

Congress of the United States

House of Representatives

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

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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 inflates 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

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.

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.

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.

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.

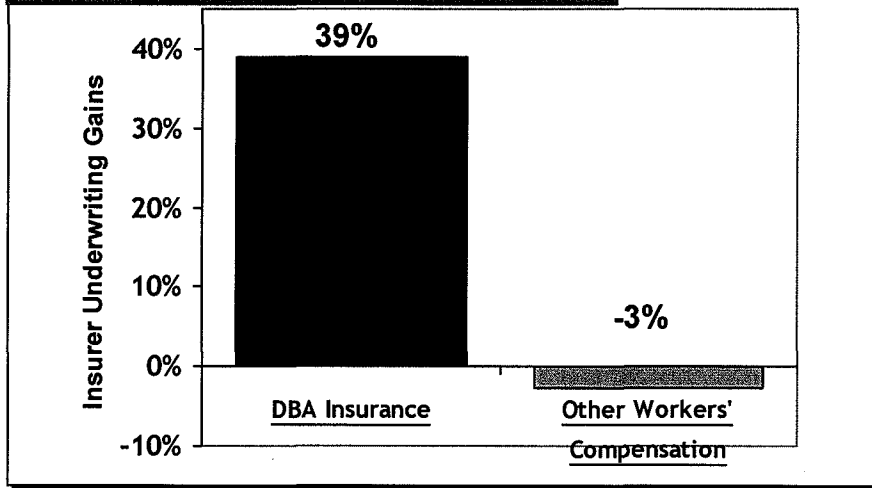
The profits earned by the four insurance companies under the Defense Base Act program in Iraq and Afghanistan far outpaced profits made by insurance companies under other workers' compensation plans. According to *A.M. Best*, a leading source of insurance industry analysis and data, insurance companies 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).

Figure A: DBA Underwriting Gains Compared to Other Workers' Compensation



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 known 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.

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.

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

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

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

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

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

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.