

Congress of the United States

House of Representatives

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

2157 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515-6143

MAJORITY (202) 225-5051
FACSIMILE (202) 225-4784
MINORITY (202) 225-5074

www.oversight.house.gov

MEMORANDUM

To: *Domestic Policy Subcommittee Members*

From: *Majority Staff*

Re: *Hearing on Workers' Compensation for Civilian Contractors in War Zones*

Date: *Tuesday, June 16, 2009*

On Thursday, June 18, 2009 at 2:00 p.m., in Room 2154 of the Rayburn House Office Building, the Domestic Policy Subcommittee of the Oversight and Government Reform Committee will hold a hearing entitled, "*After Injury, the Battle Begins: Evaluating Workers' Compensation for Civilian Contractors in War Zones.*" This hearing will examine the administration of workers' compensation insurance for federal contractors working overseas by insurance carriers and the Department of Labor ("DOL"). The hearing will also explore ways to improve the Defense Base Act's workers' compensation program and increase oversight in order to enhance protections afforded to injured civilian contractors.

A little-known law passed in 1941, the Defense Base Act ("DBA"), requires that all U.S. government contractors and subcontractors secure workers' compensation insurance for their employees working overseas. The DBA program was created in an era when the U.S. military made sparing use of civilian contractors, handling a few hundred claims a year. When the U.S. invaded Afghanistan in 2001 and Iraq in 2003, the number of civilian contractors sent overseas to guard bases, drive supply trucks, cook meals and do other work once done by soldiers, skyrocketed. These civilians, who include Americans and foreign nationals, are currently working in Iraq in numbers exceeding U.S. troops, under U.S. contracts paid for by U.S. tax dollars.¹ A significant number of these contractors are former members of the military who believe they're answering the same call they would have answered had the crisis arisen while

¹ T. Christian Miller, "Contractors Outnumber Troops in Iraq," Los Angeles Times (Jul. 4, 2007), available at <http://articles.latimes.com/2007/jul/04/nation/na-private4>.

they were on active duty. Last year alone, there were 200,000 contractors in the war zone.² As of June 2008, more than 1,350 civilian contractor personnel have died in Iraq and Afghanistan. Approximately 29,000 contractors had been injured, more than 8,300 seriously.³ As the use of contractors and rates of injuries have grown, so too have the number of DBA claims; increasing the caseload more than six-fold between 2004 and 2007. The DBA claims caseload peaked in 2007, while the average amount of compensation and medical benefits paid per claim in 2007 dropped to its lowest level since 2003.⁴

The numerous stories regarding the difficulty that claimants have encountered in receiving benefits for medical care and disability payments, as well as the challenges faced by the families of those killed in receiving death benefits, have made clear that improvements to the DBA statute and its administration are needed to keep pace with the exploding growth of the program. This hearing will bring clarity to the challenges of the Defense Base Act program and an opportunity to explore improving and reforming the program.

I. Background on the Defense Base Act

The DBA adopted the insurance requirements under the Longshore and Harbor Workers' Compensation Act (LHWCA), which requires disability, medical, and death benefits for injury or death occurring in the course of employment for maritime workers.⁵ The DBA covers all eligible federal contractors, including non-U.S. citizens and foreign nationals.⁶ Workers' compensation insurance under the LHWCA and DBA can be provided either by a private carrier

² T. Christian Miller and Doug Smith, "Injured War Zone Contractors Fight to Get Care from AIG and Other Insurers," ProPublica (Apr. 16, 2009), available at <http://www.propublica.org/feature/injured-war-zone-contractors-fight-to-get-care-from-CNA-416>.

³ Steven Schooner, "Remember Them Too" Don't Contractors Count When We Calculate the Costs of War?" The Washington Post (May 25, 2009), available at <http://www.washingtonpost.com/wp-dyn/content/article/2009/05/24/AR2009052401994.html>.

⁴ Valerie Bailey Grasso et. al, Congressional Research Service, The Defense Base Act (DBA): The Federally mandated Workers' Compensation System, RL34670 at 9 (Oct. 20, 2008) (hereinafter "CRS DBA Report").

⁵ 33 U.S.C. § 901 et seq.

⁶ There are two limitations to eligibility for foreign nationals. First, benefits for the survivors of a foreign nationals 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. By contrast, in the case of the death of an American citizen or national, survivors' benefits 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 DOL and can be requested by the insurance carrier responsible for paying benefits. CRS DBA Report at 7.

approved by DOL or through a self-insurance system. Like all workers' compensation systems, the DBA provides no-fault coverage and is an exclusive remedy to injured workers. 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. Benefits are also paid to survivors of covered workers killed on the job.⁷ Contracting firms that fail to provide compensation for their injured employees covered by the DBA can be subject to criminal prosecution and civil suits brought by the injured workers.

The War Hazards Compensation Act, (WHA) enacted in 1942, supplements the DBA by providing a form of reinsurance for injuries and deaths to contractors directly related to military conflict.⁸ WHA cases are normally adjudicated under the Defense Base Act, but once it is determined that an employee's injury or death is caused by a war hazard, the federal government will provide benefits instead of the insurer. WHA benefits are paid out of the Employees' Compensation Fund under the Federal Employees' Compensation Act ("FECA").⁹ The insurance carrier can seek reimbursement from DOL under the WHA for any benefits paid, as well as a 15% administrative charge.¹⁰

DOL's Office of Workers' Compensation Programs ("OWCP"), Division of Longshore and Harbor Workers' Compensation, administers the Defense Base Act, and is supposed to "ensur[e] that workers' compensation benefits are provided for covered employees promptly and correctly."¹¹ DBA claims are processed through one of eleven regional offices. The Division of Federal Employees' Compensation, Branch of Special Claims, handles WHA reimbursement once the claim has been declared a result of a war hazard.

II. High Costs of DBA Insurance and Prior DBA Hearing

The insurance system for civilian contractors has generated lucrative profits for the insurance providers, especially AIG, the war zone's dominant insurance carrier. Last year, the Oversight and Government Reform Committee investigated the costs issue and held a hearing titled, "Defense Base Act Insurance: Are Taxpayers Paying Too Much?" The hearing examined allegations of waste and abuse in the procurement of DBA insurance. The Committee determined that AIG had collected \$1.3 billion in premiums on the insurance between 2002 and 2007, while it

⁷ *Id.* at 3.

⁸ 42 U.S.C., section 1701 et seq.

⁹ CRS DBA Report at 9.

¹⁰ 20 C.F.R. 61.101(a). As of March 31, 2009, AIG has submitted approximately \$42 million to the DOL for reimbursement under the WHCA. As of that same date, the DOL has only reimbursed AIG approximately \$3 million.

¹¹ U.S. Department of Labor, The Defense Base Act, December 2003, available at <http://www.dol.gov/esa/owcp/dlhwc/ExplainingDBA.pdf>

had paid out about \$800 million -- leaving the company with a nearly 40% profit over the five-year period.¹² A 2007 military audit found AIG's premiums "unreasonably high."¹³ The Committee also found that CNA, a smaller carrier in the DBA business, made over 50% profits on its DBA insurance contracts. In total, insurers collected more than \$1.5 billion in premiums paid by U.S. taxpayers and have earned nearly \$600 million in profits.¹⁴ The Subcommittee's investigation found that AIG's profit numbers have declined annually since 2004, and AIG's underwriting gains for 2008 were approximately 20% profit. For the period 2002-2008, AIG has averaged a 35.7% gain from its DBA business. CNA's profits for 2008 were approximately 33%, but because of consistently high returns in prior years, the company still averaged a 50% gain from its DBA business with private contractors for the period 2002-2008.¹⁵

Even with the declining profits, these DBA profits are significantly higher than the profits typically earned by conventional workers' compensation insurers due to higher premiums paid. The vast majority of these premiums were negotiated between the insurance companies and Defense Department contractors. GAO, the Army Audit Agency, and Congress have long recommended that DOD negotiate for better prices on DBA insurance.¹⁶ As a result of the Committee's work, the Duncan Hunter National Defense Authorization Act of 2009 (P.L. 110-417), which was signed into law on October 14, 2008, includes a provision that requires the Secretary of Defense to adopt an acquisition strategy to acquire insurance under the Defense Base Act that minimizes overhead and coverage costs and present a competitive marketplace strategy that will likely to save taxpayers hundreds of millions of dollars. A report on this new strategy is due to congressional committees on or around July 13, 2009.¹⁷

Because of the ongoing work being conducted by DOD and the impending report, the Subcommittee will not focus on cost issues at the June 18, 2009 hearing except to highlight that

¹² Committee on Oversight and Government Reform, Majority Staff, "Supplemental Information on Defense Base Act Insurance Costs," at 6 (May 15, 2008), available at <http://oversight.house.gov/documents/20080515102024.pdf>.

(hereinafter "Supplemental Memo")

¹³ Army Audit Agency, *Audit of Defense Base Act Insurance for the Logistics Civil Augmentation Program, Audit of Logistics Civil Augmentation Program Operations in Support of Operation Iraqi Freedom* (Sept. 28, 2007) (A-2007-0204-ALL).

¹⁴ Supplemental Memo, *supra* note 12 at 6.

¹⁵ CNA also provides DBA insurance to the State Department, USAID, and the Corps of Engineers through their single risk-pool programs. Unlike the DOD program whereby insurers contract directly with the private contractors, these premiums under the risk-pool program are negotiated directly with the agencies.

¹⁶ Committee on Oversight and Government Reform, Hearing on "Defense Base Act Insurance: Are Taxpayers Paying too Much?," Hearing Summary, Rep. Henry A. Waxman, Chairman, available at <http://oversight.house.gov/documents/20080523145802.pdf>

¹⁷ Congressional Research Service, Valerie Bailey Grasso, *Defense Contracting in Iraq and Afghanistan: Issues and Options for Congress*, RL33834 (Feb. 19, 2009) (citing Section 843: Requirement for Department of Defense to Adopt an Acquisition Strategy for Defense Base Act Insurance. P.L. 110-417, enacted into law on October 14, 2008).

given the high profits that insurance companies are earning under the DBA program, there should be even greater responsibility imposed on carriers to provide quality care and compensation to injured contractors.

III. The Battle After the War: Obtaining Benefits from Insurance Carriers

The most recent data from the Department of Labor on injuries and fatalities payable under the Defense Base Act and War Hazard Compensation Act indicate that 35,137 contractors have been killed or seriously wounded in Iraq and Afghanistan since 2002.¹⁸ AIG alone has handled approximately 36,000 DBA claims (each injured contractor can generate multiple claims for medical coverage and disability payments). ProPublica's analysis of Labor Department data found that insurers had denied about 44% of all serious injury claims, those defined as injuries involving more than four days of lost work. The companies also turned down about 60% of contractors who claimed to suffer psychological damage such as post-traumatic stress disorder.¹⁹

This high denial rate is partly due to the requirement under the DBA that an insurance carrier is required to either make the first installment of compensation within fourteen days after the employer has been notified or has knowledge of the injury or death, or alternatively to "controvert" a claim by filing an LS-207 (Notice of Controversion of the Right to Compensation) prescribed by DOL.²⁰ Unlike many state workers compensation forms, the LS-207 form does not allow the carrier to postpone making a compensability decision pending receipt of additional information. The LS-207 form requires the carrier to essentially deny the claim outright, even if the carrier believes that the claim may ultimately be compensable with further information.²¹ Insurance Companies like AIG complain that this system forces the insurer into a corner because it is unrealistic for a claims processor to be able to obtain the information needed to verify a claim within this short time period. Since DBA claims often involve a worker injured in a war zone in Iraq or Afghanistan, it is challenging to obtain the requisite medical information and employer information to make a compensability determination within the 14-day period.

¹⁸ Department of Labor, Updated Defense Base Act Statistics (June 9, 2009). These numbers are based on injuries and deaths reported by employers, insurance carriers, or claimants, and are likely under-reported.

¹⁹ T. Christian Miller, "AIG Faces Inquiry Over Medical Care for U.S. Contractors," Los Angeles Times (Apr. 22, 2009), available at <http://articles.latimes.com/2009/apr/22/nation/na-aig22?pg=1>.

²⁰ 33 U.S.C. § 914.

²¹ AIG, for example, claims that its internal policy is to continue to investigate a claim after an LS-207 has been issued. From about August, 2006 until March, 2008, AIG collaborated with the DOL's New York office, which handles the vast majority of DBA claims, and created a substitute form to replace the LS-207, which advised the claimant that payments had not yet begun since all medical and/or wage information had not yet been received. After reorganization within DOL, AIG was instructed by the District Director of DOL that the substitute form does not meet standards in the LS-207 form and required AIG to return to using the LS-207.

Where a carrier continues to contest a claim, DOL will hold an informal conference to attempt to amicably dispose of controversies and to narrow the issues for subsequent proceedings.²² Where informal conferences do not resolve disputes, claims are brought before an Administrative Law Judge (“ALJ”). There have been over 800 DBA dispositions by the Office of Administrative Law Judges (“OALJ”) since 2002, many resolved after months or years of delay. Decisions of the ALJ are appealable to the Benefits Review Board, and thereafter to the U.S. District Court or to the U.S. Court of Appeals.

Claims disputes generally revolve around three issues: 1) whether a claim is covered; 2) the extent of required provision of medical services; and 3) the amount of disability benefit owed. While AIG could not support its assertion with data, AIG maintains that a vast majority of the disputes that arise between claimant and insurer are about how much the disability benefit should be. Under the DBA, if an injury is serious enough to prevent the employee from returning to work, the employer or its insurer must pay compensation to the injured worker. The formulas for determining the amount of indemnity compensation owed are dictated by the Longshore Act, (which are incorporated by reference into the DBA). This formula is referred to as the average weekly wage (“AWW”), which is complicated and somewhat discretionary, and therefore creates a system that encourages disputes over the correct calculation.²³ AIG, for example, has adopted a “blended rate” approach to determining AWW whereby it averages compensation earned overseas with compensation while employed stateside. AIG has stated that this chosen methodology is based on the belief that the Longshore Act did not contemplate providing benefits to civilian contractors who took new jobs to pursue higher wages in a new and different capacity for a short time. Some of the ALJs who hear these cases interpret the statute differently, and have taken different positions on whether lower stateside earnings should be used to determine AWW. This inconsistency has spiked litigation over AWW disputes.

The Defense Base Act also affords injured war zone contractors their first choice of doctor for each specialty that is required.²⁴ In practice, those severely injured in a war zone are medivac’d and treated in the military system, but once they are brought home often want to see specialists and receive treatment that will improve the condition of disabilities that have occurred. The Subcommittee’s investigation reveals that it is often once a contractor returns home that his medical needs start to be more closely scrutinized and challenged by the insurers. As two former civilian contractors will testify at the hearing, they have had to fight long legal battles to obtain adequate medical treatment like prosthetic limbs of sufficient quality to permit them adequate quality of life.

Civilian Contractors returning from the war zone who experience posttraumatic stress disorder (PTSD) and other psychological problems have had particular challenges obtaining treatment and benefits. Civilian Contractors are not afforded the same immediate screening and treatment that is available to soldiers coming home from war, despite the fact that they see the same terrible warzone violence and destruction. Because civilian contractors are not getting

²² Division of Longshore and Harbor Workers’ Compensation (DLHWC), §4-2000, <http://www.dol.gov/esa/owcp/dlhwc/lspm/lspm4-200.htm>

²³ 33 USC §§ 910(a)-(c).

²⁴ 33 USC §907(b).

diagnosed up front on battle-zone or upon leaving the battle-zone, they often have no support for their claims of psychological trauma, and often end up battling the insurance companies over their diagnosis. These disputes are costly and lengthy, requiring litigants to obtain medical experts, and result in delayed treatment of PTSD.

A complete analysis of insurance carriers' rates of accepting, denying and litigating cases is difficult, if not impossible: the insurance companies themselves do not track the data, and while DOL attempts to track some data, it has admitted its data are not reliable.²⁵ Thus, while clear statistics aren't available, numerous stories from civilian contractors who have come home from Iraq seriously injured and struggling with psychological trauma have documented that these workers are left vulnerable to a system that provides no incentive for insurance carriers to grant claims outright. Rather, the fact that insurance carriers are profit-making enterprises means there is an incentive to deny claims until ordered to pay by an ALJ. Moreover, carriers also litigate claims solely to obtain a judicial ruling that the claim is a WHA claim to assure that DOL will reimburse the carrier, increasing litigation even when there is no dispute over whether benefits should be paid.

One attorney who specializes in DBA cases and has represented thousands of civilian contractors estimates that 80% of his cases are litigated, and only 10% settle prior to the hearing before the ALJ. Despite the frequency with which insurers dispute claims, the insurers lose over 95% of the disputed claims that are brought before ALJs.²⁶

IV. Department of Labor's Oversight of DBA Program

While DBA insurance is provided by private insurance companies or, in certain cases, through government self-insurance, the DBA program is administered by DOL. As explained by Shelby Hallmark, Director of the Office of Workers' Compensation Program ("OWCP"), DOL "oversees this benefit delivery by receiving and monitoring reports of injury and of benefit payment, and providing informal but critical dispute resolution services."²⁷ DOL's OWCP district offices conduct informal conferences to help the parties resolve their disputes by way of mutual agreement or compromise without formal litigation. If the parties are unable to resolve their disputes informally, they may request the referral of the claim to the OALJ for formal hearing.

Outside of this role as monitor and technical assistant, the DBA provides very little authority to DOL to be able to ensure that the benefits claims process is functioning fairly and expeditiously. DOL has no enforcement authority to make insurance carriers pay claims when they are disputed; they can only recommend action. DOL can impose civil fines if an employer

²⁵ AIG and CNA both rely on branch office managers to conduct quality control of claims process; neither have a comprehensive database that allows for tracking how many claims have been denied, the reasoning for such denial, how many claims are litigated before an ALJ or the outcome of the litigation.

²⁶ Supplemental Memo, *supra* note 12.

²⁷ Hallmark Testimony at 1.

fails to secure the payment of compensation when deemed required,²⁸ but has used this power sparingly. AIG estimates that out of the 36,000 claims that have been filed since 2002, approximately 50 claims have triggered statutory fines for late payments. CNA has stated that prior to 2008 there were no fines or penalties assessed against CNA by DOL for failing to secure compensation. Since 2008, CNA has paid fines in six cases for late payment of benefits or failure to file forms timely.

The Act also provides that if an insurance carrier knowingly makes a false statement or representation for the purpose of reducing, denying or terminating benefits to an injured employee, the carrier should be subject to a fine of up to \$10,000 and/or imprisonment up to five years.²⁹ Despite the high number of cases where an ALJ finds against the insurance carrier, DOL represents it referred only one such case to DOJ for prosecution in the last 20 years. DOJ, for its part, indicated an unwillingness to prosecute these charges. Moreover, because attorneys representing both insurance carriers and claimants are often repeat players who work together frequently, it is unlikely a defense attorney will accuse a colleague of lying and move for sanctions under the Act. The current system therefore provides little incentive for enforcement actions.

DOL's limited resources have also prevented it from being able to capitalize on the authority granted to it under the DBA. DOL has been hindered by lack of staff and updated technology to be able to oversee the growing program. Staffing levels at DOL devoted to the administration of LHWCA and DBA claims have actually dropped since 2000 despite the explosion of DBA claims. DOL's data collection system is also extremely outdated and unreliable. The Subcommittee found that the database produced unintelligible data as a result of company names not being standardized and incomplete data fields. The OWCP has made requests for increased funding for technology upgrades and staffing, but apparently these requests were declined under the previous Administration.

²⁸ U.S. Department of Labor, The Defense Base Act (Dec. 2003), available at <http://www.dol.gov/esa/owcp/dlhwc/ExplainingDBA.pdf>

²⁹ 18 USC 33 Sec 933(c).

WITNESS LIST

Panel One

Seth D. Harris
*Deputy Secretary
Department of Labor*

Panel Two

Timothy Newman
former civilian contractor in Iraq

Kevin Smith
former civilian contractor in Iraq

John Woodson
former civilian contractor in Iraq

Panel Three

Kristian P. Moor*
President of AIU Holdings, Inc., a division of AIG

George R. Fay
Executive Vice President, Worldwide P&C Claims, CNA Financial

Gary Pitts, Esq.
Pitts and Mills Attorneys at-Law

** Appearing with assistance from: Charles Schader, Senior Vice President & Chief Claims Officer, AIU Holdings*

