or premium increase for the war risk has been added in these filings.

Implementing an insurance-driven program in Iraq and Afghanistan has many challenges. Nevertheless, we believe the system is functioning and improving. There are many complicating factors, but most contractors are complying with insurance coverage requirements and are being monitored by their contracting agencies; insurers are reporting injuries and deaths, and are providing healthcare and weekly benefits. The Department continues to engage in monitoring, education, technical support, compliance assistance, and dispute resolution to achieve appropriate outcomes.

WAR HAZARDS COMPENSATION ACT

The War Hazards Compensation Act (WHCA) (42 U.S.C. § 1701 et seq.) supplements the DBA and completes the protection provided to employees of federal contractors performing work outside the United States. Like the DBA, it was enacted during World War II. The WHCA establishes a compensation system that provides reimbursement to contractors covered by the DBA for both benefit and administrative costs resulting from an injury or death caused by a war-risk hazard. In reimbursement cases, OWCP is also authorized to make payments directly to injured employees or their survivors.

WHCA is also administered by OWCP, but by our Division of Federal Employees' Compensation (DFEC), rather than the Longshore Division. Section 1704(a) of the WHCA requires that reimbursements are paid from the same Employee Compensation Fund from which DFEC also pays workers' compensation benefits to Federal employees. These general revenue reimbursements were established as a form of reinsurance for DBA policies, to ensure that DBA insurance would be available and affordable.

An insurance carrier, self-insured employer or compensation fund may claim reimbursement from the Employees' Compensation Fund for benefits paid on cases approved under the DBA, if it can be shown that the injury or death was due to a war-risk hazard. A war-risk hazard is defined in the WHCA as a hazard arising during a war in which the United States is engaged; during an armed conflict in which the United States is engaged, whether or not war has been declared, or during a war or armed conflict between military forces of any origin, occurring within any country in which a covered individual is serving and the hazard arises from the discharge of a weapon, the action of a hostile force, the explosion of munitions intended for use in connection with a war, collision of vessels or the operation of vessels or aircraft in a zone of hostilities. (42 U.S.C. § 1711(b).) DFEC claims examiners make the determination as to whether an injury resulted from a war-risk hazard.

While not absolutely necessary, claims for reimbursement from insurance carriers usually receive a formal decision under the DBA prior to filing under the WHCA. A claim for reimbursement must be supported by copies of the forms, statements and medical reports submitted by the employee (or survivors) and the employer to establish a claim under the DBA, the compensation order awarding benefits under the DBA, and the insurance policy under which the employee was covered. If the claim is accepted as resulting from a war-risk hazard, the request for reimbursement must also be accompanied by documentation of the payments for which reimbursement is being claimed. The WHCA permits reimbursement for benefits paid and reasonable and necessary claims expenses, which includes expenses incurred in determining liability such as expenses for attorneys' fees, court and litigation costs, witnesses and expert testimony, examinations, autopsies, etc. (42 U.S.C. §1704(a).) Under the WHCA regulations, these allocated claims expenses must be itemized and documented in order to be reimbursed. The insurance carrier may claim other unallocated expenses in an amount up to 15 percent of the sum of the reimbursable medical, compensation and burial payments. These expenses represent the cost incurred by the company handling the claim in its regular course of operations that cannot be specifically itemized or documented.

DFEC will deny a claim for reimbursement if we find that the benefits paid or payable on account of injury or death arose from a war-risk hazard for which a premium for such hazard was charged – a practice referred to as "premium loading." By submitting a Form CA-278 (Claim for Reimbursement), the party seeking reimbursement is certifying that premium loading has not occurred. A copy of the insurance policy must be submitted with every reimbursement claim, and DFEC reviews the policy, as well as verifying that the insurer has properly certified via the Form CA-278 that such premium

loading has not occurred and that the claim does not contain, nor will the insurance carrier or self-insured demand, an additional charge or loading for war-risk hazard.

Insurance carriers and self-insured employers whose claim for reimbursement is denied or reduced may appeal for review by the Director of DFEC. The objection must be filed within 60 days of the date of the decision for domestic carriers and within 6 months of the date of the decision for carriers outside the United States.

In cases where ongoing entitlement to compensation has been established, OWCP may assume direct payment of benefits rather than continue to reimburse the insurance carrier or employer. As a rule, cases are accepted for direct payment only when the rate of compensation and the period of compensation have become relatively fixed. Cases in which the nature and extent of entitlement to compensation either have not been determined or are in dispute will remain under the control of the insurance carrier until the issues have been resolved.

To clarify procedural requirements and expedite the process for submitting a reimbursement claim, we published OWCP Bulletin 05-01 in October 2005. This bulletin clarified that insurers or employers need not obtain a formal compensation order under DBA from a Longshore District Director to obtain a WHCA reimbursement in a given case but strongly recommended that such an order be obtained. The findings in the order regarding compensability under the DBA would be accepted absent extraordinary circumstances which would allow DFEC to simply focus on whether the injury was the result of a war-risk hazard. In circumstances where a formal compensation order could not be obtained either because the claimant declined to participate in the proceeding or because one or more parties did not agree to the issuance of such an order, rather than having the matter referred to an ALJ for a decision (a process generally requiring many months) the insurer or employer may obtain from the appropriate Longshore District Director a recommendation on the compensability of the DBA claim by requesting an informal conference at the office of the Longshore District Director. If no agreement is reached at the informal conference the Longshore District Director will issue a Memorandum of Informal Conference setting forth his recommendations on the DBA claim. Absent extraordinary circumstances, DFEC will accept the recommendations made by the Longshore District Director with regard to DBA compensability and adjudicate the reimbursement claim under WHCA. The DFEC Cleveland district office, which handles all WHCA claims, has communicated with insurance carriers and their attorneys on a regular basis to develop an expeditious process for obtaining the documentation necessary for adjudicating and reimbursing WHCA claims.

WHCA CLAIMS STATISTICS

Although the WHCA workload has increased, DFEC has issued decisions on a relatively timely basis and has a small inventory of pending cases. Based on the number of DBA claims for which no WHCA claim has yet been received, and the extended period required for DBA case processing to reach stability so that a WHCA claim is ripe, OWCP anticipates that the WHCA claim volume will continue to grow.

Table 4
WHCA Claims Filed, Iraq & Afghanistan
2003 through March 31, 2008 (Calendar Years)

	2004	2005	2006	2007	2008
Iraq	2	33	99	80	25
Afghanistan	0	0	5	4	4
Totals	**2**	**33**	**104**	**84**	**29**

Table 5
Disposition of Claims, Iraq & Afghanistan, through March 31, 2008

	TOTAL FILED	ACCEPTED	DENIED	PENDING ADJUDICATION	ACCEPTED & PENDING REIMBURSEMENT
Iraq	239	207	12	20	25
Afghanistan	13	9	0	4	5
Totals	**252**	**216**	**12**	**24**	**30**

Table 6
WHCA Benefits Paid
2003 through March 31, 2008

	CARRIER REIMBURSEMENT	COMPENSATION	TOTAL
Iraq	$7,432,105	$4,950,814	$12,382,919
Afghanistan	$178,155	$256,647	$434,802
Totals	**$7,610,260**	**$5,207,461**	**$12,817,721**

CONCLUSION

Thank you for the opportunity to discuss OWCP's administration of the Defense Base Act and the War Hazards Compensation Act. I will be pleased to answer any questions you may have.

Chairman WAXMAN. Thank you very much, Mr. Hallmark.
Mr. Moser.

STATEMENT OF WILLIAM MOSER

Mr. MOSER. Chairman Waxman, Representative Davis, and distinguished members of the committee, thank you for the opportunity to appear before you today to discuss Defense Base Act insurance and the War Hazards Compensation Act program. As the Deputy Assistant Secretary for Logistics Management, the Department of State's central contracting authority reports to me, and I am happy to address the Department of State's contracting for DBA insurance.

The Defense Base Act of 1941 mandates that Federal prime and subcontractors provide and maintain a broad form of Workers' Compensation insurance coverage for their personnel working on construction and service contracts outside the United States. The cost of DBA insurance is ultimately borne by the contracting agency, often, as we have heard here today, as a reimbursable cost. The Department's goal, however, is to ensure that all of our contractors, both large and small, are able to obtain legally compliant coverage at a manageable cost.

DBA insurance covers U.S. citizens as well as host country and third country nationals who are working under State Department contracts. A waiver of DBA insurance is often available for local national employees who are employed under a Department contract if they are covered by a local host country Workers' Compensation Program that provides effective compensation for work-related illnesses and injuries.

In Iraq and Afghanistan, however, the lack of an effective local worker compensation program requires that DBA coverage be extended to local nationals. All Iraqi and Afghani citizens working under State Department contracts in these countries are covered under the DBA. When any employee working under a Department of State contract is injured or killed, a determination must be made by the insurance carrier and, if there is a dispute the Department of Labor, as to the reason for injury or death and whether it might be covered by the DBA. The Department of Labor, subsequently, will determine eligibility for reimbursement under the War Hazards Compensation Act program, which we are very proud to work with.

Prior to 1990, the Department of State required contractors to obtain DBA insurance independently, and rates varied based on the contractor's number of employees, claims history, and work location. Small businesses with limited overseas experience often found it difficult to obtain DBA insurance, or were required to pay very high premiums. The people that were working in our authority at that time really talked about how many times they had to pay an entry fee, essentially, to get DBA coverage.

In 1990 a State Department Office of Inspector General audit concluded that the Department's DBA insurance costs could be significantly reduced if a blanket insurance contract were awarded to a single insurance provider. Subsequently, in an effort to control costs and provide uniform DBA insurance rates and coverage for all our contractors, both large and small, the Department competi-

tively awarded a multi-year contract in 1991 to CIGNA Property and Casualty Insurance Co.

The follow-on DBA insurance contract was completed in 2000 with four offerors competing: CIGNA, AIU, Ace International, and CNA. The contract was awarded to CNA in 2001 and remains in place today. So this is the same contract that we have had since 2001, is the one we are using today in Iraq and Afghanistan.

This blanket contract business model has stabilized rates from 2000 to 2007. Premium rates were unchanged: $3.87 to $6.45 per $100 of employee salary for services and $5 to $8.34 of employee salary for construction. In July 2007, the CNA contract was extended for 1 year with two additional specific service categories, which Mr. Ginman has also addressed, services without aviation and security services with aviation. Due to the high risk in claims associated with these categories, CNA proposed higher rates for these categories: $10.30 per 4100 of employee salary for security services without aviation and $17.50 for services with aviation.

These rates became effective with the July extension, however, since most contractor policies are not renewed until June 2008, the effect of these rates have not yet been realized by our contractors or by the Department.

In April 2008, the Department issued a synopsis in FedBizOpps announcing the availability of a fully competitive solicitation to continue to provide DBA insurance coverage. That solicitation is expected to be issued later this month.

Mr. Chairman, thank you and the members of the committee for your interest in DBA insurance, and I would be happy later to address your questions.

[The prepared statement of Mr. Moser follows:]

Statement of

William Moser
Deputy Assistant Secretary of State
For Logistics Management
United States Department of State

Before the

Committee on Oversight and Government Reform
U.S. House of Representatives

Defense Base Act Insurance: Are Taxpayers Paying Too Much?

2154 Rayburn House Office Building

May 15, 2008
10:00 a.m.

Chairman Waxman, Representative Davis, and distinguished members of the Committee, thank you for the opportunity to appear before you today to discuss Defense Base Act (DBA) insurance and the War Hazards Compensation Act (WHCA) program. As the Deputy Assistant Secretary for Logistics Management, the Department of State's central contracting authority reports to me, and I am happy to address the Department of State's contracting for DBA insurance.

The Defense Base Act of 1941 mandates that Federal prime and subcontractors provide and maintain a broad form of workers' compensation insurance coverage for their personnel working on construction and services contracts outside the United States. The cost of DBA insurance is ultimately borne by the contracting agency, often as a reimbursable cost. The Department's goal is to ensure all our contractors, both large and small, are able to obtain legally compliant coverage at a manageable cost.

DBA insurance covers U.S. citizens as well as host country and Third Country Nationals who are working under a State Department contract. A waiver of DBA insurance is often available for local national employees who are employed under a Department contract if they are covered by a local host country worker compensation program that provides effective compensation for work-related illness and injuries. In Iraq and Afghanistan, the lack of an effective local worker compensation program requires that DBA coverage be extended to local nationals. All Iraqi and Afghani citizens working under a Department contract in those countries are covered under the DBA. When any employee working under a Department of State contract is injured or

killed, a determination must be made by the insurance carrier and (if there is a dispute) the Department of Labor, as to the reason for the injury or death and whether it might be covered by the DBA. The Department of Labor subsequently will determine eligibility for reimbursement under the WHCA program.

Prior to 1990, the Department of State required contractors to obtain DBA insurance independently and rates varied based on the contractor's number of employees, claims history, and work location. Small businesses with limited overseas experience often found it difficult to obtain DBA insurance, or were required to pay very high premiums. In 1990, a State Department Office of the Inspector General audit concluded that the Department's DBA insurance costs could be significantly reduced if a blanket insurance contract was awarded to a single insurance provider. Subsequently, in an effort to control costs and provide uniform DBA insurance rates and coverage for all our contractors, both large and small, the Department competitively awarded a multi year contract in 1991 to CIGNA Property and Casualty Insurance Company.

The follow-on DBA insurance contract was competed in 2000 with four offerors competing: CIGNA, AIU, Ace International, and CNA. The contract was awarded to CNA in 2001 and remains in place today.

The blanket contract business model has stabilized rates and from 2000 to 2007 premium rates were unchanged: $3.87 to $6.45 per $100 of employee salary for services and $5.00 to $8.34 of employee salary for construction. In July 2007, the CNA contract was extended for one year with two additional specific service categories: security services without aviation and security services with aviation. Due to the high risk and

claims associated with these categories, CNA proposed higher rates for these categories: $10.30 per $100 of employee salary for security service without aviation and $17.50 of employee salary for security services with aviation. These rates became effective with the July extension; however, since most contractor policies are not renewed until June 2008, the effects of these rates have not been realized by contractors or the Department.

In April 2008, the Department issued a synopsis in FedBizOpps announcing the availability of a fully competitive solicitation to continue to provide DBA insurance coverage. The solicitation is expected to be issued later this month.

Mr. Chairman, thank you and the members of the committee for your interest in DBA insurance. I would be happy to address any question that you may have.

Chairman WAXMAN. Thank you very much, Mr. Moser.
Mr. Dalton.

STATEMENT OF JAMES C. DALTON

Mr. DALTON. Chairman Waxman, and members of the committee, thank you for the opportunity to testify before you today concerning the methods used by the Corps of Engineers to reduce DBA insurance costs, to the extent which other methods are used and how successful they have been, and the lessons learned from these efforts.

Due to the increase in DBA insurance in 2003, the Corps of Engineers and the Office of the Secretary of Defense agreed to conduct a Centrally Managed DBA Insurance pilot program, centralizing the management and acquisition of Defense Base Act insurance for Corps contracts worldwide, and modeled the USAID and the Department of State.

The pilot objectives were the following: make DBA insurance affordable through economies of scale; leverage lessons learned under DBA insurance undertaken by USAID and the State Department; pool the risk; centrally manage DBA insurance; and develop a business case analysis.

This pilot, which is a series of two contracts, made the DBA insurance carrier the party responsible for dealing directly with Corps contractors requiring DBA insurance during performance of their contract. Insurance rates were based on category of labor and considered all risks and all possible geographic locations of contract performance, including hostile and non-hostile environments and safety considerations.

The pilot provided a single entry point for coverage and access to DBA insurance for all Corps contractors and subcontractors at all tiers, no matter the business size or location of the firm requiring insurance. Insurance premiums were paid directly to the insurance carrier based on the rates in the Corps DBA insurance contract.

Under the pilot, there were no minimum premiums paid by contract. When contractors independently acquired DBA insurance coverage, they could expect to pay a minimum premium of $15,000 to $25,000 per contract. This adversely affected overall contract pricing and likely precluded small and local business firms from competing on supporting Global War on Terrorism programs.

The first Corps DBA contract was solicited on a competitive best value basis and was awarded in November 2005 to the sole offeror, CNA insurance. The terms of the contract was 1 year and provided a coverage for services and construction labor at a premium of $5 per $100 of employee labor for services, and $8.50 per $100 for construction labor. These rates were well below the 2005 GAO Report which stated the contractors performing work in Iraq were paying DBA insurance rates between $10 and $21 per $100 of employee salary cost.

The Phase I contract premiums proved lower than the GAO's report, and the Corps continued to a Phase II contract to gather additional data for the business case. The Phase II pilot contract was competitively solicited on the lowest price technically acceptable basis, and again one offer was received from CNA Insurance. The

proposed Phase II premiums continued to decline with the CNA premiums now at $3.50 per $100 for services, and $7.25 per $100 for employee labor costs on construction.

A Phase II pilot contract was awarded to CNA on March 31, 2007. During performance of the contract, two additional labor categories were added for security and aviation. The contract also included standard insurance industry definitions of all labor categories. The standard definitions clarify the labor category applicable to the work performed in the contract and the rate applied for insurance.

In March 2008, the contract was extended with the CNA insurance until 2008 to allow the Corps to solicit and obtain an award a follow-on DBA contract.

A major success of the Corps' centralized DBA insurance is the ability to reach all tiers of subcontractors. The smallest subcontractor in Iraq has access to DBA insurance.

To close, I would like to thank you once again, Chairman Waxman, for allowing the Corps the opportunity to appear before this committee today. I will be glad to answer any questions you or the members of the committee may have.

[The prepared statement of Mr. Dalton follows:]

COMPLETE STATEMENT OF

MR. JAMES C. DALTON
CHIEF OF ENGINEERING AND CONSTRUCTION

U.S. ARMY CORPS OF ENGINEERS

DEPARTMENT OF THE ARMY

BEFORE THE

Committee on Oversight and Government Reform

HOUSE OF REPRESENTATIVES

May 15, 2008

Chairman Waxman and Members of the Committee, I am James C. Dalton, Chief of Engineering and Construction for the U.S. Army Corps of Engineers (Corps). Thank you for the opportunity to testify before you today concerning the methods used by the Corps of Engineers to reduce Defense Base Act insurance costs, the extent to which these methods have been successful and the lessons learned from these efforts.

DBA Insurance was established by Congress in 1941. As initially enacted, the Defense Base Act covered workers on military bases outside the United States. The Act was later amended to include public works contracts with the government for the building of non-military projects such as dams, schools, harbors, and roads abroad. A further amendment added enterprises revolving around the national security of the United States and its allies.

After September 11, 2001, the Department of Defense (DoD) received complaints from companies doing business in Iraq that rates for mandatory insurance increased from $4 to over $20 per $100 of labor costs, and in some cases firms were unable to receive DBA insurance. These higher costs were experienced by firms independently purchasing DBA Insurance. Some small host-nation firms were unable to pay upfront minimum insurance premiums of $15,000 to $25,000. Minimum premiums did not take into account the duration of the contract, labor expended and length of time in the hostile environment.

In 2003, the Corps and the Office of the Secretary of Defense (OSD) agreed to conduct a Centrally Managed Defense Base Act Insurance Pilot Program, centralizing the management and acquisition of Defense Base Act insurance for Corps' contracts worldwide, and modeled on the U.S. Agency for International Development and

Department of State.

The pilot objectives were:

- Make DBA Insurance affordable through economies of scale
- Leverage lessons learned under similar DBA Insurance programs undertaken by the U.S. Agency for International Development and the Department of State.
- Pool risks
- Centrally Manage DBA Insurance
- Develop a Business Case Analysis

This pilot, a series of two contracts, made the DBA Insurance carrier the party responsible for dealing directly with Corps' contractors requiring DBA insurance during performance of their contract. Insurance rates were based on category of labor and considered all risks, all possible geographic locations of contract performance, including hostile and non-hostile environments and safety considerations.

The pilot provided a single entry point for coverage and access to DBA insurance for all Corps' contractors and subcontractors at all tiers, no matter the business size or location of the firm requiring insurance. Insurance premiums were paid directly to the insurance carrier based on the rates in the Corps' DBA Insurance contract. Under the Pilot there were no minimum premiums by contract. When contractors independently acquired DBA Insurance coverage they could expect to pay minimum premiums of $15,000 to $25,000 per contract. This adversely affected overall contract pricing, and likely precluded some small and local business firms from supporting the Global War on Terrorism.

The first Corps' DBA pilot contract was solicited on a competitive best value basis and was awarded in November 2005, to the sole offeror, CNA Insurance. The term of the contract was one year, and provided coverage for services and construction labor at a premium of $5.00 per $100 of employee remuneration for services and $8.50 per $100 for construction labor. These rates were well below the 2005 Government Accountability Office Report which stated that contractors performing in Iraq were paying DBA Insurance rates between approximately $10.00 and $21.00 per $100 of employee's salary cost.

The Phase I Pilot contract premiums proved lower than GAO's report and the Corps continued to a Phase II Pilot contract to gather additional data for the business case. The Phase II Pilot contract was competitively solicited on a Lowest Price Technically Acceptable basis and again one offer was received from CNA Insurance. The proposed Phase II premiums continued to decline with the CNA premiums now $3.50 per $100 of employee remuneration for services and $7.25 per $100 of employee remuneration for construction. A Phase II Pilot Program contract was awarded to CNA Insurance on March 31, 2007. During performance of the contract two additional labor categories for security and aviation were added to the Phase II contract. The Corps also added standard insurance industry definitions for all current labor categories: services, construction, security and aviation. The standard definitions clarify the labor category applicable to the work performed in the contract and the rate applied for insurance.

In March of 2008 the Corps extended the Phase II contract with CNA Insurance until September 2008, to allow the Corps to solicit and award a follow-on DBA Insurance contract.

A major success for the Corps of centralized management of DBA Insurance is the ability to reach all tiers of subcontractors. The smallest subcontractor in Iraq has access to DBA Insurance coverage. Previously if the contractor couldn't meet the minimum payment of $15,000 to $25,000 we couldn't do business with them because DBA Insurance coverage is mandatory.

Some of our lessons learned from the DBA Insurance Pilot Program are:

- Two labor categories for services and construction were unduly restrictive and placed Information Technology Helpdesk workers in the same category of coverage as security guards. We added security and aviation to better define the labor categories working in a hostile environment.
- A "self–administering" DBA Insurance Program isn't actually self administering, as Corps management is required for reporting, claims management, and enforcement of Corps contracting offices inclusion of centrally managed DBA requirements in contracts.
- Validation of savings/cost is not easily accomplished.

The Corps has begun working with the Army Audit Agency to analyze the results of the Corps' Phase I and Phase II pilot outcomes and welcomes further collaboration on centralized managed DBA Insurance with HQDA and DoD.

Summary

To close, I would like to thank you once again, Chairman Waxman, for allowing the Corps of Engineers the opportunity to appear before this Committee today. I will be happy to answer any questions you or Members of the Committee may have. Thank you.

Chairman WAXMAN. Thank you very much, Mr. Dalton.

Mr. Mizzoni.

STATEMENT OF JOSEPH P. MIZZONI

Mr. MIZZONI. Mr. Chairman, Mr. Davis, and distinguished members of the committee, thank you for the opportunity to be here today to discuss our work related to Defense Base Act insurance for LOGCAP operations. I have submitted my full statement to the committee, and I ask that it be made part of the hearing record.

I have been with the U.S. Army Audit Agency for 31 years and became the Deputy Auditor General for Acquisition and Logistics in October 2005. The Agency is the Army's internal audit organization, and throughout our history we have deployed with our troops in Vietnam and Bosnia, during Desert Shield and Desert Storm, and lately in support of Operations Iraqi Freedom and Iraqi Enduring Freedom.

In December 2004, General Casey, then Commander of the Multinational Force Iraq, asked us to help him reduce the overall costs of LOGCAP operations supporting OIF. To help General Casey achieve his goal, we established two audit objectives. These objectives were to determine if overall management of the LOGCAP program was adequate and determine if LOGCAP operations was providing the needed services in a cost-effective manner.

Our LOGCAP audits have covered many topics to include Defense Base Act insurance. DBA insurance is basically Workers' Compensation insurance. It provides benefits to contractor and subcontractor employees who are injured or killed as the result of normal working conditions while working on U.S. Government-financed contracts performed outside the United States. Because DBA insurance is required by law and because a LOGCAP contract is primarily a cost-reimbursable contract, the cost of this insurance is openly paid by the U.S. Government.

The objective of DBA audit was to determine if adequate controls were in place to minimize costs paid for DBA insurance under the LOGCAP contract. We concluded that the Army was at risk at paying more than needed. Here is what we found: DBA insurance represented a significant cost of the LOGCAP contract. The LOGCAP contractor paid about $284 million in premiums for DBA insurance between fiscal year 2003 and fiscal year 2005. The premiums increased steadily each year from about $5 million in fiscal year 2003 to about $165 million in fiscal year 2005.

DBA rates, which were a percentage of the contractor's total payroll costs for both contractor and subcontractor employees, increased substantially between fiscal year 2003 and fiscal year 2004. These rates then declined in fiscal year 2005 and fiscal year 2006.

The premium increases and year-to-year rate fluctuations seemed inconsistent with the risk associated with providing Workers' Compensation and with the contractor's good safety record.

The estimated amount of claims expected to be paid was substantially less than the DBA premiums the Army paid. Excessive DBA premiums may have been paid because DBA rates are applied against total payroll costs. However, benefits paid under the DBA program are based on an employee's average weekly wage and are

capped by statute. Many of the contractor's employees earned wages that exceeded the cap.

The LOGCAP contractor pays many of its employees danger pay for working in areas such as Iraq and Kuwait. As a result, the LOGCAP contractor paid premiums on the danger pay component of the payroll. To address these issues, we recommended that the Office of the Assistant Secretary of the Army for Acquisition, Logistics and Technology use more cost-effective means of providing Workers' Compensation insurance.

Although the Office didn't fully agree with all parts of the recommendation, the actions it proposed met the intent of the recommendation.

In closing, I would like to thank you once again, Mr. Chairman, for inviting me to appear before this committee. DBA insurance under contracts issued by the United States, we are currently reviewing DBA insurance under contracts issued by the U.S. Army Command in Kuwait, and we have also recently agreed to review the cost-effectiveness of the Corps of Engineers DBA pilot program.

We will remain responsive to Army leadership in continuing working to provide the best possible solution to Army challenges. I am very proud of my auditors in Southwest Asia. Their dedication and hard work has provided valuable real-time support to the Army.

I appreciate the opportunity to testify before you today and would be glad to answer your questions.

[The prepared statement of Mr. Mizzoni follows:]

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House Committee

RECORD VERSION

STATEMENT BY

MR. JOSEPH P. MIZZONI
DEPUTY AUDITOR GENERAL FOR ACQUISITION AND LOGISTICS, UNITED STATES ARMY AUDIT AGENCY

BEFORE THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES

ON

DEFENSE BASE ACT INSURANCE FOR THE LOGISTICS CIVIL AUGMENTATION PROGRAM, AUDIT OF LOGISTICS CIVIL AUGMENTATION PROGRAM OPERATIONS IN SUPPORT OF OPERATION IRAQI FREEDOM

FIRST SESSION, 110TH CONGRESS

May 15, 2008
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House Committee

Mr. Chairman and distinguished Members of the Committee, it is my pleasure to be here today and have the opportunity to discuss with you our audit of Defense Base Act Insurance related to the Logistics Civil Augmentation Program—commonly called LOGCAP.

I have been with U.S. Army Audit Agency for more than 31 years and became The Deputy Auditor General for Acquisition and Logistics in October 2005. The Agency is the Army's internal audit organization, and we provide objective and independent auditing services that help Army leaders make informed decisions, resolve issues, use resources effectively and efficiently, and satisfy statutory and fiduciary responsibilities. The scope of our audit responsibility includes selecting the subjects and organizations within the Army to audit, as well as responding to requests for audit service from Army officials.

Throughout its history, Army Audit Agency has deployed with our troops—in Vietnam and Bosnia, during Desert Shield and Desert Storm, and lately in support of Operation Enduring Freedom and Operation Iraqi Freedom. We have performed extensive audit work on LOGCAP in support of Operation Enduring Freedom and Operation Iraqi Freedom dating back to 2002.

In December 2004 General Casey, then Commander of the Multi-National Force – Iraq, asked us to audit LOGCAP operations supporting Operation Iraqi Freedom. LOGCAP is the Army's program for using civilian contractors as an additional means to adequately support the current and programmed force by performing selected services during wartime and other operations. The principal objective of LOGCAP is to provide combat support and combat service support to combatant commanders and Army service component commanders, primarily during contingency operations, throughout the full range of military operations, including reconstitution and replenishment.

General Casey's goal was to reduce overall LOGCAP costs without degrading the welfare of our deployed forces. Accordingly, we established two

audit objectives to help reach the Army's goal. These objectives were to determine if:

- Overall management of the program was adequate.
- The contractor was providing the needed services in a cost-effective manner.

Since beginning our LOGCAP work in support of OEF/OIF, we have issued 31 audit reports that include potential monetary benefits totaling about $273.1 million. We have also identified other cost avoidance initiatives we could not reasonably estimate the value of. Our LOGCAP audits have covered various topics such as overall program management, dining facility operations, supply support activity operations, warehouse operations, cross-leveling and distributing contractor-acquired property, bulk and retail fuel operations, and Defense Base Act (DBA) insurance.

DBA insurance is basically workers' compensation insurance. DBA insurance carriers provide benefits to contractor and subcontractor employees who are injured or killed under normal work conditions, while working on U.S. Government financed contracts performed outside the United States.

DBA insurance (in conjunction with the War Hazards Compensation Act) also covers war-risks (injury, death, capture, or detention). However, no premium is charged for war-risk coverage because, under the War Hazards Compensation Act, the U.S. Government reimburses insurance carriers for claims paid that were a direct result of a war-type incident. In effect, the U.S. Government self-insures itself against war-related injuries and deaths. DBA insurance rates are based on a percentage of the contractor's payroll costs for both contractor and subcontractor employees.

Because DBA insurance is required by law, and because the LOGCAP contract is primarily a cost-reimbursable contract, the cost of this insurance is ultimately paid by the U.S. Government.

We performed the audit of Defense Base Act insurance for LOGCAP because of the:

- Large amount paid for DBA insurance under the contract.
- Significant fluctuations in DBA insurance rates from year to year.
- Complexity of the DBA program.
- Army's and DOD's increased use of contractors in war zones.
- Government-wide implications of potential cost avoidances.

The objective of our DBA audit was to determine if adequate controls were in place to minimize costs paid for DBA insurance under the LOGCAP contract. We concluded that the Army was at risk of paying more than necessary. Although the Army had taken some actions to reduce DBA insurance costs, we believe additional actions were needed to minimize costs. We issued our audit report, Audit of Defense Base Act Insurance for the Logistics Civil Augmentation Program (Report: A-2007-0204-ALL) on 28 September 2007.

Here's what we found:

- DBA insurance represented a significant cost of the LOGCAP contract. The LOGCAP contractor paid about $284.3 million in premiums for DBA insurance in FY 03 through FY 05. The premiums increased steadily each fiscal year--from about $4.7 million in FY 03 to about $164.7 million in FY 05.
- DBA rates (a percentage of the contractor's total payroll costs for both contractor and subcontractor employees) increased substantially for Iraq and Kuwait in FY 03 (3.75%) and FY 04 (16.2%). The rate then declined to 13.8% in FY 05 and 8.5% in FY 06.
- The premium increases and year-to-year rate fluctuations seemed inconsistent with the risk associated with providing workers'

compensation insurance, and the contractor's reported safety statistics.

- The U.S. Government reimburses insurance carriers for claims resulting from war-type incidents. As a result, the primary risk is the cost of claims associated with injuries and deaths under normal working conditions.
- The contractor reported safety statistics that were much lower than the U.S. private industry average.

- The estimated amount of claims expected to be paid as a result of normal workplace injuries and deaths was substantially less than the DBA premiums the Army had paid. The insurance carrier would pay about $73.1 million in normal workers' compensation claims for FY 03 through FY 05, or about 26% of the total $284.3 million in premiums paid during this period.
- Excessive DBA premiums may have been paid because DBA rates are applied to total payroll costs. Total payroll costs include base pay, overtime pay, foreign-service bonuses, post differential, and danger pay. However, benefits the insurance carriers pay under the DBA program are based on an employee's average weekly wage and are capped by statute. Many of the contractor's employees earned wages that exceeded the cap.
- The LOGCAP contractor pays many of its employees an incentive for working in dangerous areas such as Iraq and Kuwait. From 1 January 2003 to 30 September 2005 the LOGCAP contractor paid about $23.1 million in premiums related to the "danger pay" component of payroll. We recommended that the Office of the Assistant Secretary of the Army for Acquisition, Logistics and Technology (ASA (AL&T)) use more cost-effective means of providing workers' compensation insurance to contractor and

subcontractor employees. The Office should consider using one of the following approaches:

- Require contractors to use insurance carriers that use retrospective rating plans in determining DBA insurance premiums.
- Self-insure for DBA insurance for countries where war-risk hazards have been recognized by the Department of State.
- Change the definition of remuneration (payroll) used in computing DBA insurance premiums to exclude danger pay and place a salary cap on an individual's wages that exceed the current Department of Labor approved benefit level.

The Office of the ASA (AL&T) partially agreed to the recommendation and provided alternative measures. The Office stated that:

- It would review the results of the Army Corps of Engineers centrally managed pilot program.
- Competition under the pilot program had successfully reduced rates and it will consider implementing an Armywide program based on the pilot program.
- In the interim, it would carefully audit DBA premiums with the assistance of the Defense Contract Audit Agency to make sure that the base used to calculate insurance rates is fair and reasonable.

Although the Office of the Assistant Secretary didn't fully agree with all parts of the recommendation, the actions it proposed met the intent of the recommendation.

In closing, I would like to say we are continuing our LOGCAP work and are reviewing DBA insurance under contracts issued by the U.S. Army Contracting Command office in Kuwait. We also recently agreed to review the cost-effectiveness of the Corps of Engineers DBA Pilot Program.

I am very proud of my auditors on the ground with our Soldiers in Iraq, Afghanistan, and Kuwait. Their dedication and hard work have provided valuable, real-time help to the Army. I appreciate the opportunity to testify before you today to provide a summary of our audit of DBA insurance for LOGCAP.

I will be glad to respond to your questions.

Chairman WAXMAN. Thank you very much, Mr. Mizzoni.
Mr. Needham.

STATEMENT OF JOSEPH K. NEEDHAM

Mr. NEEDHAM. Chairman Waxman, Ranking Member Davis, and members of the committee, thank you for inviting me here today to discuss the Defense Base Act and GAO's observations on the actions by the Departments of Defense and Labor, to address the findings from our 2005 Report on DBA's implementation in Iraq.

We initiated our review of DBA in 2004 after concerns were raised over the cost of Workers' Compensation insurance provided under DBA. According to recent DOD data, there were over 163,000 contractor personnel working in Iraq. We obtained the rates spent on DBA insurance for 21 contracts held by 13 prime contractors performing work under Iraq under cost-reimbursable contracts.

These contracts at the time represented 69 percent of U.S. appropriated contracting dollars awarded. We selected companies of difference sizes performing a range of services for DOD, the Department of State, and the U.S. Agency for International Development. We did not obtain DBA rates from subcontractors in our review.

We were limited in what we can conclude about the cost of DBA insurance because investigations by several States into the practices of a number of insurance companies and brokerages during the course of our review, raised questions over the reliability of the information we obtained from the insurance industry.

In April 2005, we reported that the total cost of DBA insurance to the Government, or the extent to which Iraq reconstruction funds were being spent on DBA insurance, could not be calculated due in part to the difficulty of gathering data on the large number of contractors and the multiple levels of subcontractors performing work in Iraq.

There were wide variations in the amounts Federal agencies were paying for DBA insurance. We reported that eight DOD prime contractors paid from $10 to $21 per $100 of salary cost, a rate that was significantly higher than the rates paid by the State Department and USAID contractors, which are at that time $2 to $5 per $100 of salary costs to their respective and self-insurer programs.

Last, what we found was that there were challenges in implementing the DBA insurance requirements for Iraq, such as the lack of clarity in DBA requirements, delays in processing claims, and difficulty in monitoring contractor compliance. As a result of our work, Congress directed DOD to work with other agencies to address these challenges.

Where do things stand today? As other witnesses have noted this morning, since the Army Corps implemented its single insurer program in December 2005, its insurance rates have decreased from what DOD was previously paying. While DOD has taken steps to reduce DBA insurance rates through the Army Corps' program, it has not yet implemented similar efforts Department-wide. DOD continues to lack reliable aggregate data on the total cost of DBA insurance.

It should be noted that Congress directed DOD to identify methods to collect data on DBA insurance costs in fiscal year 2006.

While State, USAID, and the Army Corps can now obtain aggregate DBA cost data for their single respective insurer programs, DOD recently reported to us that it had not collected this data Department-wide.

GAO has issued several reports on best practices, noting that agencies can analyze financial data to leverage their buying power, reduce costs, and better manage suppliers of goods and services. This is referred to as strategic sourcing, which calls for an organization to analyze its spending and use that information to make more effective business decisions about the acquisition of commodity conservatism.

As we have noted on other occasions—and it bears repeating today—in discussing DBA insurance premiums, DOD needs to be more strategic, as it has been in the acquisition of other services. In short, it needs to manage the suppliers of insurance and not have the suppliers managing DOD.

Turning to Labor's actions, Department officials told us that they have taken steps to address several of DBA's insurance implementation challenges that we identified in our 2005 Report. For example, GAO found that there was uncertainty among Agency officials regarding when DBA insurance was required as well as problems in processing claims and monitoring compliance.

Labor officials recently told us they have been receiving fewer questions after holding seven seminars through 2006 on DBA insurance for contractors, insurance companies, and Agency officials, as well as attorneys, to clarify what the DBA requirements were. While Labor officials also noted improvements in processing insurance claims, they still face challenges in verifying that subcontractors in Iraq have obtained DBA insurance.

In conclusion, Mr. Chairman, there is one overriding issue, and that is DOD's need to manage the cost of DBA insurance premiums. While DOD has taken steps for the Army's Corps Insurer Program to reduce its Dod rates, it does not know what it is spending Department-wide on such insurance. Without this information, DOD is limited in its ability to make fully informed decisions regarding its options for minimizing Department-wide insurance costs and limiting its ability to manage its suppliers strategically.

Furthermore, the lack of detailed information on these costs makes it difficult for Congress to conduct full oversight of the reconstruction funds.

Mr. Chairman, this concludes my statement. I thank you for the opportunity, and I will be happy to answer any questions.

[The prepared statement of Mr. Needham follows:]

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Testimony
Before the Committee on Oversight and Government Reform, House of Representatives

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DEFENSE CONTRACTING

Progress Made in Implementing Defense Base Act Requirements, but Complete Information on Costs Is Lacking

Statement of John K. Needham, Director
Acquisition and Sourcing Management Issues

GAO-08-772T

May 15, 2008

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Highlights

Highlights of GAO-08-772T, a testimony before the Committee on Oversight and Government Reform, House of Representatives

DEFENSE CONTRACTING

Progress Made in Implementing Defense Base Act Requirements, but Complete Information on Costs Is Lacking

Why GAO Did This Study

The Defense Base Act (DBA) requires U.S. government contractors and subcontractors to buy workers' compensation insurance for employees working overseas, and the cost of this insurance is then passed on to the government. The Department of Labor oversees the claims process and ensures contractors are aware of DBA insurance requirements. Given the large number of contractor personnel working in Iraq, concerns have been raised over the cost of workers' compensation insurance provided under DBA. Since the Iraq conflict began in March 2003, federal agencies have issued contracts for Iraq reconstruction and to support deployed forces. The Department of Defense (DOD) recently reported it alone has 163,591 contractor personnel working in Iraq.

Based on GAO's 2005 report on DBA insurance, Congress directed DOD to address challenges identified. This testimony is based on the 2005 report and GAO's analysis of recent agency efforts. As requested, it provides an update on (1) DOD's efforts to reduce DBA insurance rates; (2) DOD's ability to calculate its total DBA insurance costs; and (3) the progress toward addressing prior DBA implementation challenges.

In preparation for this testimony, GAO reviewed related reports to identify agency efforts to address prior findings and interviewed officials from DOD, State, Labor, and USAID. GAO discussed this testimony with agency officials.

To view the full product, including the scope and methodology, click on GAO-08-772T. For more information, contact John Needham at (202) 512-4841 or needhamjk1@gao.gov.

What GAO Found

While DOD has taken steps to reduce DBA insurance rates through the U.S. Army Corps of Engineers' (Army Corps) single-insurer pilot program, it has not yet implemented similar efforts departmentwide. GAO previously reported that eight DOD prime contractors paid from $10 to $21 per $100 of salary cost, a rate that was significantly higher than the rates paid by State and USAID contractors—$2 to $5 per $100 of salary cost—through the agencies' respective single-insurer programs. Since the Army Corps implemented its single-insurer program in December 2005, its insurance rates have decreased from what DOD was previously paying. For example, the Army Corps is now paying from $3.50 to $7.25 per $100 of salary cost for service and construction contracts.

DOD continues to lack reliable aggregate data on the total cost of DBA insurance. Based on GAO's 2005 report, Congress directed DOD to identify methods to collect data on DBA insurance costs. While State, USAID, and Army Corps can obtain aggregate DBA cost data for their respective single-insurer programs, DOD reported that it has not collected this data departmentwide. As GAO has previously reported, agencies can analyze financial data to leverage their buying power, reduce costs, and better manage suppliers of goods and services.

Labor officials told GAO they have taken steps to address several of the DBA insurance implementation challenges GAO identified in its 2005 report. For example, GAO found there was uncertainty among agency officials regarding when DBA insurance was required as well as problems in processing claims and monitoring compliance. Labor officials told GAO they have been receiving fewer questions after holding seven seminars through 2006 on DBA insurance for contractors, insurance companies, agency officials, and attorneys in order to clarify DBA insurance requirements. While Labor officials also noted improvements in processing insurance claims, they still face challenges in verifying that subcontractors in Iraq have obtained DBA insurance.

Mr. Chairman and Members of the Committee:

Thank you for inviting me here today to discuss the Defense Base Act (DBA)[1] and its implementation in Iraq. DBA requires U.S. government contractors and subcontractors to buy workers' compensation insurance for employees working overseas. The cost of this insurance is then passed on to the government. Given the large number of contractor personnel working in Iraq, concerns have been raised over the cost of workers' compensation insurance provided under DBA. Since the Iraq conflict began in March 2003, the departments of Defense (DOD) and State, the U.S. Agency for International Development (USAID), and other federal agencies have issued contracts for Iraq reconstruction and to support deployed forces. DOD recently reported it alone has 163,591 contractor personnel working in Iraq. These personnel would be subject to DBA requirements unless covered by an exception.[2]

In April 2005, we reported on cost and implementation issues associated with DBA.[3] Based on a review of DBA insurance rates for contracts representing 69 percent of U.S.-appropriated contracting dollars awarded for ongoing work as of May 2004, and interviews with officials from selected contractors, DOD, State, Department of Labor, Department of Justice, and USAID, we found

- the total cost of DBA insurance to the government or the extent to which Iraq reconstruction funds were being spent on DBA insurance could not be calculated due in part to the difficulty in gathering data on the large number of contractors and the multiple levels of subcontractors performing work in Iraq;
- wide variations in the amounts federal agencies were paying for DBA insurance, ranging from $2 to $21 per $100 of salary;
- several challenges in implementing DBA insurance requirements for Iraq, such as the lack of clarity in DBA insurance requirements, delays in processing claims, and difficulty in monitoring contractor compliance.

[1] 42 U.S.C. 1651-1654.

[2] These exceptions include contracts approved or financed by the Development Loan Fund, contracts exclusively for materials or supplies, or waivers issued by the Secretary of Labor with respect to any contract, work location, or class of employees.

[3] GAO, *Defense Base Act Insurance: Review Needed of Cost and Implementation Issues*, GAO-05-280R (Washington, D.C.: April 29, 2005).

As a result of our work, Congress directed DOD to work with other agencies to address these challenges.

My statement today is based on our 2005 report and our analysis of recent agency efforts. I will provide an update on (1) DOD's efforts to reduce DBA insurance rates; (2) DOD's ability to calculate its total DBA insurance costs; and (3) the progress toward addressing prior DBA implementation challenges. In preparation for this testimony, we reviewed reports related to DBA insurance to identify agency efforts to address our prior findings and interviewed officials from DOD, State, Labor, and USAID. We conducted our work from April to May 2008, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We discussed our analysis of recent agency efforts with agency officials and made technical corrections where appropriate.

Summary

DOD and Labor have made progress in addressing challenges we identified in our April 2005 report, but several still remain. While DOD has taken steps to reduce DBA insurance rates through the U.S. Army Corps of Engineers' (Army Corps) single-insurer pilot program, it has not yet implemented similar efforts departmentwide. Through its pilot program, the Army Corps has lowered its DBA insurance rates from what DOD had previously paid. While State, USAID, and Army Corps can obtain aggregate DBA cost data for their respective single-insurer programs, DOD reported that it has not collected this data across the department. We previously reported that the lack of such data prevents DOD from calculating the total cost of DBA insurance or the extent to which Iraq reconstruction funds were being spent on DBA insurance. In addition, while we previously reported several challenges in implementing DBA insurance requirements in Iraq, Labor officials told us that several of these challenges have since been addressed—requirements are clearer and claims processing has improved. However, Labor still faces challenges in verifying that subcontractors in Iraq have obtained DBA insurance.

Background

Congress enacted DBA in 1941 to provide workers' compensation protection to employees of government contractors working at U.S. defense bases overseas. Subsequent amendments to DBA extended coverage to other classes of government contractor employees. The

insurance required under DBA provides employees with uniform levels of disability and medical benefits or—in the event of death—provides death benefits to eligible dependents. Under DBA, contractors working in Iraq, including all levels of subcontractors, are required to obtain DBA insurance for all employees, including foreign nationals. The cost of DBA insurance premiums is then passed on to the government. State, USAID, and the Army Corps have single insurer programs that require all contractors performing work overseas to purchase DBA insurance from a specified insurance carrier at a set rate. Labor oversees the claims process, provides dispute resolution services, and is responsible for ensuring that contractors are aware of the requirement to purchase DBA insurance for covered employees.

DOD Has Taken Steps to Reduce Insurance Costs, but Has Not Yet Implemented Similar Efforts Departmentwide

While DOD has taken steps to reduce DBA rates since 2005 through the Army Corps' single-insurer pilot program, it has not yet implemented similar efforts departmentwide. We previously reported that eight DOD prime contractors paid from $10 to $21 per $100 of salary cost, which was significantly higher than the rates paid by State and USAID contractors—$2 to $5 per $100 of salary cost—through the agencies' respective single-insurer programs. The following example illustrates the impact of these rates on cost. We reported in July 2005 that security employees providing protection to civilians in vehicle convoys could earn from $12,000 to $13,000 per month.[4] Assuming a DBA insurance rate of $10.30 per $100 of salary cost[5] and that security employee salaries cited in our July 2005 report have remained the same, the contractor could bill the government between $1,236 and $1,339 per security employee per month. In addition, DOD reported in April 2008 that it had 12,258 security contractors in Iraq as of December 31, 2007. After receiving complaints from companies doing business in Iraq that the rates for this mandatory insurance had increased precipitously, DOD officials asked the Army Corps to initiate a single insurer pilot program for DBA insurance covering all Army Corps contractors and subcontractors performing work overseas. The pilot program was in place from December 2005 until March 2008 and was subsequently extended through September 2008. Army Corps and DOD officials told us a contract will be awarded in September 2008 for a

[4] GAO, *Rebuilding Iraq: Actions Needed to Improve Use of Private Security Providers*, GAO-05-737(Washington, D.C.: July 28, 2005).

[5] This rate is based on what State and the Army Corps currently pay under their single insurer programs to insure security personnel.

permanent single-insurer program. While USAID's current rate for DBA insurance is still the lowest at $1.58 per $100 of salary cost, the Army Corps DBA insurance rates have decreased from those paid by DOD prior to the Army Corps' single-insurer program. For example, the Army Corps is now paying from $3.50 to $7.25 per $100 of salary cost for service and construction contracts.

DOD Lacks Reliable Aggregate Data on Total DBA Insurance Costs

DOD continues to lack reliable aggregate data on the total cost of DBA insurance. While State, USAID, and Army Corps can obtain aggregate DBA cost data for their respective single-insurer programs, DOD reported that it has not collected this data departmentwide. We previously reported the lack of reliable aggregate data to calculate the total cost of DBA insurance to the government or the extent to which Iraq reconstruction funds were being spent on DBA insurance was due, in part, to the difficulty in gathering data on the large number of contractors and multiple levels of subcontractors in Iraq. In response to our report, Congress directed DOD to identify methods to collect data on DBA insurance costs. We have previously reported that agencies can analyze financial data to leverage their buying power, reduce costs, and better manage suppliers of goods and services.[6] As recently as last year, DOD still was not collecting aggregate data on its DBA insurance costs and reported that such data collection efforts would be expensive and would divert already limited contracting resources without any clear benefit to the procurement process. However, a recent Army Audit Agency report[7] indicates that the Army was at risk of paying more than necessary for DBA insurance under its LOGCAP contract,[8] showing DOD still has challenges managing these costs.

[6] GAO, *Defense Acquisitions: Tailored Approach Needed to Improve Service Acquisition Outcomes*, GAO-07-20 (Washington, D.C.: Nov. 9, 2006).

[7] U.S. Army Audit Agency, *Audit of Defense Base Act Insurance for the Logistics Civil Augmentation Program, Audit of Logistics Civil Augmentation Program Operations in Support of Operation Iraqi Freedom (Project A-2005-ALS-0340.000), Audit Report: A-2007-0204-ALL*, Sept. 28, 2007.

[8] The Army's Logistics Civil Augmentation Program (LOGCAP) provides logistics and engineering services, such as food preparation, laundry, housing, and construction in support of contingency operations.

Labor Reports Improvements to Prior DBA Implementation Challenges

Labor officials told us they have taken steps to address several of the DBA insurance implementation challenges we identified in our April 2005 report. These included the lack of clarity in DBA insurance requirements, delays in processing claims, and difficulty in monitoring contractor compliance. For example, we found there was uncertainty among agency officials regarding whether (1) previously granted waivers by Labor for DBA insurance were still valid, (2) the grants process is required to follow DBA insurance requirements, and (3) DBA applied in cases where non-U.S.-appropriated-funds were mixed with U.S. appropriations. In addition, we found that the processing of claims had been delayed due to language barriers and the difficulty in obtaining medical and other personal information. Further, Labor could not verify that every contractor and subcontractor working in Iraq had purchased DBA insurance.

According to Labor officials, they have held seven seminars through 2006 on DBA insurance for contractors, insurance companies, agency officials, and attorneys in order to clarify DBA insurance requirements. Labor officials noted that these efforts to clarify DBA insurance requirements have led to a significant reduction in phone calls, e-mails, and other DBA inquiries. Furthermore, Labor officials told us that State and DOD's recent revisions to their regulations or policy memos should help to clarify when DBA insurance requirements apply. These officials also reported that the claims process has improved as claims forms and other insurance information have been translated into Arabic and that two out of the three insurance companies have hired Arabic speaking employees and stationed them in the Middle East. Lastly, Labor officials told us that while prime contractors have generally been compliant in purchasing DBA insurance, they still face challenges in verifying that subcontractors in Iraq have obtained DBA insurance.

Concluding Observations

Considering the unprecedented number of contractors and subcontractors involved in Iraq reconstruction efforts and supporting deployed forces, the U.S. government is likely spending considerable sums on DBA insurance. While DOD has taken steps through the Army Corps' single-insurer program to reduce its DBA rates, it does not know what it is spending departmentwide on such insurance. Without this information, DOD is limited in its ability to make fully informed decisions regarding its options for minimizing departmentwide DBA insurance costs. Furthermore, the lack of detailed information on these costs makes it difficult for Congress to conduct full oversight of reconstruction funds.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any questions that you or other Members of the Committee may have at this time.

Contacts and Acknowledgments

For further information regarding this testimony, please contact John Needham at (202) 512-4841 or (needhamjk1@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this product. Staff making key contributions to this statement were John Neumann, Assistant Director; Jeffrey Hartnett; Greg Campbell; Sarah Jones; Tara Copp; and John Krump.

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Chairman WAXMAN. Thank you very much, Mr. Needham.

I want to thank all of you for your testimony. We are now going to have questions from members of the panel, and I want to start off those questions.

To illustrate this program which might seem very complex, I wanted to focus my questions on a particular example. The insurance purchased by KBR under the Army LOGCAP contract, the LOGCAP contract is the single biggest contract in Iraq. It is worth more than $27 billion. Halliburton's KBR Division won this Cost Plus Contract in 2001, and this committee has raised a number of questions about it since then.

Mr. Mizzoni, your agency, the Army Audit Agency, issued a report about KBR's charges under the LOGCAP contract for DBA insurance, and the committee obtained a copy of the report, and we are making it public today. I thought your findings were pretty astounding.

KBR hired AIG as its insurance company. Your report, page 5, says that AIG charged KBR about $284 million for DBA insurance from——

Mr. MIZZONI. That is correct. One clarification, though, sir. My understanding is that KBR actually did not buy the insurance. I am not an insurance expert, but I understand that KBR actually had to use an insurance broker in the State of Texas, and that insurance broker then bought the insurance for KBR.

Chairman WAXMAN. And did the insurance broker get a fee for doing that, that purchase?

Mr. MIZZONI. I honestly don't know, sir.

Chairman WAXMAN. OK. The total cost of providing this insurance is actually higher than the $284 million. KBR has a Cost Plus Contract so it can add up a markup up to $8 million on top of the $284 million premium to AIG. This makes a total cost to the taxpayers as much as $292 million, all of which I mentioned in my opening statement.

Your report, page 8, also says that of that $292 million AIG will pay out about $73 million in claims after all adjustments and reimbursements. Is that right, $73 million?

Mr. MIZZONI. That is what we found, sir, yes.

Chairman WAXMAN. So looking at it from a taxpayers' perspective, the purpose of this insurance is to provide injured workers with benefits, yet under this contract the taxpayer is paying nearly $300 million, and the injured workers are getting less than $75 million. I am trying to figure out if this makes any sense.

Mr. Needham, you represent GAO. Do you think the taxpayers are getting a good return on their investment?

Mr. NEEDHAM. Based on the data that has been presented today, Mr. Chairman, it is not apparent that they are. One of the concerns that we have had is that DOD needs to be more on top of this in terms of what it is that we are spending.

DOD took on a practice of doing spend analysis several years ago after we had issued reports on these best practices. They have done this for other areas, clerical services, they do it for software, wireless services. This represents an opportunity for DOD to get on top of that so they could get a better return.

Chairman WAXMAN. Well, that is certainly one of the purposes of the hearing, but we are trying to see where we are before we push them even harder to get where we should be. KBR and AIG set the price of the insurance. Neither of them pays the bills.

Mr. NEEDHAM. Right.

Chairman WAXMAN. The taxpayer does. That means they have no incentive to keep costs low. Because KBR is operating under a cost plus contract, the higher the premiums it pays AIG the more money it makes.

Now, Mr. Mizzoni, do you think it makes sense to rely on a contractor like KBR which has a cost plus contract and negotiate its own insurance premiums?

Mr. MIZZONI. Again, sir, the way I understand it, they did not negotiate it; it was the insurance broker in Texas.

Chairman WAXMAN. They relied on their broker, but none of them paid the bills?

Mr. MIZZONI. None of them paid, correct.

Chairman WAXMAN. And they had no reason to hold down the costs?

Mr. MIZZONI. It is a cost reimbursable contract. We do pay the cost. One or two things I would like to mention is that KBR safety record was actually very good, and the safety record is used when negotiating award fees.

During our audit, when we brought this to the attention to the KBR as far as the rate increases from fiscal year 2003 to fiscal year 2004, they did question their broker.

Chairman WAXMAN. Well, the concerns about this problem are not new. Since 2005, auditors and experts have been warning that the taxpayers are being overcharged, but it has been hard to get a definitive picture of what is really going on with this program because the administration has not wanted to compile the data. So that is what we tried to do.

We asked the top four insurance companies that account for more than 99 percent of the DBA market to provide the committee with profit and pay out data, and we are now able to see some concrete trends. What the data shows is that from 2002 through 2007 these four insurance companies received $1.5 billion in premiums under contracts negotiated with private contractors in Iraq and Afghanistan. These companies will pay out $928 million in claims and expenses, and they will retain net underwriting gains of $585 million. In other words, these four insurance companies have retained as profit 39 percent of the premiums they receive.

Now my time has expired, but I certainly want to pursue this with Mr. Ginman and others because it seems to me it is quite excessive. But other Members may want to question on this point, and I think it is well worth going into.

Mr. DAVIS OF VIRGINIA. May I answer your——

Chairman WAXMAN. Well, I had a long series of questions, so why don't you go ahead.

Mr. DAVIS OF VIRGINIA. Thank you very much.

Chairman WAXMAN. If not, other Members on the second round.

Mr. DAVIS OF VIRGINIA. Mr. Moser, let me start with you. You note in your testimony there were four offerors during State's most recent DBA competition, is that correct?

Mr. MOSER. Yes, that is correct.

Mr. DAVIS OF VIRGINIA. When was that contract awarded?

Mr. MOSER. In 2001.

Mr. DAVIS OF VIRGINIA. Could you speculate for us why State gets more offers than the Army Corps?

Mr. MOSER. Well, it is very difficult for me to make comments about any other agency's contracting activity. I will say for our contracting activity, we very much want to promote as much competition as we can get, so I will turn that over to Mr. Dalton for comments about the Army Corps.

Mr. DALTON. I think maybe one of the reasons why we get fewer offerors than the State Department is because we concentrate heavily in more hostile areas than perhaps the State Department. A large part of our work is in Iraq, is in Afghanistan, and some over in the Balkans, and so when we get our prices and contractors take a look at where we are working, there is a higher risk associated with bidding on Corps of Engineer contracts than perhaps State Department that are more spread out across the world.

Mr. DAVIS OF VIRGINIA. Thank you. Last year the CBO estimated that creating a single DBA insurance pool for the entire DOD would save the Government millions of dollars. But the CBO also warned that due to the increased Government administrative costs and the uncertainty over whether insurance providers would be willing to underwrite such a massive policy, the creation of such a pool would not necessarily result in savings for the Department of Defense.

Creating a pool would also effectively subsidize contractors in more dangerous areas by charging inflated rates to those in safer areas than subsidized contractors—you understand what I am saying. Would the creation of this type of Department-wide insurance pool result in savings to the Government, let me just ask? I will start with the GAO.

What effect would it have on contractor safety systems? Would this type of arrangement result in more contractors moving to self-insurance model? What is your thought on that?

Mr. NEEDHAM. Mr. Davis, in terms of looking at options, one of the things we recommended back 3 years ago was that DOD begin to assess the various options. What they actually did was adopt the Army Corps single insurer program for the Corps.

What we would like to see them do is to look at possibly—the Government has a self-insurer, but that is one option—but you could create multiple pools. There are tradeoffs, and according to Admiral Ginman, they are going to be looking at these possible business cases on this and what they can do in terms of what the risks are with various job categories in various parts of the world.

This is what we are looking for is that they make this kind of a tradeoff analysis. They haven't done this yet.

Mr. DAVIS OF VIRGINIA. Let me ask this, Admiral Ginman. Could you, for example, do a single provider system for Iran and Iraq, another in other regions of the world, and do three or four single provider systems? Would that work, seeing that it is so large and diverse?

Admiral GINMAN. Mr. Davis, I think, as Mr. Needham just said, there are a lot of options available to us. We, frankly, don't have

the data today, and we have committed that we will go collect the data. A single contractor for in a risk pool for Iraq/Afghanistan is certainly an option. The single contract concept that State and USAID and the Corps are using is an option.

Mr. DAVIS OF VIRGINIA. Well, let me ask you this. Wouldn't a single contractor for Iraq/Afghanistan make more sense than one across all regions given the different diversity and risks?

Admiral GINMAN. I think from risk pool perspective, having a single contractor in Iraq and Afghanistan would make sense to me, personally, but I am dong that without the benefit of the business analysis to make that determination behind it.

Mr. DAVIS OF VIRGINIA. Right. How many insurers are there in Iraq and Afghanistan, do you have any idea?

Admiral GINMAN. Department of Labor has worked with the Joint Contracting Command in Iraq and Afghanistan. There are currently three that are being used, and Department of Labor is working to add a fourth. So that the contractors doing work, particularly the local contractors, have an option of three today and, hopefully, they will have an option of four soon.

Mr. DAVIS OF VIRGINIA. What generally happens is the contractor hires the company?

Admiral GINMAN. Absolutely. It is the contractor's responsibility to get the insurance.

Mr. DAVIS OF VIRGINIA. And they have to take it off an approved list?

Admiral GINMAN. Yes. It is approved by the Department of Labor.

Mr. DAVIS OF VIRGINIA. OK, that is fine.

Chairman WAXMAN. Thank you, Mr. Davis.

Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman. What we are really talking about here, folks, is war profiteering. Private companies making money, profits, off of people who are injured or killed in a war zone. When Mr. Waxman left off his questioning, he pointed out that the profit margins are unusually large, 39 percent, whereas a domestic ratio would be maybe closer to 1 percent.

That is not a pretty picture. Now, I suppose there are a lot of bureaucratic reasons for this, but, Admiral Ginman, as the DOD representative here, are you concerned that insurance companies have made nearly $600 million in profits as a result of the War in Iraq and Afghanistan?

Admiral GINMAN. Am I concerned. I think any time the Government is taken advantage of, it is a concern.

Mr. COOPER. Can you speak louder?

Admiral GINMAN. I said any time the Government is taken advantage of, it is a concern.

Mr. COOPER. Well, you have been on duty in this assignment since October 2006.

Admiral GINMAN. Yes, sir.

Mr. COOPER. Has the Government been taken advantage of during your time on duty?

Admiral GINMAN. I don't have the data that the chairman provided, so based on simply what he said and the data that was there, if in fact 1 percent, as you provided, is a correct number, and

39 percent is in fact the percentage that is being made, that would certainly be an opportunity to go look in more detail at those specifics.

Mr. COOPER. Admiral Ginman, you are acting like this is a new issue. This was raised in 2005, 2006, 2007. Congress passed a law in 2006 requiring the Secretary of Defense to do exactly what the GAO has been recommending. So this isn't news.

Admiral GINMAN. And we implemented the pilot program with the Corps of Engineers to go collect the necessary data so that we would have the data to do a reasonable business case analysis to make a determination on a DOD-wide or an Army-wide or service-wide approach.

Mr. COOPER. Who completed those?

Admiral GINMAN. And the pilot program showed $19 million in savings that DOD did nothing to implement it more broadly. So here you had a very encouraging result, and we are dragging our feet. I mean the pilot program has not been completed and has not reported out all of the analyses, and we are looking for support from the Army Audit Agency and from the Corps of Engineers to be able to provide us the data to make that business case analysis.

Mr. COOPER. Mr. Needham, you represent GAO. Don't you think these are high-profit levels for these insurance companies and for the KBR contractor?

Mr. NEEDHAM. Based on what the norm is for the insurance industry, that is what I have been told, that these are high.

I would mention, too, that part of that is driven by what the loss rate is, and the loss rate that was cited by the Army Audit Agency for the contract that they looked at was 26 percent. That is pretty low. The normal is about 68 percent according to AIM. Best that has done studies of this. So if you have a high rate of losses over a period of years, you may try to increase your profits in some years so you can compensate for those losses in those later years.

This is the kind of analysis that needs to be done: What should we be paying so that we are a smart buyer when it comes to these kinds of insurance products?

Mr. COOPER. Let's try to put it in plainer English. If you were a private insurance contractor and you faced a risk in a war zone, you would essentially be trying to exaggerate that risk so that you would protect your ability to make money. You would essentially be betting against our Government and our servicemen because you would want to be prepared for the worst possible case. That puts our private companies in a terribly awkward and unpatriotic position in anticipating a worst case scenario for the outcome of the war and for the welfare of our contractors, when there are other ways to do this.

Mr. Mizzoni mentions one in his testimony talking about retrospective risk analysis rating plans where you can see the actual results in the field, so you are not betting against the Government and our Army and our military, so you can see what the losses are and compensate insurance companies appropriately, based on their actual losses so that they can make a profit but not an extraordinary war profiteering profit.

Mr. Mizzoni, has the retroactive approach been used?

Mr. MIZZONI. I believe other parts of the Government have used it, but certainly the Army has not. Like you say, sir, our recommendations to the Assistant Secretary for Acquisition and Logistics technology gave them several options. One was to use retrospective pricing plans.

In their reply back to us, they indicated they wanted to see the end of the pilot program, which was supposed to be March 2008, and decide the success of the program to see if it should be expanded Army-wide.

Our position, or my position, is if that program does not get expanded Army-wide, our recommendations to include retrospective pricing plans or self-insurings are on the table again.

Mr. COOPER. I apologize, I see my time has expired, but this is May 2008. The decision was supposed to have been made in March 2008, and that has not been done, right?

Thank you, Mr. Chairman.

Mr. TIERNEY [presiding]. Thank you, Mr. Cooper.

Mr. Sarbanes.

Mr. SARBANES. Thank you, Mr. Chairman. I have a little bit of a cold so I apologize for my voice.

I am listening to this and I remember the images way after we invaded Iraq of the terrible looting that occurred. You all may remember that. I saw those images on television. I think Secretary Rumsfeld ascribed that to the enthusiasm of democracy or something in a way that later didn't prove out as a particularly sensible observation.

But listening to this and thinking back over the various hearings that we have been having about what Congressman Cooper, I think, has accurately referred to as war profiteering, that initial spate of looting was immediately followed by another round of looting. This is kind of white collar looting. It is looting with a tie sitting in an office someplace.

The definition of looting I just found on my Blackberry is to plunder, to seize booty in a conquered or sacked city. And this one was interesting: to carry off as plunder, or to secure a prize lawfully by war. So whatever definition you want to use, I view this as looting: high-end, upscale, white collar looting.

Now, what is the most troubling, and it is really grotesque, the whole thing, but what is most troubling is the profit margins that we have discussed already, and that is troubling for two reasons.

One is it can mean that the premiums are being exaggerated beyond what the risk is so that, in other words, there is a dedicated effort to make money off the enterprise beyond what is appropriate or acceptable.

That is bad enough, but there is also evidence that maybe the profits are the result of not paying out the claims that are deserved, which is even more offensive. I mean in the first instance you are making more money in a situation in which maybe you are paying the premiums that people ought to have, so at least those being injured as being fairly compensated, even if the taxpayers are being taken advantage of.

But there is evidence that not only were the premiums exaggerated to get some of these profits, but in addition, there was denial of the claims going on, on the other end to help maximize the prof-

its, which is supremely offensive because that means people who are injured were not getting the compensation they deserve.

I think my time has started but isn't being accounted for there, so I wanted to ask about these insurance companies delaying the benefits because, in the committee's investigation, the committee staff spoke with a number of injured employees, their families, physicians, and others who have been engaged first hand in trying to get their claim satisfied, and they indicated that despite receiving massive profits under this DBA program, many of the insurance companies are fighting which are to make claims.

So I guess, Mr. Hallmark provided a briefing on the DOL's role in monitoring the DBA claims and told us that the insurance companies are contesting at the outset virtually every DBA claim that is being filed. Is that essentially correct for substantial numbers of those claims?

Mr. HALLMARK. I don't believe I indicated that statistic. The Longshore DBA process is a complicated one, and there are filings that occur on many, many cases called contraversions which are filed oftentimes routinely. They don't necessarily mean that the insurer is not paying the claim.

So it could be viewed as opposition of claims when it is simply an ineffective administrative filing.

Mr. SARBANES. Well, I gather we discovered that about, in 45 percent of the claims made by the employees' insurance companies were filing formal disputes, and when it goes up the chain to a judge, the companies are winning those disputes at only a rate of 5 percent.

So this just gets back to the notion of them fighting as hard as they can to secure profits against these exorbitant premiums that they are getting.

Then I will just finish up, let me just finish up because I know I am probably out of time here——

Mr. TIERNEY. That would be appropriate.

Mr. SARBANES [continuing]. By noting—I won't ask you to answer this question—but I gather that the way the benefit capping works as it was described, the premium is set against the salary, and so it can be, if you have a salary of $180,000 versus $90,000, the premium that is being charged by the insurer can be double, so they are obviously getting a higher premium. But the payout is capped by law at $90,000 as it would be for the person making $180,000. So there is obviously something wrong with that system.

So in any event, clearing insurance companies have been taking advantage, and setting up these pools seems like a better approach.

Thank you, Mr. Chairman.

Mr. TIERNEY. Mr. Sarbanes.

Mr. Issa.

Mr. ISSA. Thank you, Mr. Chairman. Mr. Dalton, if the reports of widespread fraud by mostly, we will just say, Iraqi-based companies, contractors, who in fact are charging for insurance that is never purchased and thus the absence of benefits often comes from the fact that there was no coverage, and the company may selectively decide to take care of their employees.

What are you able to do to end that double-billing, billing for a service not received?

Mr. DALTON. Actually, what we are taking a look at right now is part of our normal—I will call it the Q/A process of contract, which is contract administration—is we are requiring contractors to provide those certificates of insurance prior to us allowing them to proceed with construction work.

Now, certainly, there are cases where we might miss some, and we are trying to be a lot more diligent in following up on those. Recently, a case was cited where we had a contractor doing just exactly what you just mentioned. That was found through just part of our routine oversight of the contracts.

While we don't have it perfect yet, and we are still learning as we go with the DBA insurance how to administer it, what we are doing is making sure that we train our people to watch for those areas that might be fraudulent. We train folks before they actually go in the theater, and that is how this particular case got identified.

Mr. ISSA. Mr. Dalton, I served with the Corps of Engineers before most of the people sitting behind me were born, so we have been doing contract oversight for a long time, both domestically and around the world.

If Congress empowered or passed a law, today we seem to be concentrating in some cases on profit made rather than real oversight and reform, if we in fact said, look, your general contractor must supply the umbrella for all subs, and then they have to administer it, and then we have a single point of contractor on each prime, would that make it easier for you to ensure, one, that there was insurance, and, two, that there was, in fact, a single point of accountability on multiple contracts, but comparatively few? Would that make it more possible for your inspectors to actually accurately inspect?

Mr. DALTON. I think it definitely would. I mean, the contracts that we administer now, as you well know, we have multiple subs, and to try and reach into and look at all the tiers of subs to verify they have insurance is not an easy task.

Mr. ISSA. So it would be fair to say that right now the system is a system in which you only hope to get better, and in fact a change in the system would be what would allow us to have a confidence that you would be able to get to 100 percent compliance.

Mr. DALTON. I think it is fair to say that if we had the ability to do, as you described, a one contractor being responsible that it makes it a lot more easier to administer, and it places the responsibility within that prime contractor.

Mr. ISSA. Mr. Needham, we are supposed to be the committee on Oversight and Government Reform, and as I was alluding to, once you find out there is a problem the question is, should we be part of the reform?

Let me pose a question from my years in business. On the size contract that we are dealing with, I have to tell you, long before I got to the size of KBR, and certainly long before I got to the size of USA, Inc., I would have an administrative-only contract in which I would bear the responsibility as the Federal Government with no markups for the actual payouts, effectively realizing that I have more money as the U.S. Government than any insurance company, and I would be paying for an administrative-only fee, meaning that

$73 million in payout, I would have paid, and whatever the delta is that was mentioned by the chairman earlier by AIG, that would be on a fee basis, an administrative cost plus basis, if you will.

Why in the world haven't we looked at that? That is one-step removed from the scenario I gave Mr. Dalton. That is saying, why is it, in fact, we don't treat these contractors under best case scenario similar to the way we dealt with maneuver damage in Europe when you ran over a chicken. You didn't call somebody's insurance company. We had active duty personnel whose job it was to go out and deal with that in order to not have a premium paid over and above the payout.

Mr. NEEDHAM. Your question being, why haven't we looked at that?

Mr. ISSA. Yes. Why wouldn't you say today in your opening remarks that the system is fundamentally wrong to begin with, that on these size dollars we should only be paying for administration because the actual payout, numerically, we don't—we could absorb the risk as the Government much easier for less money than AIG or any other company, even if it was a single contractor is doing today.

Mr. NEEDHAM. Right. That is one of the options we wanted to have explored that we talked about with OMB and DOD back in 2005. When that was put into legislation for them to look at options, we expected that there would be a full range of options looked at: the self-insuring, also the single contractor which—the idea of a single insurer, though, there is a question about whether or not any one company would step up and take that on.

Mr. ISSA. And I am not proposing a single insurance company. I think it is pretty easy for us all to see that the size and scope, you could split this up into different theaters, different administrative contracts, but the idea that we would essentially not self-insure at the size of our exposure seems to be absurd, considering this committee regularly sees us self-insuring, if you will, the success of a new destroyer coming out of the Coast Guard. And when it fails, we pay the bill. By the way, we are paying a big bill on some of these new ships.

But why? Is it that we failed you, to give you the right, or that you failed to be able to exercise that, administratively?

Mr. NEEDHAM. The reason this is now an issue is because of the size of the premiums we are paying. I think the Army Audit Agency mentioned that they were paying $5 million in 2003, and it was up to $165 million 2 years later.

I mean it is DOD's responsibility now with this kind of increase to go back and look at what are the reasonable tradeoffs here, and what should we be doing—not continuing business as usual, which is what they have allowed to happen without the—I mean, aside from the Corps' program of the single insurer.

DOD-wide, there has not been anything else looked at, and that needs to be done.

Mr. ISSA. Then I guess I will close by saying, when will this committee know what the comparative cost would have been had we simply, essentially self-insured and paid administrative costs and not allowed, whether it is true or not, contractors to essentially go out and bid a local broker to get an insurance policy on this size.

It seems to me like that is a question we would like to have answered coming out of this hearing, if possible. Is that something you can help us with?

Mr. NEEDHAM. Certainly. I mean, we can begin to look at that. We looked at this 3 years ago. We stopped the work because we couldn't rely on the data we were getting from the insurance industry at that time. So we focused our efforts on what DOD was doing or not doing in that case.

Mr. TIERNEY. Thank you, Mr. Issa.

Mr. ISSA. Mr. Chairman, I appreciate that, but I hope the record can indicate that is something that I think, on a bipartisan basis, the committee should followup on, because this could represent billions of dollars that a system change would have to be implemented to do. That is what we do best is when we ask for system changes that save America money.

Mr. TIERNEY. Thank you, Mr. Issa.

Mr. Cooper, you are recognized for 5 minutes.

Mr. COOPER. Thank you, Mr. Chairman. I would like to congratulate my friend from California on his line of questioning because it is a fundamental business point that I had actually hesitated to bring up in a hearing like this. It is who is the appropriate risk-bearing entity? And my friend from California hit the nail on the head: even a large company can effectively self-insure, but certainly the U.S. Government is the best insurance company of all, and we don't have to pay the premium, the overhead, the stuff like that. It is an amazingly efficient mechanism if we allow ourselves to use it.

Sadly, the rhetoric of recent years has called that big government, even though it might save the taxpayer the most money. So it actually ends up being smaller government than relying on all sorts of contractors who each have to have their huge profit margins.

But another key point, we have been sold a bill of goods here, and again my friend from California hit the nail on the head. We did not need to buy insurance from a private carrier. All we needed to buy was administrative services only, ASL, maybe a little help with the paperwork because we, the U.S. Government, are the best risk-bearing entity. It sounds like the GAO was discouraged from even seriously considering this first best solution. Instead we have been paddling around with pooling and things like that are second or third-best solutions.

But I would join my friend from California, and let's put all the solutions on the table because our job is to get the taxpayer the best deal. But the key point here is clearly seeing what is at stake.

I have seen this over and over in health care. Giant academic medical centers with billions of dollars in the bank hiring a little puny insurance company to provide HMO services when they should have been buying ASO services, not HMO services. So let's think large. So that has been one problem, failure to clearly perceive.

Another problem is foot-dragging. Again, Admiral Ginman, you know, the deadline was March 2008. I know you haven't been eager to pursue this topic, but this hearing would have been a great op-

portunity to announce a bold new initiative from DOD to save the taxpayer money.

Admiral GINMAN. Yes, sir.

Mr. COOPER. That opportunity has not happened.

Admiral GINMAN. One, it is my understanding that the pilot has been extended out to September 2008.

Mr. COOPER. Can you talk louder?

Admiral GINMAN. I said it is my understanding the pilot has been extended out to September 2008 and that we don't have the data and the business case analysis back. We will happily work with the GAO to take a look and evaluate the option of, does it make sense to be a self-insurer in this instance.

Mr. COOPER. Could you repeat that last sentence?

Admiral GINMAN. I said we will happily work with GAO to make a determination as we look at the business case analysis as to whether it makes sense as one of the options on the table to look at being a self-insurer.

Mr. COOPER. Well, here we have a 3-year pilot program that in the first 6 months we knew it saved $19 million, and now the pilot program has apparently been extended. You don't seem anxious to tackle this problem.

If the FDA discovers a new medicine that is clearly superior and lifesaving, do you know what they do—and doesn't have bad side effects? They go ahead and allow the people to buy the new medicine. This is an example like that. We could have saved tens of millions of dollars, but you don't appear eager to tackle this project.

Admiral GINMAN. I don't know the impact that decision has on the rest of the insurance programs that we have around the world when I go to the single program that has today four rates: one for construction, one for services, one for aviation, and one for security services that I am now going to apply not just in Iraq and Afghanistan but to all of the insurance coverages throughout all of the countries that we operate in.

Mr. COOPER. There are always uncertainties, but can you guarantee this committee you will not be going to work for one of these companies, because I assume your tour of duty is going to be about up this fall, right?

Admiral GINMAN. Well, one, I retired in 2000 from the Navy. I worked in private industry for 6 years, and I made a decision to come back to the Federal Government. It is my intention to stay with the Federal Government. I am not a political appointee, I am a career civil servant.

Mr. COOPER. So you are planning on staying. Well, that is good.

Admiral GINMAN. So I plan to be around to help work this issue.

Mr. COOPER. I would hate to have to educate a new group right when the Pilot Study is finally completed. Can you help this committee understand? Have you received any memos, phone calls, or other contacts from superiors asking you to slow-walk this issue?

Admiral GINMAN. We have not been asked to slow-walk this issue by anyone, sir.

Mr. COOPER. So you have done the slow walking on your own? [Laughter.]

Admiral GINMAN. Again, I would like to think that we are waiting until we had adequate data to do a significant business case

analysis so that we understand the decision we are making, as opposed to making a decision based on information that is not yet complete.

Mr. COOPER. Well, what was the key factor that requires the Pilot Study to be extended another 6 months? What information was lacking? Why wasn't it wrapped up March 2008 and you have a great report for us here today?

Admiral GINMAN. I would have to ask the Army the question as to why it was extended another 6 to 8 months. I know when we just——

Mr. COOPER. You would have to ask who to know?

Admiral GINMAN. I would have to ask the Army why the pilot program was extended another 6 months. I do not know the answer to that question.

Mr. COOPER. Can the Army answer that?

Mr. DALTON. I can answer that. So the reason why we extended for another 6 months was because we were not necessarily just to collect the data. The data is something that we have ongoing to try and provide to OSD so that they can have the business case analysis.

But the reason we extended it for 6 months was because we needed to have time to actually get a new contract in place because this contract simply would expire and we would be left with no DBA central insurer. So it was not to just collect additional data; it was actually just to maintain continuity in having an insurance company, single DBA insurance company.

Some of the things that we need to provide to OSD to help approve the business case are things like, for instance, the impact across the rest of the work that we do. For instance, there have been claims that if you have DBA insurance and pay higher rates, or lower rates in places like Iraq/Afghanistan, then—I think it has been alluded to here—that if there is an increase in places that are more in a non-hostile environment—we are looking at that now to try and help us to help OSD with the business case, in the few that we have found, we haven't found there has been a substantial increase in those insurance premiums as was certainly mentioned in the beginning.

Just as an example, in one contract in the Balkans, we only found it was about a $2,000 increase, I think. So there is information that we are gathering in terms of overall costs on contracts, subcontracts that we need to provide to prove the business case.

Mr. COOPER. Thank you. Mr. Chairman, I know my time has expired, but foot-dragging seems to be contagious.

Mr. TIERNEY. Well, I think the point is well taken. If you look back in 2005 when the GAO issued a report, you know, then you follow that up in 2006 when Congress made a particular ruling on this; 2007 the Defense Department issued a paper about its pilot program, did nothing to extend the program, the obvious factor is the information that you are now looking for is information that you probably should have started collecting and had mostly done since 2005.

So the frustration of the committee I hope is appreciated, that there are just so many times you have to be told to do something

before you actually get off the back side of your lap and do it. That is the frustration that is here.

Mr. Needham, at the Government Accountability Office you issued a report on the DBA program in 2005. In it you stated that the agencies lack reliable data on how many contractors and subcontractors are in Iraq, the cost of the Government of DBA coverage of contractors and whether all contractors operating in Iraq provided their employees required DBA coverage. Is that right?

Mr. NEEDHAM. Yes.

Mr. TIERNEY. Mr. Hallmark, as I understand it, the Department of Labor has the responsibility to process DBA claims to ensure the workers get the benefits they are entitled to. You don't track how many employees are covered or how DBA rates are determined, or the overall cost to the employer, is that correct?

Mr. HALLMARK. That is correct. We don't actually process claims, we oversee the delivery of those claims through the insurance companies.

Mr. TIERNEY. And, Mr. Ginman, turning to the Department of Defense, can you tell us the total amount of Pentagon expenditures on DBA insurance.

Admiral GINMAN. I do not know the answer to that question.

Mr. TIERNEY. Mr. Moser, can you tell us how many State Department contractor employees are covered by DBA insurance?

Mr. MOSER. No, we can't, but we feel that figure is not really important, because we felt that we got good rates out of our contract for DBA insurance, and we are satisfied with that contract. Then the number of employees employed by each of our individual contracts depends on the nature of the work that they are doing.

Mr. TIERNEY. Mr. Dalton, can you tell us how many contract employees are covered by DBA insurance at the Army Corps?

Mr. DALTON. I can't do that at this point in time. I can tell you how many contracts we have, but certainly not the number of contracting employees.

Mr. TIERNEY. So, Mr. Needham, it doesn't look to me like everybody is following your advice here. At least they are not putting the kind of attention to it that we would have thought would be warranted by that report.

What, exactly, did your report recommend back in 2005? Didn't you recommend at that point in time that the Office of Management and Budget, the OMB Office, get involved?

Mr. NEEDHAM. Yes, we did, Mr. Chairman. We met with the Office of Management and Budget prior to—we had been discussing this with DOD. We then had formulated a recommendation. We met with OMB, they looked at it, and they said this makes perfect sense.

We then put the recommendation into the draft report and went to the Department of Defense. When it came back, there was disagreement from both OMB and DOD as to what we were recommending. At that point we met with Senate Armed Services Committee, and they took our recommendation and placed it into legislation.

Mr. TIERNEY. What, specifically, was the White House's response to your recommendation?

Mr. NEEDHAM. I don't know if there was any White House response. There was a Department of Defense response.

Mr. TIERNEY. OK. And OMB didn't make a response?

Mr. NEEDHAM. No.

Mr. TIERNEY. OK.

Mr. NEEDHAM. I don't think so.

Mr. TIERNEY. Mr. Waxman.

Chairman WAXMAN [presiding]. Thank you very much. Before we conclude the hearing, I just wanted to say that I am very grateful for the witnesses that have appeared today to talk about this issue. I am disappointed, and I have to say it, about what I have heard from the Department of Defense.

For 3 years Congress, auditors, and other experts have raised concerns about DOD, about the cost of the Defense Base Act insurance, and we have tried to get this whole issue moved forward. I don't think Congress can simply allow a waste of money to continue. I have prepared legislation that would require DOD to establish an agency-wide single insurer risk pool for Defense Base Act insurance, the same approach successfully used by the Department of State and the Corps of Engineers, to hold down costs.

We have already submitted it to CBO, and under their analysis it would save taxpayers over $360 million over the next year. I have determined to end the waste and abuse in the Defense Base Act Insurance Program. This legislation I think will do that. We are going to look to both sides of the aisle to see if we can get this legislation enacted.

This hearing was to be constructive. I hope it will be constructive, and I hope we will get the kind of result that will make sure we have the insurance we need at a price that the taxpayers can afford.

Mr. Davis.

Mr. DAVIS OF VIRGINIA. Oh, thank you. Just very quickly, I want to thank all the witnesses. I know how CBO scored it, I would like to see GAO take a look at this as well.

Chairman WAXMAN. Yes.

Mr. DAVIS OF VIRGINIA. One of the concerns is when the Corps of Engineers went out there, they just got one bidder. I don't know that you can save money under those circumstances where we have real competition going on. But I am open on the question.

Let me just particularly thank Admiral Ginman for coming back into Government service after you retired. I appreciate your service both before and after and your willingness to step out from the big salaries in the private sector to come back and serve the public.

Admiral GINMAN. Thank you.

Mr. DAVIS OF VIRGINIA. And to all of you who serve the public, thank you as well.

Chairman WAXMAN. I thank you all and Admiral Ginman, and I also want to praise you for your service. My criticisms, of course, in no way are personal to you. It is the issue that we are looking at.

Thank you. That concludes the hearing. We stand adjourned.

[Whereupon, at 11:40 a.m., the committee was adjourned.]

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