

# CRS Report for Congress

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

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

## 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, and in 2007 over \$170 million in cash and medical benefits were paid to nearly 12,000 DBA claimants who were injured or killed while working under contract to the federal government.

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 a single-source model 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.

The Duncan Hunter National Defense Authorization Act (NDAA) for FY2009 (S. 3001, P.L. 110-417) includes a provision that requires DOD to change the way its contractors provide DBA coverage for their workers. In addition, the House Committee on Oversight and Government Reform held hearings in 2008 on the DBA. Current DOD DBA policies have also been criticized by the Government Accountability Office (GAO) and the Army's own auditors. It is expected that cost issues associated with the DBA will continue to be the subject of congressional attention for the remainder of the 110<sup>th</sup> Congress and beyond.

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. This report will be updated to reflect any legislative changes.

A list of acronyms used in this report is provided in the Appendix.

# Contents

Workers' Compensation in the United States .....	1
Federal Workers' Compensation .....	2
The Defense Base Act (DBA) .....	3
Legislative History .....	4
Major New Developments .....	5
Basic Provisions of the Defense Base Act (DBA) .....	5
DBA Eligibility .....	6
DBA Insurance .....	7
Insurance Through Private Carriers .....	7
Self-Insurance .....	7
DBA Waivers .....	8
DBA Benefits for Foreign Nationals .....	8
DBA Administration .....	9
Dispute Resolution .....	9
War Hazards Compensation Act (WHCA) .....	9
Selection of Defense Base Act (DBA) Providers .....	10
Department of State (DOS) and the U.S. Agency for International Development (USAID) .....	11
Department of Defense (DOD) .....	12
Government Accountability Office (GAO) Audit and Review of the DBA Program .....	12
Congressional Response to GAO's Audit of the DBA Program .....	12
DOD's Response to GAO's Audit of the DBA Program .....	13
U.S. Army Corps of Engineers (USACE) Pilot Program .....	13
GAO Re-Examination of the DBA Program .....	14
Costs to the Federal Government .....	14
DBA Costs Associated with the Department of the Army's Logistics Civil Augmentation Program (LOGCAP) Contract .....	15
U.S. Army Audit Agency (USAAA) Report on DBA Insurance under LOGCAP .....	17
Options for Congress .....	19
P.L. 110-417, the FY2009 NDAA, as an Outline for Possible DBA Reform .....	19
Single-Source Contract for DBA Insurance .....	20
Experience Rating for DBA Insurance .....	21
Federal Self-Insurance .....	22
Appendix: List of Acronyms .....	24

## List of Tables

Table 1. Workers' Compensation Coverage, Benefits, and Costs for the United States, 2005 .....	1
Table 2. Total Defense Base Act (DBA) Payments, 1997 to 2007 .....	4
Table 3. DBA Insurance Premiums for the U.S. Army Corps of Engineers (USACE) Pilot Program, the Department of State (DOS), and the U.S. Agency for International Development (USAID), 2008 .....	16
Table 4. Defense Base Act (DBA) Premiums for the Logistics Civil Augmentation Program (LOGCAP) Contract in Iraq and Kuwait, FY2002 to FY2006 .....	18
Table 5. Defense Base Act (DBA) Premiums and Claims for the Logistics Civil Augmentation Program (LOGCAP) Contract in Iraq and Kuwait, FY2003 to FY2005 .....	19

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

## Workers' Compensation in the United States

Over 130 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, 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.

**Table 1. Workers' Compensation Coverage, Benefits, and Costs for the United States, 2005**

Covered workers (in millions)	128.1
Covered wages (in billions of \$)	5,212
Total benefits paid (in billions of \$)	55.3
Medical benefits paid (in billions of \$)	26.2
Cash benefits paid (in billions of \$)	29.1
Employer costs (in billions of \$) <sup>a</sup>	88.8

**Source:** Ishita Sengupta, Virginia Reno, and John F. Burton, Jr., *Workers' Compensation: Benefits, Coverage, and Costs, 2005*, (Washington: National Academy of Social Insurance 2007), p. 2.

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

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<sup>1</sup> Ishita Sengupta, Virginia Reno, and John F. Burton, Jr., *Workers' Compensation: Benefits, Coverage, and Costs, 2005*, (Washington: National Academy of Social Insurance 2007), p. 9. Hereafter cited as Sengupta et al., *Workers' Compensation, 2007*.

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>

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 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. In 2005, state workers' compensation programs paid \$52.1 billion, or 94.2%, of the \$55.3 billion in total cash and medical benefits paid by the workers' compensation system; federal workers' compensation programs paid \$3.2 billion, or 5.8%, of total workers' compensation benefits.<sup>5</sup>

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<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.

<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*, p. 19.

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. 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 (DBA)**

The Defense Base Act (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 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.

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. The number of DBA cases continues to grow with the caseload increasing more than six-fold between 2004 and 2007 and 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. 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

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<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 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.

lost work time.<sup>7</sup> **Table 2**, below, provides an overview of DBA claims paid between 1997 and 2007.

**Table 2. Total Defense Base Act (DBA) Payments, 1997 to 2007**

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

**Source:** *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)*, statement of Shelby Hallmark, Director, Office of Workers' Compensation Programs, Department of Labor.

## 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

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<sup>7</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)*, statement of Shelby Hallmark, Director, Office of Workers' Compensation Programs, Department of Labor. Hereafter cited as Hallmark testimony, 2008.



the types of work covered under the DBA to include service contracts.<sup>8</sup> In 2006, Congress directed the Department of Defense (DOD) to examine ways it could improve its DBA procedures.<sup>9</sup> Legislation passed by the House of Representatives in 2008 would require DOD to establish a single DBA strategy and provides a list of options for DOD to consider when designing this strategy.<sup>10</sup>

## Major New Developments

The Duncan Hunter National Defense Act for FY2009 (P.L. 110-417) was signed into law on October 14, 2008. Section 843 of the act requires DOD to adopt an acquisition strategy that minimizes insurance cost for both DOD as well as DOD contractors. The acquisition strategy must consider the following criteria:

- (1) Minimize overhead costs associated with obtaining such insurance, such as direct or indirect costs for contract management and contract administration;
- (2) Minimize costs for coverage of such insurance consistent with realistic assumptions regarding the likelihood of incurred claims by contractors of the Department;
- (3) Provide for a correlation of premiums paid in relation to claims incurred that is modeled on best practices in government and industry for similar kinds of insurance;
- (4) Provide for a low level of risk to the Department; and
- (5) Provide for a competitive marketplace for insurance required by the Defense Base Act to the maximum extent practicable.<sup>11</sup>

Other provisions of the bill require that DOD consider several options, including entering into a single DBA insurance contract. The Secretary of Defense is required to submit a report to certain congressional committees within 270 days of the bill's enactment (on or about July 14, 2009) including a discussion of each option, and a plan to implement the acquisition strategy within nine months following the report issuance. Additionally, the Secretary of Defense is required to review the acquisition strategy adopted, at least once every three years.

## Basic Provisions of the Defense Base Act (DBA)

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

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<sup>8</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>9</sup> P.L. 109-163.

<sup>10</sup> H.R. 5658. The Senate has not taken any action on this bill.

<sup>11</sup> Section 843, P.L. 110-417.

in longshore, harbor, or other maritime occupations.<sup>12</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>13</sup> Benefits are also paid to survivors of covered workers killed on the job.

## 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>14</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>15</sup>

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<sup>12</sup> 33 U.S.C. §§ 901-950.

<sup>13</sup> For example, a covered worker is entitled to receive benefits for a maximum of 312 weeks if he or she loses an arm 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>14</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>15</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. 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.

## 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>16</sup>

**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.

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>17</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>18</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'

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<sup>16</sup> Department of Labor, *Defense Base Act: Workers' Compensation for Employees of U.S. Government Contractors Working Overseas*, page 2, available on the website of DOL at [<http://www.dol.gov/esa/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>].

<sup>17</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/esa/owcp/dlhwc/lspm/lspm7-400.htm>]. The full regulations for self-insurers can be found at 20 CFR §§ 703.301-703.313.

<sup>18</sup> See the website of the DOL at [<http://www.dol.gov/esa/owcp/dlhwc/lscarrier.htm>].

compensation risks.<sup>19</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 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.

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<sup>19</sup> Self-Insurance Institute of America, *Workers’ Compensation Programs*, available on the website of the Self-Insurance Institute of America at [<http://www.siiia.org/i4a/pages/index.cfm?pageid=3284>].

## 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 ten regional offices, with all claims originating in Iraq and Afghanistan processed through the New York office.

**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>20</sup>

## War Hazards Compensation Act (WHCA)

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>21</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
- during a war or armed conflict between military forces of any origin in a country in which a covered employee is working;<sup>22</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;

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<sup>20</sup> Hallmark testimony, 2008.

<sup>21</sup> 42 U.S.C. § 1701 et seq.

<sup>22</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.

- 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>23</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>24</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.

WHCA claims make up a relatively small percentage of the total DBA claims that originate in Iraq and Afghanistan. Between 2003 and the end of March 2008, over 27,000 DBA claims have been filed for cases originating in Iraq and Afghanistan. However, during that same time period, 252 WHCA claims have been filed.<sup>25</sup> 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 less than 1% of all DBA claims filed. Among the WHCA cases that have been paid since 2003, a total of \$5,207,461 has gone for compensation and benefits, whereas \$7,610,260 has gone to reimburse insurers for itemized and non-itemized administrative expenses associated with these claims.<sup>26</sup>

## **Selection of Defense Base Act (DBA) 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

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<sup>23</sup> 20 C.F.R. § 61.104.

<sup>24</sup> The Federal Employees' Compensation Act (FECA) is codified at 5 U.S.C. § 8101 et seq.

<sup>25</sup> Hallmark testimony, 2008.

<sup>26</sup> Id.

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>27</sup>

Much of the recent attention focused on the DBA program has been due to the media reports of the experience of contractors in combat operations in Iraq and Afghanistan. According to testimony at a recent congressional hearing on the DBA, 90% of DBA business is for DOD contracts.<sup>28</sup> The DBA program came to the attention of the media in part because of a lawsuit filed against Blackwater Worldwide by the families of four contractor employees killed in Iraq in March 2004. Blackwater Worldwide had asserted that it was immune from any civil litigation because the contractor employees were working under a contract with DOD and thus covered by the exclusive remedy of the DBA. This case, as well as a countersuit against the plaintiffs filed by Blackwater Worldwide, is pending.<sup>29</sup>

## **Department of State (DOS) and the U.S. Agency for International Development (USAID)**

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>30</sup>

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<sup>27</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)*, statement of John K. Needham, Director, Acquisition and Sourcing Management Issues, Government Accountability Office. Hereafter cited as Needham testimony, 2008.

<sup>28</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)*, statement of Hon. Henry Waxman, Chairman.

<sup>29</sup> The U.S. District Court case involving Blackwater's petition for arbitration is currently stayed pending an appeal before the U.S. Court of Appeals (*Blackwater Security v. Nordan*, No. 07-1508 (4th Cir.)); a related case is also pending in the Superior Court of Wake County, North Carolina (*Nordan v. Blackwater Security Consulting*, No. 07CVS7061).

<sup>30</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)*, statement of William Moser, Deputy Assistant Secretary of State for Logistics Management, Department of State.

USAID, like DOS, has a single insurer program that requires all contractors performing work overseas to purchase DBA insurance from a specific insurance carrier at a set rate. USAID's current rate for DBA insurance is the lowest among the three agencies, at \$1.58 per \$100 of salary costs. This is a single rate for DBA coverage for all USAID contractors worldwide.<sup>31</sup>

## **Department of Defense (DOD)**

The Department of Defense (DOD) permits its overseas contractors to purchase DBA insurance from any insurance company approved by DOL. In 1996, DOD studied the DBA issue and compared its rates with a sampling of rates paid by DOS and USAID. At that time, DOD officials concluded that their rates were lower, in most cases, than rates paid by DOS and USAID, and that DOD contractors as a whole did not report difficulty in securing appropriate DBA insurance coverage for their employees. Furthermore, DOD rejected the use of a single payer insurance system, reportedly because of the opinion that such a system would not provide enough incentives for companies to improve safety practices to keep rates more competitive.

**Government Accountability Office (GAO) Audit and Review of the DBA Program.** Largely in response to congressional concerns, the Government Accountability Office (GAO) conducted an audit and review of the entire DBA program in April 2005.<sup>32</sup> GAO reviewed DBA claims for DOS, USAID, DOD, and other federal agencies that have issued contracts for Iraq reconstruction and to support deployed forces. In its investigation, GAO reported significant problems with its ability to determine the total cost of the program because it was difficult to gather and analyze data on large numbers of contractors and multiple layers of subcontractors. GAO found it difficult to analyze wide variations in the amounts federal government agencies were paying for DBA insurance or explain inordinate delays in the processing of claims. GAO also reported that it could not calculate the impact that DBA insurance costs had on reconstruction activities in Iraq. GAO found that DOD contractors were being charged premiums that ranged between \$10 and \$21 per \$100 of employee salary.<sup>33</sup> Thus, if an employee earned \$100,000 a year, DBA insurance costs could run as high as \$21,000.

**Congressional Response to GAO's Audit of the DBA Program.** Largely as a result of the GAO report, Congress, with the passage of the National Defense Authorization Act for FY2006, P.L. 109-163, directed DOD to conduct a

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<sup>31</sup> Needham testimony, 2008.

<sup>32</sup> Government Accountability Office, *Defense Base Act Insurance: Review Needed of Cost and Implementation Issues*, GAO 05-280R, (Washington: GPO 2005), p. 1. GAO reports that over 100 Members of Congress requested a review of a number of Iraq-related issues, including issues involving the DBA. The Comptroller General initiated this review under his statutory authority and the objectives of this review were, according to the final report, "to identify the cost to the Federal government for all insurance coverage purchased under DBA and to assess the Act's implementation."

<sup>33</sup> *Id.*, p. 4.



full review of its DBA program. Section 1041 of P.L. 109-163 requires that this review address

- cost-effective options for acquiring DBA insurance;
- methods for coordinating DBA data collection efforts among agencies and contractors;
- improved communication and collaboration within and among agencies on DBA insurance implementation; and
- actions to be taken to address difficult DBA issues including cost, data, enforcement, and claims processing.

Section 1041(c) of the law also required DOD to submit to Congress a report on the results of its review of the agency's DBA policies and procedures.

**DOD's Response to GAO's Audit of the DBA Program.** In response to the requirements of Section 1041(c) of P.L. 109-163, DOD issued a report to Congress on its DBA activities in February 2007.<sup>34</sup> DOD's report discussed DBA-related data collection efforts among various federal government agencies. According to the DOD report, since 2003, DOL has provided the Special Inspector General for Iraq Reconstruction (SIGIR) with quarterly reports of DBA claims activity in Iraq.<sup>35</sup> According to the report, while DOL has statutory responsibility for administering the DBA claims processing for all agencies, federal agencies do not undertake independent efforts to collect specific DBA data. According to the report, "such data collection efforts would be expensive and would divert already limited contracting resources, without any clear benefit to the procurement process."<sup>36</sup> The report later asserts that DOD does not view any additional independent data collection efforts on its part as necessary stating that DOL already provides for sufficient collection of DBA data and is responsible for monitoring the processing of DBA claims. DOD also stated that its personnel with responsibilities for overseas contracting are already aware of the DBA and its various requirements.<sup>37</sup>

**U.S. Army Corps of Engineers (USACE) Pilot Program.** Shortly after the 2005 GAO report, DOD began working closely with the U.S. Army Corps of

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<sup>34</sup> Department of Defense. *Report to Congress: Review of DBA Insurance pursuant to the National Defense Authorization Act for Fiscal Year 2006*, February 27, 2007, p. 5. Hereafter cited as DOD, *Report to Congress*, 2007.

<sup>35</sup> The Special Inspector General for Iraq Reconstruction (SIGIR) replaced the Inspector General for the Coalition Provisional Authority (CPA-IG) in 2004 with the enactment of the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005, P.L. 108-375. As provided for in P.L. 108-106, the SIGIR provides for independent and objective audits, analyses, and investigations into the use of U.S.-appropriated resources for Iraq relief and reconstruction. The SIGIR, Stuart W. Bowen, Jr., was appointed as CPA-IG on January 20, 2004. He reports to both DOS and DOD, provides quarterly reports and semi-annual reports to Congress, and has offices in Baghdad and Arlington, VA. For a summary of the history of U.S. reconstruction assistance in Iraq, see CRS Report RL31833, *Iraq: Recent Developments in Reconstruction Assistance*, by Curt Tarnoff.

<sup>36</sup> DOD, *Report to Congress*, 2007, p. 3.

<sup>37</sup> *Id.* p. 4.

Engineers (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>38</sup> On the basis of these results, the pilot program was extended through September 2008. The Department of the Army announced that a new contract will soon be competitively awarded for a permanent single-insurer program. 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:

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>39</sup>

**GAO Re-Examination of the DBA Program.** The GAO examined the DBA program again in 2008 and reported that although DOD's single insurer pilot program through USACE has reduced DOD's DBA rates, DOD has not implemented a department-wide program to reduce rates. GAO also concluded that DOD lacks reliable data on the total amount of funds spent on DBA insurance claims across the agency.<sup>40</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

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<sup>38</sup> Id. p. 5.

<sup>39</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), 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>40</sup> Needham testimony, 2008.

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 incentive for the contractor to limit the government's costs.

Because DOD requires that nearly all of its contractors purchase DBA insurance separately, it is not possible to compare its overall DBA costs with those of DOS and USAID. However, 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. In 2008, USAID contractors paid the lowest DBA insurance premiums at \$1.58 per \$100 in payroll for all workers. Contractors in the USACE pilot program paid lower premiums than did DOS contractors on their service workers. **Table 3**, below, provides DBA insurance premiums for contractors in the USACE pilot program, DOS and USAID.

### **DBA Costs Associated with the Department of the Army's Logistics Civil Augmentation Program (LOGCAP) 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 missions during times of war and other military mobilizations.<sup>41</sup> LOGCAP contracts are intended to augment combat support and combat service support to military forces.<sup>42</sup>

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<sup>41</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 Contracts in Iraq*, by Valerie Bailey Grasso.

<sup>42</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.

**Table 3. DBA Insurance Premiums for the U.S. Army Corps of Engineers (USACE) Pilot Program, the Department of State (DOS), and the U.S. Agency for International Development (USAID), 2008**

Agency	Insurer	Premium for Service Workers (rate per \$100 in salary)	Premium for Construction Workers (rate per \$100 in salary)
USACE Pilot Program	CNA	\$3.50	\$7.25
DOS <sup>a</sup>	CNA	\$3.87 to \$6.45	\$5.00 to \$8.34
USAID	CNA	\$1.58 (for all workers)	

**Source:** Congressional Research Service (CRS) table compiled from *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), statements of James Dalton, Chief of Engineering and Construction, U.S. Army Corps of Engineers; William Moser, Deputy Assistant Secretary of State for Logistics Management, Department of State; and John Needham, Director, Acquisition and Sourcing Management Issues, Government Accountability Office.

- a. DOS contractors pay separate premiums of \$10.30 for security services without aviation and \$17.50 for security services with aviation.

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>43</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.

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 dollars 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

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<sup>43</sup> See the Special Inspector General for Iraq Reconstruction, *Quarterly Report to Congress*, April 30, 2008.

reported instance, a \$320 million payment in cash was made without justification beyond a signature.<sup>44</sup>

**U.S. Army Audit Agency (USAAA) 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>45</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>46</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>47</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 4** provides the LOGCAP DBA premiums for Iraq and Kuwait for the period between FY2002 and FY2006.

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<sup>44</sup> *Accountability Lapses in Multiple Funds for Iraq: Hearing Before the House Committee on Oversight and Government Reform*, 110th Cong. (2008), statement of Mary L. Ugone, Deputy Inspector General for Auditing, Office of the Inspector General, Department of Defense.

<sup>45</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>46</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>47</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*.

**Table 4. Defense Base Act (DBA) Premiums for the Logistics Civil Augmentation Program (LOGCAP) Contract in Iraq and Kuwait, FY2002 to FY2006**

Fiscal Year	Premium (rate per \$100 in salary)	Percent 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.

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 future claims arising from cases during this period.<sup>48</sup> **Table 5** provides data on LOGCAP DBA premiums and potential claims for the period between FY2003 and FY2005.

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>49</sup> 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>50</sup> In addition, DBA benefits, but not the wages used to calculate DBA 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.

<sup>48</sup> *Id.*, p. 8.

<sup>49</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” (*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), 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>50</sup> USAAA, *Audit of Defense Base Act Insurance*, p. 11.

**Table 5. Defense Base Act (DBA) Premiums and Claims for the Logistics Civil Augmentation Program (LOGCAP) 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>

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

**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.

## 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 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>51</sup> On May 15, 2008, the 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>52</sup>

### **P.L. 110-417, the FY2009 NDAA, as an Outline for Possible DBA Reform**

Section 843 of the FY2009 NDAA 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

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<sup>51</sup> P.L. 109-163.

<sup>52</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).*

House provided an outline of several policy options that DOD was required to consider when formulating its overall DBA strategy.<sup>53</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 and the USAID use a single-source contract 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. USACE is currently testing this model for its contracts as part of a pilot program. 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.

As shown in **Table 3**, above, USAID, DOS, and USACE have experienced cost savings by single-sourcing DBA insurance. Currently, premiums under the USAID DBA contract are lower than those paid by DOS and USACE contractors as well as those paid by KBR under the LOGCAP contract. In addition, 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>54</sup> The Congressional Budget Office (CBO) estimates that adopting a single-

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<sup>53</sup> See Section 850(c) of H.R. 5658, the House-passed version of the bill.

<sup>54</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>].



source model for all DOD DBA insurance would result in savings of \$33 million dollars in the first year and a 10-year cost savings of \$362 million.<sup>55</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>56</sup> Additionally, it is not known whether contractors would accept not being able to select their own insurance carriers to cover their employees.

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>57</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>58</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 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

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<sup>55</sup> Congressional Budget Office, *Budget Options*, (Washington: GPO 2007), p. 35. Hereafter cited as CBO, *Budget Options*.

<sup>56</sup> USAAA, *Audit of Defense Base Act Insurance*, p. 6.

<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), statement of James Dalton, Chief of Engineering and Construction, U.S. Army Corps of Engineers.

<sup>58</sup> CBO, *Budget Options*, p. 35.

agencies has any authority to regulate DBA claims makes it difficult assess what factors are currently used to set current DBA premiums.<sup>59</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>60</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>61</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.

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.

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<sup>59</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>60</sup> USAAA, *Audit of Defense Base Act Insurance*, p. 7.

<sup>61</sup> *Id.*, p. Enclosure 6.

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 five years under the WHCA, the federal government has paid more in reimbursements to insurers for administrative expenses (\$7,610,260) than it has paid in compensation to claimants (\$5,207,461).

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.

## Appendix: List of Acronyms

AIG:	American International Group
ALJ:	Administrative Law Judge
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
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
LOGCAP:	Logistics Civil Augmentation Program
LHWCA:	Longshore and Harbor Workers' Compensation Act
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