

# SIGAR

**Special Inspector General for  
Afghanistan Reconstruction**

**OFFICE OF SPECIAL PROJECTS**

**NONPAYMENT OF AFGHAN CONTRACTORS: SIGAR  
INVESTIGATIVE EFFORTS HAVE HELPED RESOLVE  
DISPUTES, BUT PROBLEMS REMAIN**



**JANUARY 2017**

SIGAR-17-21-SP



**SIGAR**

Office of the Special Inspector General  
for Afghanistan Reconstruction

January 17, 2017

The Honorable John F. Kerry  
Secretary of State

The Honorable Ashton B. Carter  
Secretary of Defense

The Honorable Gayle E. Smith  
Administrator, U.S. Agency for International Development

In June 2013, SIGAR issued a management alert letter regarding the nonpayment of subcontractors in Afghanistan.<sup>1</sup> The letter provided information concerning complaints SIGAR received about the nonpayment of subcontractors by companies working on U.S.-funded contracts in Afghanistan. The letter also highlighted the risks associated with nonpayment of both subcontractors and prime contractors, and identified possible actions to mitigate the problem of nonpayment. I am now writing to provide updated information concerning SIGAR's efforts to address nonpayment complaints and to suggest actions that your offices may be able to take in order to help address the problems associated with the nonpayment of Afghan contractors.

The problems SIGAR first identified in 2013 regarding the nonpayment of Afghan contractors continue to receive attention at the highest levels of the Afghan government and present challenges to the U.S. government's effort to reconstruct Afghanistan. While this report focuses on Afghan prime contractors and subcontractors, it also discusses the effects of nonpayment on other stakeholders in the Afghanistan reconstruction effort, such as U.S. prime contractors. The report also describes the impact of nonpayment on U.S. contracting commands, relevant Afghan government agencies, and Afghan business organizations.

To prepare this update, SIGAR reviewed 164 nonpayment-related complaints received through SIGAR's Hotline between October 2012 and August 2015. We found that many of the contractor nonpayment disputes reported to SIGAR were due to the contractor's lack of understanding of the contracting process, the contractor's lack of access to U.S.-based legal remedies, or the contractor's lack of access to the U.S. contracting officer.

In conducting our review, SIGAR sought input from the Departments of Defense (DOD) and State (State), the U.S. Agency for International Development (USAID), a government services advocate representing a number of U.S. contractors in Afghanistan, and representatives of Afghan subcontractors who had filed complaints and were familiar with the Afghan perspective. We provided a draft of this report to DOD, State, and USAID on November 22, 2016. We received official comments from State and USAID. Those comments acknowledged that only one nonpayment complaint included in our review was associated with State or USAID and thanked SIGAR for its efforts to raise awareness of this issue and ensure fair payments to contractors. State's comments are reproduced in appendix I and USAID's comments are reproduced in appendix II. We also received technical comments from DOD, which we incorporated, as appropriate.

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<sup>1</sup> SIGAR, *Management Alert: Subcontractor Nonpayment Issues*, SIGAR SP-13-4, June 17, 2013.

We conducted this special project in Washington, D.C. from July 2015 to November 2016, in accordance with SIGAR's quality control standards. These standards require that we carry out work with integrity, objectivity, and independence, and provide information that is factually accurate and reliable. For more information on the policies and procedures and quality control standards for conducting special project work, please see SIGAR's website ([www.SIGAR.mil](http://www.SIGAR.mil)). SIGAR performed this special project under the authority of Public Law No. 110-181 and the Inspector General Act of 1978, as amended. Should you or your staff have any questions about t this project, please contact Mr. Matthew Dove, Director of Special Projects, at (703) 545-6051 or [matthew.d.dove.civ@mail.mil](mailto:matthew.d.dove.civ@mail.mil).

Sincerely,

A handwritten signature in black ink, appearing to read 'John F. Sopko', with a long horizontal flourish extending to the right.

John F. Sopko  
Special Inspector General  
for Afghanistan Reconstruction

In 2009, SIGAR began receiving hotline complaints alleging that Afghan contractors working on U.S.-funded contracts in Afghanistan were not being properly compensated for the work they performed.<sup>2</sup> By the end of 2012, nonpayment complaints represented approximately one of every four complaints received on SIGAR's Hotline. In response to these complaints, we analyzed the problems associated with the nonpayment of Afghan contractors and issued *Management Alert: Subcontractor Nonpayment Issues* in June 2013.<sup>3</sup> That letter provided general information concerning complaints SIGAR received, highlighted the risks associated with contractor nonpayment, and identified possible actions to mitigate the problem of contractor nonpayment.

The complaints SIGAR received and continues to receive suggest that contractor nonpayment remains a significant problem in Afghanistan. SIGAR continues to collect testimonial and documentary evidence indicating that subcontractors are being victimized by prime contractors who refuse to pay them for the work they had performed. However, SIGAR has also found that subcontractors are alleged to have made death threats, engaged in work stoppages and strikes, seized worksite equipment, obtained questionable legal orders leading to arrests, and engaged in extortion in order to obtain payment from prime contractors. Of particular concern are reports that thousands of Afghan workers remain unpaid and that they may contribute to security concerns because they might align with insurgents out of frustration. The nature and frequency of the complaints made to SIGAR regarding subcontractor nonpayment and the actions of some subcontractors to obtain payment indicate a relative lack of remedies or resources that would assist Afghan subcontractors in resolving nonpayment disputes.

This report provides an update to SIGAR's 2013 analysis of nonpayment complaints, explains the results of SIGAR's recent work in this area, and suggests additional actions to address the problems associated with contractor nonpayment disputes. In conducting our review, SIGAR sought input from the Departments of Defense (DOD) and State (State), the U.S. Agency for International Development (USAID), a government services advocate representing a number of U.S. contractors in Afghanistan, and representatives of Afghan subcontractors who had filed complaints with SIGAR, DOD, Congress, and the Afghan Minister of Justice. In particular, SIGAR requested that DOD, State, and USAID:

- identify nonpayment complaints received by their agency since January 2013, including how nonpayment issues may have affected projects (i.e., projects temporarily shutting down, or individuals unwilling to work or receiving threats) and how complaints were resolved;
- provide agency observations on the extent and cause of the issue and recommendations with respect to what the Afghan government is doing or can do to help alleviate subcontractor nonpayment problems; and
- identify contracting mechanisms available to the contracting officer that have been effective in alleviating nonpayment disputes.

Attorneys from the U.S. Army Corps of Engineers (USACE) Middle Eastern District responded and provided insights related to its challenges in ensuring appropriate and timely payments to subcontractors in Afghanistan.<sup>4</sup> SIGAR also received feedback from several State contracting officers in Afghanistan and spoke with State's Afghanistan Public Affairs Section Program Manager and contracting officer's representative. USAID's Afghanistan Office of Acquisition and Assistance

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<sup>2</sup> For the purposes of this report, the term "Afghan contractors" refers to both Afghan subcontractors and Afghan prime contractors.

<sup>3</sup> SIGAR, *Management Alert: Subcontractor Nonpayment Issues*, SIGAR SP-13-4, June 17, 2013.

<sup>4</sup> USACE-administered contracts were impacted by nonpayment complaints at a far greater frequency than contracts administered by State or USAID. According to USACE, the Defense Contract Audit Agency, the Armed Services Board of Contract Appeals, and the USACE Transatlantic Afghanistan District are aware of the concerns USACE reported to us.

advised SIGAR that they were not aware of any recent instances or complaints regarding subcontractor or prime contractor nonpayment related to USAID activities.<sup>5</sup>

We also reviewed hotline complaints, during the course of which we determined that the SIGAR Hotline received 164 new nonpayment complaints between October 2012 and August 2015.<sup>6</sup> Those complaints involved contracts valued at more than \$493 million in total, of which contractors disputed more than \$82 million as unpaid.<sup>7</sup>

SIGAR was able to link 80 of the 164 complaints to a specific U.S. contract. All but one of the contracts were administered by DOD. SIGAR held meetings with senior DOD officials and agreed to provide DOD with relevant data related to each of the complaints and DOD agreed to review the complaints and take appropriate action. SIGAR and DOD also agreed to review their respective reporting processes to ensure that DOD is provided future DOD-related complaints in a timely fashion. SIGAR has resolved, closed, or referred all but 14 of the complaints and DOD has already taken a number of actions as a result of the complaints and DOD was reviewing several others.<sup>8</sup>

## CONTRACTOR NONPAYMENT CONTINUES TO POSE RISKS TO SUBCONTRACTORS, PRIME CONTRACTORS, AND RECONSTRUCTION PROJECTS IN AFGHANISTAN

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SIGAR's efforts to assist contractors and agencies resolve nonpayment disputes have led to significant accomplishments and helped settle disputes between contractors, some of which are discussed below. Nevertheless, the frequency of complaints and concern expressed by the highest levels of the Afghan government show that the nonpayment of Afghan contractors remains an important issue that poses risks to the companies involved and to ongoing reconstruction efforts in Afghanistan. As discussed below, reliance on multiple tiers of subcontractors and the relative lack of direct U.S. government oversight of projects tend to increase these risks.

### Risks to Subcontractors

Through interviews with U.S. government and Afghan sources, SIGAR found that Afghan subcontractors are particularly vulnerable to nonpayment disputes. Afghan subcontractors often have limited access to capital, placing them in a financially precarious position when a prime contractor or higher-tiered subcontractor does not promptly pay for work performed.<sup>9</sup> Subcontractors have told SIGAR that they are unable to pay their own employees and lower-tier subcontractors, bid

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<sup>5</sup> SIGAR's Hotline analysis identified only one USAID-related complaint.

<sup>6</sup> These complaints were processed after the 183 complaints reflected in SIGAR's 2013 report, which included complaints received through October 2012. SIGAR's Investigations Directorate employs a team of investigative analysts to process hotline complaints and conduct preliminary inquiries. The team includes two full-time Dari- and Pashto-speaking analysts.

<sup>7</sup> Not all SIGAR Hotline complaints of nonpayment necessarily have merit. For example, after receiving a nonpayment complaint by an Afghan construction company, we conducted a review and discovered that the subcontractor was not paid due to poor quality performance and had not completed the project in accordance with the statement of work.

<sup>8</sup> Many of the complaints were closed due to a lack of information or because the complainant failed to respond when further information was requested.

<sup>9</sup> Subcontractors work at a variety of levels or "tiers." A prime contractor's subcontractor is referred to as the first-tier subcontractor. If the first-tier subcontractor subcontracts to another company, that company is referred to as a second-tier subcontractor; if the second-tier subcontractor then subcontracts to another company, that company is referred to as a third-tier subcontractor, and so forth down the subcontracting chain (see Small Business Administration, *A Handbook for Small Business Liaison Officers*, June 2010, p. 11).

on new jobs because of inadequate cash flow, or even support their families as a result of nonpayment by prime contractors and higher-tier subcontractors.

Afghan subcontractors also face threats when they are unable to pay creditors and lower-tier subcontractors. These subcontractors are vulnerable to retaliation by unpaid lower-tier subcontractors who do not understand that the higher tiered contractor needs to be paid by their prime before the lower tiered contractor can get paid or believe that they have yet to be paid by the prime contractor on a particular project. SIGAR agents learned of subcontractor employees who had no other source of income and subcontractors who were unable to recover money owed by prime contractors that subsequently left Afghanistan. According to DOD and Afghan sources, negative outcomes included strikes and worksite blockages by unpaid subcontractor employees, subcontractors having to sell land and property to satisfy unpaid vendors, subcontractors unable to obtain compensation for war-related loss of life and equipment, and subcontractors detained by Afghan police on behalf of creditors in attempts to obtain payment. In addition, according to Afghan sources, unpaid workers may pose a security concern. For example, a representative of a consortium of 54 Afghan subcontractors—created for the specific purpose of pursuing outstanding claims—told SIGAR the consortium is owed at least \$150 million from various U.S. prime contractors. The representative reported that 10,000–20,000 Afghans are affected and that it is a dire situation, driving some to potentially becoming sympathetic to insurgents.

After interviewing DOD sources, SIGAR determined that Afghan subcontractors seemed to have little recourse when not paid. The U.S. government is limited in what it can do to assist subcontractors due to a lack of a direct contractual relationship. Afghan subcontractors told us they had difficulty contacting U.S. contracting officers in order to explain how the nonpayment by a prime contractor was negatively affecting their businesses. Additionally, Afghan contractors told us that while subcontractors could choose the relatively expensive and logistically difficult option of bringing legal action against the prime contractor in a U.S. court, it is often impractical for most to do so.

### Risks to Prime Contractors

Prime contractors working on reconstruction contracts in Afghanistan also face risks associated with the nonpayment of subcontractors. In particular, Afghan prime contractors encounter many of the same problems as Afghan subcontractors when facing payment disputes with the U.S. government. Although the U.S. government has a clear and well-defined process in place to address disputes regarding prime contractor performance, there is no comparable process in place to address similar issues arising from Afghan subcontractor performance, such as when an Afghan subcontractor has not met its contractual obligations. According to USACE legal staff, in these cases, without a clear or functioning arbitration process, the Afghan subcontractor may attempt to pressure the prime with strikes or threats in order to coerce a favorable outcome.

Some of the hotline complaints we received were from prime contractors alleging that they were threatened when they were unable to pay their subcontractors or when they were accused of not paying them. For example, some Afghan prime contractors told SIGAR that they were forced to flee their homes after receiving threats from subcontractors. According to U.S. government and Afghan sources, subcontractors have also conducted strikes that disrupted or closed down the prime contractor's work site, threatened the prime contractor's employees, or attempted to have them arrested or detained. In some cases, subcontractors have attempted to convince the Afghan National Police and other Afghan law enforcement organizations to arrest or detain prime contractor employees to gain leverage in resolving these payment disputes. For example, in September 2015, the president of a U.S. construction company performing work in Afghanistan wrote President Ghani to plead for his assistance with an Afghan subcontractor who was threatening the company's Afghan and international staff with unlawful arrest. The letter claimed that the subcontractor tried to arrest

the company's chief executive officer and two senior managers after improperly obtaining a judgement from the Afghan Attorney General's Office and Afghanistan's court system.

U.S. prime contractors who were accused of not paying their subcontractors also told us that they wrote to President Ghani complaining that they received threats of property damage and work site disruptions, and their employees were targets of death and kidnapping threats. These contractors also alleged that subcontractors attempted to use the Afghan Attorney General's Office to extort payment by threatening to arrest contractor employees. USACE attorneys and contracting officers are aware of an incident where an Afghan National Army commander, on behalf of an Afghan subcontractor, told a U.S. prime contractor that he was under house arrest, and other incidents where arrest warrants were issued against prime contractor employees at the request of subcontractors. U.S. prime contractors have told us that they have found themselves in a precarious position when subcontractors have taken retaliatory actions following a contracting officer's ruling or arbitration decision in favor of the prime.

Prime contractors also face challenges due to the security situation in Afghanistan. According to U.S. government and Afghan sources, in some cases, U.S. employees are unable to conduct site visits to confirm that the work has been completed, which slows down the payment approval process. They also told us that Afghan prime contractors, like subcontractors, must often borrow money to purchase equipment in order to meet anticipated future work that may be cancelled, delayed, or curtailed. Many of those same Afghan contractors often lack enough investment capital to cover payments to subcontractors in the event that there is a delay in payment from the U.S. government.

According to those same sources, another serious problem for Afghan prime contractors is their inability to communicate with contracting officers when seeking to resolve payment issues. Given the high turnover among U.S. contracting officers in Afghanistan and the resulting lack of continuity, issues and claims remain unresolved leading to frustration and a lack of trust. This is particularly difficult when the United States reorganizes its contracting offices in Afghanistan, as it has done several times over the course of U.S. reconstruction efforts.

## Risks to Reconstruction Projects

In addition to contributing to disputes that can lead to the insolvency of local Afghan businesses, the abuse of the local legal system, and even to acts of violence, the problem of contractor nonpayment poses risks to reconstruction projects in Afghanistan. According to DOD, the U.S. reconstruction effort has been affected by disrupted worksites due to striking and blocked roads, along with other delays. In addition, in some instances the government has been forced to terminate contracts due to the prime contractor's failure to pay its subcontractors.<sup>10</sup> Following termination of these contracts, government agencies were then forced to expend additional funds in order to hire a new contractor to complete projects.

Afghan contractors and their representatives told us that contractor nonpayment could lead Afghan businesses to lose not only financial resources but also confidence in the U.S. government's commitment to reconstruction in Afghanistan—conditions that are necessary to sustain current and future projects. According to Afghan contractors, business organizations, and legal advocates, Afghan business owners generally have a positive perception of the U.S. government and recognize the benefits that U.S. investment has provided. However, Afghan companies are particularly vulnerable to the negative effects of nonpayment, and, according to Afghan prime contractors and

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<sup>10</sup> According to USACE, the U.S. government still has pending affirmative claims that are in litigation for recouping overpayments, liquidated damages, and reprourement costs against a contractor awarded a \$26 million construction contract in support of the Afghan National Army. The contract had been terminated for default due in part to allegations of subcontractor nonpayment throughout the contract's period of performance.

subcontractors, a contract dispute can be potentially catastrophic for an Afghan business. According to these firms, when Afghan contractors are not paid or fail to obtain a prompt and equitable resolution of a payment dispute, they have often perceived the U.S. government as at least being partially responsible for their losses.

Nonpayment situations can lead to Afghan contractors feeling resentful and believing that, in contracting with the U.S. government, they are risking their lives, as well as their livelihoods, given the risk of being targeted by insurgents. SIGAR was told by an Afghan attorney representing Afghan subcontractors that lowered-tier subcontractors have a more negative perception of the U.S. government. Some of the subcontractors believe that the U.S. government does not care about them and only protects the prime contractors.

An example of this dissatisfaction occurred in April 2015, when, according to an Afghan news report, a number of small business owners protested outside the Afghan parliament over nonpayment for construction work. The protestors claimed that they were owed over \$90 million from Turkish and American companies and threatened an extensive strike if not provided government help in resolving their claims for payment.<sup>11</sup>

## CHALLENGES CONTINUE TO HINDER NONPAYMENT RECOVERIES

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Our review of and investigations into contractor nonpayment complaints since October 2012 found that several challenges related to the prompt and appropriate payment of contractors in Afghanistan continue to plague the contracting process. These challenges include few legal remedies for Afghan subcontractors seeking payment, little or no Afghan understanding of the U.S. contracting process, the turnover of contracting officers, and the lack of capital and financing.

### Limited Legal Remedies

The legal remedies and resources available to Afghan contractors when facing nonpayment disputes are limited due to Afghan law, U.S. government regulations, and contract clauses used by prime contractors.

- **Afghan Law:** The U.S. Embassy in Kabul has described Afghanistan as having a “weak legal framework, and weak regulatory enforcement and dispute resolution mechanisms make it difficult to resolve business disagreements in country.”<sup>12</sup> Since 2013, there have been no identifiable changes to Afghan law regarding subcontractor nonpayment disputes. SIGAR is only aware of one legal action since 2013 involving the failure to pay subcontractors in Afghanistan.<sup>13</sup>
- **U.S. Government Regulations:** The U.S. government has limited ability to assist subcontractors because the government does not have privity (i.e., a direct contractual relationship) with subcontractors and, therefore, is not contractually obligated to pay them directly for work they performed for a prime contractor. For example, the Federal Acquisition Regulation (FAR) states that a subcontractor:

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<sup>11</sup> Tolo News, “Builders Protest Over Non-payment by Turkish, US Companies,” April 20, 2015.

<sup>12</sup> U.S. Embassy Kabul, “Business: Frequently Asked Questions,” accessed March 22, 2016, <http://kabul.usembassy.gov/business-faq.html>.

<sup>13</sup> On October 28, 2013, following a 13-day trial, the jury in the matter of *Global Hub Logistics (GHL) v. Tamerlane Global Services, Inc.* found in favor of GHL, awarding the company \$1,937,559 based on Tamerlane’s failure to pay GHL for delivery of cargo in Afghanistan between October 2010 and June 2011.



Has no contractual rights against the Government upon the termination of a prime contract. A subcontractor may have rights against the prime contractor or intermediate subcontractor with whom it has contracted. Upon termination of a prime contract, the prime contractor and each subcontractor are responsible for the prompt settlement of the settlement proposals of their immediate subcontractors.<sup>14</sup>

Although there are some steps that contracting officers can take to encourage prime contractors to properly pay their subcontractors, these remedies are limited in their scope and effectiveness. For example, when subcontractors assert that they have not been paid by a prime contractor in accordance with the terms of a contract for noncommercial items,<sup>15</sup> a contracting officer may determine whether: (1) the contractor has made payment to its subcontractor “in compliance with the terms of the subcontract, purchase order, or other agreement with the prime contractor”; or (2) “whether the contractor’s certification of payment of a subcontractor or supplier accompanying its [own] payment request to the Government is accurate.”<sup>16</sup> However, it is not mandatory that the contracting officer make such determinations. Additionally, contracting officers are required in the case of noncommercial contracts, upon the request of a subcontractor, to advise the subcontractor as to: “(1) Whether the prime contractor has submitted requests for progress payments or other payments to the Federal Government under the contract; and (2) Whether final payment under the contract has been made by the Federal Government to the prime contractor.”<sup>17</sup> Moreover, the FAR authorizes the contracting officer, upon a finding that a prime contractor is not in compliance, to: (1) “encourage the contractor to make timely payment to the subcontractor”; or (2) if authorized by the contract, “reduce or suspend progress payments to the contractor.”<sup>18</sup> However, a contracting officer is not required to exercise this authority.

- **Arbitration Contract Clauses:** Contract clauses commonly used by prime contractors in Afghanistan also limit the remedies available to subcontractors when facing payment disputes. According to USACE, U.S. prime contractors in Afghanistan typically insert arbitration language requiring subcontractors to bring disputes to a U.S. venue (typically, the state where the prime contractor is headquartered). Taking such an action would be costly for Afghan subcontractors, and USACE noted that, even if the subcontractor received a judgment and award, the subcontractor would have considerable difficulty enforcing the judgment due to the cost and logistical challenges of doing so. A director in the Afghan Investment Support Agency (AISA) reported that the Afghanistan Centre for Dispute Resolution is playing a role in resolving disputes, but most of the disputed nonpayment issues are related to contracts containing clauses that require the disputes be heard in the United States or Dubai.<sup>19</sup>

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<sup>14</sup> FAR 49.108-1.

<sup>15</sup> “Commercial item” means—(1) Any item, other than real property, that is of a type customarily used by the general public or by non-governmental entities for purposes other than governmental purposes, and—(i) Has been sold, leased, or licensed to the general public; or, (ii) Has been offered for sale, lease, or license to the general public. See FAR 2.101.

<sup>16</sup> FAR 32.112-1(a)(3).

<sup>17</sup> FAR 32.112-2(a)(2).

<sup>18</sup> FAR 32.112-1(b)(2).

<sup>19</sup> The Afghanistan Centre for Dispute Resolution is a dispute resolution center which aims to attract and maintain domestic and international commercial business interests to the region. It was started in June 2015 and has provided domestic and international mediation services and reportedly will provide arbitration services for commercial disputes in Afghanistan.

In addition to these legal limitations, Afghan contractors and their representatives told us that the business culture in Afghanistan has contributed to distrust between U.S. prime contractors and Afghan subcontractors, as well as distrust between Afghan prime contractors and the U.S. government. USACE observed that Afghanistan has a business culture where there is no disincentive for fraud. According to USACE, a major contributing factor to this business culture is the lack of U.S. jurisdiction over Afghan citizens in most cases. As a result, companies have determined that there are no repercussions if they submit a questionable or fraudulent claim. They can submit frivolous or disingenuous claims knowing that they will not be prosecuted in the United States. Although administrative action against a company, such as suspension and debarment, can be taken for filing fraudulent claims, such actions do not result in the resolution of the claims made by the Afghan companies because they do not provide for payment for damages or restitution.<sup>20</sup>

According to U.S. and Afghan sources, the difficult business environment in Afghanistan and the relative lack of legal remedies continue to be challenges to ensuring Afghan subcontractors receive proper payment for the work they perform. Because the legal remedies and resources available to Afghan subcontractors are limited, it may be helpful for U.S. government contracting offices to be more proactive in working with Afghan subcontractors to ensure that they receive prompt and proper payment. DOD, State, and USAID contracting offices could consider partnering with Afghan business community organizations to identify and provide legal points of contact (e.g., Afghan law firms, the Ministry of Justice) to all Afghan contractors to help ensure proper payment for work performed in accordance with contractual requirements.

### Lack of Understanding of the U.S. Government Contracting Processes

The FAR requires, in the case of fixed-price construction contracts,<sup>21</sup> that contractors certify with each request for progress payments that “[a]ll payments due to subcontractors and suppliers from previous payments received under the contract have been made, and timely payments will be made from the proceeds of the payment covered by this certification . . . .”<sup>22</sup> The FAR also requires, in the case of construction contracts,<sup>23</sup> that the contractor include a clause in its subcontracts that obligates the contractor to pay its subcontractors for satisfactory performance “not later than 7 days from receipt of payment out of such amounts as are paid to the Contractor under [the] contract.”<sup>24</sup>

According to an official with the USACE Middle East District, the most pressing and far-reaching problem associated with current contracting practices in Afghanistan is that U.S. prime contractors are convincing their Afghan subcontractors to sign “pay when paid” clauses. These clauses only require a prime contractor to pay its first-tier subcontractors when the prime is paid by the U.S. government.

According to a USACE attorney, the basic problem with these clauses is that they delay payment to subcontractors who have already performed (and incurred costs) on their subcontract with the prime contractor. Under a “pay when paid” clause, a prime contractor would not be required to pay subcontractors until and unless the prime contractor obtained payment from the U.S. government. This leaves the subcontractors unpaid when the government rejects a prime contractor’s improper

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<sup>20</sup> According to USACE, there is an additional ever-present problem with foreign firms (contractors and subcontractors) being somewhat incentivized to submit frivolous or disingenuous [requests for equitable adjustment] and claims, as being foreigners, they are somewhat “insulated” from U.S. federal prosecution. Many of these foreign firms do not have adequate cost accounting systems and are unable to provide sufficient proof that monies were spent.

<sup>21</sup> FAR 32.111.

<sup>22</sup> FAR 52.232-5(c).

<sup>23</sup> FAR 32.909

<sup>24</sup> FAR 52.232-27(c)(1).

claim for payment, as well as when the contractor merely fails to seek compensation for work performed by a subcontractor. If prime contractors were contractually prohibited from incorporating “pay when paid” clauses into their subcontracts, it is less likely that subcontractors would be left uncompensated when a prime contractor neglects to submit a claim or submits a claim that is determined by U.S. contracting officers to be improper under the contract.

According to U.S. government and Afghan sources, another challenge related to Afghan contractors’ lack of understanding of U.S. government contracting practices is the relative lack of communication between subcontractors and contracting officers or their representatives. A USACE contracting officer explained that clear instructions and guidance are generally not provided from the contracting officer to the entire chain of contracting tiers in order to educate and protect subcontractors and lower-tiered subcontractors about U.S. government contracting practices. The contracting officer’s primary focus is the prime contractor, which has direct obligations to and a contractual relationship with the U.S. government. The prime contractor is expected to act in good faith with its subcontractors and is obligated to make sure that certain contractual provisions are incorporated into its subcontracts. However, lower tiers of subcontractors, typically providing construction services, are reportedly not provided clear guidance about their rights, responsibilities, and remedies for disputes. For example, according to USACE, there have been several instances in which prime contractors received complaints from subcontractors who did not understand that the prime contractors were properly reducing amounts paid to subcontractors who did not provide materials that complied with subcontract requirements.

USACE staff informed SIGAR that, in addition to “pay when paid” clauses, U.S. contractors in Afghanistan often use a clause in their subcontracts stating that the subcontractor will receive final payment after the prime contract is officially closed out, which can take years after a subcontractor has already completed its work. This is an example of a subcontract clause that may not always be adequately explained to an Afghan subcontractor who expects payment upon completion of its work under the subcontract. The clause may delay the final payment to the subcontractor and, in some instances, could be used by a prime contractor as a pretext for never making final payment to the subcontractor.

USACE staff also mentioned that when DOD first began contracting in Afghanistan, it used cost-reimbursement contracts that put most of the contracting risk on the U.S. government, rather than the contractor.<sup>25</sup> USACE staff stated that the use of cost-reimbursement contracts was an onerous administrative burden for the contracting officer. However, USACE stated that this method was later viewed as too risky for government contracting in Afghanistan, and agencies were encouraged by Congress to use fixed-price contracts.<sup>26</sup> According to USACE, most of its construction contracts are now fixed-price, and the winning bid is the lowest price technically acceptable bid. Fixed-price contracts shift the cost risk onto the prime contractor, who, by inserting the “pay when paid” clause, then shifts the risk down to its Afghan subcontractors.<sup>27</sup> This issue is further complicated by a lack of understanding regarding U.S. contracting regulations by Afghan contractors.

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<sup>25</sup> See FAR 16.301-1. “Cost-reimbursement types of contracts provide for payment of allowable incurred costs, to the extent prescribed in the contract. These contracts establish an estimate of total cost for the purpose of obligating funds and establishing a ceiling that the contractor may not exceed (except at its own risk) without the approval of the contracting officer.”

<sup>26</sup> See FAR 16.201. “Fixed-price types of contracts provide for a firm price or, in appropriate cases, an adjustable price. Fixed-price contracts providing for an adjustable price may include a ceiling price, a target price (including target cost), or both. Unless otherwise specified in the contract, the ceiling price or target price is subject to adjustment only by operation of contract clauses providing for equitable adjustment or other revision of the contract price under stated circumstances.”

<sup>27</sup> According to USACE attorneys, in situations where the risk of a contract cannot be accurately assessed, a cost-reimbursement contract may be the more appropriate vehicle.

To help remedy these issues, USACE staff suggested that the Federal Acquisition Regulatory Council consider prohibiting or limiting the use of “pay when paid” clauses. As a temporary measure, DOD, State, and USAID contracting offices could also take steps to educate Afghan contractors about the risks posed by agreeing to a “pay when paid” clause.

In addition, USACE attorneys suggest DOD, State, and USAID contracting officers consider asking for and reviewing all first-tier subcontracts, in order to identify clauses that may unfairly disadvantage the subcontractor with regard to pay, performance, or other material contractual requirements. SIGAR suggests that contracting officers could request that prime contractors provide written guidance and instructions to all subcontracting tiers that would clearly explain subcontractors’ obligations, rights, and risks. Contracting officers could also request that prime contractors certify that they have shared the guidance with their subcontractors.

In order to be effective, any such guidance or other materials provided to Afghan subcontractors would need to be available in all appropriate Afghan languages and (1) generally explain the U.S. contracting process with respect to all contracting tiers, highlighting the roles and responsibilities of the subcontractor, prime contractor, and U.S. government; (2) explain the options available to address nonpayment complaints, including arbitration, mediation, and dispute resolution, and the limits to the U.S. government’s liability; and (3) use government pre-construction conferences at the beginning of projects as a venue to discuss the prime contractor’s responsibilities to its subcontractors with both the prime and subcontractors.

Finally, according to Afghan sources, there are a number of Afghan government entities that can help Afghan companies understand the U.S. government contracting process and the risks inherent to the subcontracting tiers, including the Independent Joint Anti-Corruption Monitoring and Evaluation Committee (MEC).<sup>28</sup> Therefore, SIGAR suggests that DOD, State, and USAID contracting offices should consider: leveraging these entities to identify and communicate with Afghan contractors, to include enlisting MEC to provide direct educational and contract dispute assistance to subcontractors working in areas with limited U.S. direct oversight, and training Afghan quality assurance contractors (currently supporting U.S. contracting officers) in remote sites to provide educational and contract dispute services to subcontractors working at those sites.

### **Turnover of U.S. Contracting Officers and Lack of Capital**

Payment disputes between prime and subcontractors are aggravated by the constant turnover of U.S. contracting officers due to base closures and frequent redeployments. For example, when Afghan contractors lose their point of contact with the U.S. government, even if the military facility or project is still active, they may have difficulty locating other U.S. contracting personnel who can address their complaints.

In addition, according to Afghan contractors, the U.S. government does not fully understand their lack of access to capital and financing. Contracts with the U.S. government or with a prime contractor working on a U.S. government project are often an Afghan contractor’s primary source of income, and in some instances Afghan contractors will leverage most of their assets to obtain equipment and other material needed to compete for contracts. We suggest that having timely access to contracting officers to resolve nonpayment issues can be critical to their financial viability.

Afghan subcontractors also must rely on Afghan banks to quickly process their payments from prime contractors. State officials and Afghan contractors we interviewed were concerned with the recurring problem of Afghan banks’ ability to conduct electronic funds transfers. According to a State

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<sup>28</sup> MEC acts as a key facilitator and coordinator among actors involved in the fight against corruption in Afghanistan. MEC has initiated stakeholder working groups to identify corruption issues and solutions. MEC also conducts regular provincial missions to gain a regional perspective.

contracting officer's representative, State pays its Afghan contractors by electronic funds transfers through off-shore commercial banks. The commercial banks then wire the funds to the Afghan banks servicing the contractors. Troublingly, the Afghan banks often delay payment by up to 2 weeks, which places a financial burden on the contractor.

USACE staff also noted that another challenge linked to lack of on-hand capital is the lack of secured bonds that would help provide confidence to lower-tier subcontractors and creditors in cases where payments are delayed. Typically, U.S. companies are bonded, which helps to guarantee that a project will be completed even if a contractor becomes insolvent. However, not all DOD contracting organizations require bonding in Afghanistan, and relatively few Afghan contractors are bonded. According to the USACE officials, the creation of an Afghan financial institution, with U.S. support, that could provide surety bonds to prime contractors would support the concept of Afghan contractors investing in their own country.<sup>29</sup>

According to these USACE officials, both performance<sup>30</sup> and payment bonds<sup>31</sup> should be issued—the latter would provide protection to subcontractors in the event that a prime contractor would not or could not pay for work performed. The typical risk borne by the prime contractor would be shifted to the surety rather than the subcontractor. To help remedy these issues, DOD, State, and USAID could consider the feasibility of providing assistance to appropriate Afghan financial institutions to enable the bonding of prime contractors operating in Afghanistan.

## U.S. Contractor Perspective

The Professional Services Council (PSC), which represents approximately 400 companies in the professional and technical industry—including companies that conduct business in Afghanistan—provided additional perspective. PSC acknowledged the difficulty resulting from the rotation of contracting officers and base closure, noting that their clients had experienced difficulty in locating contracting officers and that no one provided continuity. PSC recommended that U.S. contracting agencies go to a regionalized and centralized “hub” system in order to provide continuity in contract coverage. PSC recommended the hub be located in Dubai due to its stable location and air connections throughout the region. In PSC's view, disputes between Afghan subcontractors and U.S. prime contractors should be resolved at the lowest level possible. The first entry point should be the contracting officer. A second source of liaison could be the Defense Contract Management Agency representative, either in Afghanistan or the United States, with contract administration responsibility for that contractor. Finally, PSC recommended the creation of alternative dispute resolution capabilities to provide additional mechanisms for bringing parties together and a dedicated ombudsmen to help facilitate dispute resolution.

## SIGAR EFFORTS HAVE HELPED RESOLVE A NUMBER OF CONTRACTING DISPUTES

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Since issuing our 2013 report on subcontractor nonpayment, we have updated our procedures to better address the growing number of nonpayment complaints we receive. Now, when we receive a

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<sup>29</sup> See FAR 28.001. The FAR defines a “bond” as “a written instrument executed by a bidder or contractor (the ‘principal’), and a second party (the ‘surety’ or ‘sureties’) (except as provided in FAR 28.204), to assure fulfillment of the principal's obligations to a third party (the ‘obligee’ or ‘Government’), identified in the bond. If the principal's obligations are not met, the bond assures payment, to the extent stipulated, of any loss sustained by the obligee.”

<sup>30</sup> FAR 28.001 states that a “performance bond secures performance and fulfillment of the contractor's obligations under the contract.”

<sup>31</sup> FAR 28.001 states that a “payment bond assures payments as required by law to all persons supplying labor or material in the prosecution of the work provided for in the contract.”

complaint regarding nonpayment on a U.S. government-funded reconstruction contract, our investigators contact the subcontractors, prime contractors, and contracting officers (if necessary) involved in an effort to resolve the complaints. SIGAR's actions have resulted in effective dispute resolution and dozens of referrals for suspension or debarment, as well as monetary recoveries for Afghan subcontractors.

SIGAR procedures call for investigative review of all hotline complaints and that administrative, civil, or criminal action be taken by the agency, as appropriate. Although we cannot provide legal advice to the parties in nonpayment disputes, all Afghan contractor nonpayment complaints receive follow-up action by our investigative staff.<sup>32</sup> Specifically, in January 2014, we began identifying and classifying nonpayment complaints. Since then, SIGAR contacts the complainant and requests the following information:

1. The prime contract number/task order number
2. The invoice(s) not paid under the contract
3. The total amount due to the company (supported by invoices)
4. A copy of the contract
5. Proof of performance on the part of the company

SIGAR staff review the documentation provided and, if appropriate, attempt to contact the contracting officer or contractor identified as not having made full payment.<sup>33</sup> If the parties allegedly involved do not respond, the complaint is forwarded to SIGAR's Senior Counsel for Investigations for review, which may lead to referral for debarment based on a lack of present responsibility as a government contractor. In those instances when the complainant fails to provide the requested information, they are sent a second request and asked to comply within 1 week. If no response is received, the complaint is closed.

SIGAR's investigative division reports that these measures have directly helped resolve a number of these nonpayment disputes and have led to administrative actions against companies we identified as serial offenders. For example, of the 164 complaints we received between October 2012 and August 2015, 47 concerned the actions of 4 companies that have been, or are in the process of being evaluated for administrative action by SIGAR's suspension and debarment program.<sup>34</sup> An additional 5 hotline complaints have resulted in companies being debarred or referred for debarment. As of February 2016, SIGAR's investigative efforts related to nonpayment issues have led to 59 debarments, one Administrative Compliance Agreement, and 28 cases where SIGAR made a suspension or debarment referral but the agency declined to take action.<sup>35</sup>

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<sup>32</sup> SIGAR is uniquely equipped to investigate nonpayment complaints related to U.S. government contracts in Afghanistan. With the largest number of U.S. fraud investigators on the ground in Afghanistan, SIGAR has highly experienced support staff consisting of auditors, analysts, and attorneys specializing in contract matters.

<sup>33</sup> SIGAR also works closely with DOD, State, USAID, and the Afghan Attorney General's Office on trying to resolve nonpayment issues. The Afghan Attorney General's Office has worked on a number of nonpayment complaints and has provided information and evidence to the International Security Assistance Force (now Resolute Support), USACE, and SIGAR.

<sup>34</sup> FAR Subpart 2.1 defines "debarment" as "action taken by a debarring official under 9.406 to exclude a contractor from Government contracting and Government-approved subcontracting for a reasonable, specified period; a contractor that is excluded is 'debarred.'"

<sup>35</sup> Administrative Compliance Agreements are entered into by agencies to address concerns regarding contractor responsibility where appropriate assurances of responsibility, coupled with continuing oversight, are deemed to be of greater advantage to the government than suspension or debarment of a contractor. These agreements place emphasis on changing the contractor's behavior through the adoption of an ethical business environment, imposition of internal controls, and other changes to the company's decision-making process. Administrative Compliance Agreements are often used in cases where the responsibility of a sole source for a particular good or service is in question or in cases where a

In some cases, agencies or contractors made payments subsequent to SIGAR's investigative inquiries. With SIGAR's assistance, seven contractors were eventually successful in recovering payments. For example, a road construction contractor asked SIGAR for assistance with a payment dispute with DOD. At the time, DOD could only review the project via map imagery. SIGAR analyzed the contractor's complaint and supporting data, and coordinated a settlement with DOD. In another case, an Afghan contractor incurred costs for moving equipment, supplies, and personnel under a DOD contract, but received a stop work order before starting work. The contractor was instructed to bill DOD for costs incurred, but was never paid because of an administrative oversight by DOD. Unfortunately, DOD had transferred contracting responsibility to another office and apparently failed to inform the contractor. SIGAR was able to track down the new contracting activity and secure a \$145,000 payment for the contractor. In another instance, a diesel and fuel subcontractor sought SIGAR's assistance in recovering \$319,000 in unpaid invoices from a prime contractor. After SIGAR conducted inquiries, the subcontractor received full payment. One subcontractor SIGAR assisted noted that without SIGAR's support, the prime contractor would have never agreed to release the payment.

## CONCLUSION

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Nonpayment is an ongoing problem that negatively affects Afghan subcontractors; Afghan, U.S. and international prime contractors; and U.S. reconstruction projects. A review of SIGAR's hotline complaints indicated that, in many instances, Afghan contractors continue to be denied prompt and proper payment for work performed in support of Afghanistan reconstruction projects. Important reconstruction projects are underway in remote or insecure areas of Afghanistan where there is little or no direct U.S. oversight. The United States depends on multiple tiers of Afghan contractors and subcontractors to perform work on these projects. These contractors face safety and financial risks by accepting work relating to these contracts, and when there is a contract dispute, the subcontractors in particular have little practical recourse. Afghan subcontractors and their representatives have also told us that Afghan subcontractors often blame the U.S. government when they are not paid for their work on a reconstruction project, even though the U.S. government does not have a direct contractual relationship with the subcontractors. Of particular concern are the reports by Afghan contractors that thousands of Afghan workers remain unpaid and may consider cooperating with insurgent forces out of frustration and the need for money.

Given the persistence of contractor nonpayment disputes and the associated risks to the Afghanistan reconstruction effort, these issues warrant further attention from both the U.S. and Afghan governments. After speaking with USACE staff, Afghan contractor representatives, and other stakeholders, as discussed throughout this report, we identified some actions that could help address some of the root causes of contractor nonpayment disputes and lead to more equitable outcomes for all parties involved. By considering whether some of the suggested actions present feasible ways of addressing the challenges many Afghan contractors face, U.S. government agencies operating in Afghanistan may be able to eventually reduce risks and encourage greater local cooperation with the Afghanistan reconstruction effort. These suggested actions may also help expedite resolution of disputes where the Afghan contractor performed shoddy or inadequate work—or no work at all.

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contractor can show that it has developed a viable plan to prevent the reoccurrence of the conduct that initially called its present responsibility in to question.

## AGENCY COMMENTS

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We provided a draft of this report to DOD, State, and USAID on November 22, 2016. We received official comments from State and USAID. Those comments acknowledged that only one nonpayment complaint included in our review was associated with State or USAID and thanked SIGAR for its efforts to raise awareness of this issue and ensure fair payments to contractors. State's comments are reproduced in appendix I and USAID's comments are reproduced in appendix II. We also received technical comments from DOD, which we incorporated, as appropriate.



## APPENDIX I – DEPARTMENT OF STATE COMMENTS ON DRAFT REPORT

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United States Department of State  
*Bureau of South and Central Asian Affairs*  
*Washington, D.C. 20520*

December 21, 2016

Matthew Dove  
Director, Special Projects  
Office of the Special Inspector General for  
Afghanistan Reconstruction (SIGAR)  
1550 Crystal Drive, Suite 900  
Arlington, VA 22202

SUBJECT: State Department Response to Draft SIGAR Review “Nonpayment of Afghan Contractors: SIGAR Investigative Efforts Have Helped Resolved Disputes, but Problems Remain”

Dear Mr. Dove:

The State Department thanks SIGAR for the opportunity to comment on this draft review. The Department is committed to ensuring that its contractors in Afghanistan receive appropriate and timely payment, and strictly monitors its policies to this end. The Department is pleased to note that SIGAR’s review does not identify any complaints of nonpayment against State, and cites only one USAID-related complaint out of a total of 164 received since its last review.

While nonpayment of contractors does not appear to be an issue for State’s operations in Afghanistan, the Department welcomes SIGAR’s efforts to ensure the fair payment of U.S.-funded contractors and its suggestions to reduce the potential for nonpayment.

Sincerely,

A handwritten signature in black ink, appearing to read "John Ginkel".

John Ginkel  
Acting Special Representative for Afghanistan  
and Pakistan



**MEMORANDUM**

December 12, 2016

**TO:** John F. Sopko  
Special Inspector General for  
Afghanistan Reconstruction (SIGAR)

**FROM:** Herbert Smith, Mission Director 

**SUBJECT:** Mission Response to Draft SIGAR Review titled:  
“Nonpayment of Afghan Contractors: SIGAR  
Investigative Efforts Have Helped Resolved Disputes, but  
Problems Remain” (SIGAR-17-XX-SP)

**REF:** SIGAR Transmittal email dated 11/23/2016

USAID thanks SIGAR for the opportunity to comment on this draft review and commends SIGAR for their efforts in facilitating payments to contractors and subcontractors in Afghanistan.

SIGAR’s review has documented that out of 164 nonpayment complaints received by SIGAR, one allegation was identified as related to USAID (*see Footnote 5, SIGAR Review Report*), which was investigated and subsequently closed by SIGAR.

USAID has not received any allegations or complaints from its contractors or subcontractors regarding nonpayment. USAID’s policies and procedures mandate timely payment to its contractors and subcontractors. USAID remains committed to helping the Afghans and working with SIGAR in this area.

USAID acknowledges SIGAR’s efforts in raising awareness of this issue and continues to have no complaints to date.

U.S. Agency for International Development  
Great Massoud Road  
Kabul, Afghanistan

Tel: 202-216-6288 / 0700-108-001  
Email: [kabulusaiddinformation@usaid.gov](mailto:kabulusaiddinformation@usaid.gov)  
<http://afghanistan.usaid.gov>

cc: Robert Clark, Controller, USAID/Afghanistan  
Daniel Wartko, U.S. Embassy/Kabul  
OAPA Audit

This project was conducted  
under project code SP-05B.

## SIGAR's Mission

The mission of the Special Inspector General for Afghanistan Reconstruction (SIGAR) is to enhance oversight of programs for the reconstruction of Afghanistan by conducting independent and objective audits, inspections, and investigations on the use of taxpayer dollars and related funds. SIGAR works to provide accurate and balanced information, evaluations, analysis, and recommendations to help the U.S. Congress, U.S. agencies, and other decision-makers to make informed oversight, policy, and funding decisions to:

- improve effectiveness of the overall reconstruction strategy and its component programs;
- improve management and accountability over funds administered by U.S. and Afghan agencies and their contractors;
- improve contracting and contract management processes;
- prevent fraud, waste, and abuse; and
- advance U.S. interests in reconstructing Afghanistan.

## Obtaining Copies of SIGAR Reports and Testimonies

To obtain copies of SIGAR documents at no cost, go to SIGAR's Web site ([www.sigar.mil](http://www.sigar.mil)). SIGAR posts all publically released reports, testimonies, and correspondence on its Web site.

## To Report Fraud, Waste, and Abuse in Afghanistan Reconstruction Programs

To help prevent fraud, waste, and abuse by reporting allegations of fraud, waste, abuse, mismanagement, and reprisal, contact SIGAR's hotline:

- Web: [www.sigar.mil/fraud](http://www.sigar.mil/fraud)
- Email: [sigar.pentagon.inv.mbx.hotline@mail.mil](mailto:sigar.pentagon.inv.mbx.hotline@mail.mil)
- Phone Afghanistan: +93 (0) 700-10-7300
- Phone DSN Afghanistan: 318-237-3912 ext. 7303
- Phone International: +1-866-329-8893
- Phone DSN International: 312-664-0378
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Arlington, VA 22202

## Public Affairs