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TESTIMONY OF

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(ACQUISITION AND TECHNOLOGY)

BEFORE THE UNITED STATES

HOUSE OVERSIGHT AND

GOVERNMENT REFORM COMMITTEE

May 15, 2008

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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.