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Congress of the United States

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COMMITTEE ON GOVERNMENT REFORM

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December 2, 2005

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

Dear Mr. Chairman:

I am writing to request a hearing on the decision by the Army Corps of Engineers to pay Halliburton $130 million in cost reimbursements, profits, and bonuses for billings that Defense Department auditors determined to be unreasonable and unsupported. The Committee should also insist that the Corps of Engineers provide the award fee documentation for Halliburton's contract that we requested in April.

The payments in question were made under the no-bid Restore Iraqi Oil (RIO) contract, which Halliburton was awarded 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 $2.5 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. The profits are based on a negotiated estimate of the contract costs, known as a "definitization." Under the RIO contract, Halliburton receives 2% of the definitized costs as an automatic base fee and up to 5% of the definitized costs as an additional award fee bonus. Based on considerations such as cost control and performance, a government award fee board or official determines what percentage bonus, if any, Halliburton should receive under each task order.

Recently, without any announcement, the Corps of Engineers posted on its website the definitized value of six RIO task orders and the amount of Halliburton's fees and bonuses under each of these task orders. The posted information reveals that the Corps of Engineers appears to have ignored auditor findings in three ways: by reimbursing Halliburton for costs determined to be unreasonable or unsupported, by permitting Halliburton to collect profits on these challenged costs, and by giving Halliburton unwarranted bonuses.

Pentagon auditors identified $169 million in excessive and unsubstantiated costs under the six task orders. The auditors 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.

It now appears, however, that the Corps rejected the auditor findings and paid Halliburton for $124 million of the challenged costs. Although between 60% and 70% of costs challenged by Pentagon auditors are typically sustained, the Corps sustained only 27% of the challenged costs in this case. The Administration has offered no explanation for this decision to pay three-quarters of Halliburton's challenged costs.

Moreover, because RIO is a cost-plus contract, the decision to pay Halliburton for these challenged costs increased the company's profits by millions of dollars. Under the RIO contract, Halliburton received a larger base fee because the pool of definitized costs is larger. In this case, Halliburton was paid $2.5 million in base fee profits for billings that Pentagon auditors challenged.

Compounding these egregious payments, it appears that the Corps also gave Halliburton million-dollar bonuses for overbilling the taxpayers. Two factors determine the size of Halliburton's award-fee bonus: the percentage of the award fee provided to Halliburton and the value of the definitized task orders. In this case, both appear to be inflated, with Halliburton receiving bonus awards of up to 3.4% on the challenged costs being reimbursed. In fact, given Halliburton's track record of overcharging the government, the entire $38 million in bonuses awarded to Halliburton under the six task orders is questionable.

The decisions by the Corps of Engineers seem inexplicable. For many months, Pentagon auditors have criticized Halliburton's cost estimation systems as "inadequate" and its fuel charges as "unreasonable." Our Committee should require the Corps to explain why it decided to reimburse Halliburton for challenged costs, to permit Halliburton to collect profits on challenged costs, and to give Halliburton large bonuses as a reward. With reimbursement and fee decisions still pending on four other RIO task orders, it is important that we receive prompt answers.

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 had previously been awarded a task order to prepare a contingency plan for Iraq's oil sector. The Government Accountability Office later investigated the award of the contingency contract and concluded that it was not "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 $2.5 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 approximately $1.5 billion for fuel work and $1 billion for infrastructure work.[5] There were two sources of funding for this work: approximately $875 million came from U.S. taxpayer funds and $1.64 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 a negotiated estimate of the contract costs. The process by which the government and Halliburton agree on a cost estimate for each task order is called "definitization." Under the RIO contract, Halliburton receives 2% of the definitized costs as an automatic base fee and up to an additional 5% of the definitized costs as an optional award fee bonus. A government award fee board or award fee

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[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.*

determination official considers factors such as cost control and performance to determine what bonus percentage between 0% and 5% Halliburton should receive under each task order.[7]

Audit Findings

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 final 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] DCAA determined that all of these costs were unreasonably high. DCAA also identified $60 million in "unsupported" charges under the RIO contract.[13]

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

[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

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."[14]

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."[15] According to DCAA, Halliburton "agreed to pay the higher prices retroactively."[16] 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."[17]

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).

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

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

[16] *Id.*

[17] *Id.*

All the DCAA audits reported that Halliburton's proposals were "not acceptable for negotiation of a fair and reasonable price."[18] DCAA found that Halliburton's cost and pricing submissions were "not adequate" because "proposed" costs "exceed recorded costs," because Halliburton's proposals "did not contain data to support the reasonableness of the negotiated purchase orders," and because they were not prepared "in accordance with applicable Cost Accounting Standards and appropriate provisions of FAR," the Federal Acquisition Regulation.[19]

Moreover, DCAA criticized Halliburton for producing inadequate cost estimates for definitization. On December 31, 2003, DCAA issued a "Flash Report," alerting various Defense Department agencies about "significant deficiencies" in Halliburton's cost estimating system.[20] According to the auditors, these deficiencies "could adversely affect the organization's ability to propose subcontract costs in a manner consistent with applicable government contract laws and regulations."[21] On August 4, 2004, DCAA found Halliburton's "estimating system to be inadequate for providing verifiable, supportable, and documented cost estimates that are acceptable for negotiating a fair and reasonable price."[22]

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 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.[23]

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[18] *See, e.g.*, DCAA, *Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 8, supra* note 12, at 2.

[19] *See, e.g.*, DCAA, *Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 9, supra* note 12, at 4, 2, and 1.

[20] DCAA, *Flash Report on Estimating System Deficiency Found in the Proposal for Contract No. DAAA09-02-D-0007, Task Order No. 59* (Audit Report No. 3311-2004K24020001) (Dec. 31, 2003).

[21] *Id.*

[22] DCAA, *Audit Report No. 3311-2004K24010001* (Aug. 4, 2004). *See* also, DCAA, *Audit Report No. 3311-2005K21000024* (Feb. 25, 2005).

[23] *Halliburton's Gasoline Overcharges*, *supra* note 1.

On April 15, 2005, the Committee requested award fee determinations and related documents for a number of Iraq contracts.[24] After meeting with Committee staff, the Defense Department provided the requested information for 20 contracts.[25] However, the Department still has not provided the requested compensation documentation for the RIO contract.

Halliburton's Reimbursements, Profits, and Bonuses

On November 3, 2005, without any announcement, the Corps of Engineers posted on its website the definitized value of six RIO task orders and the amount of Halliburton's base and award fees under each of these task orders.[26] Information was posted for Task Orders 1, 2, 4, 5, 6, and 7. Together, these task orders are worth over $1.5 billion, or about 60% of the total value of the RIO contract.[27] Information for Task Orders 3, 8, 9, and 10 was not posted.

For these six task orders, DCAA had identified $169 million in questioned and unsupported costs.[28] The auditors recommended that Halliburton not be reimbursed for or receive profits on these costs.

The posted information reveals that the Corps of Engineers appears to have ignored the findings of the Defense Department's own auditors. According to the information from the Corps, the agency reimbursed Halliburton for unreasonably high costs challenged by auditors, allowed Halliburton to collect profits on these challenged costs, and even gave Halliburton a substantial bonus.

Instead of disallowing the costs challenged by DCAA, the Corps largely ignored the Pentagon auditors and reimbursed Halliburton for $124 million in questioned or unsupported costs.[29] This represents 73% of the $169 million in costs challenged by the auditors under these task orders. These figures are shown in Table A.

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

[25] *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).

[26] U.S. Army Corps of Engineers, *Frequently Asked Questions: Engineer Support to Operation Iraqi Freedom* (Nov. 3, 2005) (available online at http://www.hq.usace.army.mil/CEPA/Iraq/March03-table.htm).

[27] *Id.*

[28] DCAA audits, *supra* note 12.

[29] U.S. Army Corps of Engineers, *FAQ*, *supra* note 26.

Table A: Comparison Between Halliburton's Proposals and the Definitized Value of Six RIO Task Orders				
Task Order	**Halliburton's Proposed Value**	**Negotiated Definitized Value**	**Difference in Proposed and Definitized Values**	**Amount Questioned and Unsupported**
1	$10,076,410	$8,019,155	$2,057,255	$904,146
2	$1,395,831	$1,149,158	$246,673	$199,804
4a	$45,357,263	$42,390,043	$2,967,220	$86,264
4b	$30,800,000	$28,144,202	$2,655,798	$13,699,411
5	$887,339,958	$871,635,875	$15,704,083	$84,446,016
6	$212,091,705	$194,000,000	$18,091,705	$34,214,379
7	$324,943,044	$322,000,000	$2,943,044	$35,681,321
Totals	$1,511,994,211	$1,467,338,433	$44,665,778	$169,231,341

Sources: U.S. Army Corps of Engineers, *Frequently Asked Questions: Engineer Support to Operation Iraqi Freedom* (Nov. 3, 2005) (online at http://www.hq.usace.army.mil/CEPA/Iraq/March03-table.htm); Defense Contract Audit Agency audits, *supra* note 12.

Historically, between 60% and 70% of DCAA's challenged costs have been sustained. But in this case, the Corps sustained only 27% of the challenged costs. On Task Order 7, one of the large fuel importation task orders, the Corps upheld just 8% of the costs challenged by auditors.

In addition to reimbursing Halliburton for challenged costs, the Corps also allowed Halliburton to profit from the challenged costs. Because Halliburton's pool of definitized costs includes $124 million in challenged costs, Halliburton's 2% base fee is larger than it should be. The company will automatically receive $2.5 million in profits for costs Pentagon auditors found to be unreasonably high or unsubstantiated.

Finally, the Corps gave Halliburton a large bonus for the costs challenged by the Department's auditors. For each task order, Halliburton's award fee bonus depends on two determinations: the percentage bonus awarded to Halliburton and the definitized value of each task order. Under the RIO contract, the Halliburton can receive a bonus fee of up to 5% of the definitized value of a task order. The bonus percentage selected by the award fee board or determination official is multiplied by the definitized value to produce the final bonus award.

As Table B shows, the Corps awarded Halliburton a bonus of up to 3.4% on the six task orders. This produced a bonus of nearly $38 million and a total profit for Halliburton of over $64 million for the six task orders.

Table B: Halliburton Fees for Six RIO Task Orders			
Task Order	**Base Fee (2%)**	**Award Fee (0-5%)**	**Total Fee (2-7%)**
1	$159,430	$175,378 (2.2%)	$334,808 (4.2%)
2	$21,764	$39,175 (3.4%)	$60,939 (5.4%)
4	$847,776	$763,020 (1.8%)	$1,610,796 (3.8%)
5	$15,683,246	$26,661,519 (3.1%)	$42,344,765 (5.1%)
6	$3,880,000	$388,000 (0.2%)	$4,268,000 (2.02%)
7	$5,741,741	$9,760,959 (3%)	$15,502,700 (5%)
Totals	$26,333,957	$37,788,051 (2.6%)	$64,122,008 (4.6%)

Source: U.S. Army Corps of Engineers, *Frequently Asked Questions: Engineer Support to Operation Iraqi Freedom* (Nov. 3, 2005) (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. On the two fuel importation task orders, Task Orders 5 and 7, the company was given an award fee of 3% despite repeated auditor findings of unreasonable charges for Kuwaiti fuel and improper overpayments to Turkish subcontractors. In fact, although Halliburton's fuel costs were deemed unreasonable by DCAA and have been the subject of widespread criticism, over $36 million of the $38 million bonus awarded to Halliburton are for these fuel task orders.

In total, Halliburton received reimbursements worth $124 million, base-fee profits worth $2.5 million, and bonuses worth $3.4 million for the specific charges challenged by DCAA. Given that Halliburton's entitlement to any bonuses could be called into question by its pattern of unreasonable billings, the company's entire bonus of $38 million for the six task orders is also suspect.

Conclusion

The Administration has consistently asserted that cost-plus contracts protect the taxpayer because the government can use the prospect of raising or lowering award fees to encourage "effective control of costs" by the contractor.[30] Clearly this has not occurred with the RIO contract. Rather than relying on the findings of its own auditors, the Pentagon reimbursed Halliburton for $124 million in costs that the auditors determined to be excessive or unsupported. And rather than holding Halliburton accountable for squandering taxpayer and Iraqi funds, the Administration rewarded Halliburton with large bonuses and special treatment.

The Committee on Government Reform has held no full Committee hearings on Iraq this Congress. In light of the mounting reconstruction problems in Iraq and the questions raised in this letter, the Committee should initiate a series of hearings into contracting in Iraq, starting with a hearing to investigate the federal payments to Halliburton. In order to adequately prepare

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[30] *See, e.g.*, Letter from Lt. Gen. Robert B. Flowers, U.S. Army Corps of Engineers, to Rep. Henry A. Waxman (May 2, 2003).

for these hearings, we should also insist that the Pentagon produce the detailed RIO compensation determination documents previously requested by the Committee. We cannot allow the Administration to waste additional taxpayer dollars paying Halliburton's inflated costs and undeserved profits on the remaining four RIO task orders.

Sincerely,

Henry A. Waxman

Henry A. Waxman
Ranking Minority Member