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INDEPENDENT

December 7, 2006

The Honorable Donald H. Rumsfeld
Secretary of Defense
1000 Defense Pentagon
Washington, DC 20301

Dear Mr. Secretary:

On October 23, 2006, the Special Inspector General for Iraq Reconstruction issued a report concluding that reconstruction contractors in Iraq are wasting huge amounts of taxpayer funds on overhead fees. In one particularly egregious example, the IG estimated that the largest private contractor in Iraq, Halliburton, billed at least 55% of its contract charges to overhead and that the actual overhead amounts were likely even higher.

One explanation for exorbitant overhead fees appears to be the use of multiple tiers of subcontractors, each of which adds unnecessary overhead charges to the contract. Rep. Waxman first wrote to the Army about this problem more than two years ago when he sought information about reports describing the tiering of security services under Halliburton's $16 billion LOGCAP contract. In particular, he asked about media reports that Blackwater USA was providing exorbitantly priced security services as a third-tier subcontractor under Halliburton's LOGCAP contract. Rep. Van Hollen also asked about these reports during hearings on June 13 and September 28 of this year.

On July 14, 2006, the Secretary of the Army finally responded to these questions, asserting that the Army had no knowledge of any subcontracts for security services under Halliburton's LOGCAP contract. The Army Secretary pointed out that the LOGCAP contract explicitly prohibits such security subcontracts, and that the military theater commander never authorized them. Rep. Van Hollen raised questions about this letter at a hearing on September 28, and in response the Army witness testified repeatedly that she had researched the question thoroughly and stood by the Army Secretary's assertions.

We have obtained new evidence, however, that contradicts the Army's letter and this sworn testimony. Specifically, we have received information that a Halliburton subcontractor, ESS, entered into security subcontracts with Blackwater. ESS describes itself as "the largest foodservice company in the world" and was operating in Iraq as a dining facility subcontractor in Iraq. According to a November 30, 2006, memorandum from ESS's parent firm, a British company called Compass Group, ESS had a subcontract under Halliburton's LOGCAP contract

and used Blackwater "to provide security services" under that subcontract. In other words, the ESS memo confirms precisely what we have been asking about for the past two years.

If the ESS memo is accurate, it appears that Halliburton entered into a subcontracting arrangement that is expressly prohibited by the contract itself. As a result, we have serious concerns about whether it was proper for Halliburton to bill these services to the U.S. taxpayer. We are also concerned about the failure of the Army to provide this information to the Committee and the testimony of Army officials that subcontracts for these security services never occurred.

In addition, we continue to have concerns about the costs of these tiered security service subcontracts. In Rep. Waxman's November 2004 letter, he cited reports that each individual employee hired by Blackwater to provide security services was paid $600 per day; that Blackwater was charging the second-tier subcontractor, Regency, $815 per day per individual (a 36% markup), plus expenses for food, housing, equipment, and administrative support; and that Regency in turn was charging the first-tier subcontractor, ESS, $1,200 to $1,500 per day per individual. If accurate, this is already a 100% to 150% markup, and it does not even include the markup charged by ESS or Halliburton.

After more than two years, we still do not know how much ESS and Halliburton charged for these security services, nor do we know the compound effect of overhead fees billed under each tier. For these reasons, we renew our request for a full accounting of these costs, as well as copies of all relevant subcontracts, invoices, and other contract documents. We also request briefings on (1) the Army's processes for overseeing multiple subcontract tiers, and (2) the Army's plans for recovering taxpayer funds paid under prohibited subcontracts.

Background

Halliburton has the largest contract in Iraq, the Logistics Civil Augmentation Program (LOGCAP). Under this contract, Halliburton provides meals, housing, laundry, and other support services to the troops. As of September 2006, the value of Halliburton's work under this cost-plus contract was $16.5 billion.[1] Problems with the LOGCAP contract have been described in detail by internal company whistleblowers, federal government auditors, and congressional investigators. These problems include the Administration's failure to plan properly, control costs, or heed the advice of auditors who recommend curtailing contractor payments.[2] One of the most significant

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[1] Army Field Support Command, *Media Obligation Spreadsheet* (Sept. 1, 2006).

[2] *See, e.g.,* Special Investigations Division, Minority Staff, House Committee on Government Reform, *Dollars, Not Sense: Government Contracting Under the Bush Administration* (June 2006) (online at www.democrats.reform.house.gov/ story.asp?ID=1071).

problems highlighted with Halliburton's performance has been its failure to adequately oversee its subcontractors.[3]

Rep. Waxman first raised concerns about Blackwater USA's role as a subcontractor under Halliburton's contract on November 30, 2004, when he wrote to the U.S. Army Field Support Command. In that letter, Rep. Waxman cited reports by the *News & Observer* that Blackwater was serving as a third-tier subcontractor under Halliburton's LOGCAP contract.[4] He sought a breakdown of how much each contractor in the tier was paid for the security services being provided by Blackwater. He also requested copies of the subcontracts, invoices, and other documentation.[5]

On December 21, 2004, General Jerome Johnson of the Army Field Support Command sent a pro forma response, saying he had forwarded the request to "the Office of the Secretary of Defense for formal staffing and response."[6]

On June 13, 2006, the Subcommittee on National Security, Emerging Threats, and International Relations held a hearing on private military contractors in Iraq. At that hearing, Rep. Waxman proposed issuing a subpoena to obtain the documents requested in November 2004. Rather than hold a vote on this motion, Subcommittee Chairman Christopher Shays asked Rep. Waxman to withdraw his motion, promising that the documents would be delivered within two weeks.[7]

A month later, on July 14, 2006, Army Secretary Francis J. Harvey sent a letter in response to this request, which is attached for your review. No contract documents were provided. Instead, the letter explained that security operations such as those provided by Blackwater are prohibited under the contract with Halliburton's KBR subsidiary. The Army Secretary explained that

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[3] *See, e.g.*, Defense Contract Audit Agency, *Flash Report on Estimating System Deficiency Found in the Proposal for Contract No. DAAA09-02-D-0007, Task Order 59* (Audit Report No. 3311-2004K24020001) (Dec. 31, 2003) (concluding that "significant deficiencies" in Halliburton's cost estimating system "could adversely affect the organization's ability to propose subcontract costs in a manner consistent with applicable government laws and regulations").

[4] *Contractors in Iraq Make Costs Balloon; Extensive Paramilitary Work Earns Profit on Several Levels,* The News & Observer (Raleigh, North Carolina) (Oct. 24, 2004).

[5] Letter from Rep. Henry A. Waxman to Brigadier General Jerome Johnson, Commander, U.S. Army Field Support Command (Nov. 30, 2004).

[6] Letter from Brigadier General Jerome Johnson, Commander, U.S. Army Field Support Command, to Rep. Henry A. Waxman (Dec. 21, 2004).

[7] Subcommittee on National Security, Emerging Threats and International Relations, House Committee on Government Reform, *Hearings on Private Security Firms: Standards, Cooperation and Coordination on the Battlefield* (June 13, 2006).

Halliburton personnel "cannot carry weapons without the explicit approval of the theater commander" and stated that "[u]nder the provisions of the LOGCAP contract, the U.S. military provides all armed force protection for KBR unless otherwise directed."[8]

The letter from the Army Secretary further stated that Blackwater's security operations were never authorized under the LOGCAP contract:

> To date, KBR has not pursued any requests under the LOGCAP contract for personnel to carry weapons nor has the theater commander directed or authorized KBR <u>or any LOGCAP subcontractor</u> to carry weapons.[9]

Finally, the Army Secretary claimed that Halliburton itself had no information about any Blackwater subcontract for security operations, stating: "KBR has stated they have no knowledge of any subcontractor utilizing private armed security under the LOGCAP contract."[10]

At a hearing on September 28, 2006, Rep. Van Hollen asked Tina Ballard, Deputy Assistant Secretary of the Army for Policy and Procurement, about the Army Secretary's letter. As Rep. Van Hollen stated; "if this letter is correct from the Army, it suggests that this whole subcontract for private security personnel was never authorized. Is that right?" In response, Ms. Ballard stated: "I checked before I came over here to testify, and in fact, exactly what is quoted in Harvey's letter is the information that I validated this morning." When pressed a second time, Ms. Ballard responded: "I did verify that, in fact, again this morning before I came over to the Hill." She reiterated: "the information stated in Secretary Harvey's letter is correct."[11]

The ESS Memo

Contrary to the Army Secretary's letter and the sworn testimony of Ms. Ballard, new evidence suggests that Blackwater did engage in security operations as a subcontractor under Halliburton's LOGCAP contract. On November 30, 2006, ESS's parent firm, a British company called Compass Group, sent a memorandum in response to questions posed by minority staff.[12] According to this memo, which is attached for your review, ESS confirms that it was a subcontractor under Halliburton's LOGCAP contract. The memo also confirms that ESS used

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[8] Letter from Army Secretary Francis J. Harvey to Subcommittee Chairman Christopher Shays (July 14, 2006).

[9] *Id.* (emphasis added).

[10] *Id.*

[11] House Committee on Government Reform, *Hearings on Iraq Reconstruction Contracts* (Sept. 28, 2006).

[12] Compass Group Legal Memorandum (Nov. 30, 2006).

Blackwater to provide security services and that it did so under the LOGCAP contract with Halliburton.

The ESS memo also reveals that ESS entered into similar contractual arrangements with other companies. For example, the ESS memo states that ESS had contracts or subcontracts with Fluor and Bechtel, as well as the Army's Joint Contracting Command, the Danish Camp Supply, the U.S. Marine Corps, and the British military. The ESS memo also discloses that Blackwater was operating under a subcontract with Fluor when four Blackwater employees were killed in Fallujah in March 2004. Like Blackwater's subcontract with Halliburton, these other ESS subcontracts raise similar questions about the potentially exorbitant costs of tiering multiple levels of subcontractors.

The Blackwater Subcontract

In addition to questions about whether Blackwater's security services were prohibited under the LOGCAP contract, we continue to have serious concerns about the prices charged under this subcontract.

Rep. Waxman's November 2004 letter sought information about the tiering of security contracts and its cost to taxpayers. The letter described reports that Blackwater was paying each security official $600 per day while seeking reimbursement of $815 per day, a 36% markup, while other subcontracting tiers added on additional markups, including Regency Hotel, which charged between $1,200 and $1,500 a day for these same security personnel. See Table A. What was not known, and what we sought to determine, was how much U.S. taxpayers ultimately paid for these services.

Table A. Multiple Layers of Security Subcontracts Under Halliburton's Troop Support Contract

	Company	Costs	% Increase
•	Individual Employee	$600/day	--
•	Blackwater USA	$815/day	36%
•	Regency Hotel	$1200-$1500/day	100-150%
•	ESS	Unknown	Unknown
•	Halliburton	Costs + Up to 3% Fee	Unknown
	Total Cost to Taxpayer	Unknown	Unknown

At a June 13 hearing, Rep. Van Hollen asked Chris Taylor, Vice President of Blackwater USA, whether his company's reported markup of 36% was appropriate during a time of war. In response, Mr. Taylor minimized the significance of his 36% markup. He argued that it was not all profit because Blackwater had to pay for all of its expenses out of this amount. As he put it, "$815 is the correct number, but it includes everything." When Mr. Taylor was asked what, other than profit, the 36% markup included, he said his markup was "a fully burdened figure that includes travel, training, gear, housing, food — the works."

After that hearing, minority staff obtained a copy of Blackwater's subcontract for security services. The subcontract, dated March 12, 2004, is attached for your review. It states that "thirty four (34) vetted US Ex-pat professional Security Personnel ... will form the core of the security organization" that will support the operations of ESS. The subcontract also lists specific requirements for weapons, ammunition, body armor, and other equipment to perform these security operations.[13]

Contrary to Mr. Taylor's claims, however, the subcontract makes clear that Blackwater was not paying for all of its expenses out of its 36% markup. Instead, Blackwater was being reimbursed separately for these expenses, as originally reported in the press. Some of these provisions include the following:

> **Food and Housing:** "REGENCY or ESS will provide all BLACKWATER personnel operating in the Territory with housing and subsistence. If REGENCY, or ESS, is unable to provide such housing and subsistence to any individual BLACKWATER personnel providing security services to ESS in the Territory, REGENCY will provide a per diem allowance to each such BLACKWATER person."
>
> **Office Space and Equipment:** "REGENCY or ESS will provide BLACKWATER, at no cost to BLACKWATER with office space and equipment on ESS sites in Kuwait and Baghdad in order to support the necessary command and control elements of the BLACKWATER operation in support of ESS operations in the Territory. In the event that ESS is unable to provide office space and equipment at ESS sites, REGENCY will provide optional space near ESS sites at REGENCY's direction."
>
> **Fees and Administrative Support:** "REGENCY, at no cost to BLACKWATER, will provide Kuwait visas, work permits and administrative support for BLACKWATER personnel assigned to support ESS operations and working under the terms and conditions of this Agreement. This administrative support will be provided at REGENCY's expense."

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[13] Agreement for Security Services between Regency Hotel & Hospital Company and Blackwater Security Consulting, Inc. (Mar. 12, 2006).

> **Insurance:** "BLACKWATER is required to maintain Defense Base Act ("DBA") insurance on all its employees working in the provision Security Services. ... The cost of this insurance shall be passed on at cost from REGENCY/BLACKWATER to ESS for payment of same."
> **Taxes:** "REGENCY shall be responsible for any taxes, duties, stamps, and fees imposed by the Kuwaiti Government, Iraqi Government, Jordanian Government, Turkish Government or the US CPA on BLACKWATER."

In other words, contrary to Mr. Taylor's testimony, Blackwater's subcontract itself seems to indicate that these expenses — food, housing, office space, equipment, administrative support, insurance, and taxes — were reimbursed separate and apart from Blackwater's 36% markup.

During the June 13 hearing, Mr. Taylor was asked repeatedly to provide any contract documents that would support his testimony. In fact, Rep. Waxman agreed to withdraw his subpoena motion based on assurances that these documents would be provided to the Committee within two weeks. To date, however, Mr. Taylor has provided none of the requested documents.

Conclusion

The ESS memo and Blackwater subcontract raise serious questions about the oversight exercised by Halliburton and the Pentagon regarding the tiering of subcontractors. It appears that Blackwater was providing security services under the LOGCAP contract in violation of the terms of the contract and without the knowledge or approval of the Pentagon. It also appears that the layering of LOGCAP subcontracts has dramatically expanded the costs to taxpayers. Moreover, the ESS memo reveals that Blackwater provided security services as a subcontractor to other companies, so our concerns about subcontractor overhead markups are not confined to the LOGCAP contract alone.

Yet the Defense Department still lacks a basic understanding of these contractor activities and their effect on the prices paid by U.S. taxpayers. For this reason, we renew our request for an accounting of the costs paid by the Army for Blackwater's security services in Iraq, taking into account the multiple layers of overhead caused by the contract tiers. We also renew our request for copies of all relevant subcontracts, invoices, and other contract documents. Finally, we request briefings on two topics: (1) the Army's processes for ensuring adequate oversight of multiple subcontract tiers, and (2) whether and how the Army intends to recover taxpayer funds paid to Halliburton and Blackwater for services prohibited under the LOGCAP contract.

Sincerely,

Henry A. Waxman
Ranking Minority Member

Chris Van Hollen
Member of Congress