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Congress of the United States

House of Representatives

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February 27, 2006

The Honorable Tom Davis
Chairman
Committee on Government Reform
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

Today, the *New York Times* revealed that the Army Corps of Engineers has awarded Halliburton over \$250 million in cost reimbursements, profits, and bonuses for billings that Defense Department auditors determined to be unreasonable and unsupported. The Defense Department provided no adequate explanation for this irresponsible action, and it has been withholding relevant documents about its compensation determinations from the Committee for almost a year.

The payments were made under the no-bid Restore Iraqi Oil (RIO) contract, which the Bush Administration awarded Halliburton in March 2003. Under the contract, the Defense Department issued ten task orders to Halliburton for oil-related work in Iraq, including the importation of fuel and the repair of oil facilities. Halliburton charged over \$2.4 billion for this work, which is now complete. Because RIO is a cost-plus contract, Halliburton is reimbursed for its costs and then receives additional profits and bonuses. Under the RIO contract, Halliburton receives 2% of its costs as an automatic base fee and up to an additional 5% of the costs as an award fee bonus. Based on cost control and performance, the Pentagon determines what percentage bonus, if any, Halliburton should receive under each task order.

The *New York Times* has learned the amount of Halliburton's reimbursements. Additional information about base and award fees for each of the RIO task orders is posted on the website of the Army Corps of Engineers. This information shows that the Corps of Engineers ignored auditor findings in three ways: by reimbursing Halliburton for costs determined to be unreasonable or unsupported, by permitting Halliburton to collect profits on challenged costs, and by giving Halliburton unwarranted bonuses.

Pentagon auditors identified \$263 million in excessive and unsubstantiated costs under the ten task orders. In reports provided to the National Security Subcommittee, the auditors

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found Halliburton's fuel importation and other costs to be unreasonably high and determined that Halliburton's cost proposals were "not acceptable for negotiation of a fair and reasonable price." As a result, the auditors recommended that Halliburton not be reimbursed for these costs and not receive profits on them. This recommendation was supported by the views of independent experts, who characterized Halliburton's fuel prices as "highway robbery."

As the *New York Times* reported, however, the Corps rejected the auditor findings and paid Halliburton for \$253 million of the challenged costs. Although between 55% and 75% of costs challenged by Pentagon auditors are typically sustained, the Corps sustained only 3.8% of the challenged costs in this case. According to Halliburton Chairman and CEO David Lesar, "After all the government-audit processes, we received compensation for every penny we spent to buy fuel for Iraq."

The Corps also allowed Halliburton to collect profits and bonuses on challenged costs. The Corps included in the fee pool about half of the costs Pentagon auditors found to be unreasonably high or unsubstantiated. Because the pool of costs was larger, Halliburton was paid millions in base fee profits for billings that Pentagon auditors challenged. Compounding these egregious payments, the Corps also gave Halliburton an enormous bonus for overbilling the taxpayers. Given the magnitude of the excessive and unsupported costs identified by the auditors, the payment of any bonus would be questionable. But rather than withholding Halliburton's bonus, the Corps gave the company a total bonus under the RIO contract of more than \$50 million. Included in this amount are large bonus awards on the challenged costs included in the fee pool. In total, the company received bonus payments worth millions for incurring charges challenged by auditors.

Nearly a year ago, in April 2005, we jointly requested documents from the Corps that would explain its compensation determinations under the RIO contract. But the Army has failed to fully respond to this request, providing just two summary documents. In fact, it appears that the Army gave the *New York Times* more information than the Committee.

The Committee needs to exercise its oversight authority to obtain the documents that are being improperly withheld and to investigate the special treatment that Halliburton continually receives. I therefore urge you to subpoena the RIO compensation documents without further delay.

Background

On March 8, 2003, the U.S. Army Corps of Engineers awarded Halliburton subsidiary KBR a no-bid monopoly contract to restore and operate Iraq's oil infrastructure. The contract was awarded in secret, and other qualified companies, like Bechtel, which did most of the

oilfield work after the first Gulf War, were precluded from bidding.¹ Halliburton received the contract because it previously received a task order to prepare a contingency plan for Iraq's oil sector. The Government Accountability Office later investigated this contingency contract and concluded that it was not awarded "in accordance with legal requirements" because "preparation of the contingency support plan for this mission was beyond the scope of the contract."² GAO added that the work "should have been awarded using competitive procedures."³

Halliburton charged approximately \$2.4 billion under the RIO contract, which had a potential value of \$7 billion.⁴ The Corps of Engineers issued ten different task orders under the RIO contract. Work has now concluded on all ten task orders.

Halliburton's work was split generally between oil infrastructure projects and fuel importation tasks: Task Orders 1, 2, 3, 4, and 6 related to various oil infrastructure projects, while Task Orders 5, 7, 8, 9, and 10 involved the importation of fuel from Kuwait, Turkey, and Jordan. The majority of Halliburton's charges under this contract were for fuel importation and distribution. Halliburton charged nearly \$1.5 billion for fuel work and almost \$1 billion for infrastructure work.⁵ There were two sources of funding for this work: approximately \$800 million came from U.S. taxpayer funds and \$1.6 billion came from Iraqi oil proceeds and other funds in the U.S.-controlled Development Fund for Iraq.⁶

RIO is a "cost-plus" contract, meaning that Halliburton is reimbursed for its costs and then receives additional profits and bonuses. The profits are based on the contract costs. Under the RIO contract, Halliburton receives 2% of its costs as an automatic base fee and up to an additional 5% of the costs as an optional award fee bonus. Government officials consider factors such as cost control and performance to determine what bonus percentage between 0% and 5% Halliburton should receive under each task order.⁷

¹ Minority Staff, Special Investigations Division, House Committee on Government Reform, *Halliburton's Gasoline Overcharges* (July 21, 2004).

² U.S. General Accounting Office, *Rebuilding Iraq: Fiscal Year 2003 Contract Award Procedures and Management Challenges* (GAO-04-605) (June 2004).

³ *Id.*

⁴ U.S. Army Corps of Engineers, *Frequently Asked Questions: Engineer Support to Operation Iraqi Freedom* (Oct. 7, 2004).

⁵ *Id.*

⁶ *Id.*

⁷ Letter from Lt. Gen. Robert B. Flowers, U.S. Army Corps of Engineers, to Rep. Henry A. Waxman (May 2, 2003).

Rep. John Dingell and I began to raise questions about Halliburton's RIO contract immediately after the contract was awarded in March 2003.⁸ In a series of letters, we expressed concern about the exorbitant prices of Halliburton's fuel imports from Kuwait. We reported that Halliburton appeared to be charging twice as much as it should have for fuel imports,⁹ and we cited independent experts who characterized Halliburton's charges as "highway robbery" and "outrageously high."¹⁰

Our concerns about Halliburton's inflated costs were validated by Pentagon auditors. In December 2003, the Defense Contract Audit Agency (DCAA) announced at a press conference that it had completed a preliminary draft audit of Halliburton's fuel importation work. DCAA auditors found that Halliburton had overcharged the U.S. government by as much as \$61 million for gasoline imported from Kuwait into Iraq.¹¹ This audit was preliminary, however, and covered only the period until September 30, 2003.

In 2004 and 2005, DCAA completed audits of each of the ten task orders. In this series of audits, DCAA identified \$219 million in "questioned" costs under the entire RIO contract.¹²

⁸ Letter from Rep. Henry A. Waxman to Lt. Gen. Robert Flowers, U.S. Army Corps of Engineers (Mar. 26, 2003).

⁹ Letter from Reps. Henry A. Waxman and John D. Dingell to Lt. Gen. Robert Flowers, U.S. Army Corps of Engineers (Oct. 21, 2003).

¹⁰ Letter from Reps. Henry A. Waxman and John D. Dingell to Joshua Bolten, Director, Office of Management and Budget (Oct. 15, 2003).

¹¹ U.S. Department of Defense, *News Briefing* (Dec. 11, 2003).

¹² DCAA, *Report on Audit of Proposal for Restore Iraqi Oil, Task Order No. 1* (Audit Report No. 3311-2004K17900011) (Mar. 19, 2004); DCAA, *Report on Audit of Proposal for Restore Iraqi Oil, Task Order No. 2* (Audit Report No. 3311-2004K17900009) (Apr. 9, 2004); DCAA, *Report on Audit of Proposal for Restore Iraqi Oil, Task Order No. 3* (Audit Report No. 3311-2004K17900056) (Oct. 2, 2004); DCAA, *Report on Audit of the Additional Funding Proposal for RIO I Task Order No. 04* (Audit Report No. 3311-2004K17900086) (Sept. 3, 2004); DCAA, *Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 5* (Audit Report No. 3311-2005K21000024) (Feb. 25, 2005); DCAA, *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 6* (Audit Report No. 3311-2004K21000028) (Sept. 16, 2004); DCAA, *Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 7* (Audit Report No. 3311-2005K21000025) (Feb. 25, 2005); DCAA, *Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 8* (Audit Report No. 3311-2005K21000026) (Feb. 25, 2005); DCAA, *Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 9* (Audit Report No. 3311-2005K21000019) (Feb. 3, 2005); DCAA, *Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 10* (Audit Report No. 3311-2005K21000020) (Feb. 3, 2005).

DCAA determined that all of these costs were unreasonably high. DCAA also identified \$60 million in “unsupported” charges under the RIO contract.¹³ Revised audits lowered the total amount of questioned and unsupported costs to \$263 million.¹⁴

DCAA auditors found unreasonable costs for Kuwaiti fuel under all of Halliburton’s fuel importation task orders. The auditors criticized Halliburton for failing to negotiate better pricing for the fuel and transportation costs, concluding that Halliburton failed to provide “adequate documentation to demonstrate the reasonableness of the Kuwait fuel prices over the life of the purchase orders.”¹⁵

The auditors also repeatedly criticized Halliburton for making unnecessary retroactive payments to its Turkish fuel subcontractors. DCAA noted that Halliburton had negotiated “fixed-unit-rate” and “firm-fixed-price” subcontracts with various Turkish subcontractors to import fuel into Iraq. During the term of these subcontracts, the market price of the fuel increased. DCAA reported that the Turkish companies asked Halliburton “to increase the unit price of the fuel to compensate for losses due to market increases.”¹⁶ According to DCAA, Halliburton “agreed to pay the higher prices retroactively.”¹⁷ DCAA concluded: “We do not believe it was appropriate to retroactively adjust the fuel unit prices of KBR’s fixed-unit-rate and firm-fixed-price subcontracts when there are no provisions in the subcontracts to do so.”¹⁸

I released a report in July 2004 with additional information about Halliburton’s inflated gasoline charges. This report compared the price charged by Halliburton to import gasoline from

¹³ *Id.* According to the DCAA Contract Audit Manual, “questioned costs” are costs “on which audit action has been completed” and “which are not considered acceptable.” Questioned costs may be determined unacceptable for several reasons: they may be “unallowable” under the contract terms; they may not be “allocable” because they are not “incurred specifically for the contract;” or they may be “unreasonable in amount.” Costs are considered unreasonable in amount when they “exceed that which would be incurred by a prudent person in the conduct of a competitive business.” DCAA classifies charges as “unsupported” when “the contractor does not furnish sufficient documentation to enable a definitive conclusion” about the acceptability of the charges.

¹⁴ *Army to Pay Halliburton Unit Most Costs Disputed by Audit*, New York Times (Feb. 27, 2006).

¹⁵ *See, e.g., DCAA, Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 5*, *supra* note 12, at 2.

¹⁶ *See, e.g., DCAA, Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 7*, *supra* note 12, at 2.

¹⁷ *Id.*

¹⁸ *Id.*

Kuwait to Iraq with the costs incurred by the Pentagon's fuel importation office, the Defense Energy Support Center (DESC), to perform the same task. Because DESC assumed Halliburton's fuel importation responsibilities on April 1, 2004, a direct "apples-to-apples" price comparison could be made. The report found that Halliburton charged more to purchase fuel than DESC, three times as much to transport the fuel into Iraq, and 40 times as much to cover its fees and markups.¹⁹

Halliburton's Reimbursements, Profits, and Bonuses

The Corps of Engineers has made final decisions on how much to reimburse Halliburton for all ten RIO task orders and how much to pay Halliburton in base and award fees under each of these task orders.²⁰ All of these payments have now been made to Halliburton.

As the *New York Times* reported today, the Corps of Engineers ignored the findings of the Defense Department's own auditors in making these reimbursement decisions. The agency reimbursed Halliburton for unreasonably high costs challenged by auditors, allowed Halliburton to collect profits on challenged costs, and even gave Halliburton substantial bonuses.

For the ten RIO task orders, DCAA identified \$263 million in questioned and unsupported costs.²¹ The auditors recommended that Halliburton not be reimbursed for or receive profits on these costs. Instead of disallowing the costs challenged by DCAA, the Corps reimbursed Halliburton for \$253 million in questioned and unsupported costs.²² This represents over 96% of the \$263 million in costs challenged by the auditors.

Historically, between 55% and 75% of DCAA's challenged costs have been sustained.²³ But in this case, the Corps sustained only 3.8% of the challenged costs. On the fuel importation task orders, the Corps upheld just 1.8% of the costs challenged by auditors.

In addition to reimbursing Halliburton for challenged costs, the Corps also allowed Halliburton to profit from challenged costs. According to the *New York Times*, the Corps included in the fee pool used to determine Halliburton's profits about half of the \$263 million in

¹⁹ *Halliburton's Gasoline Overcharges*, *supra* note 1.

²⁰ *Army to Pay Halliburton*, *supra* note 14; U.S. Army Corps of Engineers, *Frequently Asked Questions: Engineer Support to Operation Iraqi Freedom* (Jan. 26, 2006) (available online at <http://www.hq.usace.army.mil/CEPA/Iraq/March03-table.htm>).

²¹ DCAA audits, *supra* note 12; *Army to Pay Halliburton*, *supra* note 14.

²² *Army to Pay Halliburton*, *supra* note 14; U.S. Army Corps of Engineers, *FAQ*, *supra* note 20.

²³ *Army to Pay Halliburton*, *supra* note 14.

challenged costs. As a result, Halliburton received profits on millions in costs Pentagon auditors found to be unreasonably high or unsubstantiated. Halliburton's base is 2%. When the Corps applied this fee to the challenged costs included in the fee pool, the company automatically received millions in profits for challenged costs.

Incredibly, the Corps also gave Halliburton an enormous bonus. As shown in Table A, Halliburton's total bonus for the ten task orders is \$56.5 million. Under the RIO contract, Halliburton can receive a bonus fee of up to 5% of the value of a task order. When these bonus payments are combined with the base fee payments, the total profit for Halliburton is nearly \$100 million for the RIO contract.

Task Order	Base Fee (2%)	Award Fee Bonus (0-5%)	Total Profit (2-7%)
1	\$159,430	\$175,378	\$334,808
2	\$21,764	\$39,175	\$60,939
3	\$12,933,077	\$11,639,770	\$24,572,847
4	\$882,677	\$794,430	\$1,677,107
5	\$15,683,246	\$26,661,519	\$42,344,765
6	\$3,880,000	\$388,000	\$4,268,000
7	\$5,741,741	\$9,760,959	\$15,502,700
8	\$3,071,573	\$5,221,673	\$8,293,246
9	\$758,285	\$1,289,086	\$2,047,371
10	\$320,952	\$545,618	\$866,570
Totals	\$43,452,745	\$56,515,608	\$99,968,353

Sources: U.S. Army Corps of Engineers, *Frequently Asked Questions: Engineer Support to Operation Iraqi Freedom* (Jan. 26, 2006) (online at <http://www.hq.usace.army.mil/CEPA/Iraq/March03-table.htm>).

Ironically, Halliburton received some of its highest bonuses for projects with the most inflated costs. Although Halliburton's fuel costs were deemed unreasonable by DCAA and have been the subject of widespread criticism, over \$43 million of the \$56.5 million bonus awarded to Halliburton are for the fuel task orders.

Compounding the insult to the taxpayer, the Corps actually paid Halliburton millions of dollars in bonuses for incurring the very charges that the DCAA determined to be excessive or unsupported. In total, Halliburton received reimbursements worth \$253 million and profits and bonuses worth several million dollars more for the specific charges challenged by DCAA.

Pattern of Ignoring Auditors

This is not the first time that the Defense Department has rejected the recommendations of its own auditors in order to provide special treatment to Halliburton. In fact, the Defense Department has established a pattern of ignoring its auditors.

For example, in April 2005, the Army announced that Halliburton would receive \$145 million out of the \$200 million of the costs DCAA questioned for meal services in Iraq under Halliburton's LOGCAP troop support contract.²⁴ The Army sustained only 27.5% of DCAA recommendations. At that same time, the Army tripled the company's guaranteed fee of 1% to 3%, generating an extra \$26 million for Halliburton.²⁵ The Army previously rejected auditor entreaties to withhold 15% of Halliburton's LOGCAP payments until the company submitted adequate cost estimates for its work.²⁶

The Defense Department also ignored auditor recommendations in order to award Halliburton new contracts. In January 2004, DCAA recommended that the Corps of Engineers not enter into future negotiations with Halliburton until consulting with the auditors about the company's significant cost estimating deficiencies.²⁷ Three days after the DCAA recommendation memo was sent, the Army Corps of Engineers awarded Halliburton a new \$1.2 billion contract to restore and operate the oil infrastructure in the southern half of Iraq.

Need for a Subpoena

On April 15, 2005, the Committee requested award fee determinations and related documents for a number of Iraq contracts.²⁸ After meeting with Committee staff, the Defense Department provided the requested information for 20 contracts.²⁹ However, after ten months and numerous efforts by staff to follow up, the Department still has not provided most of the

²⁴ U.S. Army Field Support Command, *News Release: Army Field Support Command Agrees to Pay for Dining Facility Services* (Apr. 5, 2005).

²⁵ *Army, Halliburton Settle Bill Dispute*, Wall Street Journal (Apr. 6, 2005).

²⁶ Letter from Benjamin S. Griffin, Commanding General, U.S. Army Materiel Command, to Rep. Henry A. Waxman (Mar. 6, 2005).

²⁷ Defense Contract Audit Agency, *Status of Brown & Root Services (BRS) Estimating System Internal Controls* (Jan. 13, 2004).

²⁸ Letter from Reps. Tom Davis and Henry A. Waxman to Donald H. Rumsfeld, Secretary of Defense (Apr. 15, 2005).

²⁹ *See*, Letter from Bernard P. Ingold, Deputy Chief Legislative Counsel, Department of the Army, to Rep. Tom Davis (Aug. 24, 2005); Letter from Bernard P. Ingold, Deputy Chief Legislative Counsel, Department of the Army, to Rep. Tom Davis (Sept. 21, 2005).

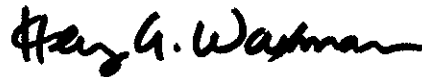
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compensation documentation for the RIO contract. The Department only recently provided two summary documents regarding the reimbursements and fees related to six task orders. We still have not received actual compensation determination documents for any of the task orders or even summary information for the other four RIO task orders. In fact, it appears that the Army provided the *New York Times* with information, such as the amount of challenged costs reimbursed for task orders 1 through 4, withheld from the Committee.

In light of the mounting reconstruction problems in Iraq and the questions raised in today's *New York Times* article, it is imperative that the Committee exercise its full oversight authority. As our efforts to persuade the Pentagon to voluntarily produce these documents have failed, it is appropriate for the Committee to issue a subpoena at this time.

I look forward to working with you to conduct this important oversight.

Sincerely,

A handwritten signature in black ink that reads "Henry A. Waxman". The signature is written in a cursive, slightly slanted style.

Henry A. Waxman
Ranking Minority Member