

Joint Statement of
Christopher Shays and Michael Thibault, Co-Chairs
The Commission on Wartime Contracting in Iraq and Afghanistan

Hearing:

Subcontracting: Who's Minding the Store?

Room 106, Dirksen Senate Office Building, Washington, DC
9:30 a.m., Monday, July 26, 2010

Good morning. I am Christopher Shays, co-chairman of the Commission on Wartime Contracting in Iraq and Afghanistan. We are a commission created by Congress to examine many aspects of federal-agency and military use of contracting. We will issue a major report with proposals for statutory and administrative changes in December, followed by our final report to Congress in July 2011.

This opening statement is made on behalf of Co-Chairman Michael Thibault, our fellow Commissioners, and myself. The other Commissioners at the dais are Grant Green, Robert Henke, Katherine Schinasi, Charles Tiefer, and Dov Zakheim. Commissioner Clark Kent Ervin could not be with us today.

This hearing concerns subcontracting in war zones. For most people, that topic conjures up about as much excitement as a talk on oral hygiene. True, it involves obscure points of contract law, arcane passages in the Federal Acquisition Regulation, and often baffling layers of business agreements. But as we have delved into the

byways and back alleys of contracting, it has become clear that subcontracting also involves—for good or ill—big money, vital tasks, the safety of Americans in war zones, and U.S. policy objectives.

Let me make it clear at the outset that we are not here to condemn subcontracting. It is a common and necessary business practice, and there are good reasons for using subcontractors. Business economists tell us that subcontracting can help businesses tap into specialized skills, configure their organization to meet changing needs, and adjust to shifts in demand. If your renovation project includes a mural in the dining room or custom windows for an office, you may find that your contractor has subcontracted the job rather than keep an artist or window maker on payroll full-time. It makes sense.

But what makes sense for a renovation project in Connecticut or Maryland can create some unique risks when the contractor is hiring subcontractors in a combat zone half a world away.

My co-workers on the Commission's legal staff have trained us to understand that the federal government lacks “privity of contract” with subcontractors. In other words, the government's contractual relationship is with the prime contractor, not with the subcontractors. So the government has limited visibility into subcontractor affairs, and limited ability to influence their actions. This fact can present a challenge to transparency and accountability for the use of taxpayers' dollars.

From an abstract point of view, the lack of privity of contract is not a big issue. After all, federal law makes prime contractors responsible for their subcontractors. The law also gives government officials authority to make primes accountable for managing their subcontractors so that the primes' contractual requirements are met in a timely and cost-effective manner. Depending on circumstances, federal officials may have power of consent on subcontracting, approval authority over the prime's subcontracting plan, the right to require certain clauses in subcontracts, and the ability to look into contracts for unreasonable, unsupported, or fraudulent costs that could be passed through the prime to the government.

From a practical point of view, however, this neat description often leads to disappointment. Contractors with inadequate business systems, for example, may not be purchasing goods or services from their subcontractors at fair and reasonable prices. In fact, two of the three prime contractors for the Army's multi-billion-dollar LOGCAP IV logistics contract are operating with purchasing systems not approved by the Defense Contract Management Agency (DCMA).

Contractors' ability to manage subcontracting can also be complicated by mandates such as small-business preferences and hearts-and-wallets initiatives like the Afghan First program for hiring host-country labor. Excessive tiering or layering of subcontractors can result in costs being passed upward to the prime with a mark-up at each hand-off, leading to excessive charges to the government. And

some subcontractors have been involved in schemes that involved inflated charges and faked invoices.

Weakness, mistakes, or misconduct in subcontracting relationships can be aggravated by weakness in the federal machinery for contract management and oversight. This Commission has documented and repeatedly warned, as have others, about inadequate numbers and training of civilian and military contracting officers, contracting officer's representatives, subject-matter experts, and auditors. We have learned that poor requirements definition and loose statements of work by the government have weakened accountability and led to waste and abuse.

We have noted that Department of Defense contract management has been on the Government Accountability Office's high-risk program list since 1992. And we demonstrated at a previous hearing that DCMA contract managers and Defense Contract Audit Agency (DCAA) overseers often disagreed on assessments of contractor business systems, but had no systematic procedure for resolving the disagreements. All of these problems within government flow into problems of subcontracting.

These problems, on both the government and the prime-contractor sides of the relationship, are even more troubling when contracting must provide vital support for contingency operations such as those in Iraq and Afghanistan. Besides the risks of a changing, wartime environment, there can be issues with the use of

low-skilled and often illiterate workers, human-rights abuses and human trafficking, a culture where bribes and kick-backs are commonplace, and where subcontractors may be improperly hiring private security companies whose armed employees may get involved in violent incidents that reflect upon the United States.

These are serious concerns, and they are not hypothetical. For example:

- The Special Inspector General for Afghanistan Reconstruction has reported that delays in subcontractor mobilization and poor subcontractor performance were factors in budget overruns and construction delays of a power plant in Kabul. The prime contractor may be responsible for the subcontractors, but U.S. taxpayers are on the hook for \$300 million in costs.
- In July 2009, the owner of a Houston food export company pled guilty to conspiring to defraud the government by making and concealing overcharges to a prime contractor supplying billions of dollars' worth of food to U.S. personnel in Iraq.
- In September 2009, the husband-and-wife owners of a Texas security subcontractor pled guilty to conspiracy and fraud that involved submitting fictitious invoices to the prime contractor on a USAID reconstruction program in

Afghanistan. The wrongdoers agreed to forfeit millions of dollars in unlawful proceeds.

- In January 2010, an Oklahoma man who had worked for the prime contractor on another USAID contract in Afghanistan pled guilty to aiding solicitation of kickbacks in return for favorable consideration of security subcontracts.

Concerns about the subcontracting process, however, are not simply about money. Poorly conceived, poorly structured, poorly conducted, and poorly monitored subcontracting can lead to poor choices in security measures and damage to U.S. foreign-policy objectives, among other problems.

This hearing will explore whether, especially in a high-risk, contingency environment, the government needs additional controls over, or more visibility into, subcontractor performance and costs to ensure the prime contractor is adequately managing its subcontractors. For example, does the government need broader authority to access subcontractor records, even if the sub is working on a fixed-price basis? Limitations on oversight increase the challenge of deterring, detecting, or dealing with misconduct.

Let me add that this hearing has a positive side. We recognize that many prime contractors and subcontractors have provided our military and other personnel in Southwest Asia with outstanding service in a dangerous setting that has brought death and wounds to thousands of them. We also recognize that these contractors can

offer useful observations and suggestions for improving the government's contracting systems. We look to them as well as to our government witnesses for information and advice to consider as we continue our work.

We have three panels of witnesses today, representing government, prime contractors, and subcontractors. All of them hold prominent positions in their organizations. We appreciate their service and cooperation in this hearing, which may be unique in focusing on subcontracting.

Panel 1, the Government Panel, consists of:

- Edward Harrington, Deputy Assistant Secretary of the Army for Procurement;
- Patrick Fitzgerald, Director, Defense Contract Audit Agency (DCAA);
- Cathy Read, Director, Acquisition Management, Department of State; and
- Drew W. Luten III, Acting Assistant Administrator for Management, United States Agency for International Development

Panel 2, the Prime Contractors Panel, consists of:

- Cheryl Ritondale, Global Director, Procurement and Supply Management, KBR, Inc.

- Norm Powell, Vice President and Government Business Acquisition Executive, Fluor Corp.
- John Supina, Senior Vice President, Business Administration, DynCorp International
- Chris Taylor, Chief Executive Officer, Mission Essential Personnel, LLC

Panel 3, the Subcontractors Panel, consists of:

- Fred Brune, President, Government Facilities & Infrastructure, CH2M Hill (subcontractor to DynCorp)
- Perry Dalby, Manager and Ethics Committee Director, Tamimi Global, Ltd. (subcontractor to KBR)
- Paul Hinks, CEO, Symbion Power Services (subcontractor to Louis Berger/Black & Veatch)
- Mark Kleckner, Chief Operating Officer, McNeil Technologies (subcontractor to DynCorp)
- Marc Krens, Chief Financial Officer, The Diplomat Group (subcontractor to Fluor)
- Jerry Torres, President and CEO, Torres Advanced Enterprise Solutions, LLC (subcontractor to MEP)

Witnesses will offer brief summaries of their testimony. The full text of their written statements will be entered into the hearing record and posted on the Commission's website. We ask that witnesses

submit within 15 business days responses to any questions for the record and any additional information they may offer to provide.

On behalf of the Commission, we thank all of today's witnesses for participating in what we believe will be a very important hearing. Now, if our witnesses will rise and raise their right hands, I will swear them in:

Do you solemnly swear or affirm that the testimony you will give in this hearing is the truth, the whole truth, and nothing but the truth?

Thank you. Let the record show that all the witnesses answered in the affirmative.

Mr. Harrington, please begin.

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