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INDEPENDENT

MEMORANDUM

March 10, 2004

To: Democratic Members of the House Government Reform Committee

Fr: Rep. Henry A. Waxman

Re: New Information about Halliburton Contracts

We have recently received significant new information from the Defense Contract Audit Agency, the General Accounting Office, and the Defense Energy Support Center about Halliburton's work in Iraq. The purpose of this memorandum is to bring this new information to your attention prior to tomorrow's Committee hearing on Iraq reconstruction contracts.

Halliburton has the largest contracts with the federal government for work in Iraq. Its two principal contracts are a contract to provide logistical support for U.S. military forces in Iraq, also known as "LOGCAP," and a contract to restore and operate Iraq's oil infrastructure. To date, Halliburton has been given task orders for projects in Iraq worth at least \$3.4 billion under LOGCAP¹ and more than \$2.4 billion under the oil contract.²

The new information we have received includes a December 31, 2003, audit of Halliburton by DCAA; a January 13, 2004, memorandum from DCAA to the Army Corps of Engineers and other Defense Department agencies; a recent briefing from GAO on the preliminary results of its investigation of the LOGCAP contract; and new information from the Defense Energy Support Center about the costs of importing gasoline into Iraq. This new information reveals the following major points:

¹ U.S. Army Field Support Command, *Media Spreadsheet: LOGCAP Contract* (Jan. 6, 2004).

² U.S. Army Corps of Engineers, *Frequently Asked Questions: March 2003 Contract Obligation Status* (Feb. 9, 2004).

- DCAA’s December 31 audit, known as a “Flash Report,” found “significant” and “systemic” deficiencies in the way Halliburton estimates and validates costs. According to the DCAA audit, Halliburton repeatedly violated the Federal Acquisition Regulation and submitted a \$2.7 billion proposal that “did not contain current, accurate, and complete data regarding subcontract costs.” For example, DCAA found that Halliburton “did not disclose the termination of two subcontracts ... [that] were the basis for over \$1 billion of projected food service costs.”
- DCAA’s January 13 memorandum to the Army Corps of Engineers concluded that Halliburton’s deficiencies “bring into question [Halliburton’s] ability to consistently produce well-supported proposals that are acceptable as a basis for negotiation of fair and reasonable prices,” and it urged the Corps to “contact us to ascertain the status of [Halliburton’s] estimating system prior to entering into future negotiations.” Despite this explicit warning, the Corps awarded Halliburton a new \$1.2 billion contract on January 16. The Corps later claimed: “We have our own internal audit process [and] haven’t turned up any serious wrongdoing or major problems.”
- GAO reported that there is a \$700 million discrepancy between the cost of the certified proposal that Halliburton submitted on October 8, 2003, for the largest task order under LOGCAP and the cost of a revised proposal that Halliburton submitted on December 23, 2003, for the very same task order.
- GAO reported that the Defense Department exercises ineffective oversight over Halliburton’s work in Iraq under the LOGCAP contract. According to GAO, a military review board approved a six-month renewal contract with Halliburton worth \$587 million in just ten minutes and based on only six pages of supporting documentation. In addition, “logistics support units” sent to the region to provide commanders with contracting advice included military reservists with no contract experience and no previous knowledge of LOGCAP.
- The Defense Energy Support Center prepared a breakdown of the costs it incurred to import gasoline from Kuwait to Iraq from August to December 2003. According to the Center, its fuel costs for this period were \$0.96 per gallon and its transportation costs were \$0.36 per gallon — for a total cost of \$1.32 per gallon. In contrast, Halliburton charged U.S. taxpayers \$1.17 per gallon for fuel, \$1.21 per gallon for transportation, \$0.24 per gallon for “markup,” and \$0.02 per gallon for “other” expenses — for a total cost of \$2.64 per gallon, twice as much as the Defense Energy Support Center.

These new findings follow months of mounting evidence that Halliburton has routinely and systematically overcharged the U.S. government. In December, DCAA reported that Halliburton submitted an unjustified cost proposal for \$67 million in food services and overcharged the government \$61 million for gasoline imports.³ In January, Halliburton admitted

³ U.S. Department of Defense, *Media Availability on the Kellogg Brown & Root Contract* (Dec. 11, 2003).

that procurement officials took up to \$6.3 million in kickbacks.⁴ And in February, two former Halliburton procurement officials described a pattern of overcharging and an irresponsible corporate ethic of “Don’t worry about price. It’s cost plus.”⁵ The Defense Department Inspector General has now opened a criminal investigation into allegations of Halliburton fraud, and criminal investigators from the State Department Inspector General’s office have been asked to join this effort.⁶

Together, the totality of this information demonstrates that the Administration’s approach to contracting in Iraq is profoundly flawed. Halliburton’s inability to estimate and validate costs, combined with a lack of sufficient oversight on the part of the Defense Department, has resulted in apparently widespread contract abuses and overcharging of the U.S. taxpayer.

Halliburton’s “Significant Deficiencies”

On December 31, 2003, DCAA issued an audit report on Halliburton’s cost estimating system under Task Order 59 of LOGCAP.⁷ Task Order 59 is the largest task order under the LOGCAP contract. This is the task order under which Halliburton provides support services such as laundry, sanitation, and food to U.S. military forces in Iraq.

The audit report, known as a “Flash Report,” found “significant deficiencies” in Halliburton’s cost estimating practices. According to DCAA, these deficiencies “could adversely affect the organization’s ability to propose subcontract costs in a manner consistent with applicable government contract laws and regulations.”

According to the Flash Report, Halliburton submitted a \$2.7 billion proposal that “did not contain current, accurate, and complete data regarding subcontractor costs.” The auditors provided specific examples. For instance, the report found that that Halliburton “did not disclose the termination of two subcontracts ... [that] were the basis for over \$1 billion of projected food service costs.” In other words, Halliburton provided government auditors an estimate for \$1 billion worth of food services, but did not inform them that the estimate was based on subcontracts that had been terminated for cause. The report also noted that Halliburton submitted costs of \$208.8 million for certain food services “without disclosing, referencing, or

⁴ *Halliburton Tells Pentagon Workers Took Kickbacks To Award Projects in Iraq*, Wall Street Journal (Jan. 23, 2004).

⁵ Letter from Reps. Henry A. Waxman and John D. Dingell to William H. Reed, Director, Defense Contract Audit Agency (Feb. 12, 2004).

⁶ Letter from Reps. Henry A. Waxman and John D. Dingell to Joseph E. Schmitz, Inspector General, Department of Defense (Feb. 24, 2004).

⁷ Defense Contract Audit Agency, *Flash Report on Estimating System Deficiency Found in the Proposal for Contract No. DAAA09-02-D-007, Task Order 59* (Dec. 31, 2003) (Audit Report No. 3311-2004K24020001).

mentioning the fact that they had already issued subcontracts for these sites ... totaling \$141.5 million.”

The Flash Report also found that Halliburton’s proposal did not comply with the Federal Acquisition Regulation. According to the Flash Report, among other violations, Halliburton (1) failed to submit cost and pricing data; (2) failed to provide data showing the degree of competition and reasonableness of price for subcontracts and procurements; and (3) failed to analyze the prices and costs of subcontractors. DCAA further noted that Halliburton did not even comply with its own Cost Estimating Manual, but provided “no valid reason for deviating from the manual.”

Prior to finalizing the Flash Report, DCAA provided Halliburton a chance to respond to its preliminary audit findings. In a December 4, 2003, letter to DCAA, Halliburton argued:

[T]his issue is not a “significant estimating system deficiency” as stated in the DCAA draft report. Rather, this was a unique situation due to the significant cost, amount of data and volume of effort that was associated with the TO 59 proposal.

DCAA categorically rejected Halliburton’s contention in the final Flash Report. DCAA concluded: “the estimating deficiency is not a one time occurrence; it is systemic.”

Halliburton’s New \$1.2 Billion Contract

Based on the Flash Report, DCAA sent a January 13, 2004, memorandum to the Army Corps of Engineers and other Defense Department offices warning that Halliburton could not adequately estimate its costs for work in Iraq.⁸ The DCAA memorandum summarized the findings of the Flash Report and emphasized that Halliburton’s systemic deficiencies “bring into question [Halliburton’s] ability to consistently produce well-supported proposals that are acceptable as a basis for negotiation of fair and reasonable prices.” The December 31 Flash Report was distributed with the memorandum as an attachment.

The January 13 memorandum concluded with the following explicit warning to the Corps:

We recommend that you contact us to ascertain the status of [Halliburton’s] estimating system prior to entering into future negotiations.

The Corps, however, appears to have ignored this warning. On January 16, just three days after DCAA sent out its memorandum, the Corps entered into a new \$1.2 billion contract with Halliburton to restore the oil infrastructure in the southern half of Iraq.⁹

⁸ Defense Contract Audit Agency, *Status of Brown & Root Services (BRS) Estimating System Internal Controls* (Jan. 13, 2004).

⁹ U. S. Army Corps of Engineers, *News Release: U. S. Army Corps of Engineers Awards Contracts for Repair of Iraq’s Oil Infrastructure* (Jan. 16, 2004).

According to the Corps, this new award was based on four factors:

- (1) past performance and experience;
- (2) business/management approach;
- (3) contract administration plan; and
- (4) cost.¹⁰

The Corps has not explained how it reached its decision that Halliburton satisfied these four factors. The December 31 Flash Report and the January 13 memorandum demonstrate major deficiencies in Halliburton's past performance, one of the most important factors in the contract award. The documents also raise significant issues about Halliburton's management approach and its plans for contract administration, as well as its ability to accurately predict costs.

Based on the significant and systemic deficiencies reported in DCAA's December 31 Flash report and conveyed in DCAA's January 13 memo, the decision by the Corps to award Halliburton the new \$1.2 billion contract just three days later is incomprehensible. In essence, it required the Corps to ignore DCAA's warnings. In explaining this decision, Army Corps spokesman Scott Saunders stated on February 1: "We have our own internal audit process [and we] haven't turned up any serious wrongdoing or major problems."¹¹

The \$700 Million Discrepancy

GAO's investigators also reported significant discrepancies in Halliburton's cost estimates under LOGCAP.

At a February 13, 2004, briefing for Committee staff, GAO reported that Halliburton submitted an "initial certified proposal" for Task Order 59 of \$2.7 billion. This initial proposal was submitted to DCAA on October 8, 2003. According to GAO, this initial certified proposal was rejected by the Defense Department after DCAA's preliminary audit found significant problems. GAO reported that six weeks later, on December 23, 2003, Halliburton submitted a revised certified proposal to the Defense Department for the same task order. According to GAO, this revised proposal was approximately \$700 million lower than the October submission.

This is an enormous discrepancy, and it remains largely unexplained. Although GAO has been in contact with Defense Department officials regarding the new estimate, GAO has reported that it was not able to obtain a breakdown of what portion of this discrepancy was due to an overstatement of costs and what portion was due to changing requirements.

¹⁰ U.S. Army Corps of Engineers, *Frequently Asked Questions: Engineer Support to Operation Iraqi Freedom* (Jan. 17, 2004).

¹¹ *Halliburton Contract Questions Dog White House*, Chicago Tribune (Feb. 1, 2004).

Moreover, the actual amount of the discrepancy may end up being even greater than \$700 million. According to GAO, Halliburton withdrew its December 23 submission under continued criticism from DCAA. GAO does not expect another revised proposal until May 2004.

According to GAO, Halliburton's fee is based on a percentage of the certified proposal, regardless of the amount of actual costs incurred. The LOGCAP contract provides Halliburton with a guaranteed 1% fee with a potential additional fee of up to 2% based on performance. Thus, had Halliburton's initial \$2.7 billion proposal been accepted, the company would have been entitled to a fee of \$27 million to \$81 million for Task Order 59, even if its actual costs were hundreds of millions of dollars less.

The Lack of Effective Pentagon Cost Controls

The GAO investigators also reported that government oversight for LOGCAP is deficient. According to GAO, Army Central Command in Kuwait has not made cost control a priority in its utilization of the LOGCAP contract.

For example, GAO reported that some members of "logistics support units" sent to the region to advise military commanders on the LOGCAP contract had no prior contract management experience. These units are supposed to prepare independent cost estimates that can be compared with Halliburton's estimates. Yet according to GAO, reservists who had never heard of LOGCAP were given only a two-week training course before being sent to the Middle East to provide contracting advice to commanders. GAO explained that, after all designated LOGCAP Support Unit reservists were tapped, inexperienced civilian reservists were called up to take on this advisory function.

GAO further reported that the Army's Combined Acquisition Review Board approved a six-month renewal contract with Halliburton worth \$587 million in just ten minutes and based on only six pages of supporting documentation.

Halliburton's Inflated Gasoline Charges

New information from the Defense Energy Support Center raises further questions about Halliburton's inflated prices for gasoline imported from Kuwait into Iraq.

In November, the Army Corps of Engineers informed the minority staff that Halliburton charged an average price of \$2.64 per gallon to import approximately 74 million gallons of gasoline from Kuwait into Iraq for civilian uses. Halliburton hired an obscure Kuwaiti subcontractor, Altanmia Commercial Marketing Company, which had no previous fuel procurement or transportation experience, to import gasoline from Kuwait. Halliburton paid Altanmia \$1.17 per gallon to purchase the gasoline from the Kuwait Petroleum Company and \$1.21 per gallon to transport the gasoline from Kuwait to Iraq by fuel truck. Halliburton then

received a \$0.24 per gallon overhead “markup” as well as a \$0.02 per gallon “other” charge, for a total cost of \$2.64 per gallon.¹²

At the same time Halliburton was using Altanmia to import gasoline from Kuwait into Iraq for civilian uses, the Defense Energy Support Center was using private contractors to import gasoline from Kuwait into Iraq for military purposes. The Center has now made available its average gasoline prices from Kuwait for the five-month period from August to December. According to the Center, its average total price to import gasoline from Kuwait between August 5 and December 31, 2003, was \$1.32 per gallon.¹³ This is exactly half the \$2.64 price charged by Halliburton. The Center’s total price is composed of the cost of purchasing the gasoline and the cost of transporting it. There is no extra \$0.26 per gallon markup like the one Halliburton charges.

Under its fuel contract, the Center paid an average of \$0.96 per gallon for the gasoline itself. This average reflects a range of gasoline market prices, from low costs of \$0.88 per gallon in September to high costs of \$1.05 in December. At no time did the Defense Energy Support Center pay more than \$1.05 for a gallon of gasoline.¹⁴ Unlike Halliburton, the Center bought its gasoline directly from the Kuwait Petroleum Company, not through a middleman like Altanmia.¹⁵ The Center’s fuel contract was a “fixed price with escalation” contract. In other words, there was an established differential between the price charged by the Kuwait Petroleum Company and the published Platt’s Arab Gulf “spot price.” Every two weeks, the gasoline price would be adjusted to take into account changes in the market price.¹⁶

The Center’s average transportation cost was just \$0.36 per gallon during this period.¹⁷ The Center relied on three contractors to transport the gasoline to Camp Cedar II, 150 miles

¹² Letter from Reps. Henry A. Waxman and John D. Dingell to National Security Advisor Condoleezza Rice (Dec. 10, 2003).

¹³ E-mail from Legislative Affairs, Defense Logistics Agency, to Minority Staff, Committee on Government Reform (Feb. 20, 2004).

¹⁴ E-mail from Legislative Affairs, Defense Logistics Agency, to Minority Staff, Committee on Government Reform (Feb. 7, 2004).

¹⁵ E-mail from Legislative Affairs, Defense Logistics Agency, to Minority Staff, Committee on Government Reform (Jan. 21, 2004).

¹⁶ Telephone briefing by the Defense Energy Support Center for Minority Staff, Committee on Government Reform (Jan. 28, 2004).

¹⁷ E-mail from Legislative Affairs, Defense Logistics Agency, *supra* note 13. According to the Defense Energy Support Center, the \$0.36 average price for transportation is an approximate price that is based upon 30-day months, truck loads equaling 8,000 gallons, and a two and a half-day delivery period.

inside southern Iraq.¹⁸ All three contracts were fixed-price contracts under which the contractor, rather than the U.S. government, “bears the risk of price fluctuations.”¹⁹ The Center’s average transportation cost was a weighted average of the rates of three contractors: TriStar Transport, Mubarak & Sons Transport, and LeNouvelle General Trading and Contracting Co. The companies charged different rates for each fuel truck per day: \$750 for TriStar, \$1,175 for Mubarak, and \$1,500 for LeNouvelle. To further reduce costs, the Defense Energy Support Center discontinued the use of LeNouvelle, the most expensive of the three contractors, on February 1.²⁰

According to the Defense Department Inspector General, Halliburton’s high fuel costs are now under criminal investigation.²¹

Conclusion

This new information has major implications for contracting in Iraq, the subject of tomorrow’s hearing. It depicts a situation where costs are virtually uncontrolled and Halliburton can overcharge the taxpayer by phenomenal sums. Given our nation’s mounting debt and the escalating costs in Iraq, all members of Congress should be extraordinarily concerned about this new evidence of waste, fraud, and abuse in contracting in Iraq.

¹⁸ Telephone briefing by the Defense Energy Support, *supra* note 16. The U.S. military handles the transportation of the gasoline from Camp Cedar II.

¹⁹ E-mail from Legislative Affairs, Defense Logistics Agency, *supra* note 14.

²⁰ *Id.*

²¹ *Pentagon Opens Criminal Inquiry of Halliburton Pricing*, New York Times (Feb. 24, 2004).