



# The Defense Base Act (DBA): The Federally Mandated Workers' Compensation System for Overseas Government Contractors

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## Summary

Many overseas federal contractors are covered by the Defense Base Act (DBA), which mandates that they provide workers' compensation insurance for their employees. As the U.S. military has increased operations in Iraq, the size of the DBA program has grown. Since September 2001, there have been 49,472 DBA cases, including 1,584 cases involving the deaths of contractors in Iraq and Afghanistan. Nearly \$200 million in cash and medical benefits were paid to DBA claimants in 2008.

Congress has become increasingly concerned with the costs involved in the DBA program because the federal government usually reimburses its contractors for their DBA premiums. The Department of State (DOS) and the U.S. Agency for International Development (USAID) have seen some cost savings since adopting single-source models for their DBA insurance in which contractors for each agency are required to purchase insurance from a single company selected by the agency. The U.S. Army Corps of Engineers (USACE) is currently testing such a model for its DBA system. For the rest of the Department of Defense (DOD), however, including the Army's large Logistics Civil Augmentation Program (LOGCAP) contract, individual contractors are free to select their own DBA insurers and negotiate their own rates, and one contractor, KBR, has been criticized by DOD auditors for failing to demonstrate that it sought to control DBA premium costs when selecting an insurer.

Although not directly related to the Defense Base Act, Congress has expressed concern over negligent contractor behavior that may jeopardize the health and safety of both contractors and government personnel. Accordingly, H.R. 5136, the proposed National Defense Authorization Act (NDAA) for Fiscal Year (FY) 2011, includes a provision that requires the Secretary of Defense to report to the House and Senate Armed Services Committees, by September 1, 2011, on incidents where contractors have earned reduced award fees or been denied award fees because of incidents where the contractor jeopardized the health or safety of government personnel. P.L. 111-84, the NDAA for FY2010, authorizes the Secretary of Defense to reduce or deny award fees due to such incidents, as defined in Section 823 of P.L. 111-84.

The NDAA for FY2009 (P.L. 110-417) includes a provision that requires DOD to change the way its contractors provide DBA coverage for their workers. In a report issued pursuant to this legislation, DOD concluded that making improvements to the current open-market DBA insurance system would best meet the criteria for reform recommended by Congress and the agency. The report also found advantages that could result from having the federal government self-insure, with third-party administration, for DBA costs. However, there may be limitations to the utility of this report as a guide for Congress in making overall changes to the DBA program.

This report provides an overview of the DBA and the systems used to provide DBA insurance at DOS, USAID, DOD, and USACE. Also included are criticisms of the current DOD DBA policy raised by GAO and Army auditors as well as responses to those criticisms by DOD and USACE. The report concludes with a discussion of several DBA reform options suggested by the House of Representatives in recent legislation and analyzed by DOD. A list of acronyms used in this report is provided in the **Appendix**.

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## Workers' Compensation in the United States

More than 131 million private and public sector employees in the United States are covered by some form of workers' compensation.<sup>1</sup> Although the details of the various state and federal workers' compensation systems differ, all workers' compensation systems in the United States provide for limited wage replacement and full medical benefits for workers who are injured or become ill as a result of their work and survivors benefits to the families of workers who die on the job. In most cases, workers' compensation is mandated by state law and administered by state agencies. However, for some classes of workers, including overseas federal contractors, workers' compensation is mandated by federal law and provided or administered by the federal government. **Table 1** provides summary data on workers' compensation in the United States.

The workers' compensation system is a no-fault system that pays workers for injuries or illnesses related to employment without considering the culpability of any one party. In exchange for this no-fault protection and the guarantee of benefits in the event of an employment-related injury, illness, or death, workers give up their rights to bring actions against employers in the civil court system and give up their rights to seek damages for injuries and illnesses, including pain and suffering, outside of those provided by the workers' compensation laws. With limited exceptions, injuries, illnesses, or deaths that are the result of accidents or incidents that occur in the workplace or that are the result of activities related to employment are covered by workers' compensation.<sup>2</sup>

**Table 1. Workers' Compensation Coverage, Benefits, and Costs for the United States, 2007**

Covered workers	131.7 million
Covered wages	\$5,855 billion
Total benefits paid	\$55.4 billion
Medical benefits paid	\$27.2 billion
Cash benefits paid	\$28.3 billion
Employer costs <sup>a</sup>	\$85.0 billion

**Source:** Ishita Sengupta, Virginia Reno, and John F. Burton, Jr., *Workers' Compensation: Benefits, Coverage, and Costs, 2007*, (Washington: National Academy of Social Insurance 2009), p. 2.

- a. Employer costs include costs paid for workers' compensation insurance or costs paid for benefits and administration by self-insured firms.

State and federal laws differ on how private employers may meet their responsibilities to insure against the economic losses to employees from workplace injuries and illnesses. In nearly every

<sup>1</sup> Ishita Sengupta, Virginia Reno, and John F. Burton, Jr., *Workers' Compensation: Benefits, Coverage, and Costs, 2007* (Washington: National Academy of Social Insurance 2009), p.2. Hereafter cited as Sengupta et al., *Workers' Compensation, 2009*.

<sup>2</sup> Common exceptions to coverage include injuries caused by the willful misconduct of an employee, the drug or alcohol use of an employee, or "acts of God." Traditionally, only injuries or deaths that resulted from specific accidents were covered by workers' compensation. Modern workers' compensation systems now generally provide coverage for illnesses or other conditions, such as hearing loss, that are the result of prolonged exposure to a dangerous workplace environment.

state and federal system, firms can self-insure or purchase workers' compensation insurance from private providers or, in some states, from state funds.<sup>3</sup>

## **Federal Workers' Compensation**

Workers' compensation policy is largely determined by the individual states. Each state and the District of Columbia, with the exception of Texas, has its own basic workers' compensation policy that mandates that private-sector employers and state and local government agencies insure against the financial damages caused by employment-related injuries and illnesses and provide no-fault cash and medical benefits to employees who are injured, killed, or become sick on the job.<sup>4</sup>

The federal government has only a limited role in the workers' compensation system and administers workers' compensation programs for federal employees and several limited classes of private-sector workers, including overseas federal contractors. In 2007, state workers' compensation programs paid \$52.1 billion, or 94%, of the \$55.4 billion in total cash and medical benefits paid by the workers' compensation system; federal workers' compensation programs paid \$3.3 billion, or 6%, of total workers' compensation benefits.<sup>5</sup>

With limited exceptions, the federal government has traditionally left workers' compensation law and policy to the states. However, the federal government has intervened in workers' compensation policy in three cases. First, the federal government administers a workers' compensation program for most federal employees under the Federal Employees' Compensation Act (FECA). Second, the federal government administers workers' compensation programs for the longshore and harbor and railroad industries because of the interstate nature of those industries. The Defense Base Act (DBA), created in 1941, extended the federal workers' compensation program for longshore and harbor workers, initially to persons working on American military bases abroad and then to most federal contractors working outside of the United States.

Third, the federal government administers limited workers' compensation systems for coal miners with black lung disease and energy workers with cancer and other diseases caused by exposure to radiation and other toxic substances because state workers' compensation systems have proven unable to provide adequate coverage for these conditions.

## **The Defense Base Act**

The DBA requires that many federal government contractors and subcontractors provide workers' compensation insurance for their employees who work outside of the United States.<sup>6</sup> Under the

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<sup>3</sup> In five states, firms are required to purchase workers' compensation from state funds. Federal agencies that provide workers' compensation for their employees essentially self-insure and are responsible for 100% of the cost of all benefits paid.

<sup>4</sup> The Texas workers' compensation system is not mandatory for private-sector employers in that state. However, private-sector employers who do not participate in the workers' compensation system can be sued for damages by employees injured on the job.

<sup>5</sup> Sengupta et al., *Workers' Compensation*, 2009, p. 19.

<sup>6</sup> The provisions of the Defense Base Act (DBA) are provided in statute at 42 U.S.C. §§ 1651-1654 and as part of the (continued...)

provisions of the DBA, overseas federal military and public works contractors are subject to the same workers' compensation rules, including the same insurance requirements and same schedules of benefits for affected workers, as maritime firms covered by the Longshore and Harbor Workers' Compensation Act (LHWCA). DBA insurance is provided by private companies or through self-insurance and the DBA program is administered by the Department of Labor (DOL). Like all workers' compensation systems, the DBA provides no-fault coverage and is an exclusive remedy to injured workers. Injured workers and the survivors of workers killed on the job are entitled to benefits for employment-related injuries, illnesses, and deaths regardless of fault and are not permitted to sue their employers or the federal government for any types of damages caused by employment-related incidents.

## DBA Benefits Paid

Prior to the start of Operation Iraqi Freedom (OIF) in 2003, DBA benefits were paid to several hundred claimants per year. OIF was accompanied by an increase in the number of DBA cases and the total amount spent on DBA claims. As shown in **Table 2**, the DBA caseload increased more than six-fold between 2004 and 2007, with 2007 having the largest caseload of the entire OIF period. The average amount of compensation and medical benefits paid per claim in 2007, however, was at the lowest level since 2003. The number of DBA payments dropped in 2008, but the average benefits per case rose to the 2006 level. DOL reports that the increase in cases in 2007 was due, in part, to greater compliance efforts that resulted in firms reporting a greater number of claims that involved only minor medical care and no lost work time.<sup>7</sup> **Table 2** provides an overview of DBA claims paid between 1997 and 2008.

## Contractor Injuries and Deaths Covered by the DBA

Between September 2001 and the end of December 2009, the DBA has processed 55,988 cases of covered injuries or deaths. Of these, 27,820 or 49.7% involved no lost work time on the part of the employee. During this period, the DBA has processed 1,987 cases involving the death of a covered employee.<sup>8</sup> Just over 40% of all injury and death cases covered by the DBA during this period involved employees working for Service Employers International Inc., an indirect subsidiary of KBR, a military and public works contractor. Service Employers International Inc. was the employer of record for 22,921 total cases including 107 death cases between September 2001 and the end of December 2009. **Table 3** provides summary data on DBA cases during this period.<sup>9</sup>

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(...continued)

Longshore and Harbor Workers' Compensation Act (LHWCA) at 33 U.S.C. §§ 901-950. Regulations implementing the DBA are provided in Parts 701-704 of Title 20 of the Code of Federal Regulations (CFR) and in the Federal Acquisition Regulation at 48 C.F.R. §§ 28.305, 52.228-3, and 52.228-4.

<sup>7</sup> U.S. Congress, House Committee on Oversight and Government Reform, *Defense Base Act Insurance: Are Taxpayers Paying Too Much?*, 110<sup>th</sup> Cong., 2<sup>nd</sup> sess., March 15, 2008; statement of Shelby Hallmark, Director, Office of Workers' Compensation Programs, Department of Labor. Hereafter cited as Hallmark testimony, 2008.

<sup>8</sup> Department of Labor, *Defense Base Act Summary by Employer*, <http://www.dol.gov/esa/owcp/dlhwc/dbaallemmployer.htm>.

<sup>9</sup> *Id.*



**Table 2. Total Defense Base Act Payments, 1997 to 2008**

Year	Cases Paid	Cash Benefits for Wage Loss and Survivors (\$)	Medical Benefits for Covered Injuries and Illnesses (\$)	Total Benefits (\$)	Average Benefits per Case (\$)
1997	432	4,905,081	1,203,217	6,108,298	14,140
1998	423	5,497,439	2,194,012	7,691,451	18,138
1999	269	3,724,290	1,727,703	5,451,993	20,268
2000	309	6,268,112	2,314,654	8,582,766	27,776
2001	516	7,212,869	2,198,061	9,410,930	18,238
2002	430	5,480,592	2,101,403	7,581,995	17,633
2003	688	7,885,666	3,452,728	11,338,394	16,480
2004	1,592	19,432,369	10,647,020	30,079,389	18,894
2005	3,080	36,140,994	23,656,467	59,797,461	19,415
2006	5,039	66,973,732	48,781,929	115,755,661	22,972
2007	11,887	100,319,949	69,815,704	170,135,653	14,313
2008	8,741	146,872,621	52,964,386	199,837,007	22,862

**Source:** Department of Labor, Office of Congressional and Intergovernmental Affairs.

**Table 3. Total Defense Base Act Cases, by Severity of Injury**

September 1, 2001 through December 31, 2009

Severity of Injury	No Lost Time	1-3 days Lost Time	4 or More Days Lost Time	Death	Other	Total
Number of Cases	27,820	3,810	21,207	1,987	1,164	55,988
Percentage of Total Cases	49.7	6.8	37.9	3.5	2.1	100.0

**Source:** Congressional Research Service (CRS) table. Data taken from Department of Labor, *Defense Base Act Case Summary by Employer*, <http://www.dol.gov/owcp/dlhwc/dbaallemmployer.htm>.

**Notes:** "Other" category includes continuation of pay cases, cases in which there is not sufficient information to determine what type of benefits are payable, and occupational illness cases in which no compensation is currently payable.

## Contractor Deaths in Iraq and Afghanistan

Between September 2001 and the end of December 2009, there were 1,987 contractor deaths covered by the DBA. Of these, 1,459 or 73.4% occurred in Iraq and 289 or 14.5% occurred in Afghanistan.<sup>10</sup> Of the 289 deaths in Afghanistan, 100 occurred during the final six months of 2009. Contractor operations in Iraq and Afghanistan account for 87.9% of all covered contractor deaths during this period. During this same period, there were 4,248 American military deaths in

<sup>10</sup> Department of Labor, *Defense Base Act Case Summary by Nation*, <http://www.dol.gov/owcp/dlhwc/dbaallnation.htm>.



Iraq and 848 American military deaths in Afghanistan.<sup>11</sup> **Table 4** provides a comparison of contractor and military deaths in Iraq and Afghanistan.

**Table 4. Military and Contractor Deaths in Iraq and Afghanistan**

September 1, 2001 through December 31, 2009

Country	U.S. Military			Contractors Covered by the DBA
	Hostile	Non-Hostile	Total	
Iraq	3,459	789	4,248	1,459
Afghanistan	662	186	848	289

**Source:** Congressional Research Service (CRS) table. Data taken from Department of Labor, *Defense Base Act Case Summary by Nation*, <http://www.dol.gov/owcp/dlhwc/dbaallnation.htm>; and Department of Defense, Defense Manpower Data Center, Statistical Analysis Information Division, *Military Casualty Information*, <http://siadapp.dmdc.osd.mil/personnel/CASUALTY/castop.htm>.

**Notes:** Deaths are classified by the country in which the incident leading to the death took place, rather than the actual place of death. Thus, a person involved in an incident in Iraq who later died in the United States is placed in the Iraq category. Military data does not include persons killed in support of Operation Iraqi Freedom or Operation Enduring Freedom who died as a result of incidents in countries other than Iraq or Afghanistan.

A direct comparison between military and contractor deaths can not be made due to the different roles played by each group and the different numbers of total military and contractor personnel who have served in Iraq and Afghanistan.

## H.R. 5136, Proposed Legislation to Deny Award Fees to Contractors due to Negligent Contractor Behavior

Congress has expressed concern over negligent contractor behavior that may jeopardize the health and safety of both contractors and government personnel. Accordingly, H.R. 5136, the proposed NDAA for FY2011, includes a provision that requires the Secretary of Defense to report to the House and Senate Armed Services Committees, by September 1, 2011, on incidents where contractors have earned reduced award fees or been denied award fees because of incidents where the contractor jeopardized the health or safety of government personnel. P.L. 111-84, the NDAA for FY2010, authorizes the Secretary of Defense to reduce or deny award fees due to such incidents, as defined in Section 823.<sup>12</sup>

<sup>11</sup> Department of Defense, Defense Manpower Data Center, Statistical Analysis Information Division, *Military Casualty Information*, <http://siadapp.dmdc.osd.mil/personnel/CASUALTY/castop.htm>. A direct comparison between military and contractor deaths can not be made due to the different roles played by each group and the different numbers of total military and contractor personnel who have served in Iraq and Afghanistan.

<sup>12</sup> Section 823. Authority for the Secretary of Defense to reduce or deny award fees to companies found to jeopardize health or safety of Government personnel. P.L. 111-84, the National Defense Authorization Act for FY 2010.

## Legislative History

The Defense Base Act, P.L. 77-208, was enacted in 1941 and extended workers' compensation coverage under the Longshore and Harbor Workers' Compensation Act (LHWCA) to persons working on American military bases that were either acquired by the United States from foreign countries or that were located outside of the continental United States. Coverage was extended to public works contractors working outside of the United States in 1942 with the enactment of the War Hazards Compensation Act, P.L. 77-784, which also established the War Hazards Compensation Act (WHCA) program. The most significant amendments to the DBA were enacted in 1958 and extended coverage to non-citizens, to persons working on projects funded under the Mutual Security Act of 1954, and to persons working to provide morale and welfare services, such as through the United Service Organizations (USO) to the armed forces. These amendments also further defined the types of work covered under the DBA to include service contracts.<sup>13</sup>

In 2006, Congress directed the Department of Defense (DOD) to examine ways it could improve its DBA procedures<sup>14</sup> and Section 843 of the Duncan Hunter National Defense Authorization Act for FY2009 (NDAA) requires DOD to change the way its contractors provide DBA coverage for their workers and to prepare a report to Congress on a new DOD acquisition strategy for DBA insurance.<sup>15</sup>

## Basic Provisions of the Defense Base Act

The DBA extends the provisions of the LHWCA to federal contractors working outside of the United States. The LHWCA is a federal law that requires that private-sector firms provide workers' compensation coverage for their employees engaged in longshore, harbor, or other maritime occupations.<sup>16</sup> Workers' compensation insurance under the LHWCA can be provided either by a private carrier approved by the DOL or through a self-insurance system.

Injured workers covered by the LHWCA and DBA are entitled to full medical benefits to treat their injuries provided by a physician of their choice. Injured workers are also entitled to cash disability benefits to replace a portion of their lost wages. The basic weekly LHWCA and DBA disability benefit is equal to two-thirds of a worker's pre-disability weekly wage. Under the LHWCA and DBA, benefits for total disability are capped at 200% of the national average weekly wage; benefits for partial disability are capped on the basis of a schedule of impairments.<sup>17</sup> Benefits are also paid to survivors of covered workers killed on the job.

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<sup>13</sup> P.L. 85-477 extended DBA coverage to contracts under the Mutual Security Act of 1954 and to morale and welfare workers; it also further defined public works contracts and extended coverage to service contracts. P.L. 85-602 extended DBA coverage to non-citizens.

<sup>14</sup> P.L. 109-163.

<sup>15</sup> P.L. 110-417. In September 2009, the DOD issued the following report pursuant to Section 843 of the NDAA: Department of Defense, Office of the Deputy Under Secretary of Defense Acquisition and Technology, Acquisition Strategy for Defense Base Act Insurance, Report to Congress in Response to Section 843 of the National Defense Authorization Act for Fiscal Year 2009, Washington, DC, September 2009. Hereafter cited as DOD, *Report to Congress*, 2009.

<sup>16</sup> 33 U.S.C. §§ 901-950.

<sup>17</sup> For example, a covered worker is entitled to receive benefits for a maximum of 312 weeks if he or she loses an arm (continued...)

## DBA Eligibility

Section 1 of the DBA applies the basic workers' compensation protections and benefits of the LHWCA to the following four categories of private-sector employees working as federal contractors:

- employees who work on U.S. military, air or naval bases outside of the United States, including bases located in U.S. territories;
- employees who work on public works projects outside of the United States under contract to any federal agency;
- employees who work outside of the United States on projects funded by the federal government under the provisions of the Mutual Security Act of 1954 that provide for the sale of military equipment or services to American allies;<sup>18</sup> or
- employees who work for American firms providing morale, welfare, or similar services to the armed forces outside of the United States.

Work performed under a grant from the federal government is not covered by the DBA.<sup>19</sup>

## DBA Insurance

The DBA is a privatized workers' compensation insurance program. Benefits are not paid by the federal government but rather are the responsibility of a covered worker's employer. Employers subject to the DBA can purchase insurance from a private provider approved by the DOL or, with the permission of DOL, self-insure. Firms that fail to provide compensation for their injured employees covered by the DBA can be subject to criminal prosecution and the firm and its officers can be subject to civil suits brought by the injured workers.

## Insurance Through Private Carriers

Contractors covered by the DBA may purchase workers' compensation insurance from private carriers approved by the DOL. Currently, the major providers of DBA insurance coverage are ACE-USA, American International Group (AIG), and CNA.<sup>20</sup> Of the 55,988 new DBA cases created between September 2001 and the end of December 2009, 54,449, or 97.3% were insured by one of these three companies or their subsidiaries. The largest single insurer of DBA cases

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(...continued)

at the shoulder and 160 weeks if he or she loses an eye. The complete schedule of maximum partial disability benefits is provided in law at 33 U.S.C. § 908(c).

<sup>18</sup> The Mutual Security Act of 1954 was replaced by the Foreign Assistance Act, codified at 22 U.S.C. § 2151 et seq., in 1961. For additional information on the Foreign Assistance Act, see CRS Report RL34243, *Foreign Aid Reform: Issues for Congress and Policy Options*, by Susan B. Epstein and Connie Veillette.

<sup>19</sup> The U.S. Court of Appeals for the Second Circuit held in *University of Rochester v. Hartman*, 618 F. 2d. (2<sup>nd</sup> Cir. 1980), that an employee injured in Antarctica while working on a scholarly research project funded through a grant from the National Science Foundation was not covered by the DBA. The DOL has adopted a position, which it claims is consistent with this decision, that work done pursuant to a federal grant is not covered by the DBA.

<sup>20</sup> Department of Labor, *Defense Base Act: Workers' Compensation for Employees of U.S. Government Contractors Working Overseas*, page 2, <http://www.dol.gov/owcp/dlhwc/ExplainingDBA.pdf>. A complete list of authorized DBA carriers is available on the website of DOL at <http://www.dol.gov/esa/owcp/dlhwc/lscarrier.htm>.

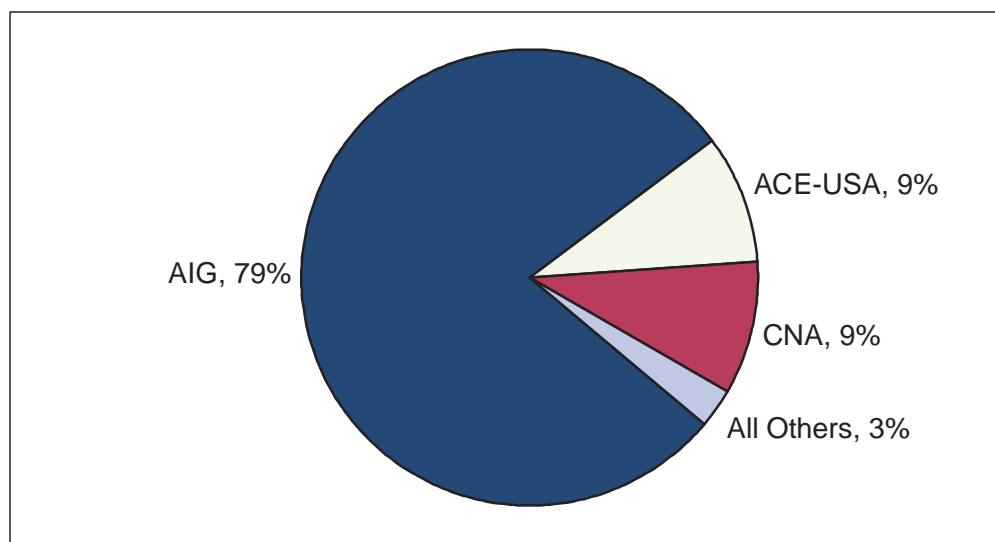
during this period was the Insurance Company of the State of Pennsylvania, an AIG company that insured 43,901 DBA cases.<sup>21</sup> **Figure 1** provides a breakdown of all DBA cases from September 2001 to the end of December 2009 by insurer.

## Self-Insurance

Insurance prices can be quite variable, moving between “hard market” periods with higher premiums and difficulties for consumers finding insurance and “soft market” periods with low premiums and relatively easy availability. Particularly when faced with high premiums, some insurance consumers choose not to purchase insurance from an insurance company but instead choose to “self-insure.” Self-insurance is a very broad term, possibly covering any situation in which an entity chooses to retain a risk rather than purchasing insurance. Self-insurers can cover a spectrum from (1) entities who essentially ignore a risk and take few, if any, steps to financially prepare for a loss; to (2) entities who consider and evaluate risks, while perhaps setting up some sort of savings or reserve accounts to pay for future losses; to (3) entities who set up a legally licensed insurance company, known generally as a captive insurer, to whom actuarially determined premiums are paid but ownership of the insurer is retained by the insured, so both profits and risks are also retained by the insured.

**Figure 1. Defense Base Act Cases by Insurance Carrier**

September 1, 2001 through December 31, 2009



**Source:** Congressional Research Service (CRS) figure. Data taken from Department of Labor, *Defense Base Act Case Summary by Carrier*, <http://www.dol.gov/owcp/dlhwc/dbaallcarrier.htm>.

**Notes:** The DOL collects and reports data by the company name on the issued insurance policies, and not by the more common corporate names. Information from the DOL Office of Congressional and Intergovernmental Affairs and AIG was used by the Congressional Research Service (CRS) to categorize this data by corporate

<sup>21</sup> Department of Labor, *Defense Base Act Case Summary by Carrier*, <http://www.dol.gov/owcp/dlhwc/dbaallcarrier.htm>. The DOL collects data by the company name on the issued insurance policies, and not by the more common corporate names. Information from the DOL Office of Congressional and Intergovernmental Affairs and AIG was used by the Congressional Research Service (CRS) to categorize this data by corporate names.

names. “All Others” category includes cases for which the insurance carrier information is pending or not available and cases in which the employer was uninsured.

Because the DBA mandates workers’ compensation insurance for federal contractors overseas, the first self-insurance option, essentially ignoring the risk, is generally not an option. Under the DBA, however, employers do have the option to self-insure if they meet certain financial criteria and are approved to do so by DOL.<sup>22</sup> Under the federal regulations, self-insurers are not required to go so far as to set up captive insurers in order to self-insure. Nearly 170 employers are listed by DOL as authorized self-insurers.<sup>23</sup> Firms may also self-insure under most state workers’ compensation laws, and according to the Self-Insurance Institute of America, more than 6,000 corporations and their subsidiaries self-insure their workers’ compensation risks.<sup>24</sup> Many self-insurers still purchase some form of insurance, typically a “catastrophic” policy that would take effect if extraordinarily high losses occurred, and federal rules actually require such a policy. Many self-insurers also hire third-party administrators, who undertake much of the administrative burden of dealing with claims but without assuming any of the financial risk.

Choosing to self-insure is a decision taken on a wide variety of business grounds. In general, those self-insuring are seeking to reduce insurance costs and ensure the availability of insurance. Self-insurance can reduce costs through three primary mechanisms. First, any profits that would have flowed to the insurer could be captured by the self-insurer; second, the self-insurer may be able to save on administrative costs, either by undertaking the administration in-house or finding a more efficient third-party administrator; and third, if the self-insurer is a relatively low-risk, its costs would be lower if it were not pooled with other, higher risk parties.

## **DBA Waivers**

The Secretary of Labor may, at the request of a federal agency, grant a waiver that exempts a firm from the DBA if the firm can demonstrate that an alternative workers’ compensation system that provides benefits in the case of disability or death is in place to cover the firm’s employees. DBA waivers do not apply to American citizens or nationals or to persons hired within the United States.

## **DBA Benefits for Foreign Nationals**

The DBA covers all eligible federal contractors, including non-U.S. citizens and foreign nationals. Foreign nationals receive the same DBA benefits as U.S. citizens or nationals with two exceptions. First, benefits for the survivors of a foreign national who was not a resident of the United States or Canada are only available to the worker’s surviving spouse and children or, if there is no spouse or children, the worker’s surviving father or mother, provided that the worker supported the father or mother for at least one year before the worker’s death. The eligibility for survivors benefits for foreign nationals is more limited than that for American citizens and

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<sup>22</sup> The DOL’s Procedure Manual outlining the authorization of self-insurers is available on the website of the DOL at <http://www.dol.gov/owcp/dlhwc/lspm/lspm7-400.htm>. The full regulations for self-insurers can be found at 20 CFR §§ 703.301-703.313.

<sup>23</sup> See the website of the DOL at <http://www.dol.gov/owcp/dlhwc/lscarrier.htm>.

<sup>24</sup> Self-Insurance Institute of America, *Workers’ Compensation Programs*, <http://www.siaa.org/i4a/pages/index.cfm?pageId=3284>.

nationals. Survivors benefits in the case of the death of an American citizen or national can be paid to the worker's spouse, children, siblings, parents, grandparents, or grandchildren.

Second, permanent disability benefits or survivors benefits payable for foreign nationals who are not residents of the United States or Canada may be commuted from installment payments to a single lump-sum payment equal to one-half of the present value of the future compensation. The decision to commute benefit payments for foreign nationals is made by the Secretary of Labor and can be requested by the insurance carrier responsible for paying benefits.

## **DBA Administration**

The DBA is administered by the DOL, Office of Workers' Compensation Programs (OWCP), Division of Longshore and Harbor Workers' Compensation (DLHWC). DBA claims are processed through one of five LHWCA regional offices, with all claims originating in Iraq and Afghanistan processed through the New York office.<sup>25</sup>

## **Dispute Resolution**

An applicant dissatisfied with the decision made on his or her DBA claim may request a hearing before a DOL Administrative Law Judge (ALJ). The decision of a DOL ALJ can be appealed to the DOL Benefits Review Board, and the decisions of this board may be appealed to the U.S. District Court. In addition to this formal process for adjudicating claims, the DOL has an informal dispute resolution process that seeks to bring the worker and his or her insurer or employer together either over the telephone or in an informal conference to resolve the dispute before an ALJ hearing is required. DOL reports that 8.2% of all DBA cases originating in Iraq or Afghanistan between 2001 and 2005 involved claims disputes.<sup>26</sup>

## **War Hazards Compensation Act**

The War Hazards Compensation Act (WHCA) supplements the DBA by providing a form of reinsurance for injuries and deaths to contractors directly related to military conflict.<sup>27</sup> If an employee's injury or death is caused by a war hazard, the workers' compensation benefits are provided not by the insurer or employer but by the federal government. Under the provisions of the WHCA, an injury or death is considered to have been caused by a war hazard if it occurred during

- a war in which the United States is engaged;
- an armed conflict in which the United States is engaged, whether or not war has been formally declared; or

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<sup>25</sup> DBA claims are processed through the following five LHWCA regional offices: Boston, New York, Houston, Honolulu, and Seattle.

<sup>26</sup> Hallmark testimony, 2008.

<sup>27</sup> 42 U.S.C. § 1701 et seq.



- during a war or armed conflict between military forces of any origin in a country in which a covered employee is working;<sup>28</sup>

and if the injury or death was caused by

- the discharge of any weapon by a hostile force or in combating an attack;
- the action of a hostile force or person, including an insurrection or rebellion against the United States;
- the discharge of any munitions intended for use against a hostile force;
- the collision of vessels in convoy, or the operation of vessels or aircraft without running lights or other aids to navigation;
- the operation of vessels or aircraft in a hostile zone or engaged in war activities.

Generally, an insurance carrier or self-insured employer will first pay DBA benefits to an injured worker or his or her survivors and then seek reimbursement from DOL under the WHCA. Insurers and employers may be reimbursed for benefits paid and itemized and non-itemized administrative costs associated with the claim. Non-itemized administrative costs are capped by regulation at 15% of the total value of the benefits due on a claim.<sup>29</sup> A claim is not reimbursed under the WHCA if the insurance carrier charged an additional premium, referred to as premium loading, to cover the specific war hazard that caused the injury or death.

WHCA benefits are paid out of the Employees' Compensation Fund, which also pays workers' compensation benefits for federal employees under the Federal Employees' Compensation Act (FECA).<sup>30</sup> The WHCA is administered by the DOL OWCP Division of Federal Employees' Compensation (DFEC), and the DFEC makes determinations on whether claims should be paid under the WHCA. While the costs associated with FECA benefits paid out of the Employees' Compensation Fund are charged back to the injured workers' host agencies, WHCA costs paid out of the Employees' Compensation Fund are not charged back to the contracting agency.

WHCA claims make up a relatively small percentage of the total DBA claims that originate in Iraq and Afghanistan. Between September 2001 and June 2009, over 37,000 DBA claims had been filed for cases originating in Iraq and Afghanistan.<sup>31</sup> However, since 2003 when combat operations in Iraq began and June 2009, 823 WHCA claims had been filed, 781 for cases from Iraq and 42 for cases from Afghanistan. Thus, even in two military operations in which the United States is fighting insurgent enemy forces without clearly established front lines and in which contractors are playing significant roles, WHCA claims make up just over 2% of all DBA claims filed. Among the WHCA cases that have been paid since 2003, a total of \$12.1 million has gone

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<sup>28</sup> For the purposes of the WHCA, a covered employee includes any person covered under the DBA, any person working outside of the United States under a personal services contract with the federal government, and any person working as a civilian employee paid by non-appropriated funds under the jurisdiction of the Department of Defense, such as an employee of a military post exchange or officer's club.

<sup>29</sup> 20 C.F.R. § 61.104.

<sup>30</sup> The Federal Employees' Compensation Act (FECA) is codified at 5 U.S.C. § 8101 et seq.

<sup>31</sup> Department of Labor, *Defense Base Act Case Summary by Nation*, <http://www.dol.gov/owcp/dlhwc/dbaallnation.htm>.



for compensation and benefits, whereas \$19.7 million has gone to reimburse insurers for itemized and non-itemized expenses associated with these claims.<sup>32</sup>

## **Selection of Defense Base Act Providers**

Although many federal agencies have had or currently have overseas contracts subject to the DBA, the Departments of State (DOS) and Defense (DOD) and the U.S. Agency for International Development (USAID) are the major DBA contractors operating in Iraq and Afghanistan. These agencies take different approaches to contracting for insurance services under the DBA. DOS and USAID have awarded competitive contracts through the use of blanket contracts, with fixed rates, to a single provider for each agency. In contrast, under the DOD approach private contractors negotiate individually with private insurers. Over time, evidence has shown that rates for DBA insurance charged to DOD have been significantly higher than DBA insurance rates for DOS and USAID.<sup>33</sup>

### **Department of State and the U.S. Agency for International Development**

Before 1990, DOS required contractors to obtain DBA insurance independently, resulting in a variety of rates on the basis of company size, claims history, and work site. This arrangement proved particularly onerous for small businesses with limited overseas experience. Such companies found it difficult to obtain insurance, and when insurance was possible, they paid significantly higher premiums. However, a DOS Inspector General (IG) found that costs could be reduced through the use of a blanket contract to a single provider. In 1991, DOS competitively awarded a multi-year contract to CIGNA Property and Casualty Insurance Company. As a result, in 2000 DOS conducted a competition for a follow-on, multi-year contract. Four companies competed: CIGNA, AIU, Ace International, and CNA. CNA was competitively awarded the DOS contract in 2001 and has held the contract since that time. DOS issued a formal notice in April 2008 of its intent to solicit bids for a permanent contract for DBA insurance.<sup>34</sup> In the most recent competitions for DBA insurance contracts, both the DOS and USAID received only single bids from CNA's Continental Casualty Company.<sup>35</sup>

### **Department of Defense**

DOD, with the exception of contracts issued by the U.S. Army Corps of Engineers (USACE) and the Joint Contracting Command-Iraq/Afghanistan (JCC-IA), permits its overseas contractors to purchase DBA insurance from any insurance company approved by DOL. Currently, DOD

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<sup>32</sup> Data provided by Department of Labor, Office of Congressional and Intergovernmental Affairs.

<sup>33</sup> U.S. Congress, House Committee on Oversight and Government Reform, *Defense Base Act Insurance: Are Taxpayers Paying Too Much?*, 110<sup>th</sup> Cong., 2<sup>nd</sup> sess., March 15, 2008; statement of John K. Needham, Director, Acquisition and Sourcing Management Issues, Government Accountability Office.

<sup>34</sup> U.S. Congress, House Committee on Oversight and Government Reform, *Defense Base Act Insurance: Are Taxpayers Paying Too Much?*, 110<sup>th</sup> Cong., 2<sup>nd</sup> sess., March 15, 2008; statement of William Moser, Deputy Assistant Secretary of State for Logistics Management, Department of State.

<sup>35</sup> DOD, *Report to Congress*, 2009.

contractors pay over 76% of their DBA insurance premiums to AIG. CNA's Continental Casualty Company, through its single provider contract for USACE and JCC-IA claims receives nearly 14% of DOD insurance premiums while ACE USA receives over 6% of DOD premiums.<sup>36</sup>

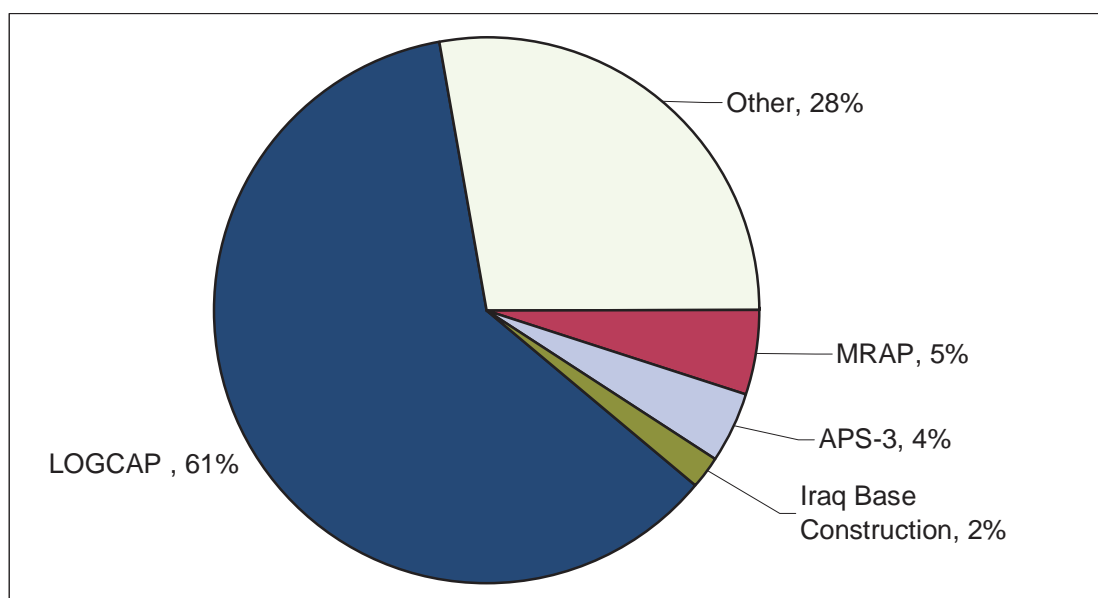
## DOD Insured Activities

Contracts issued by the Department of the Army are responsible for 69% of DOD's DBA insurance premiums. The Department of the Navy contracts account for 23% of premiums while the Department of the Air Force contracts are responsible for 5% of premiums.<sup>37</sup>

Activities in Iraq and Afghanistan account for 88% of DOD's DBA insurance premiums. A total of 61% of DOD's premiums are paid to insure activities under the Department of the Army's Logistics Civil Augmentation Program (LOGCAP) contract with KBR and KBR contracts account for the largest share of DOD premiums.<sup>38</sup> **Figure 2** and **Figure 3** provide break-downs of DOD DBA insurance premiums by primary program and contractor.

**Figure 2. Department of Defense's Defense Base Act Premiums Paid, by Program**

For policy periods ending after October 31, 2008



**Source:** Department of Defense, Office of the Deputy Under Secretary of Defense Acquisition and Technology, Acquisition Strategy for Defense Base Act Insurance, Report to Congress in Response to Section 843 of the National Defense Authorization Act for Fiscal Year 2009, Washington, DC, September 2009, p. 30.

**Notes:** APS-3: Army-Prepositioned Stock program; MRAP: Mine Resistant Ambush Protected vehicle program; LOGCAP: Army Logistics Civil Augmentation program.

<sup>36</sup> *Id.*, pp. 28-29. Data are for policy periods ending after October 31, 2008.

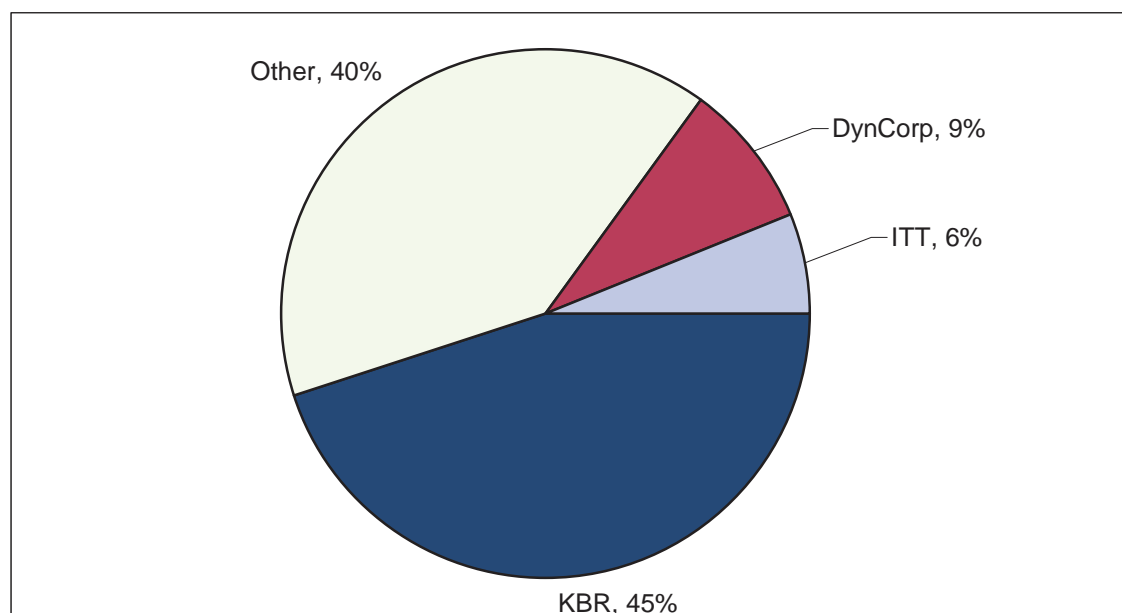
<sup>37</sup> *Id.*, p. 29. Data are for policy periods ending after October 31, 2008.

<sup>38</sup> *Id.*, p. 30. Data is for policy periods ending after October 31, 2008.

## U.S. Army Corps of Engineers Pilot Program

Shortly after the 2005 GAO report, DOD began working closely with the USACE to conduct a competition to award a contract for a pilot DBA project based on the DBA programs already in place at DOS and USAID. CNA was the only company to submit a proposal and was awarded the contract. The contract was awarded in November 2005 and coverage began in December 2005 with coverage extending through March 2008. DOD's report to Congress discussed the early results under the USACE pilot program. After the first six months of the pilot program, USACE reported that estimated savings to the federal government on DBA insurance costs already had exceeded more than \$19 million.<sup>39</sup> On the basis of these results, the pilot program was extended through September 2008.

**Figure 3. Department of Defense's Defense Base Act Premiums Paid, by Contractor**  
For policy periods ending after October 31, 2008



**Source:** Department of Defense, Office of the Deputy Under Secretary of Defense Acquisition and Technology, Acquisition Strategy for Defense Base Act Insurance, Report to Congress in Response to Section 843 of the National Defense Authorization Act for Fiscal Year 2009, Washington, DC, September 2009, p. 31.

A new contract for DBA insurance coverage of USACE contracts was awarded to the sole bidder, CNA's Continental Casualty Company, in October 2008. This new USACE contract also covers DOD contracts issued by the JCC-IA.<sup>40</sup>

At the May 15, 2008, hearing of the House Committee on Oversight and Government Reform on the DBA, Richard Ginman of the Office of the Deputy Undersecretary of Defense for Acquisition, Technology and Logistics, projected that continued success with the USACE pilot program would, in all likelihood, make it a permanent DOD program stating:

<sup>39</sup> DOD, *Report to Congress*, 2009, p. 5.

<sup>40</sup> DOD, *Report to Congress*, 2009, p. 7.

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 request (through the Deputy Assistant Secretary of the Army, Policy and Procurement) 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.<sup>41</sup>

## Costs to the Federal Government

Although the DBA requires that federal contractors working overseas either purchase workers' compensation insurance for their employees or self-insure, the costs of this insurance is usually passed along to the federal government as a cost item in the contract. If the agency is purchasing services under a cost-plus contract, the contractor receives a set percentage of the total cost of all items, including DBA insurance, billed to the federal government. In cost-plus contracts, the contractor's fees rise with contract costs. There is no financial incentive for the contractor to limit the government's costs.

## DBA Premiums Under Single Insurer Programs

It is possible to compare the costs of DBA insurance purchased through the USACE pilot program with the costs of DBA insurance paid by DOS and USAID contractors as all three agencies use single insurer programs. In the competitions for their most recent DBA contracts, each of the three agencies received only one bid, from CNA's Continental Casualty Company.<sup>42</sup> Currently, USAID contractors pay the lowest DBA insurance premiums for services, construction, and security. The highest premiums are paid by all agencies for aviation-related activities. **Table 5** Error! Reference source not found., below, provides current DBA insurance premiums for contractors in the USACE pilot program, DOS, and USAID.

## Comparison of DBA Insurance Premiums Paid by DOD and USACE

The competitive market for DBA insurance for non-USACE DOD contracts results in lower premiums than are paid by USACE under its single insurer system. For all types of contracts in all global locations, the weighted average premium for competitive market DOD contracts is currently \$5.30 per \$100 in covered payroll, versus \$8.32 for single insurer system USACE contracts. **Figure 4** compares the weighted average premiums under the DOD competitive market and USACE single insurer systems. DOD competitive market contracts have a wider variance than those under the USACE system, with the cheapest DOD premium at \$0.09 per \$100 as

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<sup>41</sup> U.S. Congress, House Committee on Oversight and Government Reform, *Defense Base Act Insurance: Are Taxpayers Paying Too Much?*, 110<sup>th</sup> Cong., 2<sup>nd</sup> sess., March 15, 2008; statement of Richard Ginman, Deputy Director for Defense Procurement and Acquisition Policy, Office of the Deputy Under Secretary of Defense for Acquisition, Technology and Logistics.

<sup>42</sup> DOD, *Report to Congress*, 2009, p. 7.

opposed to \$3.50 under the USACE system and the most expensive DOD premium at \$40, double the highest USACE premium of \$20.<sup>43</sup>

Premiums under both systems are higher in Iraq and Afghanistan than in other locations. The weighted average DOD premium in Iraq and Afghanistan is \$5.64 per \$100, while the USACE premium is \$8.64. In areas other than Iraq and Afghanistan, average premiums are lower and DOD’s competitive market premiums remain less expensive than those paid under the USACE single insurer system.<sup>44</sup>

**Table 5. Current DBA Insurance Premiums for the U.S. Army Corps of Engineers, Department of State, and U.S. Agency for International Development**

	USACE	DOS	USAID
	October 1, 2008	July 22, 2009	May 30, 2009
<i>Effective date of contract</i>			
<i>Insurance carrier</i>	CNA	CNA	CNA
<b>Labor Category</b>	<b>Premium (\$) per \$100 in Covered Payroll</b>		
Services	4.00	3.60	3.25
Construction	7.50	4.95	4.50
Security	12.50	N/A	N/A
Security without aviation exposure in Global War on Terrorism-designated areas	N/A	9.45	N/A
Security and aviation	N/A	N/A	9.00
Aviation with exposure in Global War on Terrorism-designated areas	N/A	18.00	N/A
Aviation	20.00	N/A	N/A

**Source:** Department of Defense, Office of the Deputy Under Secretary of Defense Acquisition and Technology, *Acquisition Strategy for Defense Base Act Insurance*, Report to Congress in Response to Section 843 of the National Defense Authorization Act for Fiscal Year 2009, Washington, DC, September 2009, p. 7.

## DBA Costs Associated with the Department of the Army’s Logistics Civil Augmentation Program Contract

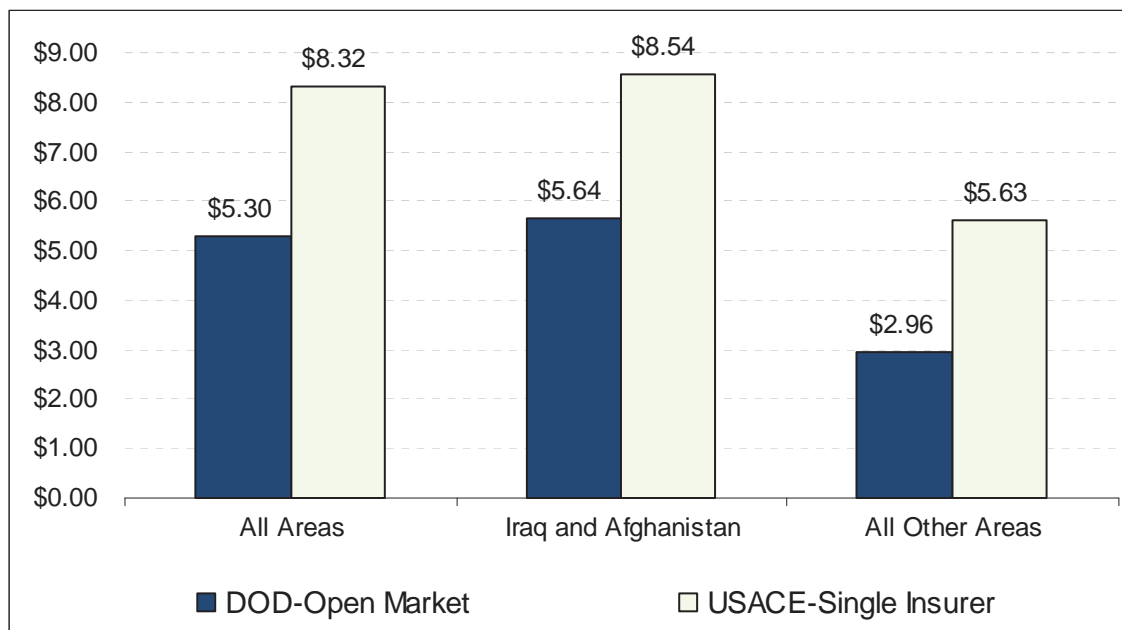
The Logistics Civil Augmentation Program (LOGCAP) was established by the Department of the Army on December 6, 1985, with the publication of Army Regulation 700-137. LOGCAP is an initiative to manage the use of civilian contractors who perform services in support of DOD

<sup>43</sup> *Id.*, p. 32.

<sup>44</sup> *Id.*, pp. 33-36.

missions during times of war and other military mobilizations.<sup>45</sup> LOGCAP contracts are intended to augment combat support and combat service support to military forces.<sup>46</sup>

**Figure 4. Average Current Defense Base Act Premiums, by Agency and Location**



**Source:** Department of Defense, Office of the Deputy Under Secretary of Defense Acquisition and Technology, Acquisition Strategy for Defense Base Act Insurance, Report to Congress in Response to Section 843 of the National Defense Authorization Act for Fiscal Year 2009, Washington, DC, September 2009, pp. 32-36.

**Notes:** Premiums are weighted by the size, in amount of payroll, of each contract.

Although the LOGCAP program began in 1985, the program has been the subject of intense scrutiny since the start of OIF. The LOGCAP troop support contract in Iraq has been the subject of several congressional hearings. The contract is the largest single contract for combat operations in Iraq to date. Policymakers continue to express concern over the reported lack of oversight of LOGCAP contracts in Iraq for several reasons, including the expense and difficulty of managing large-scale logistical support contracts; allegations and reported instances of contract waste, fraud, abuse, and financial mismanagement; and questions regarding DOD's ability and capacity to manage such contracts.<sup>47</sup> Congressional concerns over the DBA insurance program have been driven, in part, by the lack of transparency and oversight of the overall costs incurred under the LOGCAP program.

<sup>45</sup> For a detailed discussion of the origin, background, and current issues with the Department of the Army's LOGCAP program, see CRS Report RL33834, *Defense Logistical Support Contracts in Iraq and Afghanistan: Issues for Congress*, by Valerie Bailey Grasso.

<sup>46</sup> Prior to OIF, LOGCAP contracts have been awarded for work in Rwanda, Haiti, Saudi Arabia, Kosovo, Ecuador, Qatar, Italy, southeastern Europe, Bosnia, and South Korea. Under LOGCAP, private sector contractors are used to provide a broad range of logistical and other support services to U.S. and allied forces during combat, peacekeeping, humanitarian and training operations.

<sup>47</sup> See the Special Inspector General for Iraq Reconstruction, *Quarterly Report to Congress*, April 30, 2008.



Recent assessments from the GAO, DOD's Inspector General (IG), and the SIGIR reveal a lack of federal oversight, management, and accountability for funds spent for Iraq contracting. An audit conducted by the DOD IG revealed that the federal government failed to substantiate the disbursement of at least \$7.8 billion of \$8.2 billion spent for goods and services in Iraq. In a May 22, 2008, congressional hearing before the House Oversight and Government Reform Committee, DOD officials revealed estimates that the Army disbursed \$1.4 billion in commercial payments that lacked the minimum supporting justification and documentation for a valid payment, such as certified vouchers and invoices. In one reported instance, a \$320 million payment in cash was made without justification beyond a signature.<sup>48</sup>

### **U.S. Army Audit Agency Report on DBA Insurance under LOGCAP**

In early 2007, an audit of the DBA program was initiated by the U.S. Army Audit Agency (USAAA) due to several factors, including the growing complexity of the DBA program, rising program costs, wide fluctuations in insurance rates, and the federal government's efforts to reduce and avoid future program costs. In September 2007, the USAAA released its audit report.<sup>49</sup>

Army auditors found that KBR, the LOGCAP contractor, paid approximately \$284.3 million in DBA premiums during the period from FY2003 through FY2005. These premiums rose steadily each fiscal year from approximately \$4.7 million in FY2003 to approximately \$164.7 million in FY2005.<sup>50</sup> As a result of these premiums, the auditors concluded that DBA insurance represented a "significant and recently increasing cost element" of the overall LOGCAP contract.<sup>51</sup>

USAAA found that whereas total LOGCAP DBA costs rose between FY2003 and FY2005, DBA premiums for Iraq and Kuwait as a percentage of total payroll increased from FY2003 to FY2004 and then declined in FY2005 and FY2006. The audit also found that these rate fluctuations appeared inconsistent with the risks associated with providing DBA insurance for this contract. In addition, the audit found that the LOGCAP contractor reported accident rates that were lower than the U.S. private industry average yet it was paying higher than industry-average worker's compensation premiums. **Table 6** provides the LOGCAP DBA premiums for Iraq and Kuwait for the period between FY2002 and FY2006.

Army auditors found that the Department of the Army paid "substantially" more in DBA premiums than was expected to be paid out in DBA claims. The auditors found that while \$284.3 million in DBA premiums were paid under the LOGCAP contract between FY2003 and FY2005, just under 26% of these premiums went to pay the \$73.1 million in DBA claims and potential

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<sup>48</sup> U.S. Congress, House Committee on Oversight and Government Reform, *Accountability Lapses in Multiple Funds for Iraq*, 110<sup>th</sup> Cong., 2<sup>nd</sup> sess., May 22, 2008; statement of Mary L. Ugone, Deputy Inspector General for Audit, Department of Defense.

<sup>49</sup> The USAAA does not publicly release its audit reports. However, the House Committee on Oversight and Government Reform has posted a copy of this report, *Audit of Defense Base Insurance for the Logistics Civil Augmentation Program, Audit of Logistics Civil Augmentation Program Operations in Support of Operation Iraqi Freedom*, on its website at <http://oversight.house.gov/documents/20080515102103.pdf>.

<sup>50</sup> During the period covered by the USAAA audit and this report, KBR was the exclusive LOGCAP contractor under a contract referred to as LOGCAP III. On April 17, 2008 the Department of the Army announced that it was awarded its latest LOGCAP contract, known as LOGCAP IV, to KBR, DynCorp International, and Fluor Corporation.

<sup>51</sup> U.S. Army Audit Agency, *Audit of Defense Base Insurance for the Logistics Civil Augmentation Program, Audit of Logistics Civil Augmentation Program Operations in Support of Operation Iraqi Freedom*, Audit Report A-2007-0204-ALL, September 28, 2007, p. 5. Hereafter cited as USAAA, *Audit of Defense Base Insurance*.



future claims arising from cases during this period.<sup>52</sup> **Table 7** provides data on LOGCAP DBA premiums and potential claims for the period between FY2003 and FY2005.

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<sup>52</sup> *Id.*, p. 8.

**Table 6. Defense Base Act Premiums for the Logistics Civil Augmentation Program Contract in Iraq and Kuwait, FY2002 to FY2006**

Fiscal Year	Premium (rate per \$100 in salary)	Percentage Change in Premium from Previous Fiscal Year
2002	3.75	NA
2003	3.75	0.0%
2004	16.20	332.0%
2005	13.80	(14.8%)
2006	8.50	(38.4%)

**Source:** U.S. Army Audit Agency, *Audit of Defense Base Insurance for the Logistics Civil Augmentation Program, Audit of Logistics Civil Augmentation Program Operations in Support of Operation Iraqi Freedom*, Audit Report A-2007-0204-ALL, September 28, 2007, p. 5.

**Notes:** Parentheses indicate a decrease from the previous fiscal year. Data does not include subcontractors.

One explanation offered by the USAAA for what it deemed as these “excessive” premiums was the practice of basing DBA premiums on total payroll costs, including costs such as overtime pay and hazard pay while basing DBA benefit amounts, usually two-thirds of pre-injury wages, only on base pay.<sup>53</sup>

**Table 7. Defense Base Act Premiums and Claims for the Logistics Civil Augmentation Program Contract in Iraq and Kuwait, FY2003 to FY2005**

Fiscal Year	Premiums Paid (\$)	Potential Claims (\$)	Potential Claims as Percentage of Premiums Paid (%)
2003	4,671,775	9,882,515	211.5
2004	114,992,588	25,329,820	22.0
2005	164,657,004	37,905,929	23.0
<i>Total</i>	<i>284,321,367</i>	<i>73,118,264</i>	<i>25.7</i>

**Source:** U.S. Army Audit Agency, *Audit of Defense Base Insurance for the Logistics Civil Augmentation Program, Audit of Logistics Civil Augmentation Program Operations in Support of Operation Iraqi Freedom*, Audit Report A-2007-0204-ALL, September 28, 2007, p. 8.

**Notes:** Potential claims do not include claims under the War Hazards Compensation Act (WHCA) reimbursed by the federal government.

Auditors found that between January 1, 2003, and September 30, 2005, KBR paid \$23.1 million in premiums on the special incentive payments made to its employees for the hazard pay component of its payroll.<sup>54</sup> In addition, DBA benefits, but not the wages used to calculate DBA

<sup>53</sup> In his testimony before the House Oversight Committee, Joseph Mizzoni of the USAAA characterized the premiums paid by KBR for LOGCAP DBA insurance as “excessive” (U.S. Congress, House Committee on Oversight and Government Reform, *Defense Base Act Insurance: Are Taxpayers Paying Too Much?*, 110<sup>th</sup> Cong., 2<sup>nd</sup> sess., March 15, 2008; statement of Joseph Mizzoni, Deputy Auditor General for Acquisition and Logistics, U.S. Army Audit Agency). In its response to the USAAA audit report, the U.S. Army Sustainment Command stated that KBR, the LOGCAP contractor, does not pay an overtime rate (USAAA, *Audit of Defense Base Act Insurance*, p. Enclosure 5).

<sup>54</sup> USAAA, *Audit of Defense Base Act Insurance*, p. 11.

premiums, are capped, and thus a portion of the total premium is paid on salary above the cap that will not be replaced by DBA disability benefits. Because of this, KBR is essentially paying insurance on payroll that does not need to be insured because it can not, by law, be replaced under the provisions of the DBA.

### **Defense Contract Audit Agency Audit of DBA Insurance Under LOGCAP**

The Defense Contract Audit Agency (DCAA) audited the costs billed to the DOD by KBR for DBA insurance under LOGCAP in 2003. The results of this audit were reported to the Commission on Wartime Contracting in Iraq and Afghanistan at the Commission's May 4, 2009, hearing.<sup>55</sup> At this hearing, DCAA Director April G. Stephenson testified that the DCAA could find no evidence that KBR attempted to use a competitive bidding process to secure DBA insurance or ensure that the rates it paid were competitive. Because of this lack of evidence, DCAA reported that it was unable to determine the reasonableness of the DBA rates paid by KBR in 2003 or subsequent years. In addition the DCAA audit found that KBR was not verifying the actual labor costs of its subcontractors and thus was paying DBA premiums on estimated rather than actual labor costs.

As a result of its audit of KBR's DBA insurance under LOGCAP in 2003, the DCAA recommended to the Department of the Army that, unless KBR can provide some evidence that its purchase of DBA insurance was competitive, that the Department of the Army determine if KBR should be required to reimburse the federal government for some of the DBA insurance costs it billed under LOGCAP in 2003. In addition, DCAA reported that it is currently determining whether or not KBR's use of estimated rather than actual subcontract labor costs makes a reduction in the amount billed by KBR for DBA insurance for its subcontractors necessary.

## **Options for Congress**

Current military operations in Iraq and Afghanistan have brought increased congressional attention to several issues surrounding the DBA. Concerns have been raised over the following issues:

- the overall cost and variability of DBA premiums paid;
- the basis for DBA premiums;
- the costs of the program to the federal government;
- the manner in which contractors select their DBA providers; and
- the coordination of the DBA with the WHCA.

In 2006, Congress enacted language in the Defense Authorization Act that required the DOD to review its DBA procedures and to work with the DOS and USAID to find ways to more effectively provide DBA insurance to overseas military contractors.<sup>56</sup> On May 15, 2008, the

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<sup>55</sup> Commission on Wartime Contracting in Iraq and Afghanistan, *LOGCAP: Support-Contracting Challenges in Iraq and Afghanistan*, May 4, 2009; statement of April G. Stephenson, Director, Defense Contract Audit Agency.

<sup>56</sup> P.L. 109-163.

House Oversight and Government Reform Committee held a hearing on DBA issues that focused on DBA costs involved in the LOGCAP contract as well as the possibility of the DOD adopting a single-source model for DBA insurance similar to what is currently used by DOS, USAID, and USACE as part of its pilot program.<sup>57</sup>

## **P.L. 110-417, the FY2009 National Defense Authorization Act, as an Outline for Possible DBA Reform**

Section 843 of the FY2009 National Defense Authorization Act requires DOD to adopt a department-wide DBA insurance provision that will minimize costs, ensure that premium prices are tied to expected claims, minimize risk to DOD, and provide for a competitive DBA marketplace. Although this legislation does not require DOD to adopt any specific DBA strategy, an earlier version of the bill (H.R. 5658) provision passed by the House provided an outline of several policy options that DOD was required to consider when formulating its overall DBA strategy.<sup>58</sup>

In H.R. 5658, the House-passed version of the bill, Section 850 contains policy options that fall into three broad categories of DBA reform that are similar to those mentioned in reviews of the DBA performed by the GAO, the Congressional Budget Office (CBO), the USAAA, and the House Oversight and Government Reform Committee. The three categories of policy options are

- using a single contracted source, or a limited set of contracted sources, for all DOD DBA contracts, similar to the model used by DOS, USAID, and the USACE pilot program;
- using a rating system to set premiums based on past claims incurred, similar to the experience rating systems used in many private insurance lines; and
- having the federal government self-insure for all DBA costs similar to what is currently done with the workers' compensation for injuries and death related to war hazards under the WHCA and workers' compensation for federal employees under the FECA program.

### **Single-Source Contract for DBA Insurance**

Currently, DOS, USAID, and USACE use single-source contracts to provide DBA insurance for their contractors. Under this model, all agency contractors purchase DBA insurance from a single source selected through a competitive bidding process. This process allows a single insurer to pool the risks of multiple contractors and contracting activities with the goal of using this pooled risk to reduce the premiums paid by all contractors.

Because of the different nature of the contracts issued by DOS, USAID, USACE, and DOD, it is difficult to compare premiums to determine if DOD would experience cost savings from a single-source contract for DBA insurance. Currently, across all geographic areas and activities, DOD pays lower average premiums than does USACE. However, the highest premiums paid by DOD

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<sup>57</sup> *Defense Base Act Insurance: Are Taxpayers Paying Too Much?: Hearing Before the House Committee on Oversight and Government Reform, 110<sup>th</sup> Cong., (2008).*

<sup>58</sup> See Section 850(c) of H.R. 5658, the House-passed version of the bill.

are double those paid under USACE's single-source contract. In addition, both DOS and USAID have lower negotiated premium rates under their single-source contracts than USACE does under its contract.

A report issued by the Majority Staff of the House Oversight and Government Reform Committee found that underwriting gains were significantly higher for major DBA contracts independently negotiated than for the single-source contracts used by DOS and USAID.<sup>59</sup> CBO estimates that adopting a single-source model for all DOD DBA insurance would result in savings of \$33 million in the first year and a 10-year cost savings of \$362 million.<sup>60</sup>

Although there are indications that adoption by DOD of a single-source model for DBA insurance could result in cost savings, the size and complexity of the DOD and its contracts may result in difficulties in that agency adopting the system used by the smaller DOS and USAID. It is not known if a single insurer would be willing or able to take on all of the DOD's DBA business. USAAA reports that only one insurance carrier bid to provide coverage under the LOGCAP contract, and an earlier effort by DOD to find a single carrier for all DBA contracts in Iraq resulted in no carriers placing bids.<sup>61</sup> Similarly, a DOD survey of the four largest DBA insurers found that all opposed a single source contract system and none would bid for such a contract if it were offered by DOD.<sup>62</sup> This problem is not unique to DOD as in their most recent contract solicitations, DOS, USAID, and USACE each only received a single bidder for their DBA insurance.

USACE reports that even with a single source for all DBA insurance under its pilot program, the agency is still required to provide administrative support and bear administrative costs.<sup>63</sup> The CBO concurs with this assessment and notes that although it estimates overall cost savings if DOD were to adopt a single-source model for DBA insurance, these cost estimates do not take into account the costs to DOD involved in setting up and administering the system and that these costs "could greatly diminish savings."<sup>64</sup>

## Experience Rating for DBA Insurance

In its audit of DBA insurance for the LOGCAP contract, USAAA concluded that the premiums being paid by KBR did not reflect either the expected claims to be paid or the risks involved in the covered activities, especially given KBR's relatively low accident rates. USAAA also found that LOGCAP DBA rates were subject to large annual fluctuations and were a major component of the overall cost of the LOGCAP contract. The use of experience ratings, in which current

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<sup>59</sup> House Committee on Oversight and Government Reform, Majority Staff, *Supplemental Information on Defense Base Act Insurance Costs*, Memorandum to Committee Members, May 15, 2008. Available on the website of the House Committee on Oversight and Government Reform at <http://oversight.house.gov/documents/20080515102024.pdf>.

<sup>60</sup> Congressional Budget Office, *Budget Options* (Washington: GPO 2007), p. 35. Hereafter cited as CBO, *Budget Options*.

<sup>61</sup> USAAA, *Audit of Defense Base Act Insurance*, p. 6.

<sup>62</sup> DOD, *Report to Congress*, 2009, p. 41.

<sup>63</sup> U.S. Congress, House Committee on Oversight and Government Reform, *Defense Base Act Insurance: Are Taxpayers Paying Too Much?*, 110<sup>th</sup> Cong., 2<sup>nd</sup> sess., March 15, 2008; statement of James Dalton, Chief of Engineering and Construction, U.S. Army Corps of Engineers.

<sup>64</sup> CBO, *Budget Options*, p. 35.

premiums are based on past claim rates, could bring DBA premiums more into line with the risks faced by DBA contractors.

Experience rating is common in the insurance industry and is a feature of many workers' compensation systems governed by state laws. Under an experience rating system, a base premium can be increased if a customer has a history of claims that indicate a greater risk to the insurer or be lowered if the claims history indicates a reduced insurance risk. The proprietary nature of individual insurance arrangements between contractors and carriers and that neither DOL nor any of the contracting agencies has any authority to regulate DBA claims makes it difficult to assess what factors are currently used to set current DBA premiums.<sup>65</sup>

There may be difficulties in using experience ratings to determine DBA premiums. The fluctuations in the price of premiums charged under the LOGCAP program may indicate difficulties in accurately estimating insurance risk in a war zone. One such difficulty involves the determination of whether a claim should be paid under the DBA or the WHCA. For example, USAAA reports that KBR's insurance broker was concerned with the probability of increased DBA claims due to a plane crash and the current DOS insurance contract allows for higher premiums for security contracts that involve aviation.<sup>66</sup> However, under some circumstances a plane crash would be covered not by the insurer under the DBA but rather by the federal government under the WHCA. In addition, in response to USAAA's audit of the DBA insurance under the LOGCAP contract, the U.S. Army Sustainment Command stated that it "may prove difficult to find insurance carriers who use retrospective rating plans in determining DBA insurance premiums for countries where war risk hazards have been recognized by the DOS."<sup>67</sup>

## **Federal Self-Insurance**

The DBA is a privatized workers' compensation system in which individual contractors either purchase insurance from private carriers or self-insure. However, because the terms of many federal contracts allow the contractors to bill the federal government for the cost of DBA insurance, DBA insurance costs are often ultimately paid by the federal government. One option for DBA insurance reform would be to eliminate the private nature of DBA insurance and have the federal government act as the sole DBA insurer and pay 100% of all DBA administrative and claim costs. Having the federal government self-insure for DBA insurance would be similar to the way workers' compensation insurance is handled for injuries and deaths caused by war hazards under the WHCA and for federal employees under the FECA program.

Under a federal self-insurance system, benefits would likely be paid from a trust fund in a manner similar to the way that FECA and WHCA benefits are paid from the federal Employees Compensation Fund. The federal government could administer the program itself or hire a third-party administrator.

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<sup>65</sup> In an October 2006 report, the SIGIR criticized KBR for its labeling of nearly all of the data on its LOGCAP operations as proprietary and stated that this practice constituted an "abuse" of the Federal Acquisition Regulation (Special Inspector General for Iraq Reconstruction, *Interim Audit Report on Inappropriate Use of Proprietary Data Markings by the Logistics Civil Augmentation Program (LOGCAP) Contractor*, SIGR-06-035, October 26, 2006.

<sup>66</sup> USAAA, *Audit of Defense Base Act Insurance*, p. 7.

<sup>67</sup> *Id.*, p. Enclosure 6.



There are several potential advantages to having the federal government self-insure for DBA hazards. First, rather than paying insurance premiums, the federal government would only be responsible for paying the actual cost of claims and administration. Given that claims make up just over 25% of total costs paid for DBA insurance under the LOGCAP contract, the federal government could potentially see cost savings through self-insurance. In addition, issues involving premium loading and the charging of DBA insurance premiums on non-covered components of payroll such as hazard pay would be eliminated if the federal government self-insured.

Second, the use of the federal government as self-insurer would eliminate the need to distinguish between DBA and WHCA claims, because every claim would be paid by the federal government. There is evidence that the current process, in which the federal government identifies WHCA claims after they have been paid as DBA claims and then reimburses insurers for claim and administrative costs, results in the federal government paying significant amounts that do not go directly to claimants. Over the past six years under the WHCA, the federal government has paid more in reimbursements to insurers for expenses (\$19.7 million) than it has paid in compensation to claimants (\$12.1 million).

There is also evidence, including testimony provided by DBA and WHCA claimants at a 2009 House Committee on Oversight and Government Reform hearing, that in some cases, claimants with injuries that clearly fall under the statutory requirements of the WHCA must first navigate procedural and other requirements of their contractors' DBA insurers before their cases are eventually transferred to DOL.<sup>68</sup> In some cases, DBA insurers controvert claims or oppose specific benefits for claims that are likely to end up at the DOL under the WHCA. Under the current system, insurers have the right and responsibility to investigate all claims and controvert or oppose claims and benefits they feel are not their responsibility or that fall outside of the DBA. However, this can cause delays for claimants, including claimants with clear WHCA cases that will eventually be paid by the DOL.

Having the federal government self-insure for DBA hazards would change the historic private nature of the DBA program and place the program at odds with the privatized LHWCA program. In addition, federal self-insurance for DBA claims would go against current trends in state workers' compensation programs. Exclusive state funds, in which the state pays all workers' compensation claims, are being replaced either by state funds that compete on the open market with private carriers, or by systems in which all workers' compensation insurance is provided privately.<sup>69</sup>

The DOD, in its 2009 report to Congress on DBA insurance alternatives, stated that a self-insurance system, in which none of the costs of employee-injuries or deaths would be paid by the employer, could result in moral hazard.<sup>70</sup> Contracting firms with no financial stake in the health and safety of their employees may take additional risks or compromise procedures without any

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<sup>68</sup> U.S. Congress, House Committee on Oversight and Government Reform, Subcommittee on Domestic Policy, *After Injury, the Battle Begins: Evaluating Workers' Compensation for Civilian Contractors in War Zones*, 111<sup>th</sup> Cong., 1<sup>st</sup> sess., June 18, 2009.

<sup>69</sup> The DOD, in its 2009 report to Congress, also raised the issue of possible violations of the Antideficiency Act [31 U.S.C. § 1341(a)] under a self-insurance system. For additional information on the Antideficiency Act see CRS Report R40814, *Interagency Contracting: An Overview of Federal Procurement and Appropriations Law*, by Kate M. Manuel and Carol J. Toland.

<sup>70</sup> DOD, *Report to Congress*, 2009, p. 43.



fear of ultimately having to pay, through higher insurance premiums, for the negative consequences of these actions.

## **DOD Analysis of DBA Reform Options**

In September 2009, in response to Section 843 of the NDAA, the DOD reported to Congress the results of its review of various possible acquisition strategies for providing DBA insurance to its contractors.<sup>71</sup> This report used information from industry sources and data from existing DOD DBA activities to evaluate the following four DBA reform alternatives:

- Alternative A: Improvements to the existing open market DBA system;
- Alternative B: A single-source contract for all DOD DBA coverage;
- Alternative C: Limiting DBA insurance to a small number of pre-selected providers; and
- Alternative D: Federal self-insurance with third-party administration.

These four alternatives were evaluated against the following six criteria, based, in part, on criteria provided by Congress in Section 843 of the NDAA.

1. Minimize overhead costs associated with obtaining DBA insurance;
2. Minimize the costs of coverage consistent with realistic assumptions regarding the likelihood of incurred claims by contractors;
3. Provide for a correlation of premiums paid in relation to claims incurred that is modeled on the best practices in government and industry for similar kinds of insurance;
4. Provide for a low level of risk to the DOD;
5. Provide for a competitive marketplace for insurance required by the DBA to the maximum extent practicable; and
6. Consider implementation issues.<sup>72</sup>

The DOD's analysis of the four alternatives evaluated against the six criteria resulted in the highest rankings for Alternative A: improvements to the existing open-market DBA system; and Alternative D: federal self-insurance with third-party administration. Specifically, improving the existing open-market system was predicted to best minimize overhead and coverage costs; provide the best correlation of premiums paid to claims incurred; and provided the lowest risk to DOD. Federal self-insurance with third-party administration was predicted to best provide for a competitive marketplace and be the easiest to implement.<sup>73</sup>

Although the DOD's analysis of four major policy alternatives is comprehensive, there are limitations to its utility as a guide for Congress in making changes to the overall DBA system.

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<sup>71</sup> DOD, *Report to Congress*, 2009.

<sup>72</sup> *Id.*, p. 45. Criteria 1 through 5 were provided by Section 843 of the NDAA while Criterion 6 was provided by the DOD.

<sup>73</sup> *Id.*, p. 49.

The DOD report only focuses on DOD contractors and while these make up the bulk of DBA-covered firms, other contracting agencies, such as DOS and USAID may have different experiences and issues than DOD and DOD's recommended policy changes may not be as successful if applied across the entire federal government.

Two of the six criteria used to evaluate the four alternatives also serve to limit the utility of the DOD analysis. Congress required DOD to consider the how each alternative provided for a competitive DBA marketplace. This requirement may have biased the study against policy options, such as self-insurance or single or limited-source contracts for DBA insurance which, by definition, do not support a competitive marketplace but which may still be viable policy options for Congress to consider.

In its analysis, DOD added an additional criteria based on the ease of policy implementation. Evaluations of alternatives against this criterion were based, in part, on how quickly policy changes could be made and whether or not federal laws or regulations would need to be changed. It is understandable that DOD would consider this criterion necessary, given the time and cooperation within the executive branch and with the Congress that regulatory and statutory changes would require. However, when looking at alternatives for making changes to the national DBA program, Congress may not want to limit itself to alternatives that provide for easy implementation.

### **Improvements to the Current Open-Market DBA System**

The DOD report identified making improvements to the existing open-market DBA system as one of the preferred alternatives. Specifically, the DOD report suggests four improvements to the current DBA insurance system.<sup>74</sup> First, all approved DBA carriers should have access to comprehensive data on losses and costs. In its discussions with industry representatives, the DOD found that some carriers felt that they were at a competitive disadvantage without this data as more than 75% of the DOD DBA market is covered by a single carrier, AIG.<sup>75</sup> In addition, unlike in conventional workers' compensation insurance, there is no national clearinghouse, such as the National Council on Compensation Insurance (NCCI), for loss and cost data.

Second, the DOL should be given the authority to establish a program of assigned risk pools for the DBA program and require that large insurers provide coverage to pool members. An assigned risk pool would assure that small contractors, those that are high-insurance risks, or contractors otherwise unable to secure DBA insurance would be covered at reasonable rates and that all major DBA insurance carriers would share the risks of providing insurance to these contractors.

The DOD also recommends requiring that insurance carriers separate out the pricing of DBA insurance from other types of insurance, such as accidental death and dismemberment and ransom insurance. In addition, the DOD recommends establishing a single DOD contact for issues relating to country-waivers under the DBA program.

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<sup>74</sup> DOD, *Report to Congress*, 2009, pp. 54-56.

<sup>75</sup> *Id.*, pp. 29, 54, and 55.

## **Appendix. List of Acronyms**

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AIG:	American International Group
ALJ:	Administrative Law Judge
APS-3:	Army-Prepositioned Stock Program
CBO:	Congressional Budget Office
CFR:	Code of Federal Regulations
CPA-IG:	Inspector General for the Coalition Provisional Authority
CRS:	Congressional Research Service
DBA:	Defense Base Act
DCAA:	Defense Contract Audit Agency
DFEC:	Division of Federal Employees' Compensation, Department of Labor
DLHWC:	Division of Longshore and Harbor Workers' Compensation, Department of Labor
DOD:	Department of Defense
DOL:	Department of Labor
DOS:	Department of State
FECA:	Federal Employees' Compensation Act
GAO:	Government Accountability Office
IG:	Inspector General
JCC-IA:	Joint Contracting Command-Iraq/Afghanistan
LOGCAP:	Logistics Civil Augmentation Program
LHWCA:	Longshore and Harbor Workers' Compensation Act
MRAP:	Mine Resistant Ambush Protected Vehicle Program
NCCI:	National Council on Compensation Insurance
OIF:	Operation Iraqi Freedom
OWCP:	Office of Workers' Compensation Programs, Department of Labor
SIGIR:	Special Inspector General for Iraq Reconstruction
USAAA:	U.S. Army Audit Agency
USACE:	U.S. Army Corps of Engineers
USAID:	U.S. Agency for International Development
USO:	United Service Organizations
WHCA:	War Hazards Compensation Act

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