

**Senate Democratic Policy Committee**  
**Oversight Hearing on Iraq Contracting Practices**

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**Contractor Support to the Coalition in the Arabian Gulf**

Mr. Chairman and Members of this Committee,

My name is Jeffrey Jones. In November I retired from 30 years of Federal Service, nearly 20 of them as a member of the Senior Executive Service. During my last three years, I had the privilege to serve as Director of the Defense Energy Support Center, part of the Defense Logistics Agency. The DLA's annual program of nearly \$20 billion provides essential worldwide support for military supplies and logistics services. The Center which I directed provided about \$6 billion in petroleum products and other energy products and services to the Military and many Federal Civil Agencies in the U.S. and mostly to the military, overseas.

I thank you for the opportunity to be here this morning to present my views and answer your questions about a number of subjects. Specifically one subject has become common conversation since the *House Committee on Government Reform* made public its findings about prices charged by Kellogg, Brown and Root, a subsidiary of Halliburton Corporation for gasoline delivered to commercial distribution points in Iraq. To be fair I am attaching a newspaper article Halliburton has posted on its Web site in its defense.<sup>1</sup>

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**1 Army Corps Clears Halliburton In Flap Over Fuel Pricing in Iraq**

By NEIL KING JR., Staff Reporter of THE WALL STREET JOURNAL January 6, 2004

– WASHINGTON – The head of the Army Corps of Engineers quietly exonerated Halliburton Co. of any wrongdoing in a Kuwait fuel-delivery contract that Pentagon auditors asserted has overcharged the U.S. government by more than \$100 million.

In a previously undisclosed Dec. 19 ruling, the commander of the Corps, Lt. Gen. Robert Flowers, cleared Halliburton's Kellogg Brown & Root subsidiary of the need to provide "any cost and pricing data" pertaining to a no-bid contract to deliver millions of gallons of gasoline from Kuwait to Iraq.

He acted after lower-level Army Corps officials concluded in a memo to him that Kellogg Brown & Root had provided enough data to show it had purchased the fuel and its delivery to Iraq at a "fair and reasonable price."

The decision, which Halliburton itself requested, came after Halliburton's pricing of gasoline sold to the U.S. government exploded into public controversy last month when Defense Department auditors alleged that Kellogg Brown & Root, known as KBR, was significantly overcharging. While the auditors never accused the company of profiteering, when news of the audit broke, President Bush said that if Halliburton had overcharged for the fuel, he expected the company to repay the money.

First let me say that, by appearing here today, I do not intend to lay blame or criticize any organization or person in particular. That job is for investigators and auditors, who are at work on some aspects of the case as we speak.

Rather, I believe the incremental findings of a number of investigative bodies into the circumstances of KBR's provision of gasoline and other materials to Coalition Forces in Iraq do raise questions to which the Congress and the public deserve answers. These questions, apart from the pros- and cons of the war itself include—

- How was Halliburton and its Kellogg, Brown and Root subsidiary, selected to do this job in the first place;
- Who was providing expert oversight of the charges being submitted for commercial fuel supplied from Kuwait in particular; and
- What can be done to improve decision transparency so the public has more confidence in the actions its government takes?

If we have learned nothing since the two major price shocks the U, S, experienced in 1973-1974 and in 1979-1981, it is that the U. S. public considers itself expert on matters of gasoline. This is something they have daily contact with—not distribution of Precision Guided Munitions, or most anything else involving warfare or its logistics.

Underlying these questions are deeper issues about how the U.S. has come to support the fighting of its wars, and whether there are ways to reduce a variety of both costs and risks.

Let me try to present my views using three basic topics:

1. How we got into the situation we found ourselves in with KBR,
2. The KBR situation's echo in the drive to outsource Federal work; and,
3. The importance of oversight and transparency in government.

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The ruling could undermine the continuing Pentagon audit of the company's fuel-delivery contract. Still, it will keep the fuel flowing in Iraq.

Defense auditors had alleged in a Dec. 5 draft audit that KBR had picked a Kuwaiti supplier that was charging for gasoline almost twice the price asked by other suppliers in the region.

The timing of the Flowers ruling — technically known as a "waiver" because it waives a requirement that the Halliburton unit provide data justifying its pricing — is sure to draw scrutiny on Capitol Hill. The waiver came just a week after Pentagon officials confirmed that a draft audit found that KBR fuel overcharges ran to \$61 million through the end of September. Under a running Army Corps contract, that sum increased by around \$20 million a month through the end of last year, officials said.

## TOPIC I—How we got into the situation with KBR

While the U.S. has effected much change via Operation Enduring Freedom in Afghanistan and Operation Iraqi Freedom (and from our point of view, mostly good change), both military conflicts have become protracted, asymmetrical fights between opposing cultures and world views.<sup>2</sup> (Remember we have troops still in the Balkans.) We in the U.S. can claim the opposition is simply a radical minority not representative of the population at large; and this is probably true. But there are growing numbers of people around the world who openly express concern about their view that the U.S. is feeding opposition groups by its heavy-handed diplomatic and military tactics. No government in the world, not even the United States, is capable of sustaining “victory” in the presence of untiring opposition. We can minimize, discredit, or demean these opposition groups, but the fact is, they have been largely responsible for the mounting cost and delay in rebuilding infrastructure in Afghanistan and Iraq. And we have to find a way to bring other parts of the indigenous population to our side to immobilize the opposition from within.

Short wars that don’t end quickly exhaust the military’s ability to sustain its logistics operations. In fact, for reasons that are known to the Congress, the logistics capabilities of the military—particularly the expeditionary ground force—are marginal even for sustaining short periods of combat when large physical distance and speed of movement are involved<sup>3</sup>. Components of the Department of Defense, therefore, rely to a greater or lesser degree on the ability of contractors to do work they do not have ready forces, equipment, or skills to do for themselves. For example, whenever possible, fuel is sourced as close to the fight as possible, which is, in large part, feasible in the Gulf region.<sup>4</sup>

Using contractors to support the military logistics’ needs *is a good idea in general*. The Army established the “LOGCAP,” or Logistics Capabilities” contract with KBR nearly a decade ago in the Balkans. KBR built camps, provided many infrastructure services, and generally did a creditable job handling lots of tasks and accomplish them quickly. During the years since, KBR has become a mainstay of logistics for the military, particularly in less-developed, distant countries. As the number of serious U.S. military engagements increases, the dependence on contractors to perform these infrastructure tasks also increases. KBR, to its credit, has developed a substantial capability to meet essentially any task given it, so long as the government is willing and able to pay for the work.

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2 I find Tom Friedman’s book *The Lexus and the Olive Tree* particularly illuminating about culture clashes between Western, so-called modern societies and those still defining their relationship to a time and place.

3 The Army’s Director for Logistics, LTG Claude Christianson, who was at the very center of OIF support, has provided some of the sharpest criticism of all about weaknesses in the logistics system he and his forward elements depended on. Even so, no other military logistics system in the world matches ours!

4 Even so, some Gulf countries had to import jet fuel (and Kuwait, gasoline) to meet combined Coalition force needs.

If a corporation outside a military context were expanding worldwide, it would develop a marketing strategy, establish offices in strategic locations to begin developing markets, then expand in the successful ones and, if needed, drop the unprofitable ventures over time.

The military Services, of course, don't have the luxury of a business plan like this. They go where they must and stay as long as required; and to the extent they have to hire a basing service, they do. As Congress authorizes the expansion of the military's geographic reach, it incurs, knowingly or not, the added cost of a largely contractor-built and operated civil infrastructure—again, out of necessity.

The specific situation with gasoline in Iraq came about from this general cause of turning to an authorized<sup>5</sup> and familiar “solution” when an unfamiliar problem arises. But it also came from the Corps of Engineers' having to work under unexpected pressure, short deadlines, and perhaps even under the impression that the Department's own petroleum experts would not do the job (see later discussion). The experts, DESC, were fully engaged in supporting the military throughout the world, including Central Asia, Afghanistan, Pakistan, and Iraq (jet fuel and diesel in Iraq). DESC was, and presumably continues to be, operating some of the longest “Ground lines of communication, or G-LOCs” ever run by any military—from central Turkey to Northern Iran and from Azerbaijan to various points east of the Caspian Sea. DESC has, over its 61 years of existence, established the ability and the value system to work closely with indigenous contractors, governments, and military organizations in the Gulf and other distant regions. In fact, DESC provided KBR with sourcing information for trucks and oil marketers, since the knowledge was part of DESC's operating data.

DESC had been asked if it could provide propane to for a requirement that appeared vague at the time, and they turned down that request, since DESC doesn't manage propane anywhere. This may have been taken to mean DESC wanted nothing to do with the civil resupply mission that fell to KBR.

In any event, DESC has now become involved largely because of the findings of the House and other subsequent investigations. I understand commercial offers on DESC's supply contracts close in April and a normal operation should be in place shortly thereafter.

The bottom line on this topic is that the situation with KBR grew out of many causes--an increasing dependence on KBR to fill gaps in U.S. military capability, KBR's generally successful track record in doing the work, the lack of explored alternatives, the time pressure under which results had to be demonstrated, and last, insufficient resources or expertise to know whether the service provided represented good value.

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<sup>5</sup> Meaning that Halliburton as the parent company was a designated contractor.

## TOPIC 2 – The KBR example and the Push for Outsourcing

As I said in my remarks above there is a proper role for contractors in doing the government's business. The government should not attempt to duplicate what the private sector does, when in fact the same or closely analogous work is done for commercial customers outside the government. Where outsourcing becomes problematic is in three general cases:

1. The work has no real commercial equivalents and there is no "market" regulating the cost of service. Outsourcing in these cases merely moves the sign over the door from a government office to an outside business;
2. The work being outsourced represents the government's primary resource for providing oversight and for integrating private sector and (in DoD's case) military capabilities, and;
3. The work is highly complex, adaptive, and requires spontaneous innovation and expertise for problem solving.

Each of these cases represents a set of risk factors. In the case of KBR and gasoline supplies into Iraq, rules 1 and 3 apply and rule 2's risk applies because the Corps who put KBR in charge, almost certainly could not have had the resources and technical knowledge needed to provide detailed oversight<sup>6</sup>.

**ILLUSTRATION.** If you break tasks down to simple ones, such as "boil water" anyone can do it, and oversight is nil. But if the task is "whenever boiled water is necessary, make sure the water is pure, you have enough of it on hand at all times to meet emergent, but undefined needs of a coalition of forces," the simple task becomes highly qualified with added risk elements for whoever is to boil the water. Whoever that is has to build in contingent capabilities of several kinds to avoid failure in such a broad charge. In wartime, most support tasks are highly qualified because of uncertainties, the "Fog of War," if you like.

A lot of logistics work is like boiling water at the right place at the right time in the right amount with low IR signatures, etc. Contracting it out is far more difficult than many advocates of outsourcing imagine. The Defense Logistics Agency, for example, has gained lots of experience in doing public-private competitions to operate about 20 distribution centers. Distribution centers are operated commercially all the time, so this should have been relatively straightforward.

But, with a couple of exceptions, the outsourcing process was not so simple. These were not cookie-cutter facilities. Each looked different, served different customers with

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<sup>6</sup> This is not a criticism, just an observation that DoD has vested that knowledge elsewhere (DESC) and duplicating it would make no sense.

different operating needs and methods, and much of the daily routine contained lots of customized work. After more than four years' work, some of the facilities due to be outsourced are not, and in a couple of cases, DLA had to fire a winning contractor and reconstitute a civilian labor force or provide large amounts of assistance. Again this is not a criticism, but an illustration that capturing the combined work efforts of several hundred people day in and day out is just very hard to do.

My immediate past organization, DESC, which has a particularly good reputation among the industries with which it works, has been made the subject of an outsourcing study by a few staffers in the Pentagon. While no organization should be exempt *a priori* from being looked at, I can only imagine who would step in and fix the Halliburton problem once DESC ceased to exist. I'm sure the study will produce some insight into ways to do business better here and there, but the fact is, DoD must retain a capability to be an intelligent consumer of what services it decides to buy. This brings me to...

### **TOPIC III—The issue of oversight and the Public's Interest in Transparency in Government.**

I begin with a quotation that seems oddly appropriate today, even though the speaker saw an entirely different world than obtains now:

“The United States stands at this time at the pinnacle of world power. It is a solemn moment for the American Democracy. For with primacy in power is also joined an awe-inspiring accountability to the future. If you look around you, you must feel not only the sense of duty done but also you must feel anxiety lest you fall below the level of achievement.”  
--Sir Winston Churchill, 1946

In this famous “Iron Curtain” speech, Churchill saw the pistons of Communism as the force to withstand, and for 43 years, the world largely followed his prescriptions. Now the world again finds itself divided, perhaps even more perilously, and far less clearly, along lines which President Bush after September 11, 2001 referred to as “*those with us and those against us.*” As Americans we are rightly proud of what we have achieved in about 230 years. But as we see every day in Iraq and nearly as often in Afghanistan and other parts of the world, America looks far more complicated and contradicted in the eyes of others. People from all over the world still flock here to escape persecution or worse—environments most of us have never known. On the other hand, there are many who see America as a force as evil as we once saw Communism. Many of our most dependable allies in “Old Europe” may have official and economic reasons for opposing some of our operations, but people on the street who always saw the U.S. as their guarantor of freedom from Soviet expansionism, now wonder if we, too, should not be subjected to some form of restraint.

We don't have to subscribe to these views much less like them. But we can't ignore them; they cost American credibility and even American lives every day. Our obligation

as Americans is to work every day to uphold the best of American ideals, some of which are inscribed at the base of the Statue of Liberty. Our purpose in acting must be clear. If country X or Y doesn't wish to join us because they perfidiously made questionable investments in a country we find to be an intolerable loose cannon, we can agree to disagree on nationalist bases. But the U.S.'s goals must be clear, our rationale must be credible; our thinking cannot ignore the presence of strongly-opposed views that are likely, from lots of experience now, to keep throwing large or small defeats into the jaws of victory.

As the pre-eminent power we need to "be humble" as President Bush said early in his administration. We also need to be open and transparent when we make the move from "humble" to "rumble."

The United States unquestionably wants (and also needs) to make its Iraqi intervention a demonstration of leaving a national basket case in a condition where it can determine its own future without bloodshed. The U.S. obviously cannot squander any good will or credibility it might have left by acting irrationally, greedily, or behind closed doors where appearances can mean more than reality.

The American military has discharged its duties in both Afghanistan and Iraq with great distinction. I have been privileged to work with some of these men and women and their leaders. It is far more important perhaps than ever that the rest of us do what we can to make sure that their needs are not dissipated via a sloppy process on the civilian leadership side. The original \$20 billion Iraqi get-well plan became quickly insufficient. Noble goals, not shared by those who have the power to undermine them, will continue to lead to dependence on the generosity of the Congress and the U.S. taxpayer to invest billions of dollars more than expected into Iraq via mostly U.S. commercial companies.

Whether Halliburton and Kellogg, Brown and Root should have received the contracts they did in the way they did is a matter I cannot comment on with any facts or authority. What I can say, however, is that the government needs to do a great deal of introspection on restoring public confidence in its processes for making such important decisions. There is no better cure for bad process than sunlight. Both with respect to Defense matters and Government outsourcing in general, a commitment to clarity of goals, validity of process, and, above all, transparency in the decision process are much needed; and I commend these matters to this Committee for their consideration.

Thank you again, Mr. Chairman, for the opportunity to speak to you this morning. I will be pleased now to answer any questions you may have.