RENEGOTIATION

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

EIGHTY-SIXTH CONGRESS

FIRST SESSION

ON

H.R. 7086

AN ACT TO EXTEND THE RENEGOTIATION ACT OF 1951, AND FOR OTHER PURPOSES

JUNE 2 AND 3, 1959

Printed for the use of the Committee on Finance

UNITED STATES
GOVERNMENT PRINTING OFFICE
41825 WASHINGTON : 1959

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CONTENTS

STATEMENTS

LETTERS AND TELEGRAMS

ADDITIONAL INFORMATION

RENEGOTIATION

TUESDAY, JUNE 2, 1959

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room 2221, New Senate Office Building, Senator Harry Flood Byrd (chairman) presiding.

Present: Senators Byrd, Kerr, Frear, Anderson, Douglas, Gore, Talmadge, McCarthy, Williams, Bennett, Butler, Cotton, and Curtis.

Also present: Thomas Coggeshall, Chairman of the Renegotiation Board, and Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The hearing today is on the bill H.R. 7086, to extend the Renegotiation Act of 1951.

I submit for the record the text of H.R. 7086, departmental reports from the Departments of the Treasury and Commerce, Bureau of the Budget, the Tax Court of the United States, an additional letter from the Department of Commerce transmitting a statement advocating an amendment in behalf of the Maritime Commission, and a statement submitted by the Shipbuilders Council of America.

(The bill, departmental reports, and statement follow:)

[H.R. 7086, 86th Cong., 1st sess.]

AN ACT To extend the Renegotiation Act of 1951, and for other purposes

SECTION 1. EXTENSION.

Section 102(c)(1) of the Renegotiation Act of 1951, as amended (50 U.S.C. App., sec. 1212(c)(1)), is amended by striking out "June 30, 1959" and inserting in lieu thereof "June 30, 1963".

SEC. 2. FACTORS TO BE CONSIDERED IN DETERMINING EXCESSIVE PROFITS.

(a) CONTRACTUAL PRICING PROVISIONS; ENCOURAGEMENT OF SUBCONTRACTING TO SMALL BUSINESS.—The second sentence of section 103(e) of the Renegotiation Act of 1951, as amended (50 U.S.C., App., sec. 1213(e)), is amended by striking out "and" before "economy in the use of materials", and by striking out "manpower;" and inserting in lieu thereof "manpower, contractual pricing provisions and the objectives sought to be achieved thereby, and economies achieved by subcontracting with small business concerns (as defined pursuant to section 3 of the Small Business Act);".

(b) USE OF PUBLIC AND PRIVATE CAPITAL.—Paragraph (2) of the second sentence of section 103(e) of such Act is amended to read as follows:

"(2) The net worth, and the amount and source of public and private capital employed;".

(c) STATEMENT FURNISHED BY BOARD.—Section 103(e) of such Act is amended by adding at the end thereof the following new sentence:

"In any statement furnished by the Board pursuant to section 105(a), the Board shall indicate separately, but without evaluating separately in dollars or percentages, its consideration of, and the recognition given to, the efficiency of the contractor or subcontractor and each of the other foregoing factors."

SEC. 3. FIVE-YEAR LOSS CARRYFORWARD.

Subsection (m) of section 103 of the Renegotiation Act of 1951, as amended (50 U.S.C., App., sec. 1213 (m)), is amended—

(1) By striking out the heading and inserting in lieu thereof the following: "(m) RENEGOTIATION LOSS CARRYFORWARDS.—".

(2) By striking out subparagraph (A) of paragraph (2) and inserting in lieu thereof the following:

"(A) The term 'renegotiation loss deduction' means—

"(i) for any fiscal year ending on or after December 31, 1956, and before January 1, 1959, the sum of the renegotiation loss carryforward to such fiscal year from the preceding two fiscal years; and

"(ii) for any fiscal year ending after December 31, 1958, the sum of the renegotiation loss carryforwards to such fiscal year from the preceding five fiscal years (excluding any fiscal year ending before December 31, 1956)."

(3) By striking out "CARRYFORWARDS.—A" in paragraph (3) and inserting in lieu thereof the following: "CARRYFORWARDS TO 1956, 1957, AND 1958.—For the purposes of paragraph (2)(A)(i), a".

(4) By adding at the end of such subsection the following paragraph:

"(4) AMOUNT OF CARRYFORWARDS TO FISCAL YEARS ENDING AFTER 1958.—For the purposes of paragraph (2)(A)(ii), a renegotiation loss for any fiscal year (hereinafter in this paragraph referred to as the 'loss year') ending on or after December 31, 1956, shall be a renegotiation loss carryforward to each of the five fiscal years following the loss year. The entire amount of such loss shall be carried to the first fiscal year succeeding the loss year. The portion of such loss which shall be carried to each of the other four fiscal years shall be the excess, if any, of the amount of such loss over the sum of the profit derived from contracts with the Departments and subcontracts in each of the prior fiscal years to which such loss may be carried. For the purposes of the preceding sentence, the profits derived from contracts with the Departments and subcontracts in any such prior fiscal year shall be computed by determining the amount of the renegotiation loss deduction without regard to the renegotiation loss for the loss year or for any fiscal year thereafter, and the profits so computed shall not be considered to be less than zero."

SEC. 4. STATEMENTS FURNISHED BY RENEGOTIATION BOARD, ETC.

(a) STATEMENTS.—The next to the last sentence of section 105(a) of the Renegotiation Act of 1951, as amended (50 U.S.C. App., sec. 1215(a)), is amended to read as follows: "Whenever the Board makes a determination of excessive profits to be eliminated, it shall, at the request of the contractor or subcontractor, as the case may be, and prior to the making of an agreement or the issuance of an order, prepare and furnish such contractor or subcontractor with a statement of such determination, of the facts used as a basis therefor, and of its reasons for such determination."

(b) DOCUMENTS AVAILABLE FOR INSPECTION.—Section 105(a) of such Act is amended by adding at the end thereof the following new sentences: "At or before the time such statement is furnished, the Board shall make available for inspection by the contractor or subcontractor, as the case may be, all reports and other written matter furnished to the Board by a Department relating to the renegotiation proceedings in which such determination was made, the disclosure of which is not forbidden by law. Nothing in the preceding sentence shall be construed as authorizing the disclosure of any information, referred to in section 1905 of title 18 of the United States Code, in respect of any person other than the contractor or subcontractor (as the case may be) unless such information properly and directly concerns such contractor or subcontractor."

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply only in the case of determinations made by the Renegotiation Board after the date of the enactment of this Act.

SEC. 5. PROCEEDINGS BEFORE THE TAX COURT IN RENEGOTIATION CASES.

(a) TAX COURT PROCEEDINGS DE NOVO.—Section 108 of the Renegotiation Act of 1951, as amended (50 U.S.C. App., sec. 1218), is amended by striking out the fourth sentence and inserting in lieu thereof the following new sentences: "A proceeding before the Tax Court to determine the amount, if any, of excessive profits shall not be treated as a proceeding to review the determination of the Board, but shall be treated as a proceeding de novo. The petitioner in

such proceeding shall have the burden of going forward with the case; only evidence presented to the Tax Court shall be considered; and no presumption of correctness shall attach to the determination of the Board."

(b) REVIEW BY SPECIAL DIVISION OF COURT.—Section 108 of the Renegotiation Act of 1951, as amended (50 U.S.C. App., sec. 1218), is amended by striking out the fifth sentence and inserting in lieu thereof the following new sentences: "The determinations by any division of the Tax Court under this section shall be reviewed by a special division of the Tax Court which shall be constituted by the chief judge and shall consist of not less than 3 judges. The decisions of such special division shall not be reviewable by the Tax Court, and shall be deemed decisions of the Tax Court. For the purposes of this section, the court shall have the same powers and duties, insofar as applicable in respect of the contractor, the subcontractor, the Board, and the Secretary, and in respect of the attendance of witnesses and the production of papers, notice of hearings, hearings before divisions, stenographic reporting, and reports of proceedings, as such court has under sections 7451, 7453, 7455, 7456(a), 7456(c), 7457(a), 7458, 7459(a), 7460(a), 7461, and 7462 of the Internal Revenue Code of 1954 in the case of a proceeding to redetermine a deficiency."

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply whether the petition for a redetermination was filed before, on, or after the date of the enactment of this Act, if the decision by the Tax Court has not been rendered on or before such date.

SEC. 6. REVIEW OF TAX COURT DECISIONS IN RENEGOTIATION CASES.

(a) AMENDMENT OF SECTION 108A.—Section 108A of the Renegotiation Act of 1951, as amended (50 U.S.C. App., sec. 1218a), is amended to read as follows:

"SEC. 108A. REVIEW OF TAX COURT DECISIONS IN RENEGOTIATION CASES.

"(a) JURISDICTION.—Except as provided in section 1254 of title 28 of the United States Code, the United States Court of Appeals for the District of Columbia shall have exclusive jurisdiction to review decisions of the Tax Court under section 108 of this Act, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury. The judgment of such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 1254 of title 28 of the United States Code.

"(b) POWERS.—

"(1) TO AFFIRM, OR REVERSE AND REMAND.—Upon such review the United States Court of Appeals for the District of Columbia shall have power to affirm or, if the decision of the Tax Court is not in accordance with law, to reverse the decision of the Tax Court and remand the case for such further action (including a rehearing) as justice may require.

"(2) CERTAIN PROVISIONS OF INTERNAL REVENUE CODE MADE APPLICABLE.—The provisions of subchapter D of chapter 76 of the Internal Revenue Code of 1954 (relating to court review of Tax Court decisions), to the extent not inconsistent with the provisions of this section, are hereby made applicable in respect of the review provided by this section."

(b) AMENDMENT OF SECOND SENTENCE OF SECTION 108.—The second sentence of section 108 of the Renegotiation Act of 1951, as amended (50 U.S.C. App., sec. 1218), is amended to read as follows: "Upon such filing such court shall have exclusive jurisdiction, by order, to determine the amount, if any, of such excessive profits received or accrued by the contractor or subcontractor, and such determination (1) shall not be reviewed by any court or agency except as provided by section 108A, and (2) shall not be redetermined by any court or agency, except that it may be redetermined by a decision of the special division of the Tax Court if the case is remanded under section 108A(b)(1)."

(c) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to decisions rendered by the Tax Court of the United States after June 30, 1958. For purposes of the preceding sentence, in applying section 7483 of the Internal Revenue Code of 1954 (relating to time for filing petition for review) in the case of a decision rendered after June 30, 1958, and before the date of the enactment of this Act, such decision shall be treated as having been rendered on the date of the enactment of this Act.

Passed the House of Representatives May 27, 1959.

Attest: RALPH R. ROBERTS,
Clerk.

OFFICE OF THE SECRETARY OF THE TREASURY,
Washington, June 3, 1959.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

MY DEAR MR. CHAIRMAN: Reference is made to your request for the views of the Treasury Department on H.R. 7086, a bill to extend the Renegotiation Act of 1951, and for other purposes.

The bill would, among other things, extend the Renegotiation Act which expires on June 30, 1959, under present law, for 4 years. The Treasury Department would have no objection to this extension.

Section 5 of the bill would specify that in renegotiation proceedings before the Tax Court the petitioner shall have the burden of going forward with the case, only evidence presented to the Tax Court shall be considered, and no presumption of correctness shall attach to the determination of the Renegotiation Board. The report of the House committee on this provision states that it is intended to assure that proceedings before the Tax Court shall be de novo and is not intended to shift the burden of proof under existing law. While the Department is not quite sure of the implications of this provision, it would oppose the creation of any precedent for legislation which would remove the present presumption that the action of the Commissioner of Internal Revenue is correct in tax cases. Any legislation which would require the Internal Revenue Service affirmatively to sustain each adjustment before the Tax Court would result not only in an inordinate increase in administrative burdens but also in delaying the processing of cases in the Tax Court.

Section 6 of the bill would provide for review by the U.S. Court of Appeals for the District of Columbia of the determinations of the Tax Court as to the amount of excessive profits of the contractor. The amendment would apply not only to negotiated profits of future years but also of many past years. This would create an undesirable precedent for the similar treatment of tax cases. At present the Tax Court has the authority to make a final determination of abnormalities under sections 721 and 722 of the 1939 code relating to excess profits tax. The Treasury Department would oppose granting of the right to appeal retroactively decisions of the Tax Court on cases involving sections 721 and 722 of the 1939 code. This would impose on the Internal Revenue Service the very onerous administrative burden of reopening cases and scheduling additional assessments or additional overpayments depending on the final determinations by the appellate courts.

A final consideration relates to the substantially increased burden on the Tax Court which would probably result from the combined effect of sections 5 and 6. The Treasury Department has a vital interest in the primary function of the Tax Court, which is the decision of tax controversies, and views with disfavor any enlargement of its duties in other areas.

The Department has been advised by the Bureau of the Budget that there is no objection to the submission of this report to your committee.

Very truly yours,

FRED C. SCRIBNER, Jr.,
Acting Secretary of the Treasury.

THE SECRETARY OF COMMERCE,
Washington, D.C., June 2, 1959.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: This is in reply to your request of May 28, 1959, for the views of this Department with respect to H.R. 7086, a bill to extend the renegotiation Act of 1951, and for other purposes.

The Department of Commerce favors the extension of the Renegotiation Act of 1951 in the interest of enabling the Government to attain the most effective use of Government expenditures, particularly in the areas of defense procurement. With respect to amendments to the Renegotiation Act of general application, which are included in H.R. 7086, this Department would defer to the views of the Renegotiation Board and the Department of Defense.

On May 26, 1959, Under Secretary of Commerce, Frederick H. Mueller urged that your committee adopt an amendment to the Renegotiation Act which would

provide that the profit recapture provisions of the Merchant Marine Act of 1936 will apply in the case of contracts not actually renegotiated under the Renegotiation Act. The Department will present testimony with respect to this amendment before your committee.

The Bureau of the Budget has advised that it would interpose no objection to the submission of this report to your committee.

Sincerely yours,

FREDERICK H. MUELLER,
Under Secretary of Commerce.

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C., June 3, 1959.

Hon. HARRY F. BOYD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

MY DEAR MR. CHAIRMAN: This will acknowledge your letter of May 28, 1959, inviting the Bureau of the Budget to comment on H.R. 7086, to extend the Renegotiation Act of 1951, and for other purposes.

I am authorized to advise you that the Bureau of the Budget favors the purpose of H.R. 7086, and that enactment of legislation for the extension of the Renegotiation Act would be in accord with the program of the President.

Sincerely yours,

PHILLIP S. HUGHES,
Assistant Director for Legislative Reference.

TAX COURT OF THE UNITED STATES,
June 1, 1959.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: This letter is in reply to yours dated May 28, 1959, inviting views on H.R. 7086. The provisions of this bill about which the Tax Court is most concerned are those which would extend the Renegotiation Act for 4 years from June 30, 1959, would provide for appeals from the Tax Court to the Court of Appeals for the District of Columbia and, in section 5, would enact provisions which the Tax Court feels might substantially increase both the number of cases coming to the Tax Court and the expeditious disposition of those cases.

The primary function of the Tax Court of the United States, since the tribunal was created in 1924, has been and is to decide tax cases. Jurisdiction over renegotiation cases was originally placed in the Tax Court of the United States in 1942. There were then pending before the Tax Court approximately 5,300 cases, an unusually small number. The renegotiation was war connected, thus apparently temporary, and the Tax Court, when asked by Congress, agreed that it would try to handle such renegotiation cases as might come to it. Nine hundred ninety-two petitions in renegotiation cases were filed with the Tax Court from the beginning of its jurisdiction up to March 31, 1959. Nine hundred twenty-two of those cases were closed during that period, leaving 70 pending. Over two-thirds of the closed cases were dismissed, about 17½ percent were settled and the Tax Court judges wrote 123 opinions closing 153 docket numbers.

The Tax Court has been able to carry that burden despite its increased load of tax cases and it will endeavor to continue to carry the renegotiation burden if at all possible. However, any change in the renegotiation law which might tend to increase the number of renegotiation cases coming to the Tax Court or make more burdensome the task of disposing of those cases, would seriously handicap the Tax Court in its primary task of handling tax cases. There are pending before the Tax Court at the present time over 13,000 tax cases as compared to 5,300 in 1942 when the renegotiation jurisdiction was given to the Tax Court. The disposition of this tremendous load of tax cases is straining and will continue to strain to the utmost the capacity of the Tax Court.

The Tax Court feels that certain additions to the renegotiation law proposed in H.R. 7086 may be expected to increase the number of renegotiation cases filed in the Tax Court and to increase substantially the work of the Tax Court in dis-

posing of those cases. One of those changes is the addition of the following sentence to section 108:

"The petitioner in such proceeding shall have the burden of going forward with the case; only evidence presented to the Tax Court shall be considered; and no presumption of correctness shall attach to the determination of the Board."

Section 108, entitled "Review by the Tax Court," at present provides that proceedings before the Tax Court in renegotiation cases "shall not be treated as a proceeding to review the determination of the Board, but shall be treated as a proceeding de novo." The report of the Committee on Ways and Means to accompany H.R. 7086 (House Report No. 364, at page 4) states that the "committee has received a number of complaints" that "a proceeding before the Tax Court in renegotiation cases is not truly de novo but tends to have the character of a proceeding to review the determination of the Renegotiation Board." The combination of that statement together with the addition to the law of the sentence above quoted and the provision for appeal to a circuit court will indicate to many contractors that Congress recognizes that the procedure followed by the Tax Court in renegotiation cases has not been satisfactory and is therefore changing it for the benefit of contractors.

Additional litigation of renegotiation cases before the Tax Court may be expected as a result of these circumstances, and while the Tax Court is not opposed to the provisions for appeals from its decisions, nevertheless appeals and possible reversals, appropriate as they may be, will likewise increase its workload in renegotiation cases.

Actually, the quoted addition to section 108 accomplishes nothing so far as the procedure of the Tax Court is concerned. The Tax Court in the 35 years of its existence has never conducted any proceeding except a proceeding de novo and has never considered any evidence except that presented to it. No supporting findings of the Renegotiation Board are received in evidence or considered by the Tax Court. The final amount determined by the Renegotiation Board has no significance in the trial before the Tax Court except that if the evidence introduced before the Tax Court does not enable it to reach a conclusion as to excessive profits then the Tax Court must leave the parties as it found them, which means that the amount determined by the Renegotiation Board will not be disturbed by the Tax Court. It is absolutely necessary in any litigation that the moving party have the burden of proof, and the Tax Court has taken care of this by its Rule 32. Nathan Cohen, 7 T.C. 1002.

Another amendment to section 108 proposed in H.R. 7086 which will impose additional burdens upon the Tax Court without any corresponding benefit is the proposed unique requirement that every renegotiation case in the Tax Court be reviewed by a Special Division of three, despite the fact that it is also subject to review by a court of appeals. The situation under existing law is that every case decided by an individual judge is reviewed by the chief judge and the latter, if he has any doubt, can refer the report of the individual judge for review by the full court of 16 judges. A Special Division would require a third judge to review every case in lieu of the present more adequate procedure. A Special Division causes considerable additional work for the Tax Court, and it is difficult to see why this should be placed upon it, since appeal to a circuit court is to be allowed.

The court respectfully suggests to Congress that either no changes be made in section 108 of the renegotiation law such as those proposed in H.R. 7086 or that the Tax Court be relieved of jurisdiction in renegotiation cases so that it can give its full time and attention to Federal tax cases. This latter alternative might be accomplished by allowing direct appeal from the Renegotiation Board to courts of appeals as is now provided with respect to the final determinations of many other administrative agencies.

Very truly yours,

J. E. MURDOCK, *Chief Judge.*

THE SECRETARY OF COMMERCE,
Washington, D.C., May 26, 1958.

HON. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: There are presently pending before the Congress proposals to extend the Renegotiation Act for an additional period. The Department is vitally interested in securing an amendment to the Renegotiation Act,

which would provide that the profit recapture provisions of the Merchant Marine Act of 1936 will apply in the case of contracts not actually negotiated under the Renegotiation Act.

There is attached a full statement of the need for this proposed amendment and a draft of language to accomplish the purpose.

The Department would appreciate an opportunity to testify with respect to this proposal before your committee.

Sincerely yours,

F. H. MUELLER,
Under Secretary of Commerce.

STATEMENT OF PURPOSE OF AND NEED FOR DRAFT AMENDMENT TO ANY EXTENSION OF THE RENEGOTIATION ACT OF 1951 TO LIMIT THE SUSPENSION OF THE PROFIT RECAPTURE PROVISIONS OF SECTION 505(b) OF THE MERCHANT MARINE ACT, 1936

The proposed draft amendment to the Renegotiation Act of 1951 would amend section 102(e) of that act to provide that the suspension of the profit recapture provisons of section 505(b) of the Merchant Marine Act, 1936, be operative only with respect to amounts which are actually submitted to renegotiation under the Renegotiation Act.

Under the present section 102(e) of the Renegotiation Act of 1951 (United States Code, title 50, App. Supp. V, sec. 1212(e)), the profit-limitation provisions of the Merchant Marine Act, 1936 (United States Code, title 46, sec. 1155), and of the Vinson-Trammell Act of 1934 (United States Code, title 10, secs. 2382 and 7300) are suspended with respect to any contract which is subject to the Renegotiation Act, even though the contract receipts or accruals aggregate less than the minimum amount or floor prescribed in the Renegotiation Act for each year and are not, therefore, renegotiated.

For fiscal years ending after June 30, 1956, the floor is $1 million. In any case controlled by the floor provision, therefore, under existing law a contract will escape renegotiation under the Renegotiation Act and the Vinson-Trammell Act or the Merchant Marine Act, 1936, as the case may be. If the contract performance extends more than 1 fiscal year of the contractor, the same advantage accrues to the contractor, if not with respect to the entire contract, then at least in respect of those amounts received or accrued from the contract in each fiscal year for which his total renegotiable business does not exceed the floor. It should be noted that the floor provision in the Renegotiation Act was increased from $250,000 to $500,000, effective for fiscal years ending on or after June 30, 1953, by the Extension Act of September 1, 1954 (Public Law 764, 83d Cong.), and that the floor was raised from $500,000 to $1 million by the act of August 1, 1956 (Public Law 870, 84th Cong.), effective for fiscal years ending after June 30, 1956.

The recapture provisions of section 505(b) of the Merchant Marine Act, 1936, are administered by the Maritime Administration, Department of Commerce. Section 505(b) requires contractors for construction of vessels under the Merchant Marine Act, 1936, to pay to the Government profit on the contracts in excess of 10 percent of the total contract price of the contracts completed by the contracting party within the income taxable year.

The Vinson-Trammell Act provisions (codified in United States Code, tile 10, secs. 2382 and 7300) provide for 10 percent profit limitation on contracts for naval vessels. The Maritime Commission and its successors, the Federal Maritime Board and Maritime Administration, Department of Commerce, have from time to time built ships for the account of the Navy Department and have administered the Renegotiation Act in cooperation with the Renegotiation Board in respect of these contracts.

The primary interest of this Department lies in the recapture provisions of the Merchant Marine Act, 1936. The Merchant Marine Act, 1936, is permanent legislation and has been operative in peacetime as well as during or in connection with wartime operations. It is the view of the Department that contractors or subcontractors under the Merchant Marine Act should not be exempted from renegotiation under the Renegotiation Act of 1951 on Government business up to $1 million in a year, and also have the profit-limiting provisions of the Merchant Marine Act, 1936, suspended. The recapture provisions of the 1936 act have proved effective as a long-range policy. The increase in the floor provision in the Renegotiation Act from $250,000 to $1 million has made the matter of suspension of the permanent law by the Renegotiation Act a matter of increasing significance.

The Department is convinced that when amounts are received or accrued under maritime building contracts which are subject to the Renegotiation Act, but are not actually subjected to renegotiation thereunder because they do not exceed the floor, such amounts should be subjected to the recapture provisions of the Merchant Marine Act, 1936. That is, section 505(b) of that act should apply to the amounts between the 1936 act floor of $10,000, and the Renegotiation Act floor of $1 million.

Prior to enactment of the Renegotiation Act, the recapture provisions of the 1936 act proved to be a very effective and desirable instrument of public policy in the administration of the construction subsidy contracts under the Merchant Marine Act, 1936, as well as in other shipbuilding contracts handled by the Maritime Administration.

The proposed change can be accomplished by inserting in the extension measure a new section to read as follows:

"SEC. —. (a) Section 102(e) (50 U.S.C., App., Supp. V, sec. 1212(e)), is amended by striking out, where it appears with reference to the Merchant Marine Act, 1936, 'if any of the receipts or accruals therefrom are subject to this title or would be subject to this title except for the provisions of section 106(e)', and inserting in lieu thereof 'to the extent that any of the receipts or accruals therefrom are subject to renegotiation under this title or would be subject to renegotiation under this title except for the provisions of section 106(e)'.

"(b) The amendment made by subsection (a) shall apply to contracts with the Departments and subcontracts only to the extent of the amounts received or accrued by a contractor or subcontractor after December 31, 1958."

Section 102(e), if amended as above proposed, would read as follows:

"(e) SUSPENSION OF CERTAIN PROFIT LIMITATIONS.—Notwithstanding any agreement to the contrary, the profit-limitation provisions of the Act of March 27, 1934 (48 Stat. 503, 505), as amended and supplemented, and of section 505(b) of the Merchant Marine Act, 1936, as amended and supplemented (46 U.S.C. (1155(b)), shall not apply, in the case of such Act of March 27, 1934, to any contract or subcontract if any of the receipts or accruals therefrom are subject to this title or would be subject to this title except for the privisions of section 106(e), and, in the case of the Merchant Marine Act, 1936, to any contract or subcontract entered into after December 31, 1950, to the extent that any of the receipts or accruals therefrom are subject to renegotiation under this title or would be subject to renegotiation under this title except for the provisions of section 106(e)."

As of April 1, 1959, there are contracts for the construction of 32 vessels with total contract prices amounting to $344,161,297. It appears difficult to make any estimate of the excess profits; however, our records indicate that approximately 45 percent of the total contract prices represents subcontract work with a recaptural profit experience ratio of about 3.3 percent. Applying these ratios to total contract prices of $344,161,297, results in an estimated recapturable profit of $5,110,795, which is not recapturable due to the provisions of the present Renegotiation Act.

The Bureau of the Budget has advised that there would be no objection to the submission of this proposal to the Congress.

STATEMENT OF THE SHIPBUILDERS COUNCIL OF AMERICA ON H.R. 7086, PROPOSING TO AMEND AND EXTEND THE RENEGOTIATION ACT OF 1951, SUBMITTED BY L. R. SANFORD, PRESIDENT

The Shipbuilders Council of America is the national trade association of the shipbuilding and ship repair industry. It includes in its membership practically all of the major private establishments in the United States which comprise that industry.

In addition to shipyards, the council membership also includes allied industries members. These companies supply the shipyards, both Government and private, with the materials, components, and equipment needed in the construction and repair of the various types and kinds of commercial vessels which operate in the overseas and domestic waterborne trades of the United States, as well as Government-owned vessels operated by the Navy, the Maritime Adminisrtation, and other Government agencies.

Over the years, the volume of national defense business done by members of the council has totaled billions of dollars. As a result the members of the coun-

cil have had an opportunity to observe at firsthand both contract renegotiation as provided under the 1944 and 1951 acts and the operation of the more arbitrary formula profit limitation technique provided in the Vinson-Trammell Act of 1934 and Merchant Marine Act, 1936. In addition, they have experience with a new technique, not based on statutes developed by Congress but merely on an arbitrary decision made within an agency, to include some sort of profit limitation clause in its procurement contracts.

Based on this knowledge and experience, the members of the Shipbuilders Council make the following recommendations pertinent to H.R. 7086 proposing the amendment and extension of the Renegotiation Act beyond June 30, 1959.

RECOMMENDATIONS

1. The Renegotiation Act should be permitted to expire on June 30, 1959.
2. The profit limitation provisions of the Vinson-Trammell Act of 1934 and of the Merchant Marine Act should be repealed at the earliest possible date.
3. If the Renegotiation Act be extended, whether for 4 years as is proposed by H.R. 7086, or for some lesser period, the profit limitation provisions of the Vinson-Trammell Act and of the Merchant Marine Act, 1936, still should be repealed at the earliest possible time, so that such provisions will not again become applicable at the termination of any such extension. It would be most appropriate to provide for such repeal in H.R. 7086 and the committee is strongly urged to so provide.
4. The practice of certain Government agencies of including profit limitation or profit recapture clauses in their contracts without statutory provision for such inclusion and even though the contract may alreay be subject to the Renegotiation Act, should be prohibited by Congress. At the present time, and without statutory authority, the Maritime Administration imposes profit recapture by means of an article 41 of its master repair contract. Also, both the Department of the Navy and the Maritime Administration without statutory authority include a profit limitation provision in the escalation clause used in connection with their respective shipbuilding contracts.
5. If Congress extends the Renegotiation Act, then Congress should amend the act so that the determination of a contractor's excessive profits for any year will be made in the light of the statutory factors as they appear in relation to all of his renegotiable Government business for any year or years reported to and before the Renegotiation Board. While for mechanical and income tax reasons, the determinations must be made on an annual basis, nevertheless each such annual determination should involve a full consideration of the individual contractor's performance on Government work on a continuing, rather than an arbitrary annual, basis. While there does not appear to be anything in section 103(e) of the act which limits the application of the statutory factors (including "(1) reasonableness of costs and profits") to the determination of excessive profits for a single or particular year, it appears that the Renegotiation Board now makes each year's determination almost solely on that year's profit and other data. It would be only equitable and in accord with the intent of Congress that a deficiency in reasonable or nonexcessive profits in a prior year or years be considered as a favorable factor in determining what will be deemed excessive in the particular year. Section 103 of the act should be so amended to make this requirement specific and mandatory.

EXTENSION OF THE RENEGOTIATION ACT

The first recommendation of the members of the Shipbuilders council as stated previously herein is:

1. The Renegotiation Act should be permitted to expire on June 30, 1959

Nonrenegotiable pricing is and should be the joint goal of Government and industry. To that end the Renegotiation Act of 1951, as amended, should be allowed to expire on June 30, 1959.

The broad application of the renegotiation technique can be justified, if at all, only during those periods of national emergency when normal procurement procedures are abandoned in the interest of expediting production and the factors which normally control undue profits cease to function. While the present procurement and production rate is relatively high as a result of the cold war in which the United States reluctantly but inevitably finds itself involved, the situation is not of a procurement emergency nature nor is it of recent origin.

On the contrary, it is of long standing, having covered a period of years, and the prospects are, at least as far as can be foreseen as of now, that it will continue on much the same level for years to come.

Thus there is no procurement emergency such as that which existed early in World War II and which gave birth to renegotiation as a protection to the Government against excessive profits. At that time there was a definite lack of an experience background on which to base competitive prices, particularly with many new companies engaged in new fields. Even had there been such a background, competent estimating organizations could not be had, and in any event, speed was of the essence, with production the primary consideration and price the secondary, to be adjusted later. Under such conditions, there was justification for renegotiation.

No such justification exists today. Conditions are much different. Procurement orders, for the most part, are placed with experienced organizations either as a result of competitive bidding or of competitive negotiation. The pressure for speed in placing contracts and in obtaining production is no longer the controlling factor. There is time for competent estimating, there are competent estimating organizations with an experience background, there is adequate competition, and adequate time for competitive bids or completion of negotiation. The Government procurement agencies have accumulated an adequate amount of comparative cost data which should serve as a reliable basis for judging the reasonableness of prices in bids and estimates. In other words, there now is an industrial condition which does not have the characteristics of an emergency, and hence does not justify renegotiation. There may be instances of experimental contracts, but these can be handled by special forms of contracts and do not justify subjecting industry as a whole to renegotiation of all Government contracts.

As for shipbuilding and ship repair, the workload has been more or less stabilized at a very moderate level in the past few years. Competition for any ship construction or repair work that becomes available is intense. Considering the industry as a whole, conditions do not appear to warrant any form of profit control. Those segments of the Government concerned with the industry as an element of our national economy and national security should not be concerned with means to prevent the shipyards from making excessive profits, but rather with creating and maintaining conditions under which they can make any profits at all.

Fortunately, the maritime legislation enacted in recent years has had some beneficial effect on the industry although there is no present indication the workload will ever be of a volume sufficient to fill existing yards to capacity or create any lack of competition in the industry. Hence, there is no foreseeable justification for the continued application to the industry of renegotiation or of profit limitation of any description, either statutory or administrative.

The overall net result of renegotiation as an ultimate saving to the Government is a moot question. There are many factors involved, such as the net recovery after taxes, the decrease in taxable income to the Government, the cost to the Government of effecting the recovery and the cost to the Contractor of preparing reports and negotiating with the Renegotiation Board. Furthermore, renegotiation tends to destroy incentive, decrease efficiency and increase costs. Its continued use places a burden on management and creates most objectionable long continuing financial uncertainties without providing any net advantage to the Government. In fact, in this industry it probably results in an overall increase rather than a decrease in the ultimate price which the Government has to pay for the maintenance of an adequate mobilization potential.

It is the view of the members of the council that the Renegotiation Act of 1951 should be permitted to expire on June 30, 1959.

VINSON-TRAMMELL AND MERCHANT MARINE PROFIT LIMITATION PROVISIONS

The specific recommendations of the members of the council in regard to the pertinent provisions of these acts as previously stated are as follows:

2. *The profit limitation provisions of the Vinson-Trammell Act of 1934 and of the Merchant Marine Act should be repealed at the earliest possible date.*

3. *If the Renegotiation Act be extended, whether for 4 years as is proposed by H.R. 7086, or for some lesser period, the profit limitation provisions of the Vinson-Trammell Act and of the Merchant Marine Act, 1936, still should be repealed at the earliest possible time, so that such provisions will not again become applicable at the termination of any such extension. It would be most appropriate to provide for such repeal in H.R. 7086 and the committee is urged to so provide.*

Both the Vinson-Trammell Act and the Merchant Marine Act limitation provisions are discriminatory in that they apply only to shipbuilding (and in the case of the Vinson-Trammell Act also to aircraft). They do not apply to the great volume of other major products required by the Defense Department or other branches of Government.

All of the arguments which can be made with respect to the elimination of renegotiation apply equally as well to the repeal of the profit limitation provisions of the Vinson-Trammell Act and the Merchant Marine Act. In addition, the technique of these acts is much more arbitrary than renegotiation, and there is no recognition of relative efficiency, risk, or any of the other factors which are required by statute to be taken into consideration in renegotiation. Also, merchant vessels built under the Merchant Marine Act and naval vessels built under the Vinson-Trammell Act cannot be grouped for profit consideration even though the vessels were completed in the same year.

The application of the profit limitation provisions of the Vinson-Trammell Act of 1934, as amended, and the Merchant Marine Act of 1936, have been completely suspended since the enactment of the Renegotiation Act of 1951. The Vinson-Trammell Act is 25 years old this year and the Merchant Marine Act, 1936, is almost as old. The pertinent provisions of these acts are now outmoded and should have been repealed many years ago.

Renegotiation and profit limitation under the Vinson-Trammell and Merchant Marine Acts do not run concurretly, as the latter by statute is inoperative as long as renegotiation is in effect. However, as soon as renegotiation expires, statutory profit limitation under those acts automatically again becomes operative. Approopriate action should be taken by the Congress to remedy this anomalous situation.

The recurrent threat of automatic revival of the profit limit provisions of these acts by the expiration of the Renegotiation Act should no longer be allowed to influence thinking as to whether the technique of contract renegotiation should be continued by Congress. To this end, it is strongly urged that those provisions be repealed at this time regardless of what action may be taken with respect to the Renegotiation Act.

NONSTATUTORY PROFIT CONTROL CONTRACT CLAUSES

This topic concerns three separate instances of clauses currently being used by the Maritime Administration or the Navy Department in connection with shipbuilding or ship repair work which are outside of any specific statutory authority requiring their use. In view of the fact that the Renegotiation Act is still in effect, the clauses impose additional profit control on work already covered by the Renegotiation Act.

The specific recommendation by the members of the council is as follows:

4. *The practice by certain Government agencies of including profit limitation or profit recapture clauses in their contracts without statutory provision for such inclusion and even though the contract may already be subject to the Renegotiation Act, should be prohibited by Congress. At the present time, and without statutory authority, the Maritime Administration imposes profit recapture by means of article 41 of its master repair contract. Also, both the Department of the Navy and the Maritime Administration without statutory authority include a profit limitation provision in the escalation clause used in connection with their respective shipbuilding contracts.*

Article 41 of the Maritime Administration fixed-price master ship-repair contract: In August 1954, the Maritime Administration informed the Shipbuild-

ers Council of America and the ship repair industry generally that it had decided that contracts for the repair of vessels under its jurisdiction henceforth would be awarded only to those contractors who agreed to the inclusion in their contracts and subcontracts of a provision for limiting profits.

The shipyards deemed the contract clause to be objectionable and strongly protested its use. However, the Maritime Administration refused to withdraw the requirement. It took the position that there is nothing in the Renegotiation Act of 1951 or any other law which prohibits the Maritime Administration from imposing its own profit recapture system and that it could impose such recapture, even though the contracts which would be covered would be concurrently subject to the Renegotiation Act.

Unfortunately, due to the depressed state of the ship repair industry, the various ship repair contractors were compelled to reluctantly agree to the dual recapture arrangement imposed upon them by the Maritime Administration as a condition of eligibility for any further award of contracts for repairs authorized by the Emergency Vessel Repair Act of 1954.

In November 1954, the council renewed its protest against the use of such a recapture provision in its repair contracts. In connection with this protest, the council again called the Administrator's attention to the conflicting dual application of renegotiation and the Administration's contractual profit recapture system, but again to no avail. The Administration merely confirmed that it would continue to require contractors to agree, by contract, to subject themselves to profit recapture as a condition precedent to any eligibility for award of Maritime Administration controlled vessel repair work.

Actually, there is no provision in any law requiring the Maritime Administration to include a profit recapture provision in its repair contracts and such inclusion, based on mere administrative discretion, is an extraordinary assumption of power by the Maritime Administration in a field which usually and more properly is left to Congress. It is significant that, while Congress included a profit recapture provision in the Merchant Marine Act of 1936, it did not specify ship repairs as subject to such a provision. If the Congress had any intent of applying profit recapture to repair work, it is presumed that it would have so stated. The fact that it did not so state cannot help but be indicative of a contrary intent.

It is quite apparent that no purpose will be served by any further appeal to the Maritime Administration, in view of its claim of administrative prerogative to include such contract requirements. The council submits that, for the same reasons as have been advanced with respect to the proposed repeal of the profit limitation provisions of the Vinson-Trammell and Merchant Marine Acts, permanent relief should be granted by the adoption of such an amendment as may be appropriate to prevent the imposition of contractual profit recapture such as that being used by the Maritime Administration in respect to ship repairs.

The full text of article 41 of the Maritime fixed-price ship-repair contract is as follows:

"ART. 41. Report of cost—excess profits—subcontractors.

"(a) In the event any work is awarded subject to the provisions of this article, the contractor agrees that as to job order covering such work, and the supplemental job orders thereto:

"(i) To make a report under oath to the Administration upon the completion of the work awarded subject to the provisions of this article, as modified by all change orders in connection with such awarded work, setting forth in the form prescribed by the Administration the total contract price of such work, as modified by the applicable change orders, if any, the total cost of performing such work, as modified, the amount of the contractor's overhead charged to such cost, the net profit and the percentage such net profit bears to said contract price, or said modified contract price, and such other information as the Administration shall prescribe.

"(ii) To pay to the Administration profit, as shall be determined by the Administration, in excess of 10 percent of the total contract price or said modified contract price, covering work subject to the provisions of this article or work under subcontracts for work subject to provisions substantially the same as set out in this article under other lump sum ship repair contracts of the Administration, as is completed by the contractor within the income taxable year, which such amount or amounts shall become the sole property of the United States: *Provided, however*, That if there is a net loss on all such work or subcontract work such net loss shall be allowed as a credit in determining the excess

profit, if any, for the next succeeding income taxable year provided, that if such amount is not voluntarily paid, the Administration shall determine the amount of such excess profit and collect it in the same manner that other debts due the United States may be collected.

"(iii) To make no subdivisions of a job order or supplemental job order subject to the provisions of this article or any subcontract for work subject to the provisions of this article for the purpose of evading the provisions of this article, and any subdivisions of such job order or supplement job order or subcontract in excess of $10,000 shall be subject to the conditions prescribed in this article.

"(iv) That the books, files, and all other records of the contractor, or any holding, subsidiary, affiliated, or associated company, shall at all times be subject to inspection and audit by any person designated by the Administration, and the premises, including the vessel, of the contractor, shall at all times be subject to inspection by the representatives of the Administration.

"(v) The amount of profit derived by the contractor from the performance of work covered hereby shall be determined by the Administration in accordance with the 'Regulations Prescribing Method of Determining Profit' as revised by the Federal Maritime Board and Administration, U.S. Department of Commerce, July 21, 1952, including all amendments through July 29, 1954.

"(b) The contractor further agrees to include in its subcontracts for work or materials required for a job order, or supplemental job orders thereto, subject to the provisions of this article, the agreement that such subcontractor shall pay to the Administration excess profit in accordance with provisions of paragraph (a) above, in the event such subcontract, as may be modified, is in excess of $10,000, and the agreement that the subcontractor agrees that all of its subcontracts with the contractor for the same article or articles, as defined in said regulations, required for a job order or supplemental job orders thereto, subject to the provisions of this article, shall be deemed to be a single subcontract for the purpose of its agreement to pay excess profit."

Paragraph (e) of article 6 of the Navy contract for the construction of ships: Recent contracts for major naval vessels, awarded on the basis of competitive bidding and subsequent negotiation, include an escalation article to provide for increases or decreases in the contract price on account of subsequent changes in the cost of labor and material required in the construction of the vessel, as measured by indexes set out in the contract. But paragraph (e) of article 6—Escalation reads:

"The contracting officer may deny, in whole or in part, any upward adjustment in the contract price required under this article if the contracting officer finds that such adjustment is not required, in whole or in part, to enable the contractor to earn a fair and reasonable profit under this contract."

While disputes with respect to a fair and reasonable profit and as to the nonpayment of the escalation probably can be appealed to the Secretary of the Navy and to the Armed Services Board of Contract Appeals, the practical effect of this provision is a potential nullification of the escalation provisions of the contract and, contrary to the will of Congress as expressed in the Renegotiation Act, constitute the contracting officer as the authority to determine what is or is not a reasonable profit.

The basic point, of course, is that a contractor who makes a bid on an escalated basis and is awarded a contract on that basis is entitled to full reimbursement for the increases in costs of labor, material, and taxes beyond the levels prevailing when he made the bid. Such increased costs are actual out-of-pocket costs to the contractor. They are subject to Government audit and thus readily verified. They should be completely independent of any consideration having to do with the ultimate profit.

To deny such reimbursement to a contractor, either in whole or part, is completely unfair, as it is not the basis on which the contract price was predicated in the first instance and constitutes a form of profit limitation which has the effect of bypassing congressional policy.

Such denial of reimbursement likewise is grossly discriminatory in that it penalizes the efficient contractor and tends to place a premium on inefficiency.

Section 5 of the Federal Maritime Board/Maritime Administration Ship Construction Contract Special Provisions: For the last several years the standard pro forma shipbuilding contract of the Federal Maritime Board/Maritime Administration also has included a provision in its escalation article limiting or controlling the contractor's profits under the contract.

41825—59——2

Like the escalation article in the Navy ship construction contract the escalation provisions of the Maritime contract provide for increases or decreases in the contract price for changes in the cost of labor and material and in certain taxes and "fringe benefits" subsequent to the approximate bidding date. Paragraph 5 of the article (quoted in full below) provides, however, that, in effect, escalation payments will not be made if the result would yield the contractor a profit of more than 10 percent of the contract price, such profit to be determined under the Administration's regulations. The effect of such a determination of profit, in turn, is to increase the contractor's profit over his "book" profit by "disallowing" an appreciable part of his costs. Disputes under the contract may be appealed to the Maritime Board, but, as a practical matter, the only dispute that can arise is in the area of profit determination under the regulations.

Acceptance of the pro forma contracts, or course, is a prerequisite to obtaining a contract award. Prospective contractors, individually and jointly, have protested the provision as discriminatory and as beyond the power of the agency, and even as a negation of the will of Congress as expressed in the Renegotiation Act, but without effect. If a contractor bids successfully he must accept a contract conforming to the pro forma contract. The only alternative is to refrain from bidding. No provision is made to limit or control a contractor's losses or for adjustments to remedy a deficiency in "reasonable" profits on the particular contract or related contracts.

The pertinent paragraphs of the escalation article of the Maritime ship construction contract read as follows:

"Limitation on total payments under this article III and article 18 of the general provisions:

"(a) Notwithstanding any other provisions of this contract, if the total of the amounts to be paid to the contractor under this article III and under paragraph (b) of article 18 of the general provisions when added to the total payments to be made to the contractor under this contract (excluding the payments under this article III and under paragraph (b) of article 18 of the general provisions) would result in the payment to the contractor of profit in excess of 10 percent of the contract price under this contract, as said contract price is adjusted pursuant to the provisions of this contract, to the extent that such profit in excess of 10 percent would be due to payments to the contractor pursuant to this article III and paragraph (b) of article 18 of the general provisions, the payments to be made to the contractor pursuant to this article III and paragraph (b) of article 18 shall be reduced by the sum of such excess.

"(b) The profit of the contractor for the purposes of paragraph (a) above shall be determined in accordance with the 'regulations prescribing method of determining profit, as revised by the Federal Maritime Board and Maritime Administration, U.S. Department of Commerce, July 21, 1952, and amendments thereto through August 12, 1954, and such further amendments thereto prior to the date of opening bids pursuant to which this contract was awarded,' provided, however, in the determination of such profit only this contract shall be considered."

If all agencies of the Government were to pursue the practice of imposing profit controls by the arbitrary inclusion of clauses such as those reviewed above, chaotic contracting conditions would soon result. Their inclusion despite the running of the renegotiation act is inexcusable and contrary to the congressional intent. The members of the Council urge that appropriate language be added to H.R. 7086 so as to invalidate such nonstatutory clauses and to prevent their future use.

CONSIDERATION OF DEFICIENCIES IN REASONABLE PROFIT

The fifth recommendation by the members of the council has to do with the inclusion in H.R. 7086 of an appropriate amendment to section 103 of the Renegotiation Act to make it mandatory that a deficiency in profit in prior years will be considered as a factor requiring favorable recognition in determining whether profits in the particular year under consideration are "excessive."

As previously noted, the recommendation by the members of the Council is as follows:

5. If Congress extends the renegotiation act, then Congress should amend the act so that the determination of a contractor's "excessive" profits for any year will be made in the light of the "statutory factors" as they appear in relation to all of his renegotiable Government business for any year or years before the Renegotiation Board. While for mechanical and income tax reasons the determinations must be made on an annual basis, nevertheless each such annual determination should involve a full consideration of the individual contractor's performance on Government work on a continuing, rather than an arbitrary annual, basis. While there does not appear to be anything in section 103(e) of the act which limits the application of the statutory factors (including "(1) reasonableness of costs and profits") to the determination of "excessive" profits for a single or particular year, it appears that the Renegotiation Board now makes each year's determination almost solely on that year's profit and other data. It would be only equitable and in accord with the intent of Congress that a deficiency in "reasonable" or "nonexcessive" profits in a prior year or years, be considered as a favorable factor in determining what will be deemed "excessive" in the particular year under review. Section 103 of the act should be so amended to make this requirement specific and mandatory.

The members of the council feel that the potential inequities involved in the condition sought to be corrected by this renegotiation are extremely serious.

Failure to consider deficiencies in "nonexcessive" profits as a mitigation of "excessive" profits is grossly unfair, and can lead to the result in many cases where a contractor may be forced to repay "excessive" profits for one or more years when his overall profit on his renegotiable business for the prior years subject to the act, including the "excessive" profit year, is below the "nonexcessive" level or is even close to a "breakeven" level. The administrative complications involved in such a procedure should not be permitted to defeat such an obvious and equitable requirement; certainly if the Board can determine "excessive" profits it can as readily determine "nonexcessive" or "reasonable" profits as a mitigation of the "excessive" profits.

The members of the Council most strongly urge that H.R. 7086 be amended to add appropriate language to section 103 of the act so that it will be mandatory that the Board take such a moving average view of the individual company. It is not felt that objection to this suggestion—that it would entail some problems of administration—is sufficient grounds to overrule such a patently equitable improvement in the operation of the renegotiation act.

The CHAIRMAN. The first witness is Mr. Robert Dechert, General Counsel, Defense Department. Mr. Dechert, will you take a seat, sir?

STATEMENT OF ROBERT DECHERT, GENERAL COUNSEL, DEPARTMENT OF DEFENSE; ACCOMPANIED BY MAX GOLDEN, GENERAL COUNSEL OF THE AIR FORCE

Mr. DECHERT. Mr. Chairman, members of the committee, it is my pleasure to appear before you today to present the Department of Defense views on H.R. 7086, a bill to extend the Renegotiation Act of 1951, and for other purposes.

Representing the Department of Defense and the administration, I point out that H.R. 7086 is not the exact bill we presented, as I will explain in a minute. But we do favor it at this time, and urge its favorable consideration by your committee.

The members of this committee will remember that earlier this year the President in his annual budget message recommended that the act be extended beyond its current expiration date of June 30, 1959, and on March 26, 1959, the Secretary of Defense submitted proposed legislation to the Congress to carry out this recommendation.

In this next paragraph I speak about the background in which the decision was made to have the renegotiation act extended.

The state of defense preparedness which we are required to maintain today, as I do not need to say, necessitates a high level of expenditures, and it is believed that such expenditures will continue at high levels for the foreseeable future. For fiscal year 1960 the estimate for the Department of Defense is approximately $41 billion. Over one-half of this amount will represent expenditures for goods and services which are subject to the provisions of the renegotiation act. For example, $14.6 billion, or 36 percent of the total $41 billion, will be for what is described as major procurement and production. This includes such items as aircraft, missiles, ships, weapons, and vehicles. In addition, approximately $3 billion will be spent in the area of research, development, test, and evaluation.

I don't need to tell the members of the committee that the purpose of the Renegotiation Act is to eliminate excessive profits from defense contracts and subcontracts. As good as our pricing policies and techniques may be, and as much as we strive to improve them in the Department of Defense, such policies and techniques cannot guarantee in all cases that excessive profits will not be realized. Much of the defense procurement dollar is spent for specialized items where costs can only be estimated even part way through the fulfillment of the contract.

These estimates may or may not be accurate. Due to changes which may occur during contract performance because of such factors as technological advances in the industry, wholly apart from the particular contract involved, or because of increased volume of business on the part of the contractor which was not anticipated when the original contract was made, or because of variations in the prices of components and materials, estimates of costs and of the profits which were based on the original data and which may have appeared reasonable at the time the contract price was agreed upon may, in fact, become unreasonable and the profits become excessive in light of such later developments—developments wholly outside of the merits of the performance of the contractor involved.

Such changes may well occur after final revision of the price during contract performance in contracts which provide for price redetermination along the way during the conduct of the activities.

In view of the continuation of our large-scale defense procurement programs, we believe that the Renegotiation Act should be continued in effect, in order to assure that excessive profits are not realized in the course of such programs.

As I said a moment ago, the act now before this committee, H.R. 7086, is not the exact form of extension bill which the Secretary of Defense submitted to the Congress on March 26, 1959. That bill, which was not introduced at the time, was submitted to the House Ways and Means Committee by Chairman Mills with a memorandum, and it was the subject of 12 days of hearings, in open and executive sessions, before the House Ways and Means Committee, along with other bills relating to this subject.

In our judgment, the additions and changes to our bill made as a result of thorough consideration of the matter by the House Ways and Means Committee, in which we participated fully, are entirely ac-

ceptable, and indeed we believe they have improved our original proposal.

In our original proposal the Department of Defense recommended an extension of the act for a period of 2 years and 3 months through September 30, 1961. It was concluded by the House Ways and Means Committee, and by the House itself in adopting the committee's recommendation, that the present world situation and the circumstances justifying an extension beyond June 30, 1959, would continue for at least 4 years. As a result, H.R. 7086 provides an extension through June 30, 1963, a period of 4 years. The proposed 4-year extension seems to us to be a resonable period for the continuation of the act, and we are satisfied with this amendment.

The other objectives sought to be attained in our original legislative proposal submitted by the Secretary of Defense on March 26, 1959, have been met by the provisions which are incorporated in the bill before this committee at this time.

The first of these was an amendment to section 103(e) of the act, inserted for the purpose of giving recognition to contractural pricing provisions of defense contracts, and to the objectives sought to be achieved by such provisions, in determining whether excessive profits have in fact been realized This is provided in section 2(a) of the bill now before this committee.

Among the types of contracts used by the Department of Defense to which this provision particularly relates is the so-called incentive type of contract. This type of contract is designed to encourage a contractor to reduce costs by permitting him to share in the savings realized from any such reduction of costs. The target price against which such incentive provision works is established with as much care as can possibly be exercised before, and in the case of price redetermination contracts, again during the performance. However, there is always a substantial period of time after the price has been established during which time savings may be made by extra care, and it is for the purpose of encouraging contractors to make those savings from the price as determined in advance with the utmost care that this type of incentive contract is used, and indeed is favored, by the Department of Defense.

Section 103(e) in the existing law requires the Board to give favorable recognition to the efficiency of a contractor in reducing costs. That is a general statement, not made with particular referenc to the incentive type of contracts.

However, because of the concern expressed by some members of industry that sufficient recognition was not, in fact, being given by the Renegotiation Board to the nature of these incentive type contracts, and to the efforts of efficient contractors to reduce costs under such contracts, the amendment contained in section 2(a) of this bill is believed desirable to emphasize the fact that the Board must take into consideration the particular type of contract involved and the purpose to be achieved thereby.

Under the statement of this factor, cost reductions resulting from efficient performance by the contractor or subcontractor under other types of contracts would also be assured favorable recognition in renegotiation proceedings.

In amending the language as to this particular factor, section 2(a) of the present bill would also state specifically in the statute that favorable recognition must be given to economies achieved by contractors as a result of subcontracting with small business concerns, as such concerns are defined under the Small Business Act.

The purpose of this amendment, as stated in the report of the House Ways and Means Committee, is to stimulate subcontracting to small business concerns. The Department of Defense concurs in this amendment.

I ought to interpolate here that this amendment is really intended to correct a misunderstanding which has existed in the minds of some people. It has always been the policy of the Board to take into consideration savings that have been made by contracting to small business, but there has been a statement in the regulations of the Board to the effect that the mere fact that subcontracting has been brought into the picture instead of the matter being carried out through the contractor doing his own work, doesn't guarantee to the contractor the entire amount of the additional profit made by following that course. Because of misunderstanding that statement in the regulations, some people have felt that it was intended to discourage subcontracting. It was not so intended to discourage; it doesn't in fact so discourage; but this language has been inserted in order to make that fact clear.

The misunderstanding, if I may proceed just 1 minute longer on that point, is due to this fact: Suppose that a contractor said in the initial negotiation that it is essential that he himself make this component part in his own factory, since if he doesn't do so, he cannot have his production line running correctly, and suppose the Department of Defense acquiesces in that judgment. They then set the price on the basis of what it is going to cost this concern to make the component in question in its own factory.

After the price has been thus set and the contract entered signed, suppose that the contractor changes its mind, finding that by certain procedures it can effectively carry out the work by subcontracting, and by such subcontracting save a great deal of money.

Now, while it is proper that the major contractor receive an advantage from so doing, there isn't any reason why simply that shift should guarantee him the whole of extra profit resulting from such unexpected shift. It was a shift made for reason of policy, at a point where he first said he couldn't possibly follow such a course.

This is what the Board had meant when they said that subcontracting will not necessarily guarantee the keeping of whole of the contract profits which would otherwise come under the incentive terms of the contract.

But, as I say, this provision in the bill now before this committee is intended to overcome that misunderstanding; to make it plain that subcontracting will receive adequate recognition, even though a contractor may not receive the 100 percent recognition in renegotiation that the pricing of the original contract would seem to call for.

The legislative proposal submitted by the Department of Defense also contained a provision to the effect that in any statement furnished to a contractor by the Board pursuant to section 105(a) of the act in connection with the Board's determination of excessive profits, the Board should indicate separately its consideration of, and the recog-

nition given to, the efficiency of the contractor or subcontractor and of each of the other factors listed in section 103(e).

This is a statement which is given to the contractor in question in order that he may determine whether he is going to accept what the Board does, or whether he is going to appeal or take some other action.

The proposed amendment which has now been made, with added language which makes it clear that such a statement will not evaluate each of the factors in terms of dollars or percentages, is found in section 2(c) of the present bill.

As I have said, a similar provision has been contained in the Board's regulations for some time, but certain contractors have felt that statements furnished by the Board in the past have not always adequately indicated the consideration of and the recognition given to efficiency and other factors required by the act to be considered in determining excessive profits.

Accordingly, this amendment is designed really for two things: First, to give the contractors assurance that they will have sufficient information, and second, to cause the statement to have a statutory sanction so that contractors can be assured that they are entitled to such a statement by statute rather than merely by regulation.

The final provision, which was originally proposed by the Department of Defense, concerns appeals from the Tax Court to the U.S. court of appeals in renegotiation cases. This proposal is now reflected in section 6 of the bill before this committee. However, in the interest of uniformity of consideration, the present bill limits such review to the U.S. Court of Appeals for the District of Columbia. This committee may remember that the bill which last year came to this committee had in it a similar provision for appeal to the courts of appeals, which in conference was stricken out. That bill provided for appeals to the courts of appeals generally.

Here the House Ways and Means Committee has provided that any of these renegotiation appeals will come to the Court of Appeals in the District of Columbia, in order to assure uniform action on this type of appeal, which so far has not been very widespread, as I shall indicate further on, and which was thought ought to be dealt with by a court of appeals which has become familiar with the subject.

This section permits review of the Tax Court decisions in renegotiation cases in a manner and to an extent which is similar to that provided in tax cases under section 7482 of the Internal Revenue Code.

However, the House Ways and Means Committee in this bill has restricted the appellate court from making a mere modification of the Tax Court decisions. In other words, it has eliminated the possibility of the appellate court's substituting another figure for the figure that the Tax Court has made, it being thought apparently that the Tax Court has more familiarity with the figures, and that the amount of final findings, as with the judgment of a jury or of a court siting as a jury, has been already dealt with once by the Board and secondly by the Tax Court. Therefore this provision of the bill says that of the decision is to be altered on appeal, the case is to be sent back to the lower court for final action; that is, to the Tax Court.

If the reviewing court determines that the decision of the Tax Court is not in accordance with law in a case where there may still be excessive profits to be eliminated, the redetermination of such

amount of excessive profits is to be made by the Tax Court after such a remand, and not by the reviewing court.

It is believed that these provisions will afford contractors appropriate rights of appeal to higher courts of appeal, and again the Department of Defense concurs in these appellate provisions—these provisions as to appeal which have been written in by the House Ways and Means Committee.

As stated above, the other amendments contained in H.R. 7086 are entirely acceptable to the Department of Defense. These include the following:

Section 2(b) of the act amends the so-called net worth factor found in section 103(e) to make clear the distinction between a determination of net worth, on the one hand, and a comparison of the amount of private capital employed and the amount of public or Government capital employed in a contractor's operation, on the other hand.

These are among the factors which the Renegotiation Board by statute is compelled to take into consideration when it deals with the problem of whether excessive profits have been made. And we agree with that proposed change made by section 2(b).

By this particular amendment to section 103(e), no substantive change in this factor is intended, nor is it intended to deemphasize the importance of evaluating in renegotiation proceedings on a comparable basis the amount of public and private capital employed. In fact, this bill rewords this particular factor so that it reads in substantially the way in which this factor was previously set forth under the Renegotiation Act of 1943, as amended.

A second provision added by the House Ways and Means Committee, with which we are entirely in accord, is to provide a 5-year loss carryforward, as contrasted with a 2-year loss carryforward in the present law.

This new provision is in section 3 of the bill. It is designed to relieve hardship that might result from restricting contractors to a mere 2-year carryforward period.

I note here that a 5-year loss carryforward is now permitted for Federal income tax purposes, and we saw no reason why this should not be made to read alike. This amendment is acceptable to the Department of Defense.

Section 4 of the bill now before this committee amends section 105(a) of the act to require the Board upon request of a contractor made before he makes an agreement, or before issuing the order which is made when no agreement could be reached, to furnish him with a statement of its determination of the facts used as a basis therefor, and of the Board's reasons for such determination.

Although the regulations of the Board have made provision for such a procedure, it appears desirable that this requirement also appear in the statute itself, to insure permanence of this procedure and to guarantee the contractor the opportunity to know exactly why, so far as it can be set forth in such a statement, the action has been taken which asks him to refund alleged excessive profits. This gives him the basis of determining whether or not he will acquiesce in such decision.

Section 4(b) of the bill also amends section 105(a) of the act. Section 4(b) provides that before or at the time this statement I have

just mentioned is furnished to the contractor, the Board shall permit the contractor to inspect all reports and other written material furnished to the Board by a contracting department relating to the negotiation proceedings, the disclosure of which is not forbidden by law.

The chief purpose of the amendment is to give contractors the opportunity to inspect information contained in performance reports and other written matter used by the Board in arriving at its determination of excessive profits.

In fairness to contractors it appears that such information should be made available, and the Department of Defense concurs in this amendment.

I ought to say parenthetically at that point that one of the causes of criticism of the procedure with which we have dealt very actively in our discussions of this subject with other Government departments and with representatives of industry and committees from industry organizations has been this matter of the opportunity of those who sit across the table in the negotiation with the Renegotiation Board to know just what has led the Renegotiation Board to negotiate in the manner in which it does negotiate.

There has been criticism that the renegotiation process lacks the procedure that is called for in the Administrative Procedure Act. Our answer to this has been that the Administrative Procedure Act is intended to apply in a formal trial, and in the renegotiation process there is granted a formal trial de novo in the Tax Court. Therefore there isn't any reason why procedures of the Administrative Procedure Act should be read back into the earlier across-the-table renegotiations.

The answer that our friends from industry have made to this is that the proceedings before the Tax Court, although stated to be an administrative procedure type of trial starting fresh, have in fact not reached that point. They say that the trial before the Tax Court has had inherent in it some aspects of an appeal from what the Renegotiation Board did, with the result that if they are not allowed some types of administrative procedure protection before the Board, they are still in difficulties when they come to the supposed trial de novo before the Tax Court.

Our answer, coupled with the answer made by the Department of Justice and others, was that the trial before the Tax Court is in fact a de novo trial, except for the feature that the petitioner is petitioning against an order of the Board and that he necessarily has to bear the burden of the moving party to introduce evidence to carry the case forward.

We have also pointed out that wherever you are negotiating across the table you naturally don't show all the things you have in your envelope to the man with whom you are negotiating at the minute. In proceedings with Internal Revenue agents, the taxpayer or his lawyer similarly negotiates across the table, but he has no absolute right to know everything that the Internal Revenue agent has in his envelope.

On the other hand, this criticism has been so general that we felt, and the House Ways and Means Committee felt, that recognition should be given to it. There has therefore been incorporated in the bill this provision which you see here, stating that except where a law

forbids it, even in this across-the-table type of negotiation before the possible new trial in the Tax Court, the contractor will be entitled to see reports that are made about his performance by Government departments.

In order to make clear the intent of Congress that the proceedings before the Tax Court are to be de novo, section 5(a) of the bill amends section 108 of the act to provide that although the petitioner shall have the burden of going forward with the case, no presumption of correctness shall attach in the Tax Court proceedings to a determination of the Renegotiation Board, and that only evidence presented to the Tax Court shall be considered by it. As stated in the report of the House committee, this provision is not intended to shift the burden of proof under existing law. In order to provide ample review within the Tax Court, section 5(b) provides that determinations in renegotiation cases by any division of the Tax Court shall be reviewed by a special division of the court consisting of not less than three judges. These amendments are likewise acceptable to the Department of Defense.

Now, by way of conclusion of that which I am presenting, I want to introduce certain statistics on the subject of renegotiation, in order to indicate that although this matter is important because of the aspects that I have indicated already, it doesn't weigh very heavily statistically in the total number of contractors who are above the million dollar minimum, and who therefore have to make what are called filings.

There are about 4,500 statutory filings a year by contractors who have over a million dollars of defense business that is subject to the Renegotiation Act.

These filings, as I have just said, represent those who exceed the statutory minimum of a million dollars of defense business in a fiscal year.

On the average, 70 percent of these filings are disposed of by the Renegotiation Board here in Washington immediately without further proceedings, because on their face the filings indicate that the contractor involved had no excessive profits that would be subject to refund under the Renegotiation Act. That leaves 30 percent which are assigned to the various field offices of the Board for examination or are retained by the Board for its own immediate reexamination.

Of this 30 percent, more than 80 percent are subsequently cleared without there having been a determination that they owe a refund of excess profits.

We therefore find that excessive profits are found by the Board in only about 5 percent of the original number of filings (that is, 20 percent of the 30 percent just mentioned). When we come to this 5 percent, we find that in fact 90 percent of this 5 percent are settled by agreement between the contractor and the Board without a formal order by the Board.

I do not want to indicate that making of such agreements at this point means that the contractor is perfectly satisfied. He may feel that he would rather pay up what the Board has said he, in its judgment, owes, than go through the processes of an appeal to the Tax Court, with the expense and other problems that such an appeal entails. Therefore I don't want at this point to indicate that the

acceptance by the contractor necessarily means he is happy, but at least there are that number so concluded.

In those cases where orders are issued (that is, the cases that are not settled voluntarily but in which orders are issued), there is a further time when the contractor can determine whether he will pay or appeal, and 70 percent of those are, in fact, paid without appeal. Therefore the final figure is that an appeal to the Tax Court is taken only in about one-tenth of 1 percent of the total 4,500 original filings in a fiscal year.

It has been suggested that the fact that these figures worked down to relatively small percentages indicate that perhaps the total coverage of the act is too wide, and that by statute we ought to narrow the categories to which the act applies. This we studied very carefully in our discussions during the year among ourselves and with the other departments and with industry, but we could not find an appropriate manner by which we could establish categories that would include those who ought to be subjected to renegotiation and leave out those who should not. Therefore it was determined that the act should be extended with the same general coverage it has had before, but with the understanding that this will again be subjected to the same kind of review and consideration that it has been in the past few years, both by industry and by Government, and when this matter comes up again at the time when the present extension expires, this can be given further consideration.

That concludes my formal statement as amplified, and I shall be glad to answer any questions which are within my area of knowledge.

The CHAIRMAN. Mr. Dechert, will you state the money value of the one-tenth of 1 percent?

Mr. DECHERT. I don't think I can. I can get it from the Board.

Mr. COGGESHALL. One-tenth of 1 percent is something under a hundred million dollars in the Tax Court, out of determinations of excessive profits in excess of $800 million.

The CHAIRMAN. What percent has the Renegotiation Board sustained?

Mr. DECHERT. I will have to ask Mr. Coggeshall.

Mr. COGGESHALL. Of the post-war cases in the Tax Court, only one was lowered, and two have gone through where we have been sustained, and some 16 have been settled by stipulation and withdrawn with prejudice.

Senator KERR. Only one, was that?

Mr. COGGESHALL. Only one was lowered, something from $50,000 to $30,000.

The CHAIRMAN. Thank you, Mr. Dechert.

Are there any questions?

Senator COTTON. On that same point, Mr. Chairman, before you leave it, what proportion of defense contracts, is it possible to say, are under $1 million?

Mr. DECHERT. What proportion of our total defense contracts fall within the area of renegotiation?

Senator COTTON. No, just the opposite; what proportion are under $1 million so they do not fall within it?

Mr. DECHERT. Senator Cotton, the act applies to concerns whose total contracts within this area are more than $1 million per fiscal

year, so that it is not the individual contract which is the test, but it is the total business within the year.

However, I take it that your question is for me to make some estimate of the percentage of contracts in the Defense Department which are not subject to renegotiation, because the contractor does less than $1 million a year.

Senator COTTON. Yes.

Mr. DECHERT. I can't answer that. I will do my best to get the answer, Senator Cotton, but I do not know the answer to that.

Senator COTTON. Thank you.

Mr. DECHERT. A very large percentage in dollars is subject to this act, because, as you know, sir, a very large percentage of our total procurement amount is in this field of missile, airplane, and very expensive development.

Senator COTTON. Well, most of the contractual work that would be under $1 million would actually be subcontracts from someone, some major contractor, so that it would come as part of the transaction, and would come under this Renegotiation Act, is that correct?

Mr. DECHERT. I think that is right, sir. Of course, there are a large number of our contracts, both in number and amount, for stable articles which would be ordered off shelves which are not subject to the act.

Senator COTTON. I didn't mean to get out of turn, Mr. Chairman.

The CHAIRMAN. That is all right.

Mr. DECHERT. But it is true even where we have a tremendous major contract which will be subject to renegotiation, that major contractor often subcontracts.

The subcontractors, too, will be under the Renegotiation Act if their total contracts under the act are over $1 million. The Renegotiation Act applies all the way down with respect to defense business.

Senator COTTON. Excuse me, I guess I am showing my ignorance, and forgive me, Mr. Chairman, if I am. As a major contractor I have a large contract from the Defense Department, and I sublet various parts of the performance of that contract to "A," "B," and "C." When the time comes, if it does come, for renegotiation with me, the major contractor, doesn't that renegotiation include those portions of the contract that I have sublet? Am I not responsible for them and for the profits on them?

Mr. DECHERT. The final result of renegotiation with you takes into consideration what has been done, but the subcontractors are renegotiated separately.

Senator COTTON. So you reach them in two ways?

Mr. DECHERT. That is right.

Senator COTTON. Thank you.

Senator BENNETT. Mr. Chairman—excuse me.

The CHAIRMAN. Senator Kerr.

Senator KERR. The prime contractor is renegotiated with on the basis of his profits, not on the basis of the profits the subcontractor whose total amount was under $1 million, is it?

Mr. DECHERT. That is correct.

Senator KERR. The prime contractor lets out a half dozen subcontracts, each one of which is under $1 million, in the absence of collusion or fraud the cost that he has in connection with the subcontract

is accepted by the Defense Department as a fixed expense, and his renegotiation is had with reference to the profit he has left in the prime contract.

Mr. DECHERT. His renegotiation, as you state, is based upon his profit. But as has just been indicated by Senator Cotton, in connection with these subcontractors it may be——

Senator KERR. If their subcontract has a total of less than $1 million, they are not the subject of renegotiation.

Mr. DECHERT. Well, they may have had other contracts or subcontracts which add up to a total of more than $1 million.

Senator KERR. I understand that. But unless they do have——

Mr. DECHERT. Unless they do have, they are out.

Senator KERR. Tell me briefly how many principal amendments are there in this bill to the existing law, two?

Mr. DECHERT. No, there are about six or seven.

Senator KERR. I mean the principal amendments, are there six or seven?

Mr. DECHERT. No, there are not that many principal amendments. The first principal amendment is the date of extension.

Senator KERR. That is the 4 years instead of——

Mr. DECHERT. We proposed 2 years and 3 months.

Senator KERR. And the Ways and Means Committee made it 4 years?

Mr. DECHERT. Made it 4 years.

Senator KERR. What is your comment on that?

Mr. DECHERT. We are in accord with, we are satisfied with the action of the House Ways and Means Committee.

Senator KERR. On the 4 years?

Mr. DECHERT. Yes, sir.

Senator KERR. I am talking now primarily about the substance of the bill.

Mr. DECHERT. Yes. I think that the next one would have to be called an important provision, even though it doesn't, in fact, change the existing procedure, is the one that requires statutory recognition of the contractual provisions, and the objectives sought to be achieved thereby.

In other words, this is the amendment which is intended to point an arrow at the necessity for the Renegotiation Board to give full and proper effect to the purpose of the incentive type contract.

The incentive type of contract, as I have indicated, is made after it is thought that there has been a fair price reached by negotiation. At that point after both sides think that a fair price has been reached, an incentive is given to the contractor to reduce costs by sharing cost reductions with him.

In return for this incentive provision he takes less of a percentage profit.

Senator KERR. He takes less of a percentage profit, but by so doing he gets an agreement from you that what profit he does make will not be subject to renegotiation?

Mr. DECHERT. No, that isn't it. I didn't make it clear.

Suppose he was going to get 8 percent if there was no incentive provision, he now will take 6 percent at a fixed profit, and he will also have a provision, an incentive provision, that if he underruns the

cost target he will share with the United States in that saving due to the underrun, and will make an additional profit thereby.

Senator KERR. Over and above the 6 percent?

Mr. DECHERT. Over and above the 6 percent.

Senator KERR. Is that a situation where you said when he makes his original trade with you he might do so on the basis of his decision that he is going to do the best job of handling himself——

Mr. DECHERT. No, that is a different point.

Senator KERR. Tell me about the one you are talking about.

Mr. DECHERT. This point comes up this way. I ought to add one thing more, that in the incentive type contract he not only has a chance to gain, but he has a chance to lose, because if he overruns the amount of the cost target he bears some of that overrun. This provision therefore isn't a one-way street.

But he is taking less of a sure, fixed profit in order to have a chance at an increase due to the savings.

Senator KERR. What I can't get through my mind—and that is nothing against the bill; that is just the condition that exists by reason of my limitation—is this:

You have made a contract with him at a cost-plus basis of 6 percent above cost, is that it?

Mr. DECHERT. We——

Senator KERR. Is that the kind of contract you are talking about?

Mr. DECHERT. Yes, we have hit the figure which we think the cost total is going to be, and we have given him a fixed profit of 6 percent on that. We haven't said we would give him 6 percent on any cost, but we for instance have determined the cost total would be $400,000, and have made the fixed profit $24,000.

Senator KERR. And you and he have agreed on it?

Mr. DECHERT. He and we have agreed that $400,000 is the probable cost, in the example we are considering.

Senator KERR. And you give him a contract then to produce this at $424,000?

Mr. DECHERT. That is right, we give him a contract which includes $24,000 profit.

Senator KERR. You have got that profit. But first it would be $32,000, being the 8 percent on the illustration.

Mr. DECHERT. If he hadn't the incentive contract, he would have received $32,000 profit in our supposed case but in order to have this incentive feature he has got to have——

Senator KERR. Let's take it a step at a time. It ordinarily would be $432,000.

Mr. DECHERT. Yes.

Senator KERR. You have made an agreement with him that if he will do that at a cost of less than $400,000, you will give him, by reducing the 8 percent to 6 percent of the $400,000, you give him what part of what he saves on the cost under $400,000?

Mr. DECHERT. Ordinarily it is 20 percent of the saving.

Mr. GOLDEN. It ranges from 15 to 25 percent.

Mr. DECHERT. Mr. Golden is General Counsel of the Air Force, and he deals with these actual contracts much more than I do; he says that the figure ranges from 15 to 25 percent.

Mr. GOLDEN. Yes; he may in some cases by preagreement share in the savings to the extent of 15 percent thereof. Similarly, if he overruns his costs, he will have his profit reduced by 15 percent of the overrun, so——

Senator KERR. Let's see, I thought you had arranged with him that the cost was $400,000. Then under the basis of this contract, if it exceeds that, do you pay 85 percent of that costs?

Mr. GOLDEN. Yes. In other words, if the estimated cost was $400,000, and the target profit was 6 percent, or $24,000, that is the start. The target costs, the target profit. If you have a split of 15 percent——

Senator KERR. Suppose you don't have this incentive provision in here, then is your contract definite for $400,000 plus 8 percent?

Mr. GOLDEN. If you are talking about a cost-plus contract, as you know while his fee is fixed we pick up all the costs of the contract, so we will pay him actual costs.

Senator KERR. You pay him the $32,000 profit, but in addition to that——

Mr. GOLDEN. Actual costs.

Senator KERR. If his costs were over $400,000, you pay him the amount over that?

Mr. GOLDEN. That is right, sir.

Senator KERR. Well, then, that is just the contract to reimburse his cost plus a fixed fee.

Mr. GOLDEN. That is correct.

Now, I think the confusion here is this: that Mr. Dechert is talking about what we call a fixed price incentive contract, and on that basis, you negotiate a target cost; you negotiate a target profit. At that point, or somewhere during performance, you have a formula, this 85–15 percent split; if he underruns he gets 15 percent of the savings; if he overruns he loses 15 percent of the overrun.

Senator KERR. Do you make these contracts with prime contractors who then have the privilege of subcontracting under that prime contract?

Mr. GOLDEN. Oh, yes. Not only the privilege, but it is a necessity. Subcontracting is a big part of the prime contractor's job. In the airframe industry it might run as much as 30 to 40 percent. In the engine business it might run as much as 40 to 60 percent. In missiles it probably ranges from 30 to 50 percent, depending on the type of missiles.

Senator KERR. But the incentive provision that you refer to would change existing law in these aspects: No. 1, the fixed fee would be reduced from 8 percent, let's say, of the estimated cost, to 6 percent of the estimated cost.

Mr. DECHERT. No; this doesn't change existing law, sir. I think I ought to carry the illustration one point forward to be made more clear.

Let's take this $100,000 target figure that we were talking about. Suppose the actual costs were $300,000, so there was $100,000 savings. In this case, the 15 percent arrangement that Mr. Golden referred to would mean that the contractor would not only get his fixed $24,000 fee, but he would get $15,000 besides.

Senator KERR. That is under this bill?

Mr. DECHERT. No; that is under the procedures which have been in effect for years.

Senator KERR. All right.

Mr. DECHERT. These incentive-type contracts have been in effect for years. The criticism which led to this provision was that in some of the contracts it has been said that the activities of the Renegotiation Board under the Renegotiation Act have served to cut away the amount of incentive profits, and there has been very strong criticism that it isn't fair. It said: "You made a deal with us, whereby we took less of a fixed fee in expectation of being able to make further profit by making savings. We made our savings. Under the letter of the contract we were entitled to incentive compensation, but the wicked Renegotiation Board took it away." The contractors, having said this, then produce figures which in some instances——

Senator KERR. Which deprived them of the profit they made under the incentive phase of the contract.

Mr. DECHERT. That is the criticism, and in some instances they produced figures where the incentive profits appear to match in amount the Renegotiation Board's claims.

Senator KERR. What did you say they called the Renegotiation Board?

Mr. DECHERT. I said they called them "wicked."

Senator KERR. Wicked.

Now, are you in effect more or less endorsing that——

Mr. DECHERT. Criticism? No, sir. I say that our study of the situation indicates that the criticism is based upon accidental figures. There is a case now in the Tax Court where the figures happened to match up, but the fact is, so far as our study indicates, the Renegotiation Board has given full recognition to the incentive provision in the past, and where they have taken away profits from a contractor which had incentive profits, the profits they took away were somewhere else or resulted from reasons other than the efficiency of the contractor.

Again taking this hypothetical case I have been using, in which $400,000 was the target figure and the actual cost was $300,000, let's suppose that the saving was made because a competitor made a discovery as to how to reduce costs very materially, a discovery which was open to everyone, and this contractor took advantage of that discovery by someone else. That isn't the kind of a saving to which the incentive provision was intended to apply.

Senator KERR. And the situation that you are talking about arises by reason of a savings that came about that way, the contractor getting the $15,000 profit out of it in his renegotiation with the Defense Department, and the Renegotiation Board saying since the savings was the result of a discovery and not of your efficiency, we are not going to allow you this $15,000?

Mr. DECHERT. That is right. They say it is a pure windfall.

Senator KERR. How would that work under this bill?

Mr. DECHERT. Well, it wouldn't work any differently under the bill.

What the bill simply says is that it puts into the statute a little more clearly the fact that the Renegotiaion Board in is——

Senator KERR. The Renegotiation Board has really been living up to its contract?

Mr. DECHERT. In our judgment, it has; yes, sir.

Senator KERR. Then why do you feel like the statutory provision is necessary?

Mr. DECHERT. This was meant to meet, so far as we could meet, without a shift in actual policy, the criticism which was made. It is to place a statutory mandate upon the Board that it must take full consideration——

Senator KERR. It recognized the validity of these incentive contracts?

Mr. DECHERT. That is right, sir.

Senator KERR. Does it make it clear that a windfall such as you have described would not entitle the contractor to a benefit which under the contract could be his only by efficiency in accordance with an incentive provision in the contract?

Mr. DECHERT. I think it does make it clear, though it does by indirection. It says that the only thing to be rewarded here is efficiency, and such a windfall is not a result of efficiency. Therefore in my judgment the windfall type of thing will no more be rewarded in the future than it has in the past.

Senator KERR. What you are telling the committee is that in effect this provision in the bill is a statutory amendment to validate a practice which under the law, and good judgment, has been the procedure and practice heretofore?

Mr. DECHERT. That is right, sir.

The only reason I mentioned it when you asked me the important features in this bill was that this matter has been so much emphasized by industry in the discussions of this whole subject, and I thought this committee ought to know that we have done what we could to deal with it.

Senator KERR. All right, what is the next important one?

Mr. DECHERT. The next one is not an important one, nor is the next one about the statement of the Board.

The 5-year loss carryforward is important to a few people.

Mr. DECHERT. And we thought it was appropriate.

The matter of furnishing documents for inspection is a matter that I spoke of a minute ago.

Senator KERR. Yes, I heard that.

Mr. DECHERT. And that also has been, as I indicated in my earlier discussion, a subject of great controversy between many of the contractors and the Board and us. This gives them——

Senator KERR. You feel that is something the contractors are entitled to?

Mr. DECHERT. This gives them a greater right than they now have and we think they are entitled to it, and we think it will not in any degree hurt the interests of the Government, that is, making these documents available for inspection.

The one concerning the Tax Court proceedings being de novo is designed to point out even more clearly than has heretofore been pointed out in the statute, the fact that these Tax Court proceedings are a new trial.

Senator KERR. Are in reality de novo.

Mr. DECHERT. Are in reality a new trial.

Senator KERR. So that the amendment that is in that part of the bill is only to make more definite and certain that that which the present law has in mind is carried out.

Mr. DECHERT. That is right; yes, sir.

And finally is this matter of appeal.

Senator KERR. That goes from the Tax Court to the——

Mr. DECHERT. From the Tax Court to the court of appeals.

Senator KERR. You say it is in the bill to do that, that appeals from the Tax Court go to the District of Columbia court?

Mr. DECHERT. That is right.

Senator KERR. Do you think that the need for uniformity is sufficiently important that we ought to have it even though the decisions are uniformly bad? [Laughter.]

Mr. DECHERT. Well, there is a way of protecting that. There is an appeal to the Supreme Court of the United States, if necessary.

Senator KERR. But as I see it, let's say a subcontractor in the extreme Southwest or the extreme Southeast, extreme Northwest, don't you think there is a considerable burden placed upon him if his recourse is limited to the appellate court of the District of Columbia, rather than the appellate court where he lives?

Mr. DECHERT. I think not, sir, and if I may I shall indicate why. From many places the lawyer involved has to travel a good distance anyway to reach the court of appeal. If the circuit court is sitting in New Orleans, people have to go a good way to get to New Orleans from various points in that circuit, and at this time transportation is relatively easy for him to come to Washington even——

Senator KERR. You know hotel bills and meals are a lot less in New Orleans than they are in Washington.

Mr. DECHERT. That is true. We in our original proposal simply provided generally for appeals, without limitation to the court sitting in the District of Columbia. This provision was put in during the House ways and means consideration of the matter as a result of discussions pointing out that the renegotiation proceedings are different from those which court of appeals judges ordinarily handle, and there might be a substantial advantage in having them come up——

Senator KERR. It is your considered judgment that the provision that the appeal be to the District of Columbia Appeals Court is wise.

Mr. DECHERT. Yes, sir.

Senator KERR. Thank you very much.

Senator BENNETT. Mr. Chairman.

The CHAIRMAN. Senator Bennett.

Senator BENNETT. Mr. Dechert, that arithmetic at the end of your statement carries the percentages of cases down to the Tax Court. It doesn't tell us how many of those are appealed.

Mr. DECHERT. Well, at the moment there is no statutory provision for an appeal to the Court of Appeals. However, if the matter relates to the jurisdiction of the Tax Court or is on constitutional grounds, then even now there would be an appeal to the court of appeals.

I think there have been a handful, about six.

Mr. COGGESHALL. There has been one, under the 1951 act.

Mr. DECHERT. Mr. Coggeshall, Chairman of the Board, tells me there has only been one appeal based on jurisdiction which went to

the court of appeals. We do not know, of course, how many under the new provision would go to the court of appeals.

Senator BENNETT. The new legislation might widen the opportunity for appeal.

Mr. DECHERT. That is right. That was the purpose of it. Where a contractor felt that in the first record trial he hadn't gotten a fair shake, we felt that he was entitled to an appeal. At the present time this type of case is the only instance in the law, other than excess profits cases, where the first record trial is non-appealable. In every other instance after your first record trial you are entitled to an appeal somewhere.

Senator BENNETT. Statistically on the basis of the figures given us, if the Tax Court only handled one-tenth of 1 percent, somewhere roughly between 5 and 10, maybe Mr. Coggeshall could tell us how many they handled last year.

Mr. COGGESHALL. All told 70 cases have been filed with them, and I think they have come down to 46. There were two settled this last year. Most of them go out by stipulation.

Senator BENNETT. Seventy cases in how many years?

Mr. COGGESHALL. That is over 6 or 7 years. The average of 10 a year is the high point.

Senator BENNETT. Average of 10 a year. So that the prospect of loading the court of appeals in the District of Columbia is pretty thin——

Mr. DECHERT. I think that is right, sir.

Senator BENNETT. In this situation.

Mr. DECHERT. I think that is right, sir.

Senator BENNETT. Where does the Tax Court sit?

Mr. DECHERT. Under the Tax Court procedures, the Tax Court judges sit in various cities, as you know, sir, and the Renegotiation Board has regional offices in different cities.

Senator BENNETT. So the man can have his case heard in his own hometown.

Mr. DECHERT. That is right, as to the Tax Court—in or near his hometown.

Senator BENNETT. I am not a lawyer, but I had the impression that they sat in the District of Columbia.

Mr. DECHERT. They are a peripatetic court. They sit in various parts of the country, and the Boeing case is being heard by the Tax Court in Seattle at this time. There are 16 judges of the Tax Court.

Senator BENNETT. So the necessity for appearing before the court of appeals in the District is the first time that the contractor would have to appear before a court away from home?

Mr. DECHERT. That is right.

Senator BENNETT. In the District?

Mr. DECHERT. That is right.

Mr. COGGESHALL. May I interpose; some of the Tax Court hearings have been held in Washington, as a matter of fact.

Mr. DECHERT. But that would be a matter of convenience.

Mr. COGGESHALL. They don't have to be, but they have been.

Senator BENNETT. If they have a case that comes before the Renegotiation Board itself, do they come to Washington?

Mr. COGGESHALL. Yes, sir, at the top level. We have three regional boards: one in New York, one in Los Angeles, and one in Detroit, and

in the first instance those are always settled or heard in the field. If there is an appeal to us, or a case which we reassign to ourselves, then they come to Washington.

Senator BENNETT. You handle this 5 percent; is it the 5 percent mentioned in this statement that come to Washington?

Mr. COGGESHALL. We pass on all of the larger cases in excess of $800,000 profit. The field's final responsibility is limited to cases involving less than $800,000 profit in 1 year, what we call class B cases, with or without appeal.

If there is a unilateral order, if there is no agreement and a unilateral order is issued by a regional board, that can be appealed to our Board. In class A cases in excess of $800,000 profit they all come before the Board. If we are in agreement with what has been an agreement between the contractor and the Board, either a clearance or a refund, he doesn't have to come. If there is a disagreement, or if we are in doubt, then we set up a hearing.

Mr. DECHERT. In other words, many of the 30 percent (which are the ones not immediately cleared) will also come before the Board in Washington, but only 5 percent out of the whole 100 percent will result in findings of excessive profits.

Senator BENNETT. Well, the thing that started me off was trying to find out how many cases you were carrying to appeal, or would probably be carried if this bill were passed.

Mr. DECHERT. As you have indicated, sir, there would be very few, in our judgment.

Senator BENNETT. Thank you.

The CHAIRMAN. Senator Frear.

Senator FREAR. What industries are chiefly affected by the renegotiation?

Mr. DECHERT. I shall answer your question in two parts. Those which have been most vocal, who have most objected to it, are the aircraft or the airframe industry, and the industries making heavy equipment or weapons of one kind or another.

Actually, however, the act covers all those who do more than $1 million of business in a fiscal year with the Department of Defense, or with the other several departments that are involved; the Space Agency, the Department of Commerce, and one or two others.

Senator FREAR. What I was trying to determine is, do you find that any particular industry depends upon renegotiation more than others?

Mr. DECHERT. I am not clear I understand exactly what you mean by "depends upon," but the fact is that the airframe industry has produced the largest number of contested findings of excessive profits, and they are the people who have been most vocal about it.

Senator FREAR. If you had to select one industry—and I don't want to put you on the spot—that would like to do away with renegotiation, would it be the airframe?

Mr. DECHERT. Yes, sir; that is the hardest fighter.

Senator FREAR. That answers the question.

How many companies does the 5-percent carryforward affect?

Mr. DECHERT. We do not know, because we do not have all the data; of course, the provision looks forward, too, so that we wouldn't know. I don't know the answer to that, and I don't believe the Board does, either. Not very many, surely.

Senator FREAR. If whatever percentage would be affected by renegotiation by industry, would it be practically the same percentage that would be affected by the 5-year carryforward?

Mr. DECHERT. That is right, theoretically, but we think this will affect very few, as a practical matter of fact.

Mr. COGGESHALL. We have seen only three companies that have resorted to the 2-year carryforward, as a matter of fact. We have had a 2-year carryforward since 1956, and up to now in renegotiation we have seen only three companies that have had to avail themselves of that 2-year carryforward.

Senator FREAR. Did they complete their carryback?

Mr. COGGESHALL. Yes, that is an automatic carryforward. That is, if you have a $250,000 loss in 1956, and in your 1958 year you have $1 million profit on renegotiable basis for purposes of renegotiation your renegotiable profit is automatically reduced from $1 million to $750,000.

Mr. DECHERT. I think your question, sir, was whether they lost any benefits from their earlier loss position, and they didn't.

Senator FREAR. They didn't lose any?

Mr. DECHERT. They had the full benefit of their loss.

Senator FREAR. Now this carryforward provision will affect companies even though they may not have Government contracts after the year renegotiated?

Mr. DECHERT. No, this affects only renegotiated business.

Senator FREAR. Yes. That is all, thank you.

The CHAIRMAN. Senator Williams.

Senator WILLIAMS. What percentage of contracts awarded by the Defense Department are on the negotiated basis, and what percentage on the competitive bid basis?

Mr. DECHERT. This is somewhat difficult to answer with exactness. It depends on a different service, to some extent.

Senator WILLIAMS. I am speaking of the Defense Department in dollars. I would like to have dollars and percentages.

Mr. DECHERT. Here is a table for the fiscal years 1951 to 1958, and for the year 1958 it shows that the formally advertised come to 14.3 percent, and of those——

Senator DOUGLAS. Just a minute, that is dollar volume, is it not, Mr. Dechert?

Senator BENNETT. That is what he said.

Mr. DECHERT. Yes. The dollar volume represents 14.3 percent, that is right, and the dollar volume of those not formally advertised represents 85.7 percent.

Senator DOUGLAS. What about percentages of contracts let, Mr. Dechert?

Mr. DECHERT. I think I cannot give numbers of contracts.

Senator DOUGLAS. On the preceding page you will find that of the 5,100,000 contracts, 5 percent were let by competitive bidding, and 95 percent were negotiated, isn't that correct? It is on the preceding page, I think about the fourth line.

Mr. DECHERT. Yes—wait a minute. July 1957 to June 1958 formally advertised were 3,114,000——

Senator DOUGLAS. You are again talking in terms of dollars. The question is in terms of numbers of contracts. Approximately 5,100,000 contracts.

Senator WILLIAMS. Is not one of the reasons that you don't know the answer that you haven't used competitive bidding very often?

Mr. DECHERT. No, sir; I think that isn't the answer. The answer is when we are dealing with number of contracts——

Senator WILLIAMS. Could you give us the number of contracts that have been awarded on a negotiated basis in 1958, and the dollar volume involved, and the number of contracts that have been awarded on a competitive bid basis and the dollar volume?

Mr. DECHERT. As I said, I think I cannot give the number of contracts.

Senator DOUGLAS. It is in the same publication that I am aware of. You will find that the numbers would be 5,100,000 total contracts, of which something over 275,000 were let by competitive bidding, and the remainder of approximately 4,850,000 were let by negotiation.

I don't have those figures with me, but I have got them in my head, and they are certainly subject to verification.

Mr. DECHERT. I am sure you are correct, sir. I don't see them on this table, and the number of contracts, of course, is often not a significant matter. One contract may be for $1 billion, and you may have a $100,000 item which is subject to 40 or 50 different contracts.

Senator WILLIAMS. For the information of the committee, will you submit that information for the record officially?

Mr. DECHERT. Yes, sir; I shall be glad to do that.

(The information referred to is as follows:)

For fiscal year 1958, there were 5,131,704 procurement actions by the Department of Defense. Of this number, 1,145,051 either represented intragovernmental procurements, procurements outside the United States or procurements from educational and nonprofit institutions. The balance, 3,986,653 represented procurement actions with business firms for work in the United States. This U.S. total consisted of 273,811 formally advertised actions or 6.9 percent of the total, and 3,712,842 negotiated actions or 93.1 percent of the total. It is interesting to note that 2,895,028 of these negotiated actions (78 percent) were placed with small business firms. It is further noted that 87.5 percent of all negotiated actions consisted of small purchases of $2,500 or less, for which negotiation is authorized by law in order to save administrative costs.

Senator WILLIAMS. In your statement, you refer to the amendment offered to section 103(e), the so-called protection for the incentive awards, you state, in answer to the Senator from Oklahoma, that the purpose of this amendment was to spell out in the law that which the Renegotiation Board is already doing in practice, is that correct?

Mr. DECHERT. Yes, sir; that is correct.

Senator WILLIAMS. Does it go beyond that?

Mr. DECHERT. No, sir.

Senator WILLIAMS. What effect would it have on the criticisms that have been leveled against the Defense Department on some of these incentive contracts in recent weeks by the Comptroller General? Would this legalize the practice which the Comptroller General has been criticizing?

Mr. DECHERT. I am going to ask Mr. Golden to answer it, but I am going to make a preliminary answer.

Senator WILLIAMS. I would like to have your answer first, and then he can answer.

Mr. DECHERT. As I understood it first, the criticism made by the Comptroller General of three or four aircraft companies has been that the aircraft companies did not properly inform the Government

negotiating officer concerning its knowledge with respect to prospective costs. In some instances the representatives of the Comptroller General have said that the contractor didn't tell the Government negotiating officer what it knew at the time it made the contract, and in other instances they said that the contractor learned later before the contract was well under way, but had failed to come forward and say to the contracting officer, "We have discovered errors."

Senator WILLIAMS. May I interrupt just a moment?

Mr. DECHERT. Yes, sir.

Senator WILLIAMS. In one instance he said that after it was with the knowledge of the Defense Department, yet you did not take advantage of it, so the criticism was both against the contractor not furnishing the information, and in one or two instances, if I recall correctly, the Comptroller General said that after you became aware of these inflated target prices you still did not adjust your price downward, but you allowed the incentive award.

Mr. DECHERT. Well, Senator, I didn't see that in the reports, and I am going to ask Max Golden to answer that part of your question, because he is very familiar with these, which are mostly Air Force cases. I saw no suggestion of that.

Senator WILLIAMS. What effect would that amendment have on such a substitution?

Mr. DECHERT. None whatsoever. This charge was, in effect, that the contractors didn't play ball fairly, because when they sat down across the table with the Government officers to negotiate as nearly as they could what a fair price would be, they had information that in all fairness and honesty they ought to have given, and they didn't give it.

Now, that is not something with which you can deal by law. This no doubt would have turned up in renegotiation proceedings. I hope it would have. But the change we are making here has no bearing on that situation at all. You can hardly legislate in this field requiring a man to be honest beyond punishing him if he isn't honest.

Senator WILLIAMS. You referred to the fact that on these incentive contracts they have incentive payments in addition to the cost-plus arrangement. Are the cost-plus percentages also lower in instances where the incentive is allowed, or are they sometimes the same?

Mr. DECHERT. I think you are asking whether the percentage which is allowed as profit——

Senator WILLIAMS. Fixed percentage.

Mr. DECHERT. On the original target price is always lower if an incentive provision is added; the answer is "Yes," it is always lower. It wouldn't be fair to give one man a certain percentage with no incentive provision, and another man the same percentage plus an incentive provision.

Senator WILLIAMS. I agree with you, and that is the reason I would like to have the answer affirmatively that either they are or they are not always lower.

Mr. DECHERT. I am going to ask Max Golden to supplement my answer, because "always" covers a lot of ground.

Mr. GOLDEN. I think you can only answer that in this way, that the policy and technique of the three departments is that they should be

lower. We have found in these dozen cases or so, GAO has found, we have found some, that the estimated target costs have been inflated.

Now, as to what this provision does, in relation to what the GAO found, it does not contravene that at all. The Board's regulations still have the provisions in, and the statute still has the provisions in, that efficiency is the important factor. Therefore, if this windfall is due not to efficiency but to an inflated estimate at the outset, the Board will not call that efficiency, and the Board will take those unearned profits away.

Mr. DECHERT. I think that doesn't however, fully answer the question you were actually asking. You were asking, as I understand it, if we have two contracts which were absolutely alike, and in one instance the man is going to get a fixed profit, and in the other instance he is going to get a fixed profit subject to incentive provisions, whether in the latter case, it is the universal policy of the Department that the fixed part would be a less percent in the second case than in the first. Obviously, it wouldn't be fair, otherwise, and the answer is "Yes."

Senator WILLIAMS. Why does the Defense Department not use the competitive bidding practice more than you do?

Mr. DECHERT. This is a very difficult subject, and I will try to answer it as well as I can, without being a complete expert on it, of course.

A vast number of these items for which we are now contracting are items as to which it is impossible to obtain formal competition.

Senator WILLIAMS. Might I interrupt? That is recognized and has been recognized in all the proposed legislation which would make mandatory competitive bidding.

Now, in those instances where it is practical, and there are many instances in which competitive bidding would be practicable, and yet you still utilize the negotiated practices, why don't you use the competitive bids whenever it is possible?

Mr. DECHERT. Well, I think there are several further answers to it, and I shall try to give some of them. In one situation where on the surface it would appear that formal competitive bidding is possible, the fact is known that the bids, though apparently competitive, are not really so. You, sir, are familiar with a great many cases where an apparent competitive bid situation will be created by one bidder making a true and honest bid; he has to work very hard and spend a lot of money in order to determine what to bid, but others will submit superficial or collusive bids.

Senator WILLIAMS. Is that a violation of the law when a contractor makes that arrangement?

Mr. DECHERT. It is, when the other bids are collusive, but there are variations all the way down.

Senator WILLIAMS. Yes. But I am speaking——

Mr. DECHERT. And the fact it, of course, sir, and this has some bearing on it, that making a bid in a formal competitive bid situation may be very costly, and many concerns will hesitate to go into the cost of preparing a truly competitive bid when the process of computing the bid is too costly. Therefore even though there has been no illegal collusion or illegal discussion between the several ostensible competitors, one of them may be really after the business and the other one may be making a merely superficial bid.

Another thing that comes up, sir, is that a large percentage of our total contracts are for pretty complicated types of things, and the know-how of a particular concern, or the extent of its available facilities, or the personnel that it has available with past experience, are factors of the kind which enter into a determination as to whether this or that contractor would be best for the particular job.

You do not select your doctors by a competitive bidding; you do not select your lawyers by a competitive bidding. What you are really getting often is the know-how of particular people, and the proven record of performance and other factors of that kind, which intangible factors are sometimes not measured by competitive bidding.

So I, coming only 2½ years ago from private practice, find that this situation of difficulty of competitive bidding in many situations exists, and it is a situation which is extraordinarily hard to remedy when we are dealing with this kind of problem.

Of course, the statistics which we gave are weighted against formal competitive bidding because they deal with the prime contracts. We know that the prime contractors subcontract a vast amount of their work, and very often the subcontracting is done by competitive bidding.

Senator WILLIAMS. Do I understand from your statement that you are allergic to competitive bidding?

Mr. DECHERT. No, sir. I was explaining why the percentage runs so high.

Senator WILLIAMS. Would you state for the record that to the fullest extent practicable that you do utilize competitive bidding practices?

Mr. DECHERT. That is right, and I would like to ask Mr. Golden to supplement it.

Senator WILLIAMS. Just a moment.

Mr. DECHERT. Yes, sir.

Senator WILLIAMS. You are in favor of using to the fullest extent practicable competitive bidding practices?

Mr. DECHERT. That is right.

Senator WILLIAMS. Then you would have no objection to an amendment to this or to a law which spelled out specifically that such practices must be followed on a mandatory basis so far as the Defense Department is concerned?

Mr. DECHERT. No, sir, I wouldn't. When you say "mandatory basis," you leave out of consideration these factors——

Senator WILLIAMS. Might I interrupt? We would only be doing what you are suggesting that may well be done in connection with section 103(3). You are suggesting that it may be advisable to remove the suspicion in the minds of some contractors to spell out in the law that the Renegotiation Board must do that which they are already doing.

I am suggesting that we spell out in the law that you do what you say you believe in, and what you think you are doing.

Mr. DECHERT. If I understood correctly, sir, and I of course don't want to argue with you, you suggested that we would put in a mandatory provision——

Senator WILLIAMS. Yes, sir, and I am suggesting that you endorse what we put in.

Mr. DECHERT. You are suggesting that we endorse a mandatory provision that we should use competitive bidding to the same extent

that private industry did. What I am suggesting is that the latter yardstick is such an unworkable yardstick that we couldn't possibly work under it.

Senator WILLIAMS. Might I add that in all the measures that have been proposed, they have been worked out with your department, all the leeway or exemption has been given to take care of the new types of work such as in times of war, or where secrecy is necessary to protect the national security, all of that, all of those safeguards are in the bill. With this understanding will you spell out affirmatively that you must use more standard competitive bidding practices. There is a growing suspicion in the minds of a lot of us that you may be somewhat allergic to it. It has been pointed up by the Comptroller General recently instances in which you have awarded contracts even after soliciting the bids not to the lowest competitive bidder, nor to the most responsible bidder. Therefore I think that it may be well that we spell this out in the law.

Mr. DECHERT. I would like to answer it, but I am going to ask Max Golden, who is closer to this contracting business and has been for a longer period than I, to say something in response to this.

Mr. GOLDEN. I wanted to answer an earlier question, because Senator Douglas is properly disturbed.

We do have figures on dollars and numbers of actions, and if you would like those I would put those in the record right now for fiscal year 1958.

Senator WILLIAMS. Yes.

Mr. GOLDEN. In the Department of Defense for fiscal year 1958, we had a total dollar procurement of $21.8 billion; $18.7 billion was negotiated. This was 85.7 percent by dollars; $3.1 billion, or 14.3 percent by dollars was advertised. As far as numbers of transactions, Senator Douglas is correct, there were 3.9 million, approximately, transactions.

Senator DOUGLAS. Just a minute, on page 22——

Mr. GOLDEN. I have an excerpt here that may not be as——

Senator DOUGLAS. This is the official report——

Mr. GOLDEN. Yes.

Senator DOUGLAS. Filed by the Secretary of Defense entitled "Military Prime Contract Awards July 1957 to June 1958," which gives the total number of military procurement actions for the fiscal year 1957–58, 5,131,704, as I said, approximately 5,100,000.

Mr. GOLDEN. Our figures differ, I am sure, but I think the percentage——

Senator DOUGLAS. This is a report of the Secretary of Defense. Of this total number 276,233 were let under formally advertised bids, or 5.5 percent, and approximately 450,000 of these were—of the total 5,100,000 were overseas, the rest were domestic.

Mr. GOLDEN. Senator Douglas, our percentages are in the ball park, and I will reconcile these for the record. (See page 34.)

Ninety-three and one-tenth percent I have were negotiated by number; 6.9 advertised. But I think we are in the ball park. I would like with your permission to explain one thing, and I believe you understand it. If you just look at the 3.7 million transactions, that doesn't tell the whole story, because about, I would say, over 3 million of those transactions involve transactions of less than $10,000, and most of them less than $1,000. Under the law, we do business in the

case of contracts under $1,000 as is customary in the ordinary commercial channels, that is, we are authorized by law not to waste or spend the money to go out on formal competition on contracts under $1,000.

So I think the numbers are misleading. Technically you are right, but please understand that one fact.

Now, as to your, I think, more important subject of are we allergic to some statement in the Armed Services Procurement Act which enjoins us to use competitive bidding, I would say no. This is the spirit of the Armed Services Procurement Act, and if it isn't we would not object to spelling out the use of competition to the greatest extend practicable. And I think competition should be understood to mean not only formally advertised procedures. There is a substantial amount of competition under negotiated procedures where, because of the nebulous nature of the article and for other reasons, we can't formally advertise; nevertheless we go out and get competition.

I think the trouble with many of the bills that have been suggested in the past, suggested language in bills, is that they have not been carefully worked into the present Armed Services Procurement Act, and——

Senator WILLIAMS. Will you direct yourself to any specific bill when you are speaking now?

Mr. GOLDEN. No, sir; I have seen some of them in the past. I think I have seen some of yours in the past, sir, and I think we could accomplish a basic policy statement that you want of urging competition whether formally advertised or in negotiation to the greatest extent practicable and accommodate you, but I think——

Senator WILLIAMS. I am not asking you to accommodate me. You are spending about $40 billion a year, and somebody else is to be accommodated, because there is a question raised in many instances and there have been instances pointed out when you are not awarding the contracts to the lowest responsible bidders.

Mr. GOLDEN. Senator Williams, I used an unfortunate term. I mean accommodate what is a good idea that you have, and I would be willing to try to work it out. I am sure the Department of Defense will be. While the objective has been 100 percent correct, it has not been woven into the framework of the Armed Services Procurement Act. As a matter of fact, it conflicts with the negotiation exceptions and the technical procedures of the act. However, I think we can work it out.

Senator WILLIAMS. I appreciate that statement, and to follow it up, I am going to ask you to furnish the language that you think would do the job.

Mr. GOLDEN. Yes, sir; I will be glad to.

(This information was submitted by letter from Mr. Golden to Senator Williams dated June 6, 1959:)

JUNE 6, 1959.

Hon. JOHN J. WILLIAMS,
U.S. Senate.

DEAR SENATOR WILLIAMS: I refer to the recent hearings before the Senate Finance Committee on the extension of the Renegotiation Act of 1951.

In response to your questions I answered that our objective is to obtain competition wherever we can and that we are not allergic to so stating in the Armed Services Procurement Act. You then asked that I, in effect, perform a "drafting

service" and submit language that would accomplish the objective sought. I believe the attached language would accomplish this purpose.

Sincerely yours,

MAX GOLDEN, *General Counsel.*

TO AMEND TITLE 10, UNITED STATES CODE

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That title 10, United States Code, is amended as follows:

Section 2301 is amended to read as follows:

"a. It is the policy of the Congress that purchases and contracts under this chapter shall be made on a competitive basis wherever practicable, whether such purchases and contracts are made by formal advertising or by negotiation.

"b. It is the policy of Congress that a fair proportion of the purchases and contracts made under this chapter be placed with small business concerns."

Subsection (a) of section 2304 is amended by inserting a semicolon at the end of clause (17) thereof and adding to subsection (a) the following:

"*Provided,* That such negotiated purchases and contracts shall be made on a competitive basis wherever practicable, in accordance with regulations prescribed by the Secretary of Defense."

The CHAIRMAN. Senator Douglas.

Senator DOUGLAS. Following up the very excellent points that Senator Williams has made, may I say that in the fiscal year ending in June 1957 if my memory serves me, there were approximately 318,000 contracts awarded by advertised competitive bidding—Mr. Golden can correct me if I am wrong on this—out of a total of slightly less than 5.0 million, which means that you have roughly over 6 percent, 6.2 percent of the contracts in 1957 were awarded by competitive bidding.

Now, the Department of Defense says that it is making every effort to increase the zone of competitive bidding, and in the following fiscal year, the year running from July 1, 1957, to June 30, 1958, 5.5 percent were awarded by competitive bidding.

If this is progress, I would say it is progress backward.

That is the first comment, Mr. Chairman, but I think if they want to make their reply to that, then I want to go into details, if I may.

The CHAIRMAN. Do you desire to reply?

Senator DOUGLAS. May I ask if there is agreement that my figures are correct? I don't have the bulletin before me.

Mr. DECHERT. I believe, sir, they are substantially correct, although I don't have them exactly, and if they differ substantially, I shall be glad to furnish them. All I can say in answer to that is that the Department of Defense is in accord with the policy which you have suggested and which Senator Williams indicated.

We want to make these contracts by competitive bidding if that can be done.

Senator DOUGLAS. But your number diminished from fiscal 1957, to fiscal 1958, absolutely and percentagewise.

Mr. DECHERT. But I want to go on and point out again, as Max Golden did, that the mere number of contracts is hardly a significant figure.

For instance, our contracts include the things we buy from the shelf; they include the things that you will find in supermarkets; they include a vast number of things which are bought on order; and so on. Therefore the mere number of contracts is not as significant, I think, as the amount of dollars involved. I am not happy over the amounts, either; none of us are, and we are working to reduce

the amount of noncompetitively bid contracts. As Max Golden has pointed out, even when it has become essential, in the judgment of those who are charged with this contracting responsibility, to deal otherwise than on an advertised competitive bidding basis, they have sought what sometimes is called "competitive negotiation." Finding that there are several concerns which are equipped to do a certain thing, they have brought such concerns into a competitive negotiation. These do not in our statistics show up as competitively bid contracts, but that procedure is something different from merely going to a contractor and saying, "Here, you come and do this job."

Senator DOUGLAS. Mr. Chairman, turning from global figures to the specific details, I have been studying for some time the reports of the Comptroller General of the United States examining contracts of the Defense Department, and I would like to read some of these reports into the record and then ask the Department to prepare an answer on these matters, because these reports have been given to Congress, and as I understand it at least, Congress has ont received an answer from the Department on these matters, and in those cases where corrective action has been promised, we would like detailed statement as to the degree to which the corrective action has been carried out.

I would like to start with a report of the Comptroller General in January 1959 dealing with the McDonnell Aircraft Corp. of St. Louis. I read the salient paragraphs:

In establishing a firm price for airplanes to be produced under contract NOAS 53-204, Navy contracting officials utilized without adequate certification of evaluation cost data which included duplicate costs and costs not applicable to the airplanes, the contractor incurred costs of about $6 million less than the amount contemplated, of which $2,596,900 could have been recognized by Navy contracting officials by an adequate review of cost data available at the time the price was established.

As a result of our bringing our findings to the attention of the agency, the contractor offered to reduce the price by $3 million.

Notice—I interpolate here—that was the result of action of the Comptroller General, not of the Defense Department.

As of December 1, 1958, the Navy had not accepted this offer.

Then there are other critical paragraphs which follow.

Here is another case in January 1959 dealing with the same company—pardon me, it is a duplicate.

There is one dealing with the Boeing Airplane Co. issued in May of 1959:

The report discloses that proposed target prices, for certain spare parts for B-52 airplanes, submitted by Boeing and accepted by the Air Force for these fixed price incentive contracts, contained estimated subcontract prices which were higher than prices established by Boeing with its subcontractors before the target prices were submitted. Boeing did not disclose to the Air Force, and the Air Force did not obtain and consider the information on the lower subcontract prices which was known to the contractor at the time the price proposals were submitted. As a result of using higher estimated subcontract costs, target costs for these spare parts were excessive by about $5,022,465. This amount was reduced to $4,326,900 after giving effect to an adjustment of $695,565, with consequent savings to the Government of $187,295, made by Boeing subsequent to our inquiries.

Unless further adjustment of the target prices is made, the Government will incur excessive costs which we estimate will amount to about $1,211,530.

Here is another report dealing with North American Aviation of Los Angeles, Calif., dealing first with the Rheem Manufacturing Co., Downey, Calif. The paragraph in question reads:

The report shows that the prices quoted to Rheem on follow-on orders for vertical stabilizer tips by its supplier were unreasonably producing similar items prior to the time of negotiations. Rheem accepted the prices without obtaining cost information from its supplier in support of the prices quoted, and neither North American nor the Air Force required Rheem to obtain such data for use in negotiating prices.

As a result, the ultimate cost to the Government was excessive by about $178,000.

Here is one with the Boeing Co., of Wichita, Kans.

I apologize for the length of these, Mr. Chairman, but this is crucial. This is dated May 14, 1959. The paragraph in question reads:

Boeing awarded firm fixed-price purchase orders to Cessna for B–52 stabilizer assemblies and related tooling, although Cessna had not previously produced such assemblies and was not in a position to prepare realistic cost estimates for use as a basis for pricing. The prices negotiated for the stabilizers and tooling, which totaled $6,324,970, proved to be about 37 percent greater than the costs of $4,621,329 actually incurred by Cessna in performing the subcontracts.

We are recommending to the Secretary of the Air Force that the agency's control over a contractor's purchasing system include participation in, or close surveillance over, major subcontract negotiations in order to assure that appropriate types of subcontracts are used and that fair and reasonable prices are negotiated.

Further we are recommending that this case be utilized by the Air Force to emphasize to agency contracting personnel the need for continued vigilance in their surveillance over prime contractors' subcontract pricing and administration.

Here is a report dated March 20, 1958, of the Chrysler Corp. in Detroit, under a Department of the Army contract. The report states, beginning with the second paragraph:

The report shows that unnecessary cost was incurred by the Government through the extensive use of time and materials subcontracts without adequate cost controls. The exigencies of the situation and unique nature of the items made the use of time and materials subcontracting necessary for initial procurement of parts required by Chrysler Corp. under its prime contracts with the Army Ordnance Corps. However, the prime contractor continued to award time and materials subcontracts for the procurement of additional quantities of the same parts although fixed-price subcontracting would apparently have been practicable and more economical.

Comments furnished us by Chrysler Corp. and to the Department of the Army show that action has been taken to restrict the use of time and materials subcontracting and strengthen controls over costs incurred under this type of subcontracting.

Here is one dealing with the Lockheed Aircraft Corp., Georgia Division, Marietta, Ga., issued in May of 1959. I read as follows:

The report shows that the negotiated target prices included amounts for subcontracted items which were $4,100,600 in excess of amounts that the contractor knew would be incurred for those items. Of this amount, $2,844,000 was known to the contractor prior to submission of its proposal, although the proposal stated that estimated costs of subcontracted items were based on the most current information available. The remainder of the $1,266,600 became known to the contractor prior to completion of negotiations. The lower cost information was not furnished by the contractor in negotiations, nor disclosed by Air Force review. Consequently, unless appropriate adjustments are made, the contractor will receive incentive participation and target profits of about $1,250,000 because of excessive target estimates rather than contractor efficiencies.

Here is a report dated May 1959 dealing with the General Precision Laboratory, Inc., of Pleasantville, N. Y.:

The report presents our finding that the target prices negotiated for two incentive-type contracts included overestimates of about $500,700 not recognized at the time of negotiations because of inadequate reviews by agency officials of the contractor's estimated costs. These overestimates will, under the incentive provisions of the contracts, result in additional costs to the Government of about $150,200 unless an adjustment is made.

Here is a report dated December 1958 dealing with the A. O. Smith Corp. of Milwaukee, Wis. I will read the second paragraph:

The report discloses that agency officials negotiated prices without verifying cost data which the contractor furnished in support of the proposed prices. Consequently, these officials were not aware that the contractor had adjusted experienced cost data upward to correct estimated discrepancies and they accepted the proposed prices, which were excessive. As a result of our bringing this finding to the attention of the contracting agency, the contractor has refunded $126,775 to the Army and we have been advised that our findings would be brought to the attention of all ordnance installations concerned with procurement.

And I would again like to interpolate by saying this is the result of action by the Comptroller General, and not of the Defense Department.

Here is one dealing with the insurance on Chance Vought Aircraft, Inc., in Dallas, Tex., which I believe does not fix a money figure, but which states:

The report pertains to the requirement of the Department of the Navy that the contractor carry property damage insurance on Government-owned facilities, although the facilities are used almost exclusively in the performance of Government contracts and subcontracts. This requirement, which has been adopted pursuant to the provisions of the armed services procurement regulations, results in unnecessary costs to the Government through absorption of insurance charges in prices to the Government and is inconsistent with the Government's policy of self-insurance on its properties.

This is my interpolation, the contractor used Government facilities; presumably there is a policy of self-insurance on these, that the Navy Department required the contractor to carry insurance on these properties and let him include the price of this unnecessary insurance in the contract price.

Here is one dealing with General Motors, Cleveland Diesel Engine Division of the General Motors Corp., Cleveland Ohio, reading the second paragraph, and this deals with negotiable contracts totaling $118,700,000 awarded by the Bureau of Ships:

The report presents our findings that (1) excessive contract prices were negotiated because contracting officials did not give adequate consideration to the contractor's cost experience; (2) the contractor was allowed the same rate of profit on subcontracted major components as on items to be manufactured in his own plant; and (3) excessive allowance was made for overhead in spare parts prices. Comments from the Department of the Navy and the contractor on our findings are recognized in the report.

Still another examination report dated March 1959 on Friden, Inc., San Leandro, Calif., which has contracts with the Air Force:

The report discloses that excessive contract prices were negotiated because agency officials did not give adequate consideration to the contractor's previous cost experience. As a result of our review, the price of one contract was reduced $128,005, and a second contract was awarded on a price-redetermination basis. In subsequent price-redetermination negotiations the price of the latter contract was reduced about $446,200. We believe, however, that further savings

might have been realized if agency contracting officials had given adequate consideration to available cost data and had exercised their option to request a second price redetermination.

Again I want to point out it is the result of action by the Comptroller General and not of the Defense Department.

Here is an examination of subcontracts with the Firestone Fire & Tube Co. of Los Angeles, Calif., for aircraft fuel cells dated October 14, 1958. The second paragraph reads:

The report discloses that neither the prime contractors nor the Department of the Air Force have required the subcontractor to furnish evidence of the reasonableness of proposed prices for aircraft fuel cells, and as a result the prime contractors have not had sufficient information to use as a basis for negotiating fair and reasonable prices. For the 3 fiscal years ended October 31, 1956, Firestone earned a profit of about $3 million, 36 percent of cost, on these fuel cells.

Still another one dealing with the General Motors Corp., A–C Spark Plug Division, Milwaukee, Wis., the second paragraph reads—and I think I shall read the third paragraph, too:

The report discloses that unreasonably high prices were negotiated because the Air Force awarded the contract on a fixed-price basis without requiring the contractor to furnish detailed support for the estimated costs included in the prices proposed by the contractor. The estimated costs were not a reasonable basis for contract pricing because they did not reflect cost reductions which might be expected to result from purchases in larger quantities.

Further, additional quantities were ordered under the contract at prices which did not give effect to lower, more current costs of materials.

After we brought our findings to the attention of the Air Force and the contractor, the latter made a refund of $750,000 applicable to this contract, and the Air Force issued a directive to the contracting officials designed to strengthen procedures relating to the use of cost data in the negotiation of conract prices.

Report dated June 1959 on subcontracts voted to Lambert, subcontracts for the procurement of photographic ejectors from Lambert Engineering Co., St. Louis, Mo. The subcontracts were firm fixed-price purchase orders awarded and administered by various prime contractors under negotiated prime contracts of the Department of the Air Force and the Department of the Navy. The second paragraph reads:

Prices proposed by the subcontractor were generally accepted by the prime contractors without price or cost analysis or comparison with the subcontractor's cost experience, though there was no competition because Lambert was the sole source of supply. As a result, inadequate recognition was given in the subcontract prices to declining costs as production experience was gained and, therefore, close pricing was not achieved.

Here is a report of July 1958 dealing with examination of Army contracts and subcontracts with Birdsboro Armorcas, Birdsboro, Pa., and I again read the second paragraph:

This supplementary report is furnished to inform you of the following administrative weaknesses which were disclosed by our examination:

(1) Additional cost to the Government resulted from (*a*) allowing profit to the subcontractor and prime contractor on rent paid for the use of Government-owned facilities; (*b*) requiring the contractor to provide insurance on Government-owned facilities; and (*c*) not adjusting profit allowances for a reduction in the scope of the work actually performed.

(2) The contractor's fee under a cost-plus-a-fixed-fee contract included charges for indirect costs, making it difficult to determine whether regulations limiting such fees were complied with.

(3) The contractor used Government-owned facilities for commercial operations for 2 years without formal contractual agreement and without paying rent to the Government.

There is one dealing with the Department of the Navy negotiated contracts with Collins Radio Co. of Cedar Rapids, Iowa. The second paragraph reads:

Our examination disclosed that the target cost negotiated for an incentive-type contract included an unjustifiably high estimate of the cost of a major subcontracted company. Our findings and observations on this and other matters were submitted to the Navy Bureau of Aeronautics prior to the negotiation of final prices on the contracts and were given consideration in the negotiations. As a result, the major portions of the profit attributable to the overstatement of the target cost was eliminated from the final price.

I give credit to the Navy in its action on this, but it was done only after the Comptroller General made its report.

Here is a report of March 1959 dealing with examination of the Department of the Air Force contract with AVCO Manufacturing Corp., Crosley Division, Cincinnati, Ohio, the second paragraph of which reads:

An excessive price was negotiated for this contract because the Air Force accepted more than $1 million of recorded costs which the contractor included in error in its pricing proposal. As a result of our bringing this matter to the attention of the Air Force and the contractor—

I interpolate to point out again this was the action of the Comptroller and not of the Air Force or the Department of Defense.

Now, continuing to read:

The contractor has refunded $1,133,510 to the Air Force. In addition, steps have been taken by the Air Force and the contractor to prevent in the future pricing errors of the type which resulted in negotiating an excessive price for contract AF33(600)-31100.

As if this were not enough, let me read the report dated November 13, 1958, contract with Curtis-Wright Europa in the amount of $27 million, which the Comptroller General says violated existing statutes, section 4(b), Armed Services Procurement Act, prohibiting the cost plus a percentage of cost system of contracting. Reading two paragraphs, Nos. 2 and 3:

Contract No. AF-61(514)-609 was entered into on June 26, 1953, with Curtis-Wright Europa, N.V., a wholly owned foreign subsidiary of Curtis-Wright Corp., for the furnishing of spare parts and accessories for the overhaul and maintenance of J-6-A jet engines. The contract was part of the program to establish production sources in Europe and to provide logistic support for F-84-F aircraft furnished to the North Atlantic Treaty Organization countries under the military assistance program. Under the contract, Curtis-Wright Europa was to subcontract the actual production of the spare parts and accessories, furnish technical know-how to European producers, set up inspection and quality control procedures, including a complete testing laboratory, and assume limited responsibility to the Air Force for the quality of the end items. The contract provided for reimbursement of actual costs plus the lesser of (1) a fee of $2,115,553, or (2) a fee equal to 8.5 percent of the total contract costs reimbursed, costs and fee not to exceed the total contract cost of $27 million.

It is our view that the illegality of the contract with Curtis-Wright Europa nullifies the existing provisions of the agreement and requires the Curtis-Wright Europa be paid for the fair value of the items and services received by the Air Force. Accordingly, we have recommended to the Secretary of the Air Force that a thorough review be conducted of the cost reimbursement to Curtis-Wright Europa to determine whether they were incident to, and necessary for, the performance of the contract. In this connection we suggest that special consideration be given to the propriety of payments to the parent corporation of $451,000 for general and administrative expenses, to the inclusion of intercompany profits on sales by the parent corporation to Curtis-Wright Europa,

and to possible excessive costs incurred as a result of subcontracting for groups of items rather than for individual items.

We further recommend that a fair and reasonable amount of profit be determined, commensurate with the risks involved and the capital investment of Curtis-Wright Europa.

Here is a contract with Westinghouse Electric Corp., Baltimore, Md., Air Arm Division, dated April 17, 1959, reading the second paragraph:

Excessive costs were borne by the Government because the Navy negotiated a contract price based on estimated costs, when actual costs, which were $933,463 lower than the estimate, had already been incorrect. Further, the contractor received excessive reimbursements for royalty costs. We have been informed that the contractor and the Department of the Navy have established procedures to avoid recurrence of delays in negotiating final contract prices and, further, that action has been taken to prevent excessive reimbursement for royalty costs in future negotiations.

Report of April 1958 entitled "Examination of Administration of Major Subcontracts Under Department of the Navy Contract No. OA(S)56-719fw, Philco Corp., Philadelphia, Pa." The second paragraph reads:

The report presents our findings that (1) deficiencies in administering two subcontracts caused prolonged delays in refunding to the Government about $1,400,000, and (2) failure to exclude improper costs in redetermining a subcontract price resulted in excessive cost to the Government of about $29,200. We are recommending to the Secretary of Defense that Department of Defense Directive 4105.7 which limits the aggregate total payments to prime contractors on price-revise-type and incentive-type contracts be amended so that it will also apply to similar types of subcontracts. We are recommending to the Secretary of the Navy that the agency emphasize to contracting officials the need for a closer review of subcontract negotiations.

Report of December 1958, "Examination of the Pricing of the Department of the Air Force Contracts and Subcontracts With Avtron Manufacturing, Inc., of Cleveland, Ohio." The second paragraph reads:

The report discloses that unnecessary costs were incurred by the Government because firm fixed-price contracts and subcontracts were awarded without competition being obtained and before such cost experience was available. After we brought our findings to the attention of the contractor, Avtron refunded $52,000 to the Air Force. The Air Force has agreed that adequate cost analysis is essential to the use of fixed-price contracting, and informed us that our findings in this instance will be included in training courses of the Air Materiel Command. However, the Air Force did not concur in our conclusion that fixed-price contracting was not suitable in this case.

Now, Mr. Chairman, I have taken a good deal of time. There are one or two more that I could go into, but I don't wish to belabor the point.

There is a report by the Comptroller to Congress, a general report, dealing with the need for current cost data in negotiations of defense contracts, and a report of March 1959 dealing with contracts with Librascope, Inc., Glendale, Calif., which seems to indicate an overcharge of some $12,000.

This is the point. The Comptroller General, appointed by President Eisenhower, is the former comptroller of Columbia University, of which President Eisenhower was president. He cannot be charged as being prejudiced against this administration.

Here is a series of damning reports on the contract procedures of all branches of the Defense Department. And these are simply the

cases that the Comptroller General was able to investigate. He could investigate only a fraction of the cases because his funds were limited.

Now, in view of all that, what would you say about your statement at the very bottom of page 2 and the top of page 3, "as good as our pricing policies and techniques may be," would you say that your pricing policies and techniques were good? I notice you put this in a supposititious case. Would you say your pricing policies and techniques were good?

Mr. DECHERT. Senator Douglas, let me answer generally——

Senator DOUGLAS. Yes.

Mr. DECHERT. The things you have brought out.

We in the Department of Defense are deeply concerned by the defects which have been brought out by these reports. In a sense, most of the reports which you have read bear out the urgency of the need for continuation of the Renegotiation Act, because many of those reports, as you have read them, are based on allegations that business concerns, among the leaders of our country, concerns deemed to be wholly legitimate, have, when they have negotiated across the table with the Department of Defense representatives, withheld information that they should have given.

Now, at all times we cannot possibly in Government has as experienced people in the field of negotiation in a particular concern's own business as its representatives sometimes have. It has tremendous resources, it is dealing with its own subject matter, and the man representing the Government sitting across the table may not always have the knowledge of every cost element of this particular business. He does the best he can. Obviousy he may fail; to the extent that he fails it is very unfortunate.

We are doing all we can, and the reason we expressed it the way which you just read was that we recognized that we are far from perfect. We recognize there are many dificiencies. Those we want to improve. If there are ways to improve them, we will be glad to do it.

I suppose that the Renegotiation Act isn't the place to improve, to talk about improving by statute our method of contracting, but we would be glad to discuss that to any extent we can, because we don't like these any more than anyone likes them. They hit us very close.

But as I brought out, many of these reports indicate that at the time target prices were being set the Government representative, and there is no question about his honesty in those reports, he was doing the best he could, failed to arrive at the proper figure, because the man across the table was holding something back.

Now, that is what necessitates this Renegotiation Act, and that is why we feel that we canont always simply rely on the integrity and fair dealing even of our great concerns, because these things do happen.

I ought to say also, sir, that the fact that the GAO has reported it in this report to be so, doesn't necessarily prove it to be so. The Europa matter, which Max Golden can go into further, is in litigation.

I noticed in there one report saying we were grossly at fault, our contracting officer, ought to be scolded, because he allowed a private concern to insure itself against public liability when it was using,

with the permission of the Government, Government property on its own affairs, and the GAO argued in that paper that you read, sir, that there couldn't be any public liability because this was a Government-owned piece of property.

Well, I think that a misconception, because if we allowed, as apparently we did allow here, the private concern to use it in its own business, thereby probably reducing the cost to the Government, the private concern would be liable if this piece of machinery ran over somebody, and if having run over somebody they had to pay $50,000 of damages, they would then allege that this was something they could recover as part of the costs.

Maybe they don't do so, but the thing I am bringing out is that this is a risk, and you and I are on hospital boards and we carry insurance although we know we might not be liable because we want to be darned sure the fellow is going to be paid if he suffers an injury, so that I think even though the GAO says these things, it isn't necessarily the last word. The courts or somebody else may have something else to say.

I am not trying to evade the thrust of the major challenges, because the major challenges are there, and they seem to be well taken, but they are primarily a challenge that our organizational representatives in trying to reach proper costs failed, because they didn't know as much as the other fellow knew, and this is something we are very worried about and would like to have corrected, and we are working on them, I can assure you.

Senator DOUGLAS. No. 1, would you have your counsel or associates prepare a reply on these reports by the Comptroller General?

Mr. Chairman, I request this, that the Department of Defense prepare a reply on these reports by the Comptroller General, challenging the accuracy of any statements which they believe to be inaccurate, and indicating what remedial action, if any, has been taken along the lines of recommendations made by the Comptroller General.

Mr. DECHERT. Each one of these, sir, is now being studied, and we will be glad to submit the results of the study to Senator Douglas.

Senator DOUGLAS. No, not to me. I think it should be made a part of the official record of the committee. This is not a personal matter.

Mr. DECHERT. The only reason I suggested otherwise is that some of these may take a good long while. One, I say, is in litigation, I know. But we will make a report to the extent that we can, and we will make it promptly. And to the extent that it will require further reports later, we try to follow that up.

(The information referred to is as follows:)

SUMMARY OF GENERAL ACCOUNTING OFFICE REPORTS INCLUDING SPECIFIC ACTIONS ACCOMPLISHED BY THE DEPARTMENT OF THE AIR FORCE

1. The Air Force considers the criticism by the GAO to be fair and constructive and has initiated vigorous action to carry out the recommendations of the various reports. Some of these actions are:

(a) Soon after the first case came to the Air Force's attention, the Air Force procurement instruction was amended to require contractors to furnish a certificate that all available cost data affecting materials and labor were considered in the preparation of a proposal and were made known to the Air Force negotiator. In addition, the contractor certified that the data used is current. The instruction was later amended to provide that such a certificate is not to be considered a substitute for careful review and analysis of contractor's proposals

by contracting officers, price analysts, and, where appropriate, Government auditors.

(*b*) Almost simultaneously with the above action, Headquarters, USAF, in a letter to the commander, Air Materiel Command, stressed the importance of the role of the auditor as an active and effective member of the negotiating team. It outlined action to be taken to improve the effectiveness of audit support to the procurement function.

(*c*) In January of this year a concerted effort was made at all levels within the Air Force to take additional corrective action. The commander, Air Materiel Command, sent letters to the three major industrial associations drawing their attention to the cases involving incorrect representations relating to estimates of material costs in price proposals and asking that they take corrective action so that we could continue to rely on the integrity of contractors' representations. In addition, the Director of Procurement and Production sent letters to 28 of our major contractors asking that they review the pricing information, which had been furnished at the time of negotiation of targets on redeterminable and incentive type contracts, on which final settlement had not as yet taken place. The purpose was to determine the currency, completeness, and accuracy of the information and, if discrepancies were revealed, then an adjustment of the targets or the arrangement for refunds would be negotiated. Furthermore, AMC directed all of its major procuring activities to take the following actions:

(i) Negotiate, if appropriate, adjustments to targets prior to entering negotiations for any final settlement and/or arrange for refunds;

(ii) Identify the incentive contracts which have not been settled by January 6, 1959, and for which no certificate described in (*a*) above was obtained;

(iii) Advise contractors that no settlement can take place without such a certificate; and

(iv) Obtain certification from contractor that current, complete, and accurate data has been furnished either at the completion of adjustment negotiations or at the time a determination is made that no such negotiations are necessary.

In addition, the Auditor General issued instructions that a selective audit be made of contracts with respect to which certificates had been obtained.

(*d*) The Air Force procurement instruction 3-808 was further amended on May 28, 1959, to require its procurement personnel to (*a*) make a thorough analysis of contractors' proposals; (*b*) obtain current, complete, correct, and significant cost and pricing data; and (*c*) secure information on the types of subcontracts to be used before contract prices are finalized. The GAO has been advised of this by a letter from the Assistant Secretary of the Air Force (Materiel), dated June 5, 1959.

(*e*) Finally, the Air Force has recently allotted spaces for 203 additional auditors to be used in the procurement area.

2. It is believed that these actions which the Air Force has taken are responsive to the recommendations of the GAO and will enable the Air Force to maintain closer control and surveillance over Air Force pricing practices and those of Air Force prime contractors, especially in the area of major subcontracts. In so doing the Air Force will, it is believed, improve its management in the admittedly difficult area of subcontracting while, at the same time, continue to impose a rightful responsibility on the part of its contractors to discharge their contractual obligations in an effective, efficient, and economical manner. The Air Force will exercise continuing diligence to eliminate any weakness which develops in its procurement system

8. Specific actions accomplished by the Air Force are set forth below in respect to each of the following GAO reports.

(*a*) Examination of procurement of spare parts from Boeing Airplane Co., Seattle, Wash., under Department of Air Force contracts AF 33(600)-22119 and AF 33(600)-28223, dated May 19, 1959:

In this report the GAO recommended that (1) Air Force personnel be directed, by specific amendment of Air Force contracting and pricing instructions, to assure themselves, to the extent practicable, through examination of contractors' records, that the information furnished by contractors with respect to all significant elements of cost is current, complete and accurate; and (2) with respect to the excessive target prices for spare parts procured from Boeing, the Air Force take all steps necessary to obtain oppropriate adjustments.

The Air Force has accomplished the following action in respect to the first recommendation:

(i) As indicated in paragraph 1(*a*) above, AFPI 3-811(*b*) was revised by Air Force procurement circular No. 3 on February 5, 1959, to the effect that the prescribed contractors' certificate is not to be considered a substitute for careful review and analysis of contractors' proposals by contracting officers, price analysts, and where appropriate, Government auditor. The practical effect of this is to continue to emphasize careful review and analysis of contractors' proposals by Air Force personnel even though the contractor executes the prescribed certificate.

(ii) As indicated in paragraph 1(*d*) above, Air Force procurement instruction, section 3-808 has been revised directing that Air Force procurement personnel must: (a) make a thorough analysis of contractors' proposals; (b) obtain current, complete, correct, and significant cost and pricing data; and (c) secure information on the types of subcontracts used or proposed before contract prices are finalized.

In respect to the second recommendation contained in the report, the following is the present status: A reduction of $106,520 has been effected on contract 28223, which is $7,890 more than recommended in the GAO report. In respect to contract 22119, Boeing has offered a reduction of $3,875,511, as contrasted to the GAO recommendation for a reduction of $4,474,060. Negotiations are continuing.

(*b*) Examination of incentive target prices under Department of Air Force fixed price incentive contracts with Lockheed Aircraft Corp., Georgia division, Marietta, Ga. dated May 6, 1959:

In this report the GAO recommended that (1) the Air Force take necessary steps to obtain appropriated adjustments on contract AF 33(600)-28437 and AF 33(600)-30694; and (2) that the Air Force require responsible agency contracting personnel to assure themselves, by thorough examinations of prime contractors' records, that cost data being furnished on major subcontracts are current, complete, and accurate as of a date reasonably close to the time of negotiations.

In respect to the first recommendation, agreements were executed on May 14, 1959, whereby the contractor agreed to a price reduction of $2,930,256 on contract AF 33(600)-28437, and a price reduction of $1,983,024 on contract AF 33(600)-30694. The total adjustment under both contracts is $4,913,280.

The actions by the Air Force as are set forth under the Boeing report in (*a*) above, are considered as complying with the foregoing second recommendation.

(*c*) Examination of purchase order E-10008 and E-10015 awarded to Cessna Aircraft Co., Wichita, Kans., by Boeing Airplane Co., Wichita, Kans., dated May 14, 1959:

In this report, the GAO recommended (1) that the agency's control over a contractor's purchasing system include participations in, or close surveillance over, major subcontract negotiations in order to assure that appropriate types of subcontracts are used and that fair and reasonable prices are negotiated; and (2) that this case be utilized by the Air Force to emphasize to agency contracting personnel the need for continued vigilance in their surveillance over prime contractors' subcontract pricing and administration.

The first recommendation, so far as it relates to participation by Air Force personnel in major subcontract negotiation, raises a serious question of Government policy. Traditionally, we believe, in contracting by all agencies of Government, the prime contractor is held primarily responsible for efficient expenditure of moneys under his contract. In certain types of contracts, the Air Force reviews proposed subcontracts and either approves or disapproves them, but this has never been considered to dilute the responsibility of the prime contractor. If, however, Air Force personnel were to participate directly in subcontract negotiations, we would negate that responsibility and lose an effective lever against the prime contractor.

Consequently, we do not consider such direct participation to be wise. On the other hand, it may be that the furnishing of Air Force audit information to prime contractors, when requested, can result in better evaluation of subcontract proposals by the prime contractor. We presently are exploring the feasibility of such a course of action. However, we do agree that control over the prime contractors' purchasing system should and must include close surveillance over major subcontract negotiations in order to assure that fair and reasonable prices are negotiated by the prime contractor. In this connection,

attention is invited to the revision to the Air Force procurement instruction as described in (*a*) above, to require that procurement personnel make a thorough analysis of contractors' proposals and obtain (i) current, complete, and correct cost and pricing data; and (ii) the types of subcontracts, before decisions are made on contract prices.

In respect to the GAO's second recommendation, attention is invited to letter dated January 23, 1959, subject: "Action on Recent GAO Reports" from Col. W. R. Graalman, Deputy Director/Procurement, Directorate of Procurement and Production, Headquarters, Air Materiel Command, to all procurement activities, which letter together with other pertinent exhibits are set forth verbatim, as an appendix to GAO reports described in (*a*) and (*b*) above. This letter emphasizes the necessity for (i) thorough analysis of contractors' proposals; and (ii) current, complete, and correct cost and pricing data. Moreover, AFPI 54–207 was revised as of May 21, 1959, (i) stressing to all procurement personnel, that the Air Force must have substantial assurance that subcontract prices are reasonable; and (ii) stating that the pricing and contracting philosophies established in ASPR and AFPI section III, parts 4 and 8, should guide all procurement of defense materiel, whether accomplished by the Air Force or the prime contractor. The administrative contracting officer is required to use the established criteria in the review and approval of subcontracts.

The present status of this case is that Boeing has agreed that at the time of final settlement of the prime contract, an adjustment will be made for inequities resulting from the manner in which the target was established.

(*d*) Examination of prices negotiated for vertical stabilizer tips for model F–100 aircraft by Rheem Manufacturing Co., Downey, Calif., a subcontractor under Department of Air Force prime contracts with North American Aviation, Inc.:

In this report the GAO recommended that the Air Force issue instructions which set forth clearly, agency contracting officials responsibility for requiring contractors to obtain sufficient cost information with which to evaluate proposed subcontract prices and reviewing proposed prices of major subcontracts by verifying the accuracy and currency of cost information to assure that fair and reasonable prices are established. GAO further recommended that the Air Force emphasize to contractors and subcontractors their responsibilities for negotiating prices which are fair and reasonable and which adequately safeguard the financial interest of the United States.

In respect to the first recommendation above, the action taken as specified in regard to the second recommendation in (*c*) above, is considered as complying with this recommendation.

In respect to the second recommendation, attention is invited to (i) letter dated January 6, 1959, from Maj. Gen. W. O. Senter, Director of Procurement and Production, Headquarters, Air Materiel Command, to 28 major Air Force prime contractors, and (ii) letter dated January 6, 1959, from Gen. E. W. Rawlings, commander, Air Materiel Command, to 3 industries associations. These letters, and other pertinent exhibits, are set forth verbatim as an appendix to GAO reports described in (*a*) and (*b*) above. These letters stress the necessity for contractors to furnish current, complete, and correct cost and pricing data before and during negotiations.

(*e*) Examination of subcontracts awarded to Lambert Engineering Co., St. Louis, Mo., by various Air Force and Navy prime contractors, dated June 5, 1958:

GAO made the following recommendations to the Air Force and the Navy.

1. That agency contracting officials be instructed to exercise closer supervision over prime contractors' subcontracting activities to assure that (*a*) sufficient cost information is obtained from the subcontractors to enable the prime contractors to ascertain the reasonableness of proposed prices, and (*b*) the appropriate type of contract is used.

2. That, in those instances where a subcontractor fails to furnish adequate cost information to provide a satisfactory basis for negotiation of a fair and reasonable price and will not agree to provisions for subsequent price adjustment, the matter be called promptly to the attention of top officials of the military department for consideration and appropriate action.

3. That they consider the feasibility of (*a*) determining the total known requirements for sole source items, and (*b*) furnishing this information to interested officials of the contracting agencies, prime contractors, and suppliers for use in planning production, estimating costs, and evaluating proposed prices.

4. That the Air Force consider the merits of assigning to a single military department the responsibility for coordinating procurement of each such item under a master contract with the supplier, with prime contractors purchasing and obtaining delivery of these items at prices and under terms of a master contract.

The Air Force effected corrective actions on the first two recommendations to correct undesirable subcontract pricing practices.

The Air Force did not concur in the GAO recommendations pertaining to informing sole source producers of total quantities required and the possible use of master contracts to effect coordinated procurement of sole source items, as such a procedure was impracticable because of administrative problems. In a letter dated February 17, 1959, to the Comptroller General, Mr. G. C. Bannerman, Director for Procurement Policy, OSD (Supply and Logistics), also indicates that these recommendations proposed by GAO are impracticable.

(*f*) Examination of Department of the Air Force contract AF 33(600)-31100 with Avco Manufacturing Corp., Crosly Division, Cincinnati, Ohio, dated March 12, 1959:

An excessive price was negotiated for contract AF 33(600)-31100 because the Air Force accepted more than $1 million of recorded costs which the contractor included in error in its pricing proposal.

The Air Force agreed with the GAO findings and suggestion that Air Force procurement personnel continue to emphasize review of cost proposals in negotiating contract prices. In addition, GAO was advised that a clearer understanding regarding utilization of agency audit personnel was brought about as a result of letter dated August 28, 1958, in which the Deputy Chief of Staff, Materiel, advised the commander, Air Materiel Command, that it was the intent of the Air Force that auditors be active and effective members of the negotiating team.

The contractor refunded $1,133,510 to the Air Force as the result of errors discovered by the GAO.

(*g*) Examination of subcontracts with the Firestone Tire & Rubber Co., Los Angeles, Calif. for aircraft fuel cells, dated October 14, 1958:

The GAO report disclosed that there was a lack of close pricing because prime contractors and the Air Force did not have sufficient cost information to use as a basis for negotiating fair and reasonable prices.

The Air Force issued instructions to its contracting personnel emphasizing the need for prime contractors to obtain adequate cost information in negotiating prices. Moreover, Firestone has agreed to furnish to Air Force contracting officers or to contractors holding Air Force prime contracts, estimates of projected fuel cell costs in all future procurements whether sole source or competitive.

(*h*) Examination of the pricing of the Air Force contract AF 33(600)-29507 with General Motors Corp., AC Spark Plug Division, Milwaukee, Wis., dated December 8, 1958:

The report disclosed that unreasonably high prices were negotiated because the Air Force awarded the contract on a fixed-price basis without requiring the contractor to furnish detailed support for the estimated costs included in the prices proposed by the contractor. The estimated costs were not a reasonable basis for contract pricing because they did not reflect cost reductions which might be expected to result from purchases in larger quantities. Furthermore, additional quantities were order under the contract at prices which did not give effect to lower, more current, costs of materials.

The Air Force issued a directive to the effect that, in each pricing negotiation, Air Force contracting officials must obtain a written statement from the contractor affirming that all pricing data under consideration are current and that to the extent that actual cost data are available, such data have been considered by the contractor and made known to the Air Force negotiators.

In addition, the contractor has made a refund of $750,000 to the Air Force.

(*i*) Examination of price negotiated under certain Department of the Air Force contracts with Friden, Inc., San Leandro, Calif., dated March 26, 1959:

The GAO states that excessive contract prices were negotiated because Air Force personnel did not give adequate consideration to the contractor's previous cost experience. As a result of the GAO review, the price of one contract was reduced $128,005, and a second contract was awarded on a price redeterminable basis. In subsequent price redetermination negotiations the price of the latter contract was reduced about $446,200. The GAO recommended that the Air Force

direct the attention of Air Force procurement personnel to the GAO findings as another illustration of the need for giving adequate consideration to contractors' cost experience.

Air Force concurs with GAO recommendation. Action has been taken to apprise AMC field activities in order that operational personnel may have the benefit of the GAO findings.

(*j*) Examination of the pricing of Department of the Air Force contracts and subcontracts with Avtron Manufacturing Co., Inc., Cleveland, Ohio, dated December 8, 1958:

GAO states that unnecessary costs were incurred by the Government because firm fixed-price contracts and subcontracts were awarded without competition being obtained and before sufficient cost experience was available.

The Air Force agreed that adequate cost analysis is essential to the use of fixed-price contracting. However, the Air Force concluded that fixed-price contracting was appropriate in this case, but indicated that the findings in this case would be utilized in training courses of the Air Materiel Command.

As a result of the examination by the GAO, the contractor refunded $52,000 to the Air Force.

(*k*) Examination of negotiation of target prices under Department of the Air Force Contracts with General Precision Laboratory, Inc., Pleasantville, N.Y., dated May 26, 1959:

GAO states that the target prices negotiated for two incentive-type contracts include overestimates of about $500,700 not recognized at the time of negotiations because of inadequate reviews by Air Force personnel of the contractor's estimated costs. These overestimates will, under the incentive provisions of the contracts, result in additional costs to the Government of approximately $150,200 unless an adjustment is made.

GAO also recommends that Air Force contracting personnel be directed to assure themselves to the extent practicable, through examination of contractors' records, that the information furnished by contractors with respect to all significant elements of cost is current, complete, and accurate.

At the time of the final pricing of the contracts in question, equitable adjustments will be made to the estimated target costs, prior to the application of the incentive formula, in the areas disclosed in the GAO report.

In addition to the foregoing, the Air Force issued instructions during April 1958, which require contractors to certify that all available current cost data have been considered in preparing price estimates and also have been made known to Air Force negotiators.

With respect to the second recommendation, the action taken under (*a*) above, is considered to fulfill such requirement.

(*l*) Review of contract AF 61(514)-609 with Curtiss-Wright Europa:

On July 21, 1958, the GAO advised the Secretary of the Air Force that contract No. AF 61(514)-609 with Curtiss-Wright Europa N.V. violated the statutory prohibition against the cost-plus-a-percentage-of-cost system of contracting. Thereafter, the Secretary of the Air Force submitted the question to the Attorney General for an opinion on the legal issue raised by the Comptroller General. An interim reply from the Attorney General on November 7, 1958, stated "that there exist at least tentative doubts as to whether an opinion of the Attorney General should issue." By letter of December 15, 1958, the Attorney General advised the Air Force that the issue presented in this matter was so uncertain that it seems evident that the resolution of the issue can be accomplished only through litigation. Further payments were suspended in November of 1958.

On January 20, 1959, Curtiss-Wright Europa N.V. filed suit in the U.S. Court of Claims against the United States of America for approximately $1 million, the money withheld under contract No. AF 61(514)-609. In the alternative, if the contract is held invalid, Curtiss-Wright Europa has asked the court for approximately $2.2 million as the amount still fairly owing it for services rendered. This matter is presently pending in the Court of Claims.

On March 31, 1959, the Air Force was advised by the Department of Justice that as a result of satisfactory guarantee by the plaintiff, Curtiss-Wright Europa, and the Curtiss Wright Corp., it was proper to resume processing of any unpaid vouchers or claims for payment to Curtiss-Wright Europa for its vendors or

subcontractors, without prejudice to the Government's suit and pending the outcome thereof.

DEPARTMENT OF THE NAVY,
ASSISTANT SECRETARY OF THE NAVY (MATERIAL),
Washington, D.C., June 15, 1959.

Memorandum for General Counsel—Office of the Secretary of Defense.
Subject: Request by Senate Finance Committee for information regarding certain reports on Navy procurement by the General Accounting Office.
Enclosure: (1) Analysis of GAO audit reports and action taken by Navy.

1. Through the Office of the Assistant Secretary of Defense (Supply and Logistics) we were asked to provide you with certain information regarding seven specified GAO reports concerning Navy contracts. Enclosure (1) provides such information.

2. It is interesting to note that, although the policy question presented by the Chance Vought report is of continuing interest, and the McDonnell transaction occurred in 1957, all the other reports relate to contracts of the period 1950 through 1954. In the intervening years a great many changes have been made in the relevant regulations and instructions, at both the Defense and Navy Department levels. Thus, again excepting the Chance Vought question, these reports principally focus on conditions which have been, we believe, greatly improved in the intervening years.

3. The General Accounting Office has stressed the fact that they audit only 1 percent of all contracts. However, they probably audit a substantial portion of our total dollar expenditures, because they audit principally large contractors and large contracts. According to our most recent figures, only 1 percent of Navy contracts have a value of $25,000 or more, but these have an aggregate value of almost 90 percent of the value of all Navy contracts.

C. P. MILNE,
Assistant Secretary of the Navy (Material).

Subject: Navy Department consideration and use of certain General Accounting Office reports.

1. GAO B–132995, April 21, 1959, Philco Corp. In this case GAO criticized Navy for failure to recover promptly $1,400,000 excess payments to prime contractor, Philco Corp., which had been in turn paid by Philco Corp. to Control Instrument Corp. and Librascope. The Navy collected the $1,400,000 of excess payments and would have done so in any event, irrespective of the GAO report. However, GAO estimated a windfall to the contractor of approximately $29,200 as interest on interest-free capital. The contract involved was written in August 1953.

The Navy is carrying on a continuing program aimed at the expeditious redetermination of contracts which is aimed at prevention of similar cases. GAO recommended that the Department of Defense Directive 4105.7, which is designed to prevent such excess payments to primes, also be made applicable to subcontracts. The Department of Defense committee on the armed services procurement regulation is acting on this recommendation, with Navy participation.

2. GAO B–132963, April 17, 1959, Westinghouse Electric Corp., Air Arm Division. GAO's findings in this case were that redeterminable contract NOas 52–389, awarded in 1952, was redetermined after completion of performance by the contractor. Navy was not furnished completion of cost data by the contractor and, as a result, the contractor was in an advantageous position in negotiation of final price.

In July 1957, meetings were held with Westinghouse personnel, Navy Comptroller personnel, and Navy contracting personnel at which time agreements were reached concerning the timely submission of current cost data by Westinghouse in connection with the redetermination of contracts. As a result of those meetings, our problems with Westinghouse in this area have been reduced to a minimum. The revised price redtermination clauses mentioned in the GAO reports, as well as new incentive clauses, have been developed by the Defense Department and are in use. These clauses make mandatory the submission by the contractor of the latest cost data available and also place greater emphasis on the prompt redetermination of contracts.

3. GAO B–133131, March 17, 1959, Librascope Corp. In this case the GAO criticized Navy for (i) failure to use appropriate type of contract and subcontract, and (ii) failure to adequately supervise subcontracts to assure that rea-

sonable prices are obtained by price contractor. The contracts and subcontracts involved were dated from 1950 to 1954.

We certainly do not disagree with the GAO that both the proper selection of the appropriate type of prime or subcontract, and the close supervision of both prime and subcontracts are essential to good contracting. Even though we have for years had extensive instructions to contracting personnel in both areas, we have recently amplified our Navy procurement directives covering the review of subcontractor costs and there is now, in a late stage of study, additional coverage which will be included in the armed services procurement regulation. Our present instructions on the selection of the type of both prime and subcontracts are considered to be adequate.

4. GAO B-132936, January 20, 1959, McDonnell Aircraft Corp. In this case the GAO found that McDonnell's estimate of costs presented for pricing the contract were approximately $6 million more than the actual costs incurred. Of that $6 million, it was claimed that $2,596,900 could have been recognized by contracting officials through an adequate review of cost data available at the time the firm prices were established. The report further states that McDonnell offered a $3 million refund to Navy but that this offer had not been accepted at the time of writing the report.

A firm fixed price for the airplanes in this contract had been negotiated in March 1957, before the GAO report was received. After the report was received, it was not considered desirable contract procedure to open up this particular contract to make any adjustment, especially since the offer contained conditions which were unacceptable to the Navy. However, the Navy secured these benefits under this and other contracts:

(*a*) In the pricing out of the ground handled equipment, etc., in the contract which remain unpriced, the contractor accepted a reduction of $1,200,000.

(*b*) The contractor agreed to the waiver of a claim under contract NOas 51-640 in the amount of $1,400,000.

(*c*) The target cost figure in follow-on contract NOas 57-155 was negotiated downward by $4,300,294, from $62,964,094 to $58,663,800. The above-mentioned offer of $3 million had been predicated upon acceptance of the first stated figure as the target cost in the contract.

(*d*) The GAO report states that termination inventory allocable to the contract was overstated approximately $125,000. This has been reviewed by Navy contract audit personnel and found to be only approximately $25,000 and final settlement of the terminated portion of the contract will be adjusted accordingly.

The matter of insurance requirements is discussed in the Chance Vought Aircraft Corp. case below. The findings concerning lease-rental terms will be given consideration when the present lease agreement expires.

5. GAO B-125016, September 16, 1958, Collins Radio Co. The GAO report deals with three contracts written in 1951 and 1952, but principally with contract NOas 51-1155 written in December 1951. At that time the firm target cost under the contract was established. The GAO report asserts that a major subcontract item was priced at $302.75 and that the contractor had knowledge that the price thereof was being reduced to $167.07. Had this reduced unit price been used in the final pricing, the cost to the Government would have been reduced by $157,500.

As stated above, a firm target cost (and incentive share pattern) was established in December 1951 which was prior to the knowledge of the adjustment in price of the subcontract item either by Collins or by the Navy and it was determined by Navy counsel that this target cost figure could not be changed. In the negotiation of the final contract price, however, the Navy negotiator was able to secure an adjustment of $117,773, which was the major portion of the amount involved. This case again points up the need for a closer analysis of subcontract prices which has been previously discussed.

6. GAO B-133007, May 26, 1958, Cleveland Diesel Division, General Motors Corp. This report covered a series of five contracts awarded in 1953 for the procurement of diesel engines, diesel generator sets, and related spare parts, having a contract value of $32,700,000. The GAO report states that the incurred costs proposed by the contractor for repricing of these contracts were $1,017,480 too high and that the ultimate costs incurred were $1,691,978 less than the estimated cost. As compared to the GAO figure of $1,691,978, the contractor, however, represents that ultimate costs incurred were only $1,026,143 less than the estimated cost. The contractor claimed that the GAO, in computing actual

costs, did not include all general and administrative expense and that the GAO's actual cost figure was understated to that extent.

General Motors made a refund of $690,000 ($357,445 cash and a tax credit of $332,555). In proposing this refund the company stated:

"In developing the refund, Cleveland Diesel Engine Division reviewed the entire period of performance for these contracts. This period commenced with the year 1954. However, General Motors Corp. and the Renegotiation Board have heretofore executed a renegotiation agreement for the year 1954. In view of this agreement the refunds offered are applicable to performance for the period after 1954."

7. GAO B-118778, February 14, 1958, Chance Vought Aircraft, Inc. The GAO, in its audit, found that Chance Vought was carrying insurance on facilities leased from the Government under an agreement dated June 15, 1949, for a term of 5 years with option to renew for two additional 5-year periods. Insurance premiums approximate $45,000 per year. Chance Vought produces principally for the armed services and, consequently, most of this cost ultimately is borne by the Government through contract pricing. Since the Government does not generally purchase insurance, the GAO's position is that Chance Vought should terminate the insurance, thereby reducing costs to the Government.

The lease was entered into pursuant to 10 U.S.C. 2667 (formerly Public Law 364, 80th Cong.) which permitted military departments to require insurance and Navy implementation of this law did require insurance. Accordingly, by the terms of the lease, we cannot now unilaterally amend that lease and Chance Vought has been unwilling to amend by bilateral agreement. Due to the GAO exception to this policy, however, the Armed Services Procurement Regulations have been revised to modify and better define the conditions under which the Government may require, or a contractor may carry, insurance on Government-owned and contractor-leased facilities.

8. Navy consideration of General Accounting Office audits: Every GAO report is thoroughly reviewed to determine appropriate action that should be taken. Except for minor reports, each GAO report is reviewed at secretarial level, and its findings considered in formulating new policy and in revising existing instructions. Matters revealed by the report are discussed at contracting officer meetings and procurement policy advisory committee meetings and cases built around them are used in our training courses. Reports are also reviewed to discover items which can be recovered.

CASE B-118652. "EXAMINATION OF DEPARTMENT OF THE ARMY CONTRACTS AND SUBCOMMITTEE WITH BIRDSBORO AMORCAST, INC.," JULY 23, 1958

Subject report covered several operational problems involving both the Army and Navy. Of these, the report states, "The Department of the Army and the Department of the Navy have expressed general concurrence with our (the GAO's) recommendations concerned with preventing a repitition of the deficiencies found in this case."

The GAO, however, was not satisfied with the responses of the Army and Navy as to one recommendation and suggested that the Secretary of Defense adopt a policy that "prices to the Government under Department of Defense negotiated contracts or subcontracts will generally not include profit or rent paid for the use of Government facilities."

The Department of Defense finds it essential to provide extensive facilities to contractors in order to secure defense materials. When such provision is found necessary there are occasions in which the Government charges rental for use of the facilities and other situations in which the rental charges are deducted in the pricing of the supplies or services. The problem presented is whether when the use charge is paid to the Government for the use of the facilities, the charges should "generally" be excluded from the contractor's cost base in the computation of his profit or fee.

We share the GAO's objective that negotiated pricing be reasonable. As a matter of fact, this objective is stated throughout the part of the armed services procurement regulation dealing with "Price Negotiation Policies and Techniques" (ASPR, pt. 8, sec. III). This present policy covers specifically the consideration of the extent of Government assistance. In ASPR 3.808.4(c) it is provided that "* * * where extraordinary financial, facility or other assist-

ance must be furnished to a contractor by the Government, such extraordinary assistance should have a modifying effect in determining what constitutes a fair and reasonable profit."

While, in consonance with this policy, the presence of substantial sums for the rental of Government facilities is taken into consideration and often results in the negotiation of a lower price than would otherwise be appropriate, we do not agree that it is generally equitable to exclude the payment of rental expenses for the use of such Government-owned facilities from the cost base upon which the contractor computes his profit.

We believe that it is proper to consider as a cost reasonable expenditures a contractor makes in the rental of facilities from private sources. It is a cost of doing business, the contractor suffering the detriment of the making of the expenditure in the form of payment of rental charges for the facilities. We see no reason for a different view merely because the rental of the facility happens to be from this Department rather than from a private source.

Again, it should be stressed that this Department will continue to seek reasonable pricing results, utilizing in the bargaining whatever pricing factors and considerations which may present themselves in the particular transaction being negotiated.

It is to be noted that the GAO presented a similar recommendation to this Department in 1956, case B–114814. At that time also we did not accept the recommendation.

CASE B–118762, MARCH 20, 1958, EXAMINATION OF TIME AND MATERIALS SUBCONTRACTING BY CHRYSLER CORP., UNDER DEPARTMENT OF THE ARMY CONTRACTS

The case involved an alleged ill-timing by Chrysler of the conversion of subcontracts from time-and-material type to fixed-price type. The Army undertook corrective action within the Army. In view of this apparently satisfactory action, the GAO suggested that since "time and materials form of contracting is used by the Departments of the Air Force and Navy as well as by the Department of the Army, we recommend" appropriate action by the Department of Defense.

The response of the Department of Defense, under date of August 19, 1958, in part, was as follows:

"The content of your report, although it relates specifically to subcontracting, has an application also to the conversion of time-and-materials prime contracts. We have considered the problem on this basis. This consideration has resulted in the conclusion that we will amplify the direction contained in ASPR 3–803 to provide in effect that repetitive or unduly protracted use of cost-reimbursement type or time and material type contracts is to be avoided where experience has provided a basis for firmer pricing which will promote efficient performance and will place a more reasonable degree of risk on the contractor. The direction will also provide that continuing consideration be given to converting from time and material type of contract to another type as early in the performance period as is practicable.

"To cover subcontracts, appropriate cross references will be provided."

A copy of referenced action is as follows:

"3–803 *Type of contract.*—(*a*) The selection of an appropriate contract type and the negotiation of prices are related and should be considered together. ASPR 3–402 lists some of the factors for this joint consideration. The objective is to negotiate a contract type and price that includes reasonable contractor risk and provides the contractor with the greatest incentive for efficient and economical performance. When negotiations indicate the need for using other than a firm fixed price contract, there should be compatability between the type of contract selected and the contractor's accounting system.

"(*b*) In the course of a procurement program, a series of contracts, or a single contract running for a lengthy term, the circumstances which make for selection of a given type of contract at the outset will frequently change so as to make a different type more appropriate during later periods. In particular, the repetitive or unduly protracted use of cost-reimbursement type or time and materials contracts is to be avoided where experience has provided a basis for firmer pricing which will promote efficient performance and will place a more reasonable degree of risk on the contractor. Thus, in the case of a time and materials contract, continuing consideration should be given to converting to another type of contract as early in the performance period as practicable."

B-132945. REPORT TO CONGRESS, DECEMBER 3, 1958, ON EXAMINATION OF DA CONTRACT DAI-28-017-501-ORD(P)-146 WITH A. O. SMITH CORP., MILWAUKEE, WIS.

This report related to a General Accounting Office investigation into Department of the Army contracts with the A. O. Smith Corp., of Milwaukee, Wis., for the production of practice bomb bodies. This report indicated that the contractor had presented to the Government negotiator a cost analysis for the production of the bombs which was excessive in terms of the costs which had already been experienced on prior production. It alleges that the Government representatives did not adequately verify these cost estimates against the contractor's own records, and that excessive prices resulted.

In August of 1958, the Deputy Assistant Secretary of the Army (Logistics) reported to the General Accounting Office that investigation of the facts referred to in the GAO examination of the contract in question had been made, and that verification of the contractor's cost estimates should have been made. The GAO report in this instance was duplicated and forwarded to ordnance installations, with appropriate instructions covering the principles involved in the GAO report. Emphasis was placed on the need for critical analysis of proposals by contracting officials, including adequate use of the services of the cognizant Government audit agency.

Senator DOUGLAS. Mr. Chairman, maybe it is unbecoming for a member of the committee to make a general comment. I think this indicates, together with the figures, that there are continuing gross defects in the contracts of the Defense Department, and I want to heartily second Senator Williams' point that we proceed with every legitimate means to secure the number of contracts by legitimate competitive bidding.

Turning from that, there are two other questions with which I wish to conclude my examination.

I have here a report from the Department of Defense listing the 100 companies and affiliates which had the largest military contracts for the fiscal year July 1, 1957, to June 30, 1958. There are 100 companies and 153 subsidiaries.

That indicates that of a total contracts let of $21,794 million, $16.4 million were let to these 100 companies, of 74.2 percent of the total.

I take it these figures are, of course, correct.

Mr. DECHERT. These are correct, sir. Of course, they are based on what I said before, that in our present procurement situation we have so many of these things which are extraordinarily expensive and require a coordinated activity, the missiles, the antimissile missile, and many other things which are still classified.

Now, the fact that these people get the gross contract doesn't mean they get the net one. All these people subcontract very heavily, so it is true the figures which you give are correct, sir, but I think they probably do not convey the complete story.

Senator DOUGLAS. Mr. Dechert, one of the practices which has caused many of us to raise our eyebrows is the frequent tendency of high officers in the Armed Forces either upon retirement or resignation to enter the service of firms dealing with the Government, and have contracts with the Government.

I wonder if you would supply to the chairman the number of former officers in the Army, Navy, Air Force, and Marine Corps,

above the rank of colonel or equivalent, who are now in the service of these 100 corporations and their 153 subsidiaries who are the largest contractors for the Government, and who supply 74 percent of the total contracts.

Mr. DECHERT. Yes, sir, we shall be glad to supply that information. I am not sure about your last figure of 74 percent.

Senator DOUGLAS. We have here the list of—I will identify this. This is a report issued from the Secretary of Defense running to some 20 pages.

Mr. DECHERT. July 1, 1957, to June 30, 1958?

Senator DOUGLAS. That is correct.

Mr. DECHERT. Isn't the last figure 68.4?

Senator DOUGLAS. On page 1——

Mr. DECHERT. Page 19.

Senator DOUGLAS. Let me quote from page 1, the heading is as follows: "One Hundred Companies and Their Subsidiaries Listed According to Net Value of Military Prime Contract Awards, July 1, 1957, to June 30, 1958."

Then a series of headings across the top of the page, "Range of Companies in Millions of Dollars, Total U.S. Cumulative."

Now the total of contracts as let is given as $21,794,800,000 of which 100 companies and their subsidiaries received $16,164,300,000, or 74.2 percent of the total.

Mr. DECHERT. That is right, sir, 74.2.

Senator DOUGLAS. I don't want to go through the full list.

Mr. DECHERT. 74.2 is on page 9; I saw another figure on page 19. 68.4. But I see that is last year's figure.

Senator DOUGLAS. I try to be up to date.

Mr. DECHERT. You are correct, sir.

Senator DOUGLAS. Now to repeat the request, Mr. Chairman, I request that the Department of Defense furnish for the record the list of all former officers in Army, Navy, Air Force, Marine Corps in the range of captain and above, that is captain——

Mr. DECHERT. Navy captain.

Senator DOUGLAS. Navy captain, Army or Marine Corps colonel——

Mr. DECHERT. Yes, sir.

Senator DOUGLAS. Who are now in the employ of these 100 companies and their 153 subsidiaries.

Senator FREAR. That range excludes me.

Senator DOUGLAS. It excludes me, too.

The CHAIRMAN. Mr. Dechert, will you furnish that?

Mr. DECHERT. We will furnish it. I think we don't have that exact data.

(The information referred to follows:)

TABULATION

Retired officers at or above the rank of colonel, or the equivalent, who are officials or employees of the named companies

Company	*Officer*
1. American Bosch Arma Corp., 320 Fulton Ave., Hempstead, N.Y.	None.
2. American Telephone & Telegraph Co. 195 Broadway, New York, N.Y.	Capt. Forest M. Price.
Affiliates:	
Western Electric Co.	
Teletype Corp.	
3. Asiatic Petroleum Corp., 50 West 50th St., New York, N.Y.	None.
4. Avco Corp., 750 3d Ave., New York, N.Y.	Maj. Gen. Herbert M. Jones, USA. Lt. Gen. C. S. Irvine, USAF. Brig. Gen. Monro MacCloskey, USAF. Rear Adm. Edward L. Woodyard, USN.
5. Bath Iron Works Corp.,[1] Bath, Maine	Adm. Robert Bostwick Carney, USN. Col. Harry Beahan Carney, USAF.
6. Beech Aircraft Corp., 9709 East Central Ave., Wichita, Kans.	(See p. 73.)
7. Bell Aircraft Corp.,[2] Post Office Box 1, Buffalo, N.Y.	Col. William I. LeVan, USA. Col. Stuart G. McLennan, USAF.
Affiliates:	
Bell Helicopter Corp.	
Hydraulic Research & Manufacturing Co.	
Wheelabrator Corp.	
8. Bendix Aviation Corp., Fisher Bldg., Detroit, Mich.	Col. A. L. Baylies, USA. Capt. U. S. Brady, Jr., USN.
Affiliates:	Col. C. P. Burton, USA.
Bendix Westinghouse Automotive Air Brake Co.	Rear Adm. W. E. Cleaves, USN. Capt. E. R. Dare, USN.
Sheffield Corp.	Col. W. J. Darmody, USA. Col. G. W. Dauncy, USA. Col. E. J. Dorsey, USMC. Col. E. S. Matthews, USA. Col. G. A. Morgan, USAR. Col. J. H. O'Malley, USA. Capt. G. H. Richards, USN. Capt. C. H. Shildhauer, USNR. Col. F. R. Swoger, USA.
9. Bethlehem Steel Co., Inc., Bethlehem, Pa.	Rear Adm. H. L. Collins, USN. Rear Adm. W. R. Dowd, USN. Capt. G. W. Dick, USCG. Rear Adm. R. B. Goldman, USN.
Affiliate: Bethlehem Pacific Coast Steel Corp.	Rear Adm. W. T. Jones, USN. Capt. A. L. Mare, USN. Capt. H. C. Nichols, USNR. Capt. A. G. Schnable, USN.
10. Blue Cross Association, 55 East 34th St., New York, N.Y.	None.

[1] Company personnel records do not list military rank attained.
[2] Lt. Gen. William E. Kepner, USAF, acts as consultant to Bell Aircraft. He is currently employed by Radiation, Inc., Orlando, Fla.

Company	Officer
11. Boeing Airplane Co., Seattle, Wash.	Col. Charles Armstrong, USA. Col. Leo W. Bagley, USA. Col. Robert V. Bowler, USA. Capt. Portus D. Boyce, USN. Capt. John L. Brown, USN. Col. George A. Corneal, USAF. Brig. Gen. Jack C. Crosthwaite, USAF. Col. Ralph A. Dutton, USA. Col. Archie C. Edwards, USAF. Col. Wendell C. Fields, USA. Rear Adm. Gerald Galpin, USN. Capt. James A. Haley, USN. Capt. Richard D. Harwood, USN. Col. Theodore Hikel, USA. Col. Lauri S. Hillberg, USA. Col. Francis R. Hoehl, USAF. Col. Arthur L. Logan, USAF. Capt. Henry M. Marshall, USN. Col. Ned Joseph Martini, USA. Col. Paul B. Nelson, USA. Maj. Gen. Homer Oldfield, USA. Capt. James C. Partington, USCG. Col. Orville Rehmann, USAF. Capt. Herbert G. Sheplar, USN. Col. William J. Simons, USAF. Capt. Riley Site, C. & G.S. Col. Harry G. Spillinger, USA. Col. Fred L. Thorp, USA. Capt. Warren Vincent, USN. Capt. Charles S. Weeks, USN.
12. Brown-Raymond-Walsh,[3] 207 West 24th St., New York, N.Y.	None.[3] Applies to the joint venture.
13. California Institute of Technology, Pasadena, Calif.	None.
14. Cessna Aircraft Co., Wichita, Kans.	Capt. Richard J. Greene, USN.
15. Chance Vought Aircraft, Inc., Dallas, Tex.	Rear Adm. A. H. Perry, USN. Adm. H. B. Sallada, USN. Vice Adm. H. Sanders, USN. Capt. C. A. Briggs, USN. Col. H. R. Jordan, USMC. Col. E. F. Klinck, USA.
16. Chrysler Corp., 341 Massachusetts Ave., Detroit, Mich.	(See p. 73.)
17. Cities Service Co., 60 Wall Tower, New York, N.Y. Affiliates: Cities Service Petroleum, Inc. Cities Service Oil Co. (Delaware). Arkansas Fuel Oil Corp.	Col. G. H. McCullagh, USAR. Col. W. R. Boyd III, USAFR. Rear Adm. James Ross, USNR. Col. Wilmer G. Wilson, USAR.
18. Collins Radio, 855 35th St. NE., Cedar Rapids, Iowa.	(See p. 73.)
19. Continental Motors Corp., 205 Market St., Muskegon, Mich. Affiliates: Continental Aviation & Engineering Corp. Gray Marine Motor Co. Wisconsin Motor Corp.	Capt. C. C. Busenkell, USN. Col. Harrison H. Hiberg, USA.
20. Continental Oil Co.,[4] Houston, Tex.	Col. E. R. Baker, USA. Col. R. W. Hird, USA.

[3] Joint venture consists of Brown & Root, Inc., 4100 Clinton Dr., Houston, Tex.; Raymond International, Inc., 140 Cedar St., New York, N.Y.; Walsh Construction Co., 711 3d Ave., New York, N.Y.

[4] This only includes employees within knowledge of correspondent and does not include a canvass of 9,000 employees.

Company	*Officer*
21. Curtiss-Wright Corp.,[5] Wood-Ridge, N.J.	Capt. R. J. H. Conn, USN. Capt. Robert F. Jones, USN. Capt. A. R. Sanborn, USN. Capt. H. M. Sartoris, USN.
22. Defoe Shipbuilding Co., Bay City, Mich.	None.
23. Douglas Aircraft Co., Inc., Santa Monica, Calif.	Lt. Gen. Ira C. Eaker. Rear Adm. E. H. Eckelmeyer. Brig. Gen. O. F. Carlson. Brig. Gen. S. L. McCroskey. Capt. Maurice Kauffman. Capt. J. R. Ruhsenberger. Capt. J. E. Baker. Capt. J. O. Bigelow. Col. J. L. Elwell. Col. A. C. Miller. Col. J. W. Leonhardt. Col. R. A. Gardner. Col. Jerdon Coleman. Col. S. H. Hankins. Col. M. B. Chatfield.
24. I. du Pont de Nemours & Co.,[6] 1007 Market St., Wilmington, Del. Affiliate: Remington Arms Co., Inc.	Col. Douglas G. Ludlam, USA.
25. Eastman Kodak Co., Rochester N.Y.	(See p. 74.)
26. Fairchild Engine & Airplane Corp., Hagerstown, Md. Affiliate: Jonco Aircraft Corp., Shawnee, Okla.	Adm. Robert D. Carney, USN. Gen. Jacob L. Devers, USA. Brig. Gen. James F. Early, USAF. Brig. Gen. William W. Welsh, USAF. Capt. Grayson Merrill, USN. Capt. Hamilton O. Hauck, USN. Capt. Frank E. Escobar, USN.
27. Fairbanks Whitney Corp. (formerly Penn-Texas Corp.), 745 5th Ave., New York, N.Y. Affiliates: Pratt & Whitney Co., Inc. Chandler Evans Corp. Colts Patent Fire Arms Manufacturing Co., Inc. "Quick-Way" Truck Shovel Co. Fairbanks, Morse & Co.	Brig. Gen. G. H. Drewry, USA. Col. H. Pierce, USA. Brig. Gen. A. M. Prentiss, USA. Rear Adm. Clarence Broussard, USN.
28. Firestone Tire & Rubber Co., 1200 Firestone Parkway, Akron, Ohio.	Col. T. M. Belshe. Col. R. R. Studler. Capt. William White.
29. Food Machinery & Chemical Corp., San Jose, Calif.	Brig. Gen. Clifford Sayre, USA. Col. J. E. Hamm, Jr., USAR. Brig. Gen. Joseph A. Holly, USA Rear Adm. Harold A. Carlisle, USN. Col. Raymond R. Robins, USA. Col. Benjamin S. Mesick, USA.
30. Ford Motor Co.,[7] Dearborn, Mich. Affiliate: Aeronutronic Systems, Inc.	Col. Irving A. Duffy, USA. Capt. Lewis K. Marshall, USNR. Col. Carolus A. Brown, USA. Col. William J. Given, USA. Col. Zachary Moores, USA.

[5] Time did not permit a review of personnel records.
[6] Mall Tool Co. is now a division of Remington.
[7] Personnel records "do not necessarily include positive data to reflect this type of service."

Company	*Officer*
31. The Garrett Corp., 9851 Sepulveda Blvd., Los Angeles, Calif.	Vice Adm. Seldon B. Spangler, USN. Lt. Gen. Kenneth B. Wolfe, USAF.
32. General Dynamics Corp., 445 Park Ave., New York, N.Y.	Col. W. T. Abbot, USAF. Rear Adm. E. P. Abernathy, USN. Rear Adm. S. H. Armbruster, USN. Brig. Gen. M. W. Arnold, USAF. Col. S. Baker, USAF. Col. R. T. Bankard, USAF. Capt. E. L. Barr, Jr., USN. Gen. W. L. Bayer, USA. Capt. A. H. Bergeson, USN. Capt. W. J. Bettens, USN. Rear Adm. C. Briggs, USN. Capt. A. L. Dunning, USN. Capt. T. H. Dubois, USN. Capt. R. E. Farnsworth, USN. Brig. Gen. H. S. Fassett, USMC. Capt. J. P. Fitzsimmons, USN. Rear Adm. W. O. Floyd, USN. Capt. B. F. Griffin, Jr., USN. Rear Adm. R. Gross, USN. Col. O. B. Hardy, USAF. Capt. William L. Hoffheins, USN. Rear Adm. C. F. Horne, USN. Col. N. H. Jungers, USMC. Rear Adm. J. H. Kaufman, USN. Rear Adm. T. B. Klakring, USN. Capt. C. Van S. Know, USN. Rear Adm. S. Leith, USN. Rear Adm. W. A. Lent, USN. Col. M. R. MacIntyre, USMC. Rear Adm. A. I. McKee, USN. Col. E. E. McKesson, USAF. Gen. J. T. McNarney, USAF. Col. J. P. Mial, USA. Col. J. A. Moore, USAF. Capt. R. J. Moore, USN. Maj. Gen. F. P. Mulcahy, USMC. Capt. R. Noisat, USN. Rear Adm. J. R. Pahl, USN. Brig. Gen. E. P. Pennebacker, Jr., USMC. Col. J. L. Perkins, USMC. Brig. Gen. R. L. Peterson., USMC. Brig. William J. Piper, Jr., USMC. Capt. J. R. Z. Reynolds, USN. Rear Adm. L. B. Richardson, USN. Col. S. R. Stewart, USAF. Rear Adm. H. F. Stout, USN. Rear Adm. D. J. Sullivan, USN. Capt. H. M. Sumrall, USN. Capt. I. D. Sykes, Jr., USN. Rear Adm. W. V. R. Vieweg, USN. Rear Adm. W. B. Whaley, USN. Col. W. D. Wimer, USAF. Capt. J. E. Wolowsky, USN. Capt. H. Wood, Jr., USN.

Company	*Officer*
33. General Electric Co.,[a] 570 Lexington Ave., New York N.Y.	Retired officers above the rank of colonel or equivalent: Adair, C. Bennett, Ralph D. Berkley, Joseph B. Cooke, William R. Coulter, Howard N. Davidson, Jr., Charles B. Deyarmond, A. B. Earl, Charles A. Fechteler, William M. Fickel, A. A. Fouch, George E. Hansell, H. S. Hanson, Murray Harman, Leonard F. Harris, John W. Hoffman, Frank E. Horton, Paul B. Johnson, Douglas T. Kinsella, W.T. Matthews, R. I. Messer, H. G. Messick, Joseph Montgomery, J. B. Murray, C. B. Paxson, H. O. Roper, H. McK. Root, Willard G. Schmidt, Jr., Louis E. Schanklin, Elliott W. Simpson, Robert T. Smith, Loyd C. Sneeringer, E. A. Thorpe, Harlan M. Watson, Paul W. Young, D. B.
34. General Motors, Detroit, Mich.	
35. General Precision Equipment Corp., 92 Gold St., New York, N.Y.	

[a] Reflects company records since 1945. In view of time limit there may be others not on list.

Company	*Officer*
36. General Tire & Rubber Co., Akron, Ohio.	Rear Adm. Calvin M. Bolster, USN.
Affiliates:	Col. S. J. Zoller, USA.
Aerojet-General Corp.	Col. Meryl Munoz, USA.
The A. M. Byers Co.	Col. W. R. Stark, USAF.
	Col. Howard Means, USAF.
	Col. W. E. Benedict, USMC.
	Col. Elmore Seed, USMC.
	Col. R. D. McLeod, USA.
	Adm. Lowell T. Stone, USN.
	Capt. Joseph McGoughren, USN.
	Gen. W. G. Wyman, USA.
	Brig. Gen. Harrison Shaler, USA.
	Brig. Gen. David Van Syckle, USA.
	Col. Alfred L. Price, USA.
	Col. F. M. Libershal, USA.
	Maj. Gen. A. W. Vanaman, USAF.
	Col. Howard A. Moody, USAF.
	Brig. Gen. R. W. Hayward, USMC.
	Col. Wm. Frush, USMC.
	Commodore Archibald Hunter, USN.
	Rear Adm. R. S. Hatcher, USN.
	Rear Adm. J. C. Alderman, USN.
	Rear Adm. L. C. Baldauf, USN.
	Rear Adm. Robert K. Ashton, USN.
	Capt. George E. King, USN.
	Capt. W. L. Tann, USNR.
	Capt. W. G. Winslow, USNR.
	Brig. Gen. F. F. Hayden, USA.
37. Gilfillan Brothers, Inc. 1815 Venice Blvd., Los Angeles, Calif.	(See p. 74.)
38. The B. F. Goodrich Co.* Akron. Ohio.	Col. George H. Donnelly.
39. The Goodyear Tire & Rubber Co. Akron, Ohio.	Col. Max Frederic Moyer, USAFR.
Affiliates:	Rear Adm. Karl L. Lange, USNR.
Goodyear Aircraft Corp.	
Goodyear Engineering Corp.	
Kelly-Springfield Tire Co.	
40. Greenland Contractors 545 S. Broad St., Trenton, N.J.	
41. Grumman Aircraft Engineering Bethpage, Long Island, N.Y.	Vice Adm. Joseph F. Bolger, USN.
42. Hayes Aircraft Corp. Birmingham, Ala.	Brig. Gen. Walter W. Wise, USAF.
	Col. C. R. Storrie, USAF.
	Col. L. Cornell, USAF.
43. Joshua Hendy Corp. 612 South Flower St., Los Angeles, Calif.	None.
44. Hercules Powder Co. Inc., Wilmington, Del.	Col. Robert W. Mealy, USA.
45. Hughes Aircraft Co., Culver City, Calif.	Brig Gen. F. W. Coleman, USA.
	Rear. Adm. N. F. Garton, USN.
	Capt. G. M. Greene, USN.
	Col. T M. Hahn, USAF.
	Brig. Gen. S. R. Mickelsen, USA.
	Rear Adm. M. A. Nation, USN.
	Col. C. H. Welch, USAF.
46. International Business Machine Corp., 59 Madison Ave., New York, N.Y.	(See p. 74.)

* Records of this type not maintained. The one name furnished was known to the correspondent.

Company	*Officer*
47. International Telephone & Telegraph Corp., 67 Broad St., New York, N.Y.	Maj. Gen. Edmond H. Leavey, USA.
	Adm. John E. Gingrich, USN.
	Rear Adm. Frederick R. Furth, USN.
Affiliates:	Col. O. W. Lunde, USAF.
Federal Electric Corp.	Col. Houston V. Evans, USA.
Industrial Product Div.	Maj. Gen. Francis H. Lanahan, USA.
International Standard Electric Corp.	Maj. Gen. Raymond C. Maude, USA.
	Col. Alvin T. Bowers, USA.
Intelex Systems, Inc.	Rear Adm. George K. Fraser, USN.
Kuthe Laboratories, Inc.	Vice Adm. R. H. Cruzen, USN.
Royal Electric Corp.	Col. Paul H. Maurer, USA.
	Col. P. O. Vaughn, USAF.
	Col. Russel A. Baker, USA.
	Capt. R. F. Pryce, USN.
	Brig. Gen. Paul M. Seleen, USA.
	Col. Frank G. Trew, USA.
	Rear Adm. William Organ, USN.
	Rear Adm. Jess Sowell, USN.
	Rear Adm. Robert E. Laub, USN.
	Brig. Gen. Kenneth E. Fields, USA.
	Rear Adm. William L. Freseman, USN.
	Maj. Gen. C. Rodney Smith, USA.
	Col. C. F. Fiore, USA.
	Capt. Roy Jackson, USN.
48. The Johns Hopkins University, Baltimore, Md.	Maj. Gen. James G. Christensen, USA.
	Capt. John O. Dorsett, USN.
Affiliates:	Brig. Gen. Lester D. Flory, USA.
Operations Research Office	Gen. Thomas T. Handy, USA.
Applied Physics Laboratory	Maj. Gen. Gerald J. Higgins, USA.
	Brig. Gen. John G. Hill, USA.
	Rear Adm. Marion N. Little, USN.
	Col. Edward M. Parker, USA.
	Col. Edward K. Purnell, USA.
	Col. Harry D. Sheets, AUS.
	Col. W. P. Withers, USA.
	Brig. Gen. W. R. Currie, USA.
	Col. Paul Elias, USA.
	Col. D. H. Hale, USA.
	Rear Adm. M. R. Kelley, USN.
	Brig. Gen. W. R. Wendt, USMC.
49. The Kaman Aircraft Corp., Bloomfield, Conn.	Rear Adm. James A. Thomas, USN.
50. Peter Kiewit Sons Co., Omaha, Nebr.	Col. Charles L. Bell.
51. Lear, Inc., 3171 South Bundy Dr., Santa Monica, Calif.	Lt. Gen. Barney M. Giles, USAF.
	Col. Kenneth R. Rogers, USAF.

Company	Officer
52. Lockheed Aircraft Corp., Burbank, Calif.	Col. H. J. Bangs, USA.
	Col. H. P. Becker, USMC.
Affiliates:	Rear Adm. J. F. Beyerly, USN.
Lockheed Aircraft International	Brig. Gen. J. S. Blais, USMC.
	Rear Adm. W. A. Bowers, USN.
Lockheed Aircraft Service, New York Inc.	Capt. A. E. Buckley, USN.
	Capt. Wm. M. Cason, USNR.
Lockheed Aircraft Service, Inc.	Col. E. J. Cotter, USA.
	Col. C. F. Damberg, US[illegible] F.
Lockheed Air Terminal, Inc.	Col. H. O. Deakin, US[illegible]
	Capt. L. E. Divoll, US[illegible]
	Col. J. R. Donovan, US[illegible]
	Rear Adm. George B. [illegible]ling, USN.
	Col. Llewellyn G. Duggar, [illegible]SAF.
	Rear Adm. H. J. Dyson, U[illegible]
	Capt. J. B. Feder, USCG.
	Col. R. L. Finkenstaedt, USMC.
	Col. M. H. Floom, USMC.
	Rear Adm. T. R. Frederick, USN.
	Rear Adm. W. J. Giles, USN.
	Col. B. E. Hall, USAF.
	Capt. Charles C. Hoffman, USN.
	Col. Harold A. Hughes, AUS.
	Col. R. D. King, USA.
	Capt. F. A. Kinzie, USN.
	Rear Adm. W. M. Klie, USN.
	Rear Adm. E. E. Lord, USN.
	Rear Adm. H. B. Lyon, USN.
	Capt. R. H. Maynard, USN.
	Col. Robert K. McDonough, AUS.
	Col. R. C. McGlashan, USM.
	Rear Adm. R. M. Metcalf, USN.
	Col. Andres Meulenberg, USAF.
	Rear Adm. W. E. Moring, USN.
	Capt. J. F. Mullen, Jr., USN.
	Vice Adm. M. E. Murphy ,USN.
	Rear Adm. W. H. Newton, USN.
	Col. C. W. O'Connor, USAF.
	Capt. E. B. Patterson, USN.
	Brig. Gen. Hoyt Prindle, USAF.
	Capt. J. F. Quilter, USN.
	Col. E. L. Robbins, USAF.
	Capt. L. P. Scott, USN.
	Col. N. J. Senn, USA.
	Col. Norman M. Shipley, AUS.
	Capt. J. L. Shoenhair, USN.
	Adm. G. E. Short, USN.
	Col. J. E. Shuck, USAF.
	Vice Adm. C. C. Smith, USN.
	Rear Adm. W. R. Smith, III, USN.
	Col. W. S. Stephenson, USA.
	Rear Adm. P. E. Summers, USN.
	Rear Adm. W. R. Tagg, USN.
	Capt. A. E. Teall, USN.
	Col. N. M. Towner, USAF.
	Adm. A. B. Vosseller, USN.
	Col. Charles E. Ward, AUS.
	Rear Adm. W. J. Whipple, USN.
	Col. Leroy H. Barnard, USAF.
	Col. Delevan E. Wolters, USAF.
53. Marine Transport Lines, Inc., 11 Broadway, New York, N.Y.	Vice Adm. William M. Callaghan, USN.
54. Marquardt Aircraft Co., Van Nuys, Calif.	Col. H. M. McCoy, USAF.
	Capt. A. G. Rejebian, USNR.

Company	Officer
55. The Martin Co.,[10] Baltimore, Md.----	C. B. Allen. S. S. Ballentine. A. J. Cooper, Jr. L. D. Cooper. E. G. Daly. F. R. Dent, Jr. R. J. Foley. V. Harvard, Jr. S. S. Miller. E. S. Piper. R. S. Purvis. M. C. Reeves. G. D. Stephens. K. E. Tibbetts. A. F. Weirich.
56. Massachusetts Institute of Technology, Cambridge, Mass.	
57. Mathiasen's Tanker Industries, Inc., Philadelphia, Pa.	Capt. J. A. Sweeton, USN.
58. McDonnell Aircraft Corp., St. Louis, Mo.	Rear Adm. Sidney W. Souers, USNR. Rear Adm. Lloyd Harrison, USN. Col. C. M. O'Donnell, USA. Col. R. S. McConnell, USA.
59. Minneapolis Honeywell Regulator Co.,[11] Minneapolis, Minn.	None.
60. Motorola, Inc., 4545 Augusta Blvd., Chicago, Ill.	
61. Newport News Shipbuilding & Dry Dock Co., Newport News, Va.	Rear Adm. N. L. Rawlings, USN. Rear Adm. R. A. Larkin, USN. Capt. D. J. Cracovaner, USNMC. Capt. H. J. Hiemenz, USN. Capt. J. S. Bethea, USN. Capt. L. G. Richards, USN.
62. North American Aviation, Inc., Los Angeles, Calif.	(See p. 74.)
63. Northrop Aircraft, Inc., 9756 Wilshire Blvd., Beverly Hills, Calif.	(See p. 75.)
64. Olin Mathieson Chemical Corp., 460 Park Ave., New York, N.Y.	Col. James A. Bonnington, USA. Capt. N. H. Collisson, USNR. Col. Edwin B. Garrett, USAFR. Capt. Harry A. Sosnoski, USN. Capt. Clarence E. Voegeli, USN. Col. Richard W. Weaver, USAR.
65. Oman-Farnsworth-Wright,[12] 625 Madison Ave., New York, N.Y.	None.
66. Morrison-Knudsen Co., Inc., 319 Broadway, Boise, Idaho. Affiliates: International Engineering Co.[12] Morrison-Knudsen-Oman-Farnsworth-Wright-Kaiser. Alaskan Plumbing & Heating Co., Inc.	Col. E. G. Herb.
67. Pan American World Airways, Inc., 135 East 42d St., New York, N.Y.	
Penn-Texas Corp. (see Fairbanks Whitney).	

[10] Rank not indicated on list of officers submitted (colonels or above, or the equivalent).
[11] Record examination did not include Reserve officers serving on duty in World War II and who, presumably may be retired.
[12] Joint venture.
[13] Not listed in attachment.

Company	Officer
68. Philco Corp., Philadelphia, Pa------	Col. Thomas C. Brubaker, USA.
	Gen. M. D. Burnside, USAF.
	Col. Kenneth I. Davis, USA.
	Col. Ira P. Doctor, USA.
	Col. Loren E. Gaither, USA.
	Col. Francis E. Kidwell, USA.
	Col. Joseph W. Knighton, USMC.
	Adm. James Leeper, USN.
	Col. Milton M. Lewis, USA.
	Adm. Richard Mandelkorn, USN.
	Col. James A. Mylod, USA.
	Col. Samuel Pierce, Jr., USA.
	Adm. Arthur Radford, USN.
	Col. Julian E. Raymond, USA.
	Col. David Schlenker, USAF.
	Col. Patrick A. Wakeman, USA.
	Col. Stuart M. Welsh, USA.
69. Radio Corp. of America, 30 Rockefeller Plaza, New York, N.Y.	Maj. Gen. F. L. Ankenbrandt, USAF.
	Col. D. R. Corum, USA.
Affiliates:	Vice Adm. E. D. Foster, USN.
RCA Service Co.	Col. A. C. Gay, USAF.
National Broadcasting Co.	Col. C. W. Gordon, USAF.
RCA Communications, Inc.	Rear Adm. L. M. Grant, USN.
RCA Victor Distributing Corp.	Maj. Gen. H. C. Ingles, USA.
	Col. C. J. King, Jr., USA.
	Col. E. Knickerbocker, USA.
	Capt. L. R. Lampman, USN.
	Col. J. H. Madison, USA.
	Rear Adm. C. C. Mann, USN.
	Maj. Gen. W. L. Richardson, USAF.
	Capt. E. Roberts, USN.
	Col. J. H. Rothrock, USA.
	Brig. Gen. D. Sarnoff, USA.
	Capt. A. E. Scholz, USN.
	Gen. W. B .Smith, USA.
	Capt. J. R. Stewart, USN.
	Col. J. V. Tower, USA.
	Rear Adm. R. R. Waller, USN.
	Rear Adm. T. P. Wynkoop, USN.
	Capt. J. H. Brockaway, USN.
	Maj. Gen. S. P. Collins, USA.
	Col. A. L. Cox, USAF.
	Capt. L. F. Dodson, USN.
	Col. E. B. Ely, USA.
	Rear Adm. H. S. Harnly, USN.
	Col. J. L. Langevin, USA.
	Col. K. F. Marcb, USA.
	Col. A. Marcy, USA.
	Capt. K. M. McLaren, USN.
	Col. M. Moody, USA.
	Rear Adm. J. M. Robinson, USN.
	Col. H. Rund, USA.
	Maj. Gen. R. A. Schow, USA.
	Col. H. N. Sturdevent, USAF.
	Maj. Gen. T. Tully, USA.
	Capt. L. Van Antwerp, USN.

Company	Officer
70. The Rand Corp.,[14] 1000 Connecticut Ave., Washington, D.C.	Maj. Gen. F. L. Anderson, USAF. Maj. Gen. H. G. Bunker, USAF. Col. G. C. Reinhardt, USA. Capt. W. W. Cone, USN. Col. J. P. Evans, USA. Capt. C. L. Freeman, USN. Lt. Gen. G. F. Good, USMC. Col. W. H. Hastings, USA. Brig. Gen. R. E. Koon, USAF. Rear Adm. R. G. Lockhart, USN. Brig. Gen. R. G. McKee, USA. Adm. S. S. Murray, USN. Col. K. C. Strother, USA. Col. M. R. Williams, USAF.
71. Raytheon Manufacturing Co., Waltham, Mass.	(See p. 75.)
72. Republic Aviation Corp., Farmingdale, Long Island, N.Y.	Col. Hugh Helby Bowe, Jr., USAF. Brig. Gen. Charles Pratt Brown, USAF. Capt. Franklin Duerr Buckley, USN. Col. Carver Thaxton Bussey, USAF. Maj. Gen. Alden Rudyard Crawford, USAF. Brig. Gen. Harley Sanford Jones, USAF. Brig. Gen. John Mills Sterling, USAF. Col. Jesse Fuller Thomas, USA. Col. Israel Brent Washburn, USA.
73. Richfield Oil Corp., Los Angeles, Calif.	Capt. Lester Martin, USN. Col. T. C. Miller, USA. Col. H. W. Schmidt, USA. Capt. J. C. Woolfel, USN.
74. Ryan Aeronautical Co., Lindbergh Field, San Diego, Calif.	(See p. 75.)
75. Shell Oil Co., 50 West 50th St., New York, N.Y.	None.
76. Sinclair Oil Corp.,[15] 600 Fifth Ave., New York, N.Y. Affiliates: Sinclair Refining Co. Sinclair BP Sales, Inc.	Capt. Carl G. Drescher, USN.
77. Socony Mobil Oil Co., 150 East 42d St., New York, N.Y. Affiliates: Basin Oil Co. General Petroleum Corp. Magnolia Petroleum Co. Mobil Overseas Oil Co. Standard Vacuum Oil C.	Rear Adm. Thomas J. Kelly, USN.
78. Sperry Rand Corp.,[16] 30 Rockefeller Plaza, New York, N.Y. Affiliates: Sperry Gyroscope Co. Division. Remington Rand Division. Sperry Microwave Electronics Co. Division. Vickers, Inc. Wright Machinery Co. Division.	Brig. Gen. Joseph A. Bulger, USAF. Col. James E. McGraw, USA. Col. T. L. Gaines, USA. Col. W. R. Gerhardt, USA. Lt. Gen. Leslie R. Groves, USA. Col. Ernest R. Miller, USAF. Capt. Knight Pryor, USN. Col. Paul Walker, USAF. Maj. Gen. Courtney Whitney, USA. Col. E. C. Best, USMCR. Col. Ray Conners, USA. Capt. Gordon Campbell, USN.

[14] System Development Corp. is not an affiliate and will reply direct.
[15] Report from survey of payroll applications. One name furnished is president of Sinclair PB Sales, Inc. It is not clear on report whether or not he is still active or retired from that office.
[16] Gen. Douglas MacArthur not included.

Company	Officer
79. Standard Oil Co. of Califronia,[17] San Francisco, Calif.	
80. Standard Oil Co. of Indiana,[18] 910 South Michigan Ave., Chicago, Ill.	
81. Standard Oil of New Jersey,[19] 30 Rockefeller Plaza, New York, N.Y.	None.
Affiliates:	
Gilbert & Barger Manufacturing Co.	None.
Esso Export Corp	None.
Ethyl Corp	Maj. Gen. Stephen G. Henry, USA.
Esso Research & Engineering Co.	None.
Humble Oil & Refining Co.[19]	
Carter Oil Co	None.
82. State Marine Corp., 90 Broad St., New York, N.Y.	(See p. 75.)
83. Sundstrand Machine Tool Co., 2531 11th St., Rockford, Ill.	
84. Sunray Mid-Continent Oil Co.,[20] Tulsa, Okla.	None.
Affiliates:	
D-X Sunray Oil Co.	
Suntide Refining Co.	
85. Sylvania Electric Products, Inc., 1740 Broadway, New York, N.Y.	(See p. 75.)
86. Temco Aircraft Corp., Dallas, Tex	Col. W. B. Freeman, USMC. Brig. Gen. R. E. Galer, USMC. Col. M. G. Haines, USMC. Rear Adm. A. C. Olney, USN. Brig. Gen. L. S. Smith, USAF. Col. D. W. MacArdle, USA.
87. Texaco Inc., 135 East 42d St., New York, N.Y.	None.
Affiliates:	
Caltex Oil Products Co.	
Texaco (Brazil), Inc.	
Texas Co. (Caribbean), Ltd.	
Texas Co. (Puerto Rico), Inc.	
Texas Petroleum Co.	
The Texas Pipe Line Co.	
88. Thiokol Chemical Corp., Bristol, Pa.	Maj. Gen. David F. O'Neill, USMC. Capt. J. W. Antonides, USN. Capt. Albert Joseph Walden, USN. Col. Fulton G. Thompson, USA. Col. Warren C. Rush, USAR. Rear Adm. J. M. Gardiner, USN. Adm. R. E. Davis, USN. Col. Hubert duBois Lewis, USA.
89. Thompson Ramo Wooldridge, Inc., 23555 Euclid Ave., Cleveland, Ohio.	Gen. B. W. Chidlaw. Brig. Gen. William M. Garland. Lieut. Gen. H. L. George. Maj. Gen. G. P. Saville. Gen. James L. Doolittle. Col. H. K. Gilbert.
90. Tidewater Oil Co., 17 Battery Pl., New York, N.Y.	(See p. 75.)
91. Tishman (Paul) Co., Inc., 21 East 70th St., New York, N.Y.	None.
92. Todd Shipyards Corp., 1 Broadway, New York, N.Y.	Col. Charles D. McColl, USA. Capt. John A. Hayes, Jr., USN.

[17] Information not presently available.
[18] Information not presently available.
[19] Effort made to obtain information through affiliates as indicated. Generally the information is not available from the parent company records of its own employees.
[20] Information not a regular part of company records.

Company	Officer
93. Union Carbide Corp., 30 East 42d St., New York, N.Y.	(See p. 75.)
94. Union Oil Co., of California, 461 South Boylston St., Los Angeles, Calif.	None.
95. United States Lines Co., 1 Broadway, New York, N.Y.	None.
96. United Aircraft Corp., East Hartford, Conn.	Brig. Gen. Turner A. Sims, Jr., USAF.
	Capt. Albert R. Weldon, USN.
	Capt. Wendell W. Suydam, USN.
Affiliates:	Col. Edward J. Hale, USAF.
United Research Corp.	Brig. Gen. Edward C. Dyer, USMC.
United Aircraft Export Corp.	Col. Harry W. Generous, USAF.
	Rear Adm. J. P. W. Vest, USN.
	Capt. Herbert S. Brown, USN.
	Rear Adm. Marshall R. Greer, USN.
	Capt. James F. Byrne, USN.
	Capt. Frank Curtiss Lynch, Jr., USN.
	Lt. Gen. Donald L. Putt, USAF.
	Maj. Gen. Robert W. Douglas, Jr., USAF.
	Maj. Gen. John M. Weikert, USAF.
	Col. John B. Jacob, USMC.
97. Westinghouse Air Brake Co., Pittsburgh, Pa.	Anding, James G.
	Beckley, Stuart.
Affiliates:	Belderlinden, William A.
Melpar, Inc.	Bell, Charlie H.
Le Tourneau-Westinghouse Co.	Bertsch, William H., Jr.
	Bradley, William J.
	Canan, Howard V.
	Cowie, Franklin G.
	Denson, Lee A.
	Elliott, Richard E.
	Gibbs, John S.
	Hastings, Kester L.
	Herring, Lee R.
	Herron, Edwin W.
	Holley, James.
	Irving, Frederick A.
	Kastner, Alfred E.
	Kurtz, Guy O.
	Lane, Richard.
	Larew, Walter B.
	Leggett, Aubrey B.
	Lowe, Robert G.
	Maher, Joseph B.
	McAfee, Broadus.
	Menoher, William.
	Morrison, James A.
	Newton, Wallis S.
	Packer, Francis A.
	Pence, William P.
	Pierce, Edward H.
	Ping, Robert A.
	Rehm, George A.
	Riley, Hugh W.
	Rittgers, Forest S.
	Stafford, Laurance F.
	Samouce, James A.
	Sergeant, Russell C.
	Shaw, Lawrence E.
	Sherman, Wilson R.
	Stiegler, Oscar.
	Summerall, Charles P.
	Wells, Lucien F.

Company	Officer
98. Westinghouse Electric Corp., Pittsburgh, Pa.	Adm. Robert B. Carney, USN. Adm. Leonard J. Dow, USN. Maj. Gen. Albert Boyd, USAF. Rear Adm. Wm. V. Deutermann, USN. Rear Adm. Wm. L. Kabler, USN. Rear Adm. E. S. Keats, USN. Rear Adm. H. T. Walsh, USN. Brig. Gen. R. B. Pape, USA. Brig. Gen. Vennard Wilson, USA. Capt. L. M. Cockaday, USN. Capt. Neal Cole, USN. Capt. Ottis Earle, USN. Capt. W. S. Ellis, USN. Capt. C. J. Heath, USN. Capt. R. M. Huebl, USN. Capt. H. B. Hutchinson, USN. Capt. H. J. Islev-Petersen, USN. Capt. J. J. Moore, USN. Capt. C. W. Truxall, USN. Capt. Hugh Webster, USN. Col. E. M. Buitrago, USA. Col. Angelo R. Del Campo, USA. Col. J. L. Dickey, USMC. Col. O. F. Forman, USA. Col. J. A. Gerath, Jr., USMC. Col. J. J. Godwin, USA. Col. C. D. Jeffcoat, USMC. Col. F. B. Kane, USA. Col. George B. Mackey, USAF. Col. P. M. Martin, USA. Col. Francis H. Monahan, USAF. Col. George R. Oglesby, USA. Col. Fred Reiber, USA.
99. The White Motor Co., Cleveland, Ohio.	None.

Supplement No. 1.—Companies reporting after June 12, 1959. Alphabetically arranged with number corresponding to position on master tabulation.

Company	Officer
6. Beech Aircraft Corp., Wichita, Kans.	Capt. James O. Taylor, USNR. Col. Cliff K. Titus, USAR.
16. Chrysler Corp., Detroit, Mich.	Col. Gervais W. Trichel, USA. Col. William J. D'Espinosa, USA. Capt. William J. Hickey, USN. Col. John L. Hornor, Jr., USA. Brig. Gen. Joseph W. Horridge, USA. Rear Adm. Duncan C. MacMillian, USN. Col. Joseph A. McNerney, USA. Col. Samuel F. Silver, USA. Col. Horace F. Sykes, Jr., USA. Col. William M. Talbot, USAF. Rear Adm. Rutledge B. Tompkins, USN.
18. Collins Radio Co., Cedar Rapids, Iowa.	A. S. Born. L. R. Heron. E. J. Beller. R. L. Fulcher. Charles Kissner.

Company	Officer
25. Eastman Kodak Co., Rochester, N.Y.	Maj. Gen. Edward P. Curtis, USA. Col. Arthur W. Fuchs, USAR. Col. J. B. Langby, USAR. Col. J. D. Peet, USA. Capt. K. D. Gallinger, USN. Col. Rufus Wesson, USAR. Col. Philip Foss, USAR. Col. Frank N. Gunderson, USAR. Col. B. M. Prince, USAF. Col. J. J. Griffith, Jr., USAF. Col. Werner Zugschwerdt, USA. Brig. Gen. Charles W. Shelburne, USMC.
34. General Motors Corp.,[81] Detroit, Mich.	
37. Gilfillan Bros., Inc., 1815 Venice Blvd., Los Angeles, Calif.	None.
46. International Business Machine Corps., 590 Madison Ave., New York, N.Y. Affiliate: The Service Bureau Corp.	Col. J. D. Lee, USAF. Col. N. M. Martin, USA. Maj. Gen. T. C. Odom, USAF.
62. North American Aviation Inc., Los Angeles, Calif.	Capt. Markley C. Cameron, USN. Rear Adm. Stephen W. Carpenter, USN. Col. J. H. Carter, USA. Capt. T. J. Casey, USN. Col. Paul A. Chandler, USMC. Col. Richard W. Faubion, USAF. Col. Wallace S. Ford, USAF. Col. Robert F. Fulton, USAF. Col. James H. Higgs, USAF. Maj. Gen. John H. Hinds, USA. Col. John S. Holmberg, USMC. Col. W. C. Hood, USA. Rear Adm. W. B. Jackson, USN. Brig. Gen. Harold R. Lee, USMC. Capt. William Loveland, USN. Col. Lynn Mapes, USAF. Capt. W. B. Mechling, USN. Vice Adm. John L. Melgaard, USN. Rear Adm. John B. Pearson, Jr., USN. Capt. Fred D. Pfotenhauer, USN. Capt. C. A. Printup, USN. Col. Ben Z. Redfield, USMC. Col. Maurice M. Stone, USAF. Rear Adm. Frank Turner, USN. Col. Ralph J. Watson, USAF. Col. K. M. Welborn, USA. Rear Adm. George A. Whiteside, USN.

[81] A survey is being instituted in more than 120 plants and other employing units throughout the United States. Frigidaire Sales Corp., a wholly owned GM subsidiary, will make a similar survey.

Company	*Officer*
63. Northrop Corp., Beverly Hills, Calif. Affiliate: Page Communication Engineers, Inc.	Lt. Gen. Roger M. Ramey, USAF. Lt. Gen. Patrick W. Timberlake, USAF. Col. Stewart W. Towle, Jr., USAF. Lt. Gen. Ennis C. Whitehead, USAF. Capt. Thomas F. Darden, USN. Capt. Homer K. Davidson, USN. Col. Paul C. Droz, USAF. Col. Edmund R. Goss, USAF. Col. Ralph G. Lockwood, USAF. Col. Gaspare Frank Blunda, USAF. Capt. Neil E. Kingsley, USN. Rear Adm. Michael P. Bagdanovich, USN. Capt. Robert Conaughty, USNR. Col. Kenneth W. Klise, USAFR. Col. Robert R. Mallory, USAR. Lt. Gen. Joseph Smith, USAF.
71. Raytheon Manufacturing Co., Waltham, Mass.	Brig. Gen. Francis A. Kreidel, USA. Col. Mark E. Smith, USA. Adm. Roy W. Graham, USN. Capt. Francis J. Blasdel, USN. Col. Maurice A. O'Connor, Jr., USAF. Capt. Edward L. Robertson, USN. Col. Donald J. Bailey, USA. Capt. John N. Boland, USN. Capt. Marshall B. Gurney, USN. Capt. David R. Hull, USN. Rear Adm. Gill M. Richardson, USN. Capt. Joseph K. Taussig, USN. Capt. Mario G. Vangeli, USN. Capt. Malcolm M. Cloukey, USN. Capt. A. Peter Hilar, USN. Col. Arthur Kramer, USA. Col. Benjamin Whitehouse, USA.
74. Ryan Aeronautical Co., Lindberg Field, San Diego, Calif.	Rear Adm. K. J. Christoff, USN. Col. P. H. Kemmer, USAF. Rear Adm. Leslie E. Gehres, USN. Vice Adm. C. F. Coe, USN. Rear Adm. E. R. Sanders, USN. Brig. Gen. R. L. Schiesswohl, USMCR. Col. Bethuel M. Kitchen, USA. Rear Adm. L. C. Chamberlin, USN. Rear Adm. Harry A. Hummer, USN.
82. States Marine Lines, 90 Broad St., New York, N.Y. Affiliates: States Marine Corp. of Delaware Isthmian Lines, Inc.	None.
85. Sylvania Electric Products Inc., 1740 Broadway, New York, N.Y.	Rear Adm. Frederick J. Bell, USN. Brig. Gen. Wayne H. Adams, USMC. Col. Phillip A. Gugliotte, USAF. Col. Leslie E. Loken, USA. Capt. Edward G. Mason, USNR. Col. Leland Gilliatt, USAF.
90. Tidewater Oil Co., 4201 Wilshire Blvd., Los Angeles, Calif., Affiliate: Seaside Oil Co.	Capt. Creighton C. Carmine, USNR. Col. Daniel Eckerman, AUS. Capt. George Wendelburg, USN.
93. Union Carbide Corp., 30 East 42d St., New York, N.Y.	Rear Adm. George Madden, USN. Capt. C. R. Watts, USN. Col. G. B. Farris, USA. Rear Adm. W. V. Hamilton, USN.

	Company	Officer
100.	System Development Corp.,[25] 2500 Colorado Ave., Santa Monica, Calif.	Lt. Gen. Donald L. Putt, USAF. Col. Thomas A. Holdiman, USAF.

[25] Corporation had been included as an affiliate of Rand Corp. Letter of June 12, 1959, states that organization commenced operation Dec. 1, 1957, as an independent nonprofit corporation.

The CHAIRMAN. Furthermore, the Chair understands that you will furnish a reply to the Comptroller General's criticisms that were put in the record by Senator Douglas——

Mr. DECHERT. Yes, sir.

The CHAIRMAN. This bill should be taken up within 2 weeks. You will furnish all you can up to that time. If there are instances of delay, the information will be furnished later, but as promptly as possible.

Mr. DECHERT. Yes, sir.

The CHAIRMAN. Is that satisfactory?

Senator DOUGLAS. Yes. There is one final question, Mr. Chairman, if I may be permitted to put it.

One of the most respected Members of this Congress is the Honorable Carl Vinson of Georgia, a man of great integrity, and also probably the man who knows more about the armed services than anyone in the United States, even more than the old military, Navy, Air, Marine officers themselves.

I was much impressed with the fact that in the debate in the House on this matter that Congressman Vinson, out of his long experience, proposed an amendment which was designed to cure what he regarded as the abuses of the so-called incentive type of contract, and his argument, as I understand it, was that where there were negotiated contracts which cover 86 percent of the volume, and 95 percent of the number of contracts, that it was possible for one firm that was being dealt with to fix a figure and then to say, "we will fix a very high figure" and then to say, "we will get half of the savings which we make below this," and that the initial figure would be so inflated that their half of the savings below the high figure would get them an extremely high rate of profit. As a result, as you know, Congressman Vinson proposed an amendment, which I regret was defeated on the floor of the House, and I would like to have your comments on the Vinson amendment, because very frankly, Congressman Vinson's judgment has a great deal of weight with me.

Mr. DECHERT. Congressman Vinson's judgment has a great deal of weight with all of us, I may say. On this particular point I think, however, he is wrong, and therefore I think I owe a duty to say why I think he is wrong.

It is true that the target price established with respect to this incentive matter may in some instances prove to have been higher than it should have been. However, you will remember that this target price is not established finally before the contract is started to be performed. In most instances there is a provision to reexamine the target price in the course of performance. So that there is not merely the estimate in advance to go by, but there is a certain amount of experience to go by.

We are not as hopeless as might be thought, therefore, as against the criticism which Mr. Vinson has raised. You are going to say——

Senator DOUGLAS. May I say on the basis of these studies it looks to me as though you were helpless. To use the slang language, you were putting a stumblebum in the ring with a champion.

Mr. DECHERT. This may be a situation, sir, resembling that which produces the maxim of "hard cases making bad law." You will remember that Mr. Vinson's committee, through Congressman Hébert's subcommittee, studied this very matter only a couple of years ago, and they found, they said, that on the whole this contracting procedure was working all right.

It is true there are some examples which appear to be egregious cases where the procedure for setting of the target didn't work because the contractor withheld important information.

As I said before, one of the several reasons we feel renegotiation is necessary is to deal with this kind of situation where after the final target figure is set, conditions change, not as a result of good work by the contractor, but as a result of outside matters, or where it appears that there has been an error, or where for some other reason, renegotiation is the Government's means of preventing the incentive contract provisions from doing harm.

I believe from what I have learned that by and large the incentive contract is a good practice. We want the contractors to have a very strong personal motive to keep down costs. In the contracts where they are going to be paid $32,000 as their fee, and going to be reimbursed whatever the costs are—whether they are the $400,000 first estimated or run up to $800,000—there is a difficult situation with respect to the contractors' own incentive to keep the costs down.

But we in America work in large measure on the profit motive, and if there is a profit motive for keeping the costs down, we think there is more likelihood of actually keeping them down.

Senator DOUGLAS. But there is also a profit motive for the companies to raise the initial price high.

Mr. DECHERT. That is true, and that is why we have to have skilled negotiators, why we have to have honest contractors, and why we have to have this renegotiation weapon in case there is something which is withheld from us, or in case there is something that happens that couldn't have been foreseen.

But we think that with the combination of two arrows in our quiver—that is, (1) the ability to call on the profit motive as the means of keeping down costs, and (2) the ability to use renegotiation if the target price has not been proper—we are going to be better off in general than if we simply have a cost-plus-fixed-fee basis.

Senator DOUGLAS. Mr. Chairman, I have already taken more than my share of time, and I will conclude very briefly.

First, I would say that what I have said indicates that the companies have an incentive to inflate the contract price, to make it as high as possible. I don't believe that the Department of Defense has adequate protections against this. I certainly think they ought to improve their contractual procedures, and that whether on this bill or on another, we in the Congress should make every effort to see that this is made mandatory, because some of us have been talking about this for years, and no improvements have taken place.

Secondly, I would say that while this does indicate the need for a strong renegotiation act, the Renegotiation Act is sort of a secondary

defense. If I were to back up the line in football, I wouldn't like to have a line that let the opposing team, and the interference through, for the work of the defensive halfback then becomes very heavy, while it is necessary for the reserve to be there, the primary line should contain the attack of the enemy.

Certainly, I think this indicates the need, as a reserve force, for a strong renegotiation act, without question, and I think we should scrutinize the measures to see whether they are strong enough.

Mr. Chairman, with thanks for your indulgence in permitting me to take so much time, and with apologies to my colleague, Senator Butler, I conclude.

Senator BUTLER. Mr. Chairman. the question I wanted to ask was a question directed to the Maritime Administrator, who I understand will not appear but has filed a statement. I have not had an opportunity to read that statement. After I have done so, I would like maybe to have him come before the committee and testify.

The CHAIRMAN. I will say to the Senator from Maryland that I have already inserted the letter in the record. I will give him a copy to read and if he desires to have the Maritime Administrator, Mr. Clarence Morse, come before the committee tomorrow, it will be arranged.

Senator BUTLER. I had an amendment directed to section 104 that would go to the practice of inserting in some procurement contracts a provision regulating profits that is inconsistent with the overall psychology of the Renegotiating Act. The statement he has made may be directed to that and may cure it.

Mr. DECHERT. No, I think that the statement in question probably does the opposite, sir. It does the very opposite of what you want.

Senator BUTLER. It does?

Mr. DECHERT. Yes. I am not here to speak for the Commerce Department. Is no one here from the Commerce Department? Let me say——

Senator BUTLER. I would like your comment on it, because it seems to me——

Mr. DECHERT. Well, I hardly want to comment on it, but I will describe it, sir. This was not part of the proposal which we presented as the Administration proposal, but the Commerce Department was authorized by the Bureau of the Budget to present to the Congress this additional request, which was in the form of the paper you have, which is their request. It deals with the fact that the minimum amount renegotiated is $1 million. Ordinarily a concern which does less than $1 million of business in a fiscal year is not subject to renegotiation. There is another profit control act known as the Merchant Marine Act. That profit control act establishes a fixed maximum profit of 10 percent. No matter what the situation is you can't make more than 10 percent when you are building a ship under this act.

When the Renegotiation Act was amended some years ago, the language of the amendment was interpreted to mean that if the concern which was making the ship might be subject to renegotiation if it had over $1 million of business, it would be free from the Merchant Marine Act, regardless of whether it in fact had over $1 million of business in that year.

In other words, the fact that it might be renegotiated if it reached a million means that even if it did only $300,000 in that year it was free from renegotiation and free from the Merchant Marine Act, too.

This proposal which the Department of Commerce has presented, in effect, asks that the profit control 10 percent provision in the Merchant Marine Act shall apply unless the particular concern is in fact over the $1 million figure. It would apply all the way down to $5,000, or less. The Commerce Department says that there is no reason why this act should not apply unless the concern actually is renegotiated.

As I have said, I don't want to comment on it because that is not my provision, and they have been authorized to present it. But what you have in your head, sir, I am sure, is something else which the shipbuilders presented in our conferences with Mr. Stamm and otherwise.

Senator BUTLER. That is correct.

Mr. DECHERT. It develops that in certain of their contracts—and I think they are repair contracts rather than contracts for building new ships—they have inserted a contractual provision which, in effect, says: "You can't make more than 10 percent out of this, and if you make more than that you must give back the difference."

This the shipbuilders don't like, and they are suggesting that the Maritime Administration ought not be allowed to make that kind of a contract in which by contract they would place on the repair business the kind of fixed profit limitation which by statute they are now prevented from placing on new construction.

As I say, I don't want to argue the case because it is their case and not my case, but that is what you have before you, I am sure.

Senator BUTLER. My amendment went to section 104 and would render null and void those profit limitations. I submit a copy for the record.

(The amendment proposed by Senator Butler follows:)

AMENDMENT NO. 1 TO H.R. 7086, PROPOSED BY SENATOR JOHN MARSHALL BUTLER

PROPOSED LANGUAGE

Section 104 of the Renegotiation Act of 1951 (50 U.S.C. App., sec. 1214) is amended by adding at the end thereof the following:

"No contract or subcontract, if any of the receipts or accruals therefrom are subject to this title or would be subject to this title except for the provisions of section 106(e) (50 U.S.C. App., sec. 1216(e)), shall include any provision for the determination, limitation, withholding, or elimination of profits except as provided in this title and any such provision in such an existing contract or subcontract shall be without force or effect."

PURPOSE OF AMENDMENT

This amendment would add a new sentence at the end of section 104 of the Act to eliminate the practice whereby Government procurement agencies burden contractors and subcontractors with additional profit controls by arbitrarily insisting on the inclusion in their contracts of various types of clauses which are inconsistent with the philosophy of overall renegotiation. It is the evident policy of the Act as manifested in present subsection 102(e) suspending the profit limitation provisions of the Vinson-Trammell and Merchant Marine Acts that, during such time as the Renegotiation Act is in effect, it is intended to be the only method of profit limitation in use. This amendment is intended to reinforce that policy.

It is also the intent of this amendment that the Maritime Administration eliminate present Article 41 from its standard master lump sum repair contract form. Both the Navy Department and the Federal Maritime Board/Maritime Admin-

istration also would have to delete profit control provisions now being used in the escalation clauses of their shipbuilding contract forms.

Mr. DECHERT. Those provisions, that is right.

Senator BUTLER. Those provisions. I will take that up with the Department of Commerce.

Mr. DECHERT. Yes.

The CHAIRMAN. The Senator has a copy of the amendment submitted by the Commerce Department in behalf of the Maritime Commission and if he so desires arrangements will be made for the Commissioner to appear later.

Senator BUTLER. I thank the Chairman, but I do not believe it will be necessary.

The CHAIRMAN. Senator Frear.

Senator FREAR. Mr. Chairman, I don't need a legal answer to these questions, just a factual answer, and it can be done in one word, perhaps.

Under which component of the Department of Defense does the Corps of Engineers operate?

Mr. DECHERT. The Army.

Senator FREAR. Who forms the policy of awarding contracts by the Corps of Engineers?

Mr. DECHERT. The Army.

Senator FREAR. Thank you.

The CHAIRMAN. The Chair thanks you very much, Mr. Dechert.

Mr. BUTLER. Mr. Chairman, may I ask one more question maybe from the standpoint of just getting an opinion of the counsel for the Department of Defense.

Do you believe that consideration should be given to deficiencies in ordinary or reasonable years when it comes to renegotiation of excess profits?

Mr. DECHERT. I am afraid I don't understand that. What do you means by "deficiencies"?

Senator BUTLER. Suppose a company files under the act and the first year it would have a deficiency, not a normal profit, and then another year it would have a very large profit, and in another year not quite so large; do you think there ought to be an averaging, do you think you ought to——

Mr. DECHERT. We have considered that.

Senator BUTLER. Naturally.

Mr. DECHERT. Our feeling is that it would be too hard to deal with by statute. It is just an extraordinarily difficult thing to measure the extent to which profits actually made are less than what you would think fair profits might be. It is just an impossible job.

Senator BUTLER. Take the case of a year when they have a loss.

Mr. DECHERT. Well, we deal with a loss, we have a loss carryforward, but I think you are speaking, sir, of a case where instead of making $4 million, this concern made $2,750,000, and the question is whether they ought to be able somehow to carry forward to the next year's renegotiation the fact that they were $1,250,000 under the profit which they hoped they would make the year before.

This concept of fair profits not made in a previous year is just too difficult a one to measure by statute.

Senator BUTLER. Mr. Chairman, with your permission I submit for the record two additional amendments intended to be proposed by me to this bill.

The CHAIRMAN. They will be incorporated in the record as you desire.

(The amendments referred to follow:)

AMENDMENT NO. 2 TO H.R. 7086, PROPOSED BY SENATOR JOHN MARSHALL BUTLER

PROPOSED LANGUAGE

Section 103(e) of the Renegotiation Act of 1951 (50 U.S.C. App., sec. 1213(e)) is amended by inserting before the colon preceding subsection (1) thereof, the following: "having in mind, when appropriate, all of the contractor's business subject to the Act for all years reported to and before the Board."

PURPOSE OF AMENDMENT

This amendment would insure that the determination of a contractor's "excessive" profits in any year will be made in the light of all the statutory "factors" as they appear in relation to all of his renegotiable Government business for all years reported to and before the Renegotiation Board. While for mechanical and income tax reasons, the determinations must be made on an annual basis, nevertheless each such annual determination should involve a full consideration of the individual contractor's performance on covered work on a continuing, rather than an arbitrary annual basis. While there does not appear to be anything in the present language of subsection 103(e) which limits the application of the statutory factors to the determination of "excessive" profits for a single or particular year, it appears that the Renegotiation Board now makes each year's determination almost solely on that year's data. This amendment would require that appropriate data from all years reported to and before the Board be considered.

AMENDMENT NO. 3 TO H.R. 7086, PROPOSED BY SENATOR JOHN MARSHALL BUTLER

PROPOSED LANGUAGE

Section 103(e) of the Renegotiation Act of 1951 (50 U.S.C. App., sec. 1213(e)) is further amended by renumbering paragraphs (2), (3), (4), (5) and (6) as paragraphs (3), (4), (5), (6) and (7) and by adding a new paragraph (2) to read as follows: "(2) Deficiencies in nonexcessive profits for a year or years prior to the year under review."

PURPOSE OF AMENDMENT

This amendment would add a new factor to subsection 103(e) making it specific and mandatory that deficiencies in reasonable or nonexcessive profits for a year or years prior to the year under review be given favorable recognition in determining whether profits in the year under review are "excessive." Such a mandatory recognition of prior year deficiencies would eliminate extremely serious potential inequities. It would permit the Renegotiation Board to take a moving average view of the individual company's profits on work covered by the act.

The CHAIRMAN. The committee will now adjourn until 10 o'clock tomorrow morning.

(Whereupon, at 12:45 p.m., the committee adjourned, to reconvene at 10 a.m., Wednesday, June 3, 1959.)

RENEGOTIATION

WEDNESDAY, JUNE 3, 1959

U. S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 2221, New Senate Office Building, Senator Harry Flood Byrd (chairman) presiding.

Present: Senators Byrd, Kerr, Frear, Douglas, Gore, Talmadge, McCarthy, Williams, Butler, and Cotton.

Also present: Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation, and Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The Chair recognizes Senator Talmadge.

Senator TALMADGE. Mr. Chairman, the first witness this morning is the dean of the Georgia delegation, and I wouldn't want to let this opportunity pass without commenting briefly on his outstanding record of public service.

Congressman Vinson was elected to the Congress the year I was born. He has been a Member of the House since that time, and he is the second ranking Member in seniority, exceeded only by the Speaker of the House, Sam Rayburn. He has been either chairman of the Naval Affairs Committee or the Armed Services Committee for a great number of years. He was the author of the first Renegotiation Act passed by the Congress, I believe, in the year 1934. He also is the author of the present act that was passed in 1951, and has been extended since that time. It has been said about him that he knows more about the security of our country and military affairs than any man in the United States of America.

It affords me a peculiar pleasure as the junior Senator from Georgia to welcome our distinguished dean of the Georgia delegation to testify before this committee.

The CHAIRMAN. Thank you, Senator Talmadge.

Congressman Vinson, will you please come forward?

May I say that I agree with everything Senator Talmadge has said?

STATEMENT OF HON. CARL VINSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF GEORGIA; ACCOMPANIED BY JOHN J. COURTNEY, SPECIAL COUNSEL, SUBCOMMITTEE FOR SPECIAL INVESTIGATIONS, COMMITTEE ON ARMED SERVICES, HOUSE OF REPRESENTATIVES

Mr. VINSON. Thank you, Mr. Chairman, and I am deeply grateful to the junior Senator of Georgia for the kind remarks as well as the remarks you made.

Mr. Chairman, I have prepared my brief, and have laid it before the desk of each Senator, and I shall try to discuss this matter so that we can get right down to the points and find out what all these amendments mean and what they seek to accomplish.

Thank you, Mr. Chairman, for according me this privilege. I am very grateful and highly honored to be privileged to address this distinguished committee.

Mr. Chairman, H.R. 7086 as passed by the House on May 27 extends the Renegotiation Act of 1951 for 4 years from and after its present termination which is June 30, 1959.

But the House and its Ways and Means Committee, while agreeing to continue renegotiation in principle and make it a part of the Government procurement processes for military supplies, has, I believe, been misled into amendments which are first of all unnecessary; secondly, have dangerous potentials; and, thirdly, on the admission of the chairman of the Ways and Means Committee, will not change the decisions in renegotiation "on the same set of facts" from the determinations which can be and are made under the present act.

If the Renegotiation Board in 1960 would reach the same determinations under an amended law as it would in 1958 under the present law, why these amendments?

Here is an act 8 years old, admittedly accomplishing its purpose, doing the job for which Congress designed it, and as to which there has been no complaint or suggestion of faulty administration. Nevertheless, we are confronted with an age-old weakness commonly called the passion for amendment. This is a weakness to which I suppose the flesh is heir and legislators all too frequently the prey.

But mounting of undisclosed pressures, innocuous phrases, watering, and dilution of principle easily serves the selfish purpose of interests not always apparent.

Nevertheless, shadows fall across innocuous clauses in a law. And it is to these "innocuous amendments" which purport to spell out in law what is no spelled out in regulation which I suggest point to the inherent danger in what the Ways and Means Committee and the House may have unwittingly done.

So I have come to the Senate today to ask your consideration of the questions which I posed to the House. Why amend a law to which there is no definitive disagreements?

Why write regulations into the law when it is not demonstrated that the regulations are ignored? Why extend appeals with uncertain guidelines? Why change emphasis if there is no intention to change emphasis? Why amend that which is working satisfactorily?

If any of the changes which are proposed would improve the law or its administration, then I would not raise my voice.

Mr .Chairman, renegotiation is not only the law of the land but it is a contractual agreement of every contractor in the Government by specific agreement in all negotiated contracts amounting to a million dollars in any year.

The vote of the House demonstrated that the House overwhelmingly endorses, not only the need for, but the principle of renegotiation.

Now, Mr. Chairman, the first thing that struck me as I read this bill H.R. 7086 was that there were four effective dates in connection with the various amendments.

I call your attention to page 6, line 7, the effective date for section 4; and I call your attention to page 7, line 20, a different effective date for section 5; and then I call your further attention to page 9, line 22, still another effective date for section 6; and page 10, line 1, with still another effective date.

This, it seems to me, is enough to suggest that these termination dates were not accidental matters on broad legislative policy, but a good guess was that it would be centered around appellants in the Tax Court.

The law past and present, properly and justly gives an appeal and a trial de novo in the Tax Court from those aggrieved by the decisions of the Board itself. I heartily endorse and support that review.

Now here are surprising figures. In 6 years, with over 4,400 cases certified to the Board for renegotiation and a recovery of $723 million by voluntary agreement with contractors, there are on appeal only 46 cases involving $82 million in excessive profits. Seven of these cases are from our largest and most successful missile producers.

Here is the list:

Forty-six contractor-appellants have 57 cases pending. Dollar value of all assessments in 57 cases, $81,800,483.

Here is a breakdown of the cases of 46 appellants:

(*a*) Seven airframe and missile manufacturers in 13 cases account for $72,167,811 of assessments pending on appeal as follows:

Boeing	$26, 799, 828
Douglas	8, 758, 630
Lockheed	4, 254, 978
Martin	3, 162, 759
North American	17, 682, 616
Temco	4, 844, 000
Grumman	6, 665, 000
Total	72, 167, 849

(*b*) One manufacturer has on appeal $2,456,752.

(*c*) Thirty-eight manufacturers in the remaining 42 cases have appeals, the highest being $700,000 and the lowest being $14,000, for a total of $7,175,920.

When you look at these figures you can identify and isolate the problem and the problem children. I think you will quickly observe why changes in the law, if the law itself cannot be defeated—and of that I am certain the opponents of renegotiation must now be convinced—are being urged.

Let me tell you a little about the financial structure of these litigants insofar as Government investment is concerned.

The gross Government investment in plant and equipment in the Boeing Airplane Co., in 1958 was $245,476,000; it was $84 million in 1952.

These cases refer back to the renegotiation in 1952 and therefore I use the same figures as the Tax Court.

The CHAIRMAN. May I interrupt you at this point?

Has the depreciation been taken off of this?

Mr. VINSON. No; not at all.

The CHAIRMAN. That is the gross?

Mr. VINSON. Yes; that is the gross. I use the word "gross."

Now in the same period Boeing's own capital investment increased from $34 million to $145 million, an increase of $111 million, practically all as a result of retained earnings based on profits from Government contracts. Now bear in mind that Boeing has 99.6 percent of Government business.

Senator KERR. You mean that the Government provides it that much of the business it does?

Mr. VINSON. Of the 100 percent of business that Boeing does, 99.6 percent is on Government contracts.

Now I will read one more.

The gross Government investment in Douglas in 1958 was $215 million. In other words, Mr. Chairman, that much taxpayers' money had been spent by the Government in the Douglas Airplane Co.

Now it was $77 million in 1953, the Government investment. During this period the private investment of Douglas increased from $52 million—Douglas had $52 million at that time, and it is increased out of the earnings to $123 million.

The gross Government investment in Lockheed was $130 million in 1958; in 1953 it was approximately $84 million.

During this same period the private investment in Lockheed rose from $57 million to $129 million, a total of $72 million. A substantial portion of this amount undoubtedly came from the retained earnings based on the profits from Government contracts.

The gross Government investment in the Grumann Co. was $56,236,000 in 1958; in 1953 it was $24,638,000.

During this same period the private investment in Grumman increased from $13 million to $25 million, a total of $12 million derived almost entirely on retained earnings from profits on Government contracts.

The gross Government investment in North American Aviation was $125,113,000 in 1958; in 1953 it amounted to $87 million.

During this same period the private investment of North American Aviation increased from $29 million to $90 million, a total of $61 million based entirely upon the retained earnings from profits from Government contracts.

The gross Government investment in the Martin Co. was $78,623,000 in 1958; in 1953 it amounted to $33,504,000.

During this same period the private investment of the Martin Co. increased from $19 million to $81 million, a total of $62 million based entirely on the retained earnings from profits made from Government contracts.

Now, from what I have shown, this conclusion, I believe, must follow. The vast amount of public investment in these firms—almost a billion dollars—makes them not only the most acceptable source of supply of military needs, but also because this Government investment has relieved them from raising private risk capital to perform their contracts.

Now, I think you can see why I am concerned with the proposed change in the language of the bill which would deemphasize the one factor dealing with the public investment.

Mr. Chairman, the bill before the committee would amend paragraph 2 of section 103(e). You will find that it begins with the

fourth sentence from the bottom of the page. You will note that existing law refers to—

the net worth, with particular regard to the amount and source of public and private capital employed.

You see they have left that out of the bill before you, the particular words "with particular regard to," so it reads now:

the net worth, and the amount and source of public and private capital employed.

The House committee report seeks to justify this change by saying that:

Section 2(b) of your committee's bill amends section 103(e)(2) merely to clarify the distinction between the concept of net worth on the one hand, and that of amount and source of public and private capital employed on the other hand.

Now, Mr. Chairman, let us look again at page 14 of the report and take another look at the Ramseyer rule.

Remember that the committee says:

Let's clarify the words "net worth" and its relationship to public and private capital employed.

But note that the House committee did not seek to clarify the language that appears in existing law which is of benefit to the contractor. The committee did not seek to eliminate the words "with particular regard to" where they appear in section 103(e) with respect to the, first, attainment of quantity and quality production; second, reduction of costs and economy in the use of materials; third, facilities; and, fourth, manpower. In fact, to that they would add a new factor—

contractual pricing provisions and the objectives sought to be achieved thereby.

Now, this appearance of the words "with particular regard to" obviously is of benefit to the contractor. These words require the Board to give particular regard to these factors which are in favor of the contractor with respect to the profits he makes on a Government contract.

But why did not the committee, to clarify the situation, suggest that the words "with particular regard to" be eliminated from this part of the law?

And for that matter, why did not the committee ask that the words "with particular regard to," which appear in paragraph 1 of section 103(e), be eliminated?

The answer, I am afraid, can only be that in these two instances the words "with particular regard to" are of benefit to the contractor, but the words "with particular regard to" in paragraph 2, which the bill would eliminate, is the one portion of the factors which the Board must take into consideration with respect to the Government's investment in these facilities of over a billion dollars. And this is what the bill would deemphasize.

I am willing that, as in the present law, the Government and the contractor approach the renegotiation table on equal terms, but I am not willing to say that the Government must now in guise of clarification go to the renegotiation table saying that its capital investment must now be given less weight than formerly.

What possible justification could there be for making a change in existing law which requires the Board and invites a court to deemphasize the public's investment in these facilities? Obviously, any change in the law which deemphasizes the public investment is intended to be of benefit to the private contractor.

I might have a little sympathy with this proposed amendment if these words of emphasis were taken away from the favorable recognition accorded to the contractor's five factors. But I can have nothing but doubt about a proposal to take it away from the Government's one factor. I don't think it is clarification at all. It is confusion of the worst order, because it is confusion in emphasis. It is the depreciation of one factor in favor of five other factors by means of which the total of excessive profits shall be determined. That is dangerous; and I think manifestly unfair to the taxpayers.

Of one thing I am certain (and this seems so simple that it should require almost no discussion) that when you put emphasis in one place and remove it in another, you do change the meaning. All that the Government ought to be interested in, and I am sure is interested in, is that each of the parties approach the renegotiation table on equal terms.

If you take "with particular regard to" from that portion of the law which deals with the factors most favorably to be recognized for the contractor as well, I would have no objection.

But when you take them away, specifically, from the item of public investment as the same shall be viewed by the Renegotiation Board, in determining efficiency and cost reduction, then you are changing emphasis and downgrading a Government investment of over $1 billion.

If that was not the intention, why was the language changed? No instance has been shown where present law has not worked for the protection of and the recognition of the Government investment.

Why must a law be changed that is not now misinterpreted? Why seek to clarify something which is not obscure?

Let me digress to say that yesterday I had the pleasure of sitting here and listening to the statement of the General Counsel. Yesterday, Mr. Dechert brushed aside rather lightly section 2(b) of H.R. 7086 which amends the so-called net worth factor found in the act.

Mr. Dechert went on to say that H.R. 7086—

rewords this particular factor to read in substantially the way this factor was set forth in the Renegotiation Act of 1943, as amended.

Now, the Renegotiation Board Chairman also says that the amendment restored the statement of the net worth factor to substantially the same form in which it appeared in the Renegotiation Act of 1943.

Now, Mr. Chairman, in 1943 the whole section of factor determination of excessive profit was written in a different manner than the 1951 renegotiation act. The factors were set out different, therefore, the emphasis was different. But we are not concerned with the act of 1943. That was 16 years ago. We are concerned with the act of 1951.

I might say in that connection, if you are going to say that factor was used in the act of 1942 should apply to the law today, in the act of 1942 there was no statutory board as set out in the act of 1955. It was administered by the Department of Defense. And so I do not

think he makes a good point when he says, because it was in the law in 1943, 16 years ago, it should be in the law in 1959.

Now, in 1951 we rewrote the law. As said by my distinguished colleague from Georgia, Senator Talmadge, it is my privilege to introduce the act of 1951 which ultimately became the law on the statute books as a result of a hearing before Mr. Cotton's committee.

So I say the point as to the justification for changing it is not well founded.

Now, Mr. Chairman, let's go to the next amendment of the bill.

In considering the factors of cost reductions and the efficiency of the contractor, and measuring them by the six factors now set out in the law, another factor is added—that is, efficiency and cost reduction must be weighed in terms of "contractual pricing provisions and the objectives sought to be achieved thereby." You will find this clause on page 2, lines 5 and 6.

There has been developed a contract form known as incentive contract. This is grounded upon the belief that more profits get more savings.

But I think it is a fallacy to assume that the decent American businessman is dissatisfied with a reasonable profit and must have an excessive profit. I do not believe that is the standard of American business.

However, incentive contracts are widely used in the airframe and missile industry. This is a provision whereby Government and contractor agree upon an estimated "target cost" of an item being procured. Having arrived at this arbitrary forecast the parties agree that the increase or decrease above or below the targets costs be shared or divided by a factor—usually 80 percent to the Government, and 20 percent to the contractor.

In other words, if an item is estimated to have a target cost of $1 million and is actually produced for say $900,000, the difference of $100,000 would be paid out—20 percent or $20,000 to the contractor and 80 percent or $80,000 retained by the Government.

This, you can plainly see, is a different measure of profit.

Now this contract can only be fair to both sides when each party approaches the negotiating table, and the negotiation table I am referring to is in the Department of Defense when the buyer and seller are talking together—on equal terms where the information *available* and *used* (and I emphasize both) enables the parties to reach an informed judgment.

Today right at this very moment in the Armed Services Committee over on the House side, my special subcommittee, has the Comptroller General before it. And he is discussing these 14 contracts and subcontracts which he has examined since last fall, the total overpricing of estimates boosting these target prices by $30 million.

And they were the same ones that the distinguished Senator from Illinois had yesterday in examining the General Counsel of the Department of Defense.

Now, that means that by this device, or because of the inability, inefficiency, or ignorance, if you please, of Government negotiators, the contractors would, automatically, receive a profit of 20 percent or $6 million because of fictitious overpricing.

Now it isn't hard to see why this would be an attractive form of contract; and it isn't necessary to dwell on the misrepresentations which are possible in negotiations.

These are just mere preliminaries on the part of the contractor because of the unequal opportunities of Government negotiators and company negotiator. So in this fertile, potential field of profit, since the project is "cost reduction," by the process of adding on fictitious costs, it is possible to boost earnings beyond anything within the reasonable contemplation of the parties.

Ought these contracts under these conditions be let alone—these profits permitted because of alleged "cost reduction"? I might say here, are we to rely on the relatively small amount of, shall we say errors, which are discovered by the General Accounting Office. Isn't it frightening to contemplate how much may not be discovered?

So that is why I say that I would not permit more favorable recognition of any one type of contract over another. I think no matter what the type of contract, the instructions which Congress has given to this Board to consider favorable cost reduction from all sources, whatever the rate of profit, that, in these circumstances a fair and reasonable profit for cost reduction and efficiency over the usual rate of earnings for like performances, is all that ought to be honestly asked of the Government of the United States.

That is why I am troubled and concerned over the amendment contained in the clause on lines 5 and 6 of page 2, where we read—

contractual pricing provisions and the objectives sought to be achieved thereby.

This clause points to the incentive-type contract because it has a special contractual pricing provision.

Now this is potentially hazardous, as the Comptroller General points out in his letter of May 7 and it is in the record because it creates a "special rule" for a special type of contract and can lead to "windfall profits."

And the word "windfall" is the language of the Comptroller.

And it for that reason that this committee should take a long and hard look at this provision and delete these words.

Now, Mr. Chairman, let me digress again.

Yesterday, the General Counsel of the Department of Defense, Mr. Dechert said—and I am quoting him now on page 3 of his statement:

Among the types of contracts used by the Department of Defense is the so-called incentive-type contract. This type of contract is designed to encourage a contractor to reduce costs by permitting him to share in the savings realized from such reduction. Section 103(e) in the existing law requires the Board to give "favorable recognition to the efficiency of a contractor in reducing" costs. However—

now listen to this—

because of the concern expressed by some members of industry that sufficient recognition was not being given to the nature of these incentive-type contracts and to the efforts of efficient contractors in reducing costs thereunder, the amendment contained in section 2(a) of this bill is believed desirable.

Now, that is the end of Mr. Dechert's statement yesterday.

Now, Mr. Chairman, let me say this. No matter what type of a technical explanation you may hear concerning an incentive-type contract, the fact remains that an incentive-type contract is a contract which has in it an assured profit and a profit on that profit.

The purpose of renegotiation is to recoup for the Government excessive prots regardless of how, where, or when those profits are incurred. It makes no difference under what type of contract the profit is made, if it is excessive there should be recoupment by the Government.

Now what the Department of Defense supported yesterday is special recognition for incentive-type contracts, but bear in mind that the incentive-type contract to begin with has a built-in profit, and therefore any special recognition that is given a built-in profit-type of contract can result only in legalizing profits that would otherwise be considered excessive.

I am afraid if we permit this language to remain in the bill that we may be inviting excessive profits under the guise of special recognition being given to a type of contract called an incentive-type contract but which actually is nothing more and nothing less than a built-in profit-type of contract which can only result in excessive profits and reduced recovery by the Government.

What I fear may not be fully understood about an incentive contract is that the contractor starts out with a "built-in profit." Let me explain: The incentive contract is not a contract for a first performance. It is a "follow on" contract.

The prices are determined during the initial performance on unit 1 to, let us say, unit 10. Then, by agreement, an "incentive target price" is determined.

But when the original prices for units 1 to 10 were agreed to, negotiators for both company and Government negotiated a price which included profit over estimated cost.

The contractor was not expected to build the first 10 units without a profit.

So, when time came to agree upon an "incentive target price," the pricing was based on a negotiated built-in profit over estimated costs, woven together. Thus, an incentive target price has negotiated cost and profit inseparably woven together. This profit never gets out of the bookkeeping system.

Let me explain further: When the 10th unit has been completed, the parties may agree that each unit, on the experience gained in constructing 10 units, has worked out at a price of $1 million per unit.

So, actually, an airplane priced, for example, at $1 million, may have actually cost the contractor about $920,000 with $80,000 or an 8 percent built-in profit. This could then produce a target price of $1 million a unit.

Now, if the follow-on 90 airplanes can be produced for a price of $800,000 each, an incentive target price agreement provides that the contractor will share 20 percent of the $200,000 reduction in price below the target figure or $40,000 on each airplane.

Now, as Senator Kerr has pointed out, this is a profit of $40,000 on top of the $80,000 profit worked into the pricing of the first 10 airplanes upon and from which the incentive fixed target price was negotiated. Thus, a contractor could be profiting almost $120,000 on each airplane. This is called incentive. There may be some other name for it. And I think when the Comptroller said a "windfall," he probably had the correct name for it instead of "incentive."

This, Mr. Chairman, is an incentive-type contract; and this is what some of the opponents of renegotiation wanted eliminated entirely from renegotiation.

Now, if the Board has to give consideration to an incentive-type contract because of contractual pricing provisions as stated in this bill, it can force this Board to treat these contracts by a different measure.

I say to you that a fair and reasonable profit is all that anybody ought to get from any contract.

We are talking about excessive profits; we are talking about the ways and means of preventing them.

What I have just said, Mr. Chairman, can be boiled down to one sentence—what you are doing is legalizing excessive profits under the guise of cost reductions in the performance of a contract.

Now if the committee will follow me further, if you will take up at the end of page 12, I will discuss this next amendment.

Now, Mr. Chairman, let's look at page 3, section 3, of the bill which provides that losses be carried forward. Remember, there is at present a 5-year tax loss carryforward; now that is in reference to taxes, and these are not taxes which we are dealing with here today, we are dealing with renegotiation, we are not dealing with taxes—remember, there is at present a 5-year tax loss carried forward, but now the bill seeks to give an additional benefit. It would extend the loss carried forward in renegotiation for an additional 3-year period. And get this in your mind—and remember, renegotiation is after payment of taxes.

Now, Mr. Chairman, permit me to refer to section 4, and let us start unraveling a legislative riddle. And I think I have given it the right name, because it is a riddle.

Subsection (a) amends section 105 of the present act. Section 105 of the present law now provides that when the Board makes a determination it shall furnish the contractor with a statement of its reasons for the decision. That is the law today.

But under the law today the Board does not specify in this statement the dollar or percentage figure applicable to any of the factors. This is sensible and workable.

But section 4 of the bill requires this statement to be given:

*** * * prior to the making of an agreement or the issuance of an order * * *.**

And then we come to subsection (b). This makes the contractor for all practical purposes a member of the Board.

For here is what subsection (b) requires in connection with the statement to be furnished under section 105 (p. 5, line 17); here is the amendment; this is what is in the bill today:

At and before such a statement is furnished, the Board * * * shall furnish all reports and written documents of the Board to the contractor.

This is before, not after, as the law has it today, but this is before.

I call this a search and seizure provision. I do not know of its counterpart in any other legal proceeding.

This makes a contractor a full-fledged member of the Board—worse still, it effectively prevents the Board from making up its mind on any decision, independent of outside influence. Not only can all the files be rifled by a contractor before a decision, but since the Board under

the bill must make its decision and assign its reasons in advance, this practically requires the Board to state how they are going to vote before they actually vote. This is like putting a statutory window into the minds of the five Board members so that their mental processes can be viewed in actual operation.

All the provisions of law at the present time concern furnishing of statements after the fact—now the bill would require everything to be completed before the fact at the option of the contractor. This is something of a high point in judicial or administrative contradictions.

Now let me call your attention to another provision in the bill.

Section 5 on page 6, seeks to alter the trial de novo proceure of a renegotiation case in the Tax Court. Now here is what the proceedings in the Tax Court are at the present time:

A division—that may be one more appointed by the chief judge—of that court makes its determination independently. After that determination has been rendered, under present law, all 16 judges of the Tax Court can participate and review the decision if within 30 days any judge of that court is dissatisfied with the proposed decision for any reason.

Under the proposed procedure in the committee bill, the Tax Court division after having reached its decision would have that decision automatically reviewed by three judges of the Tax Court, after which the decision would then become the final decision of the Tax Court. A mandatory three-judge review of a Tax Court decision within the court is not applicable in any other matter in that Tax Court.

Now you would think, Mr. Chairman, that that would be enough to satisfy even the most dedicated professional litigant. But no, another appeal is to be added—an appeal to the Circuit Court of Appeals for the District of Columbia.

And that, Mr. Chairman, leads me to a discussion of the process which would be set in motion if the provisions of section 6 are enacted.

Section 6 authorizes an appeal to the Circuit Court of Appeals of the District of Columbia from decisions of the Tax Court.

It seems almost like running against the tide to question or oppose an appeal; but when one stops to realize that at that point, in the renegotiation processes, under existing law, the contractor has had four separate decisions, one of which was a review by a three-judge Tax Court, perhaps it does not seem unreasonable, therefore, to question further appeals.

Page 8, line 20, of this bill gives this circuit court of appeals jurisdiction with power to "affirm or reverse and remand" the decision of the Tax Court when "not in accordance with law" (line 22).

Let's examine the appellate processes set in motion in the light of the Federal Rules of Civil Procedure, and particularly rule 52, as well as the decisions of the Court of Appeals of the District of Columbia.

Section 6 confers on the contractor in his appeal a right to have the Tax Court decision considered—

in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury.

The words "without a jury" cause the difficulty. Why this distinction between a trial by a judge, and a trial by a jury?

Well, it soon becomes apparent when one examines rule 52 of the Federal Rules of Civil Procedure, which tell what shall be done with an appeal from decisions of a judge in a civil trial "without a jury." Here are the essentials of rule 52:

In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment. Requests for findings are not neecssary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein.

Now, Mr. Chairman, the sum and substance of that is that a question of fact can be raised. That is very important—not only a question of law, but a question of fact.

You will observe that this rule has a requirement for specific findings of fact and conclusions of law. And it is here that the trouble can arise.

This bill contains no limitation whatsoever that findings of fact be limited in scope and content as are decisions of the Renegotiation Board in the present law and, for that matter, in the amendment contained in section 2.

And the House Committee on Ways and Means specifically wrote into the law a provision that the Renegotiation Board should not evaluate "separately in dollars or percentages" the consideration it gave to any of the statutory factors.

Factors with dollar percentage figures are repugnant to the whole process of renegotiation.

However, this same limitation with respect to what may be required in specific findings of fact and conclusions of law, which could be required from the Tax Court, is missing. On this subject the bill is silent.

So the contractor could, on this kind of appeal, get what would be, in effect, a statement of account.

Now here is what the Court of Appeals of the District of Columbia says it can do with "findings of fact" and conclusions of law upon appeal from a decision of a judge in a civil action without a jury.

I will pass on over this next. The sum and substance of this is that they can reach a decison on the question of facts and apply the law to the facts.

(The material referred to follows:)

In the leading case of *Dollar* v. *Land*, cited at 185 Federal (2d), page 245, a case in which the Supreme Court denied certiorari, this Court said that in reviewing findings of fact by a trial court without a jury, it was not bound by the "statutory or constitutional limitations" which applied in a review of jury verdicts; that the court of appeals could disregard findings of fact made on oral evidence if the court thought a "mistake" had been made; and that where the lower court's findings were on written evidence the court of appeals was not bound by the judge's findings, but was free to make findings of its own.

If we pass this bill with the rule of *Dollar* v. *Land* staring us in the face, it would substantially defeat the purposes and present processes of renegotiation and constitute the Circuit Court of Appeals of the District of Columbia as a third renegotiation board.

All the committee report says on this amendment is that it would remove all appeal cases to the Circuit Court of Appeals of the District of Columbia to obtain uniformity in the construction of the law. What price uniformity.

If an appeal is granted, why shouldn't the appeal be treated as an appeal from a jury verdict?

Mr. VINSON. Then the question would be limited to whether or not the evidence was properly received and sufficient to sustain a jury's verdict, leaving the matter of weight of the evidence to the jury. At this point, there has already been a decision by the Renegotiation Board: the equivalent of a jury trial followed by trial de novo in the Tax Court that can be reviewed under existing law by the 16 judges of the Tax Court. Certainly that is the equivalent of a jury trial.

But to all of this the bill would add a new procedure by which a circuit court of appeals could cross-examine on the decision of the Tax Court and make its own findings of fact.

I hope that this committee will follow the course it so wisely chose when this act was up for extension last year—it deleted the provisions for appeal to the circuit court of appeals.

Now, Mr. Chairman, may I summarize my objections:

First, I see no reason for changing the emphasis in section 103 of the act on the consideration to be given public investment, from that which is in the law today. No instance is given in which the present provision of law is not operating satisfactorily.

Second, I see no reason for inviting special consideration for incentive contracts by writing into the law a direction that "contractual pricing provisions and the objectives to be achieved thereby" should be given favorable recognition.

Third, I see no reason for writing into the renegotiation a 5-year loss carryforward because this provision is already contained in the tax laws and the renegotiation assessment is after taxes.

Fourth, I think the procedural changes and requirements in section 2 are not only unnecessary but are confusing and contradictory.

Fifth, I particularly deplore the "search and seizure" provisions and the downgrading of the Renegotiation Board. I think most of these procedures are not only ill considered but are unworkable.

Sixth, I cannot believe that a broader appeal to the Circuit Court of Appeals of the District of Columbia is needed; and I particularly deplore the provision which would treat that appeal as though it was from a judge's decision without a jury, for the reasons which I have indicated. This is only an opportunity for a litigant to cross-examine the Tax Court after verdict.

Seventh, I can find no reason for tampering with an act and interferring with the work of a Board as to which there had been no specific complaint leveled. The act is understood and is understandable. The regulations are not complained about; and there is no showing that the regulations are abused.

I, therefore, am unable to support a heavyhanded amendment of a workable law; and the hamstringing of a competent board.

The report of the Committee on Ways and Means in the opening paragraph says that the bill, as amended, was intended "to be of benefit to industry" and "contribute to the administration of the act."

Far from contributing to the administration of the act, it would frustrate the operations of the Board and the courts and confuse all concerned.

But more than that, I fear in emphasizing "benefit to industry," these amendments would put the Government of the United States on

unequal and in an unfair position at the renegotiation table, with industry.

The present law provides equal treatment; the amended bill changes emphasis and introduces contradictory processes, and piles appeal upon appeal. Maybe this would be of benefit to industry; but it certainly would not be of benefit to the people of the United States who have an equal part and partnership with industry, a billion dollars invested in these great plants.

And, finally, Mr. Chairman, I pose one question to this committee which I sincerely hope someone will answer, if it can be answered?

Is there any justification whatsoever for enacting amendments to the renegotiation act which would further benefit industry. Find out if you can, because I cannot, how, where and when industry has suffered under the present act just as it is now written.

For all of the reasons I have stated, I sincerely hope that this committee, and the Senate of the United States, will see fit to strike everything after section 1 of this bill and simply extend the act for 4 years.

Thank you very much.

The CHAIRMAN. Thank you very much, Mr. Vinson. I assure you the committee will give the fullest consideration to your statement.

Senator KERR. As I understand you, Congressman Vinson, you have established that the 5-year carryforward provisions of the act are not similar to the 5-year carryforward provisions in the present law with reference to taxation.

Mr. VINSON. That is correct. This is not a tax question.

Senator KERR. What does this carryforward involve?

Mr. VINSON. Renegotiation is after taxes of all character have been paid. Now, it is true that the Renegotiation Board no doubt uses the data and information that was used in connection with the taxes, but renegotiation applies to that which is left after ad valorem, State, county, Federal and all taxes have been paid.

Senator KERR. What I am trying to get clear in my mind—and I must say you have made a great contribution to my understanding of this legislation—is what is carryforward?

Mr. VINSON. Now, Senator, I am not going to try to answer something that I do not know something about. When I talk I want to be able to have some justification for my statement. I have to pass your question up, because I am not an expert on taxes, and not much on renegotiation, but I have been trying to live with it ever since 1934. I am sorry, you will have to ask these experts.

Senator KERR. Then, I would like at this point, if I may, Mr. Chairman, to ask the chief of our staff what the carryforward provision in this bill relates to.

The CHAIRMAN. Mr. Stam?

Mr. STAM. The present renegotiation law permits a 2-year carryforward.

Senator KERR. Of what?

Mr. STAM. Of losses. If you have some contracts, and you have an overall picture of looking at the contracts for a particular year, and it shows a loss instead of a profit, under the renegotiation law at the present time you can carry that loss over in the next year, with

any excess to be carried in to the following year to reduce your excessive profits for that year.

Senator KERR. Let me ask you this question. Corporation A had a contract in 1957 with the Defense Department on which the loss is a half million dollars. In 1958, it had a contract on which it made a million and a half dollars. It owes taxes on not to excess a million dollars of that, if that was its total business, because it got the benefit of the $500,000 it lost in 1957 before computing its tax on the million and a half it made in 1958?

Mr. STAM. Let me answer that two ways, Senator: In the first place, you don't look at the individual contracts; you look at the aggregate of the contracts for the whole year.

Senator KERR. Let's say that these two contracts were all the business it had for 1957–58.

Mr. STAM. There is another question.

Senator KERR. Let's answer this one.

Mr. STAM. This will have to be settled, too. There is another question that comes up, and that is that renegotiation is determined before you get into the tax field. In other words, when they enter into a renegotiation, the determination is made before taxes. There have been several attempts——

Senator KERR. I understand the Congressman to say—and that was a question I was trying to get clear in my mind—the renegotiation——

Mr. VINSON. His statement is absolutely correct. The payment is made after taxes.

Mr. STAM. You get a deduction in your tax base for the amount of excessive profits you pay. But the determination of whether you have made excessive profits is made without regard to the tax law.

Senator KERR. Then the broad statement that renegotiation applies only to profits left in the hands of the taxpayer after he has paid his taxes would have to be subject to the amendment that it has not had after replacement in working capital or assets of the $500,000 lost in 1957?

Mr. STAM. You just make your determination——

Senator KERR. With reference to the individual contracts. And if it was found in making a million and a half dollars he was renegotiated out of $500,000. That would leave him a million dollars profit on his 1958 business. Before paying taxes on that million dollars, he then would take credit for the $500,000 he lost in 1957?

Mr. STAM. He would get a reduction; that is right.

Senator KERR. Then, I must say, Congressman, my understanding of your statement when I first heard it was mistaken.

Mr. STAM. I might say on that same point, Senator Kerr, the renegotiation, of course, at the present time is a carryforward of losses for 2 years. The attention of the committee was called to the fact——

Senator KERR. That is, under the present law, since the loss I used as an illustration occurred in 1957 and the profit occurred in 1958, they wouldn't be renegotiating a million and a half dollars profit, but a million dollars profit?

Mr. STAM. You would get credit for that loss.

Senator KERR. But in either instance, under the present law or under the contemplated bill, the renegotiations was applied before taxes and not after taxes?

Mr. STAM. That is right.

Senator FREAR. Then, going right along that line, a person could get below the exempt class if he had a loss the year before.

Senator KERR. No, the exempt clause applies to the gross amounts and not the contracts.

Senator FREAR. That is what you said, the gross amount of the contracts.

Senator KERR. The gross amount of the profits is what I said.

I am greatly impressed, Congressman, by your presentation. I believe it dramatizes your position. And I am not disposed to disagree with you. I am disposed to agree with you, that the effect of these amendments actually is to repeal certain provisions of the renegotiation law rather than to amend it. That is to say, these amendments in effect would result in reducing the amount of profit that would be subject to renegotiation.

Mr. VINSON. I will agree with you thoroughly.

Senator KERR. And in order to feel that they are justified one would need to arrive at the conclusion that heretofore we have been, under the guise of renegotiation, taking away so much profit that we were leaving the contractor with too little profit rather than a reasonable profit?

Mr. VINSON. Exactly. And that is why I put in my statement the increased private capital investment, when all of the business was Government business. It was out of the profits that were being left after they had paid whatever taxes and whatever renegotiation had been deducted.

Senator KERR. Your position is that they have done quite well operating under the present law?

Mr. VINSON. I said in my speech on the floor of the House that the first line of this bill was for the benefit of this industry. And I said, if this bill is passed in this form, it should have a new title and a new name, and be known as a bill for the relief of these downtrodden, poor, hard-pressed, industries, because it is so absurd to think, with the facts showing the enormous profits that have been made and poured back in their business that any law is hamstringing or affecting them in the slightest degree.

Here Boeing has poured back in its business since 1952 $111 million out of its earnings. Of course, it has $2 billion worth of contracts, the largest contractor in America. And all of these are in the same categories. They haven't been hurt by the renegotiation law. But, of course, Senator, they don't want any renegotiation law. And so they sought to amend this bill—so it would accomplish indirectly that which they couldn't accomplish directly.

Senator KERR. Now, the total amount being spent by the Defense Department, while it isn't as great as the amount being spent during the Korean war or during World War II, actually results in many contractors having larger contracts than they had during either of these periods; is that correct?

Mr. VINSON. That is correct, because with missiles now, we are in the very expensive field. This is big business. Missiles and airplanes cost enormous sums of money. You would be surprised to know what the flyaway cost is of some of these big planes. And, of course, we don't know what is going to be the cost of such missiles as the

Nike-Zeus, the Bomarc, and all of these things, we know they just cost money.

Senator KERR. The President said in his speech last January, among other things, as I recall, in referring to a certain bomber—I don't know whether he said the value or the cost of it exceeded the amount of its weight in gold——

Mr. VINSON. Silver.

Senator KERR. No; he said gold.

Mr. VINSON. It is absolutely correct, I checked it. And I had the figures submitted to me, but they were classified, and that is the reason I couldn't bring them over here. I have all that information. And I was astonished to know what these missiles and what these airplanes and these bombers are costing. But we have got to have them. These companies are doing a magnificent job. I find no complaint with what they turn out. All I find is that I want them to earn a reasonable profit and not an excessive profit. And if you permit this bill to go through in the language it is written, then they will earn an excessive profit.

Senator KERR. Can you tell us from information which is not classified the aggregate amount of orders outstanding at this time having been given by the Defense Department to contractors?

Mr. VINSON. It is in the neighborhood of $24 billion.

And, as I say, that brings this thought in mind, 90 percent of all contracts from the Department of Defense are negotiated contracts.

Senator KERR. You mean contracts representing 90 percent of the total value, is that what you mean?

Mr. VINSON. It is 90 percent; 90 percent of all contracts.

Senator KERR. Now, does that mean of the number of contracts or of the total amount of them?

Mr. VINSON. Both volume and in numbers.

Senator KERR. Is it a correct statement, No. 1, that there is now a backlog of $25 billion to $27 billion orders outstanding from the Defense Department to contractors.

Mr. VINSON. I do not think that is correct. We are going to spend this year about $24 billion. I don't consider them backlogs, I don't think that it is being given out for use, but there will be about $24 billion worth of business.

Senator KERR. But we know there is a very substantial backlog of orders that have not been completed.

Mr. VINSON. That is true, a great many of them.

Senator KERR. Can you give us an idea?

Mr. VINSON. No, I cannot.

Senator KERR. You cannot?

Mr. VINSON. No.

Senator KERR. But whether one has in mind the backlog of unfilled orders or the orders that will be given this year, your judgment is that 90 percent of both in terms of dollars will be on the basis of negotiated contracts?

Mr. VINSON. That is right.

Senator KERR. Not competitively bid contracts?

Mr. VINSON. That is right. The only competitive bidding to amount to anything in the Department of Defense is where we build through the Bureau of Yards and Docks and the Corps of Engineers

construction contracts, all construction contracts are bid competitively. Everything over $10,000 in the Department of Defense, speaking broadly, is done by negotiated contracting.

Senator KERR. Then is it a fact that the only thing the Government has as a substitute for its safety that it would get out of the role competitive bidding is through the Renegotiation Act?

Mr. VINSON. You have hit the nail exactly on the head. That is the only place where the Government can do it.

Senator KERR. And if this bill is amended, or if the present law is amended, we not only would continue to be without the benefit of competitive bidding, but we would surrender much of what the Government has now in lieu of it?

Mr. VINSON. Exactly. Because here sits the Government, here sits the industry, here they sit to talk about the most complicated things that the mind can think of. How can the Government know as much about it as the man who is going to turn it out and going to build it? Why, of course, in all these transactions we are absolutely at their mercy, and if it were not for the Renegotiation Act we would be in worse shape than we are now.

Senator KERR. You referred to the provisions in this bill that required the Board in advance of renegotiation to give to the contractor all of the information which the Government had with reference to the contractor.

Mr. VINSON. I am quoting the language of the bill.

Senator KERR. Let me ask you this question. Either under present law or under this bill, is there anything that requires the contractor to give to the Government all of the confidential information which the contractor has with reference to the cost of the operation?

Mr. VINSON. I fail to find one line along that line of thought.

Senator KERR. Is there anything in the present law?

Mr. VINSON. The present law does not require it.

My counsel says the present law does require it.

Senator KERR. Let's have the counsel advise us as to the extent to which it does that.

Mr. COURTNEY. Senator, the present law requires the furnishing of such data as may be needed by the Board to formulate its judgment. And it has with it, of course, the penalty of presenting false information. So that a contractor is required to present complete and accurate information to the Board.

Senator KERR. It does it in the way of a report, though, and not in the way of an opportunity of representatives of the Board to go into the files of the contractor?

Mr. COURTNEY. No, we have no provision for searching the files.

Senator KERR. There is nothing in this bill that would strengthen the position of the Government in the receiving of more complete detailed information from the contractor than is required under existing law?

Mr. COURTNEY. None.

Senator KERR. That is all, Mr. Examiner.

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. First I want to thank Mr. Vinson for great public services. And I hope he will permit me to say very sincerely that I think the whole American public holds him in very high esteem

for the magnificent public service which he has given as chairman of the Armed Services Committee of the House, and for his devotion to the public interest, as is evidenced once again this morning.

There is a question that Mr. Dechert raised yesterday that I would like to get your judgment upon. I think I should preface it by saying that I, too, have been shocked by the reports of the Comptroller General, which I know cover only a small fraction of the contracts which have been negotiated by the Department of Defense, which would certainly indicate erroneous statements of costs by the companies, and incompetence or worse by the negotiating officers of the Department of Defense. This is the question which he raised in somewhat different form but which has been worrying me, on this incentive type of contract. Assuming that the Department of Defense continues to get misrepresentation from supply and contracting officers, and assuming that the practices of American business do not change, so that inflated cost statements are made which are not detected by the Department of Defense, if you outlaw the incentive type contract, what protection do we have? Now, Mr. Dechert argued, as I remember, that the incentive type contract would permit one to recapture at least four-fifths of the overstatement of costs by the contractor, and, therefore, was a protection against an erroneous original fixation of the target costs. I know you have given thought to that.

Mr. VINSON. The trouble with an incentive type contract, as I have viewed it in its broad aspect, is that it gives a profit which the contractor is not entitled to earn.

Senator DOUGLAS. And you would think that this could be handled by the Renegotiation Board itself without the intermediary of the incentive type contract?

Mr. VINSON. That is it exactly; they can do so today. Under the law, they can give consideration to cost reduction and efficiency, they can give that consideration today, and the Chairman of the Renegotiation Board will testify no doubt to that effect if you ask him, that that is given consideration.

Senator DOUGLAS. So that the ordinary processes of the Renegotiation Board would help correct overstatements of costs, and you do not need the incentive?

Mr. VINSON. That is it exactly, you do not need it. I think when you do that, why, then, you notify the Board that they must deal with that in a separate manner from dealing with the whole contract. And it pinpoints it, legalizes it, it gives it status.

Senator DOUGLAS. Mr. Vinson, you have had more experience with this matter than I suppose any man in the country over a long period of time.

Do you share my feeling that this is probably one of the worst abuses which has crept into our Government, namely, the overstatement of costs, and the excessive profits made in war contracts, and the presence of such a large percentage of negotiated bids rather than competitive biddings?

Mr. VINSON. I have been disturbed about it, and I had one of the staff members—the House accords my committee about $150,000 a year to build up a staff and look after these matters and this is my General Counsel, Mr. Courtney, he has been with the committee for 7 or 8

years—we have a study made of the qualification of the men who sat across the table from industry. I was dumfounded and shocked at their lack of knowledge on what they were dealing with.

If any man is going to negotiate a $50 million contract, or $100 million, to deal in big figures, and he is sitting across the table from the man who is employed by industry, he must know everything or else he is absolutely at the mercy of the mind and brain of the other man.

And, unfortunately, the Government does not have people who have had that experience and that background, in a great many instances.

There are instances where they do have the background. I had a check made of all these people, and I was surprised at the lack of knowledge and background. Yet they have dealt with matters involving negotiations of $50 million or more.

Now, how could I sit across the table with some representative of the aircraft industry and talk about ballistic missiles and things of that nature? How could you, as brilliant and smart as you are? You would be absolutely at their mercy.

Senator DOUGLAS. I would be handicapped due both to a lack of ability and a lack of experience.

Mr. VINSON. Of course. And so if you don't have some law like this to protect the Government, you are absolutely at their mercy.

Senator DOUGLAS. Mr. Vinson, there is another question that has disturbed me—and I asked for further information from the Department of Defense yesterday—and that is the degree to which high ranking officers in the military, upon their retirement or resignation, become representatives of these big contractors and then deal with their former military comrades across the table, many of whom are their intimate personal friends, and some of whom they have promoted in the past.

Mr. VINSON. Well, that is a question Senator—please excuse me. I just want to keep my argument close to renegotiation. I know all about it. I know about conflict of interests.

Senator DOUGLAS. Mr. Vinson, would you be willing to let me visit you in your office and obtain private information from you?

Mr. VINSON. Yes, sir. I know all about that, we have that come up all the time.

Senator DOUGLAS. Do you regard it as a problem?

Mr. VINSON. Of course I do. And I know all about it. I know what goes on. And it doesn't only apply there, Senator, it applies up on the Hill here today.

Senator DOUGLAS. You have noticed that also?

Mr. VINSON. Yes. Right up here. You get a bright man, a brilliant man, and give him a position up here, if he stays here 3 or 4 years, industry will want him.

Senator DOUGLAS. Congressmen as well as admirals are mortal.

Senator FREAR. One question, if I may, if the Senator from Illinois has completed his questions?

Senator DOUGLAS. Yes.

Senator FREAR. Regarding the profit from the incentive program in the illustration that you used of $20,000, is that tax free to the industry?

Mr. VINSON. No.

Senator FREAR. When is tax paid on that $20,000?

Mr. VINSON. Well, it is paid, I imagine, Senator—I hadn't thought about that—when he pays his other taxes. He has made a profit.

Senator FREAR. If it is taxable, then it is due in the taxable year in which it is received.

Mr. VINSON. That is exactly right.

Senator FREAR. Thank you.

The CHAIRMAN. The next witness is Mr. Thomas Coggeshall, Chairman of the Renegotiation Board.

Mr. COGGESHALL. I would like to be accompanied, Mr. Chairman, by the General Counsel, Mr. Fensterstock.

STATEMENT OF THOMAS COGGESHALL, CHAIRMAN OF THE RENEGOTIATION BOARD; ACCOMPANIED BY HOWARD W. FENSTERSTOCK, GENERAL COUNSEL, THE RENEGOTIATION BOARD

Mr. COGGESHALL. Mr. Chairman, before I go to my short prepared statement, I feel moved to pay tribute to the distinguished chairman of the Armed Services Committee, to his remarks and the support he has given to the administration of renegotiation over the last year, which he has looked into very carefully. I would be less than human if I didn't say—not only for myself but my fellow Board members, who are present, I am sure they share my views—that after suffering the slings and arrows of outrageous fortune for the last 3 years, it is music to our ears.

Some 3 years ago, the man who was later spokesman for the Aircraft Industries Association, both last July and at the recent hearings of the House Ways and Means Committee, Mr. William Allen, president of Boeing, when we told him of the proposed determination for his company he said:

Mr. Coggeshall, if the Board supports this determination, I will fight you in the courts, I will fight you in the press, I will fight you in the Pentagon, I will fight you in the Halls of Congress.

Senator DOUGLAS. Who said that?

Mr. COGGESHALL. Mr. William Allen, of Boeing—I will say he is a gentleman of his word—the president of the Boeing Aircraft, and the chosen representative last summer of the Aircraft Industries Association at the House Ways and Means Committee and again this last month.

The CHAIRMAN. Let me ask you this question before you start.

Do you agree with Congressman Vinson that the House amendments weaken it?

Mr. COGGESHALL. I have a prepared statement which was prepared before he spoke. I will stick to my prepared statement and make some comments along the way and answer some questions.

I would like to say by way of preface to quoting the statement of our position made to the House Ways and Means Committee, we are an independent agency in the executive branch of the Government. We have never asked for our own continuance.

I started my statement at the Ways and Means Committee with this statement:

> As you gentlemen know, it is the fixed policy of the Board not to seek its own continuance. We administer the renegotiation law but we do not recommend or endeavor to initiate legislation to perpetuate it. However, when legislation is proposed to extend the act for a further period, and particularly since such proposals are usually accompanied by amendments to the substantive provisions of the act, the Board has always considered it necessary and proper to provide the Congress with the benefit of its experience in the administration of this complex and highly technical law. If we are to have renegotiation, naturally the Board is interested in helping to achieve the best possible system that can be drawn from the wisdom and experience of all interested persons. It is in that spirit that I speak today.

Now, I come to my prepared statement for this committee.

I am privileged once again to appear before this committee to express the views of the Renegotiation Board on a proposal to extend the Renegotiation Act of 1951 for a further period. This proposal is embodied in H.R. 7086, as passed by the House on May 27, 1959. It was the culmination of 3 days of public hearings and an extended and searching examination, in executive session, I think it was 9 days, of the whole subject of renegotiation.

H.R. 7086 extends the coverage of the renegotiation law for 4 years, from June 30, 1959, to June 30, 1963, and provides certain other amendments. By letter date May 19, 1959, to the chairman of the Committee on Ways and Means of the House, the Renegotiation Board stated its approval of that bill. It is also the opinion of the Board that the committee wisely rejected the numerous other changes proposed to it during and preceding the hearings.

I will say of some of them, if they were adopted, we would have nothing to do but cut out paper dolls.

The extension of renegotiation beyond the present termination date of the act was requested by the President and recommended by the Department of Defense. The Department has pointed out that world conditions today, and for the foreseeable future, require expenditures in unprecedented amounts for the national defense, and has stated that its procurement pricing techniques are not adequate to protect against excessive profits in all cases, particularly in the area of novel and complex weapons characterized by insufficient cost and production experience. The Renegotiation Board concurs in these views of the Department of Defense. It believes that a further extension of the act is in the public interest, and that the length of the extension is reasonable in all the circumstances.

Section 2(a) of the bill requires the Board, in its consideration of the efficiency of the contractor, to accord particular regard to—

> contractual pricing provisions and the objectives sought to be achieved thereby, and economies achieved by subcontracting with small business concerns.

These matters are in addition to the other elements now specified in the statute under the efficiency factor. The substance of the new provisions is already contained in the regulations of the Board, and in practice has always been taken into consideration by the Board in determining excessive profits. The new provisions thus do not compel any change in the Board's application of the efficiency factor, but it is desirable that they be given statutory expression.

I have been listening to Chairman Vinson, and I will interject that if any such interpretation as he indicates were to be placed upon that addition, I would have opposed it. It is up to this committee to decide whether or not such construction is the intent of the Congress, I don't know.

Section 2(b) of the bill affects a slight but significant change in the language of the net worth factor contained in section 103(e) of the act. It provides that the Board shall give consideration to "the net worth, and the amount and source of public and private capital employed," rather than, as now provided, to "the net worth, with particular regard to the amount and source of public and private capital employed." The amendment restores the statement of the net worth factor to substantially the same form in which it appeared in the Renegotiation Act of 1943, and eliminates the confusing and misleading effects of the modified form in which the factor is stated in the 1951 act. The amendment makes it clear that "net worth" and "capital employed" are separate and distinct matters, each requiring separate and distinct consideration. It is stated by the House to be a clarifying amendment only, and the Board welcomes the clarification. As for the reference to "with particular regard to," I think that might well be handled in the committee report.

It was made abundantly clear on the floor of the House that no change in substance was intended by the amendment, and that there was no intent, by eliminating the words "with particular regard to," to deemphasize in any degree the relative significance of the amounts and sources of public and private capital employed in the contractor's operations. The Board understands that these matters are intended to have no less importance in the determination of future cases than they have had in the determination of past cases.

Section 2(c) of the bill requires the Board to indicate separately its consideration of each of the statutory factors in any statement furnished by the Board to the contractor pursuant to section 105(a) of the act. This provision, too, is based upon the existing regulations and practice of the Board. It is entirely proper that it be made a statutory requirement.

Section 3 of the bill increases from 2 years to 5 years the loss carry-forward provision of the present act. This makes available, for losses on renegotiable business, the same carry-forward period provided for taxpayers under the Internal Revenue Code. A 5-year term is not likely to be widely needed, but it may prove helpful to contractors in particularly difficult circumstances.

Section 4(a) of the bill modifies the existing statutory provision which requires the Board, upon request of the contractor, to furnish a statement of its determination, of the facts used as a basis therefor, and of its reasons therefor. Under the present law this statement may be demanded by the contractor only in cases concluded by an order of the Board, and then only after the order has been issued. The bill makes the statement available to the contractor whenever the Board makes its determination, and before the determination is embodied in either an agreement or an order. The Board has always issued the postorder statement, upon request, in accordance with the statute; and pursuant to its own regulations it has also always issued the preorder or preagreement statement, upon request. Since the

Board's experience is that the earlier statement is more useful to a contractor, it considers the amendment a constructive change. When I say more useful, we also find that from time to time it has led to agreements which would not otherwise have come about, by giving contractors an opportunity to make up their minds.

Section 4(b) of the bill compels the Board, at the time a statement of facts and reasons is furnished, to make available for inspection by the contractor all pertinent reports and other written matter furnished to the Board by any Department named in the act, unless such disclosure is forbidden by law. Under section 1905 of title 18, United States Code, the Board is prohibited from revealing such information unless the disclosure is authorized by law. Since the provision which section 4(b) of the bill proposes to add to section 105(a) of the act would probably constitute such an authorization, it is essential that it be carefully circumscribed. An express statement is added, therefore, that the inspection provision does not authorize the disclosure of any information, of the type referred to in the cited section of the code, in respect of any person other than the contractor himself, unless the contractor is properly and directly concerned therein. The provision applies only to future determinations of the Board.

This inspection provision effects a substantial change in renegotiation practice. The Board has approved it in the hope that it will help to assure the contractor that he has been made privy to all properly disclosable information that entered into the Board's determination of his case, and that it will help him to decide whether to accept or contest such determination. If the provision is enacted, only time will tell whether these aims are realized, and whether there is any real need to supplement the Board's statement of facts and reasons with an opportunity to the contractor to inspect certain of the underlying documents in the Board's files. Time alone will tell, too, whether conferring this right of inspection upon the contractor will bring about any deterioration in the quality of performance reports customarily furnished by the procurement departments to the Board, or whether any other harm will be done either to the renegotiation process or to any persons mentioned in or connected with the preparation of such reports. It would be regrettable if the inspection provision were to be undermined by any such untoward consequences.

I would like to break in here in connection with what Chairman Vinson had to say on this subject. I was not in favor of this before it was discussed in the Ways and Means Committee. I was not in favor in advance, and I understand Mr. Dechert was not in favor in advance, but there were so many things asked that in my prophetic soul I felt it might be just lifting the lid of Pandora's box or breaking the dike or what have you. And sure enough—I went up to my home in Connecticut last weekend to get in the salt water and get in the sun, which always restores me to my usual health—and when I got back and got to my desk on Monday I found a number of letters immediately pursuing this matter—that this wasn't enough, one was from the National Security Industrial Association. They sent me a copy of their letter to you, Mr. Stam, which you can put before the committee. Maybe you will want to enter the letter in the record.

It reads:

The renegotiation task committee of the National Security Industrial Association submitted its recommendations with respect to the extension of the Renegotiation Act of 1951 in a letter to you dated April 28, 1959.

The NSIA renegotiation task committee has had an opportunity to review House Report No. 364 of the Committee on Ways and Means to accompany H.R. 7086. In connection with its second recommendation, titled "The Hardship of Renegotiation on an Annual Basis," your attention is respectfully directed to the fact that under the Vinson-Trammel Act a net loss or a net deficiency in the allowable profit would be allowed as a credit in determining excess profit, if any, during the next succeeding 4 income-taxable years. It appears to the members of the renegotiation task committee that Congress has thus in the past given recognition to the concept proposed in such recommendation. Accordingly, the NSIA renegotiation task committee reiterates its recommendation that the Renegotiation Act of 1951 should be amended to implement such concept in the manner suggested in its letter of April 28, 1959.

The renegotiation task committee is gratified to find reflection in H.R. 7086 and in House Report No. 364 of its fourth recommendation, titled "Due Process of Law," in section 4(b) of H.R. 7086. Your attention is respectfully addressed to the fact that while the stated purpose of section 4(b) of the bill is to give contractors an opportunity to inspect and rebut information contained in performance reports and other written matter used by the Board in arriving at its determinations of excessive profits, the proposed amendment limits such reports and other written matter to those furnished to the Board by a department relating to the renegotiation proceedings in which such determination was made. Since the Committee on Ways and Means was of the opinion that a contractor should, in fairness, be given the opportunity to inspect performance reports and other written matter used by the Board in arriving at its determinations, such reports and other written matter should not be limited to those from departments named in the act. To do so would deprive subcontractors of the opportunity to inspect reports and other written matter submitted by prime contractors and upper tier subcontractors. It would make unavailable to both prime contractors and subcontractors any other reports or written matter which entered into the Board's determinations. This appears to the renegotiation task committee to be an unreasonable limitation which would inevitably produce inequities.

We would certainly, if their proposal were adopted, find ourselves in the position of a friend trying to straighten out trouble between a quarreling wife and a quarreling husband—a task which I do not relish. We have always considered it obligatory upon us to make known to contractors facing a refund the substance of the performance reports, both from the Department of Defense and the Air Force and the Army and Navy, and the general substance of reports on subcontractors from their primes, particularly when we found a difference between what they have to say themselves and what is said to us about them.

It is our job to reconcile the differences, but without bringing the parties into a quarrel with each other for us to arbitrate. That is an impossible position for us to be in.

We had another letter of far greater length, which went right down the line, from a company out in California, not one of the airframe companies. It is from H. & B. American Machine Co., Beverly Hills, Calif., and Mr. Stam has a copy.

It reads:

We wish to call to your attention what we consider to be a defect in H.R. 7086 as passed by the House. H.R. 7086 amends and extends for 4 years the Renegotiation Act of 1951, as amended. Section 4(b) of H.R. 7086 provides in part that: "At or before the time the statement of the facts and reasons supporting the Board's determination is furnished, the Board shall make available for inspection by the contractor or subcontractor, as the case may be, all reports

and other written matter furnished to the Board by a department relating to the renegotiation proceedings in which such determination was made, the disclosure of which is not forbidden by law."

The effect of the language, "the statement of facts and reasons supporting the Board's determinations", is to deny the benefits of this amendment to subcontractors, since the information pertaining to a subcontractor is normally supplied by other companies, rather than by a Government department. We feel that this is an unwarranted discrimination. All companies which are subject to renegotiation proceedings should be allowed to examine and, to the extent possible, refute evidence which forms the basis for a determination that part of its profit on Government contracts or subcontracts is excessive. Section 4(b) of H.R. 7086 indicates a general concurrence in this opinion on the part of the House of Representatives, and we feel sure that the position is a basically fair one. Accordingly, we believe that section 4(b) of H.R. 7086 should be amended by deleting the words "by a department" therefrom.

Several arguments may possibly be made against amending this section—namely, (1) that the Board would have difficulty in soliciting information from private companies if they could not promise that the information would be kept confidential, (2) that the Board has in fact given such promises with respect to information which would have to be made available to subcontractors if the proposed amendment were adopted, and (3) that the subcontractor will have an opportunity to meet and refute the evidence against it in the Tax Court, which under section 5(a) of H.R. 7086 would consider only evidence presented to it and would accord no presumption of correctness to the determination of the Board. We do not find any of these arguments convincing.

And it goes on and on.

Next we have what we treated in the Board the other day as an application for membership in the Board from the Boeing Airplane Co.

It reads:

Your letter requests that this company advise you not later than May 28, 1959, whether it wishes to enter into a bilateral agreement, or whether the Board should proceed to issue a unilateral order in accordance with the foregoing determination. Before notifying you of the company's decision in this regard, it is requested that you furnish us a written summary of the facts and reasons upon which your determination is based.

That is quite proper. We have always done that.

You have heretofore been furnished with all information which the company has considered relevant to the renegotiation proceedings for the year 1955.

It is further requested that there be furnished to us as an appendix to the foregoing written summary all of the reports, correspondence, and data contained in or constituting the files of the Los Angeles Regional Renegotiation Board and of the Renegotiation Board in connection with the renegotiation of the company for the year 1955, including therein, without limiting the generality of the foregoing, the following:

1. Any and all reports, letters, or written information submitted by or on behalf of Air Materiel Command or other U.S. Air Force office or command to the Los Angeles Regional Renegotiation Board or the Renegotiation Board in response to questionnaires or requests for information from either of the latter in connection with the renegotiation of Boeing Airplane Co. for the year 1955; and

2. Any and all reports, recommendations, correspondence, and data submitted by the Los Angeles Regional Renegotiation Board to the Renegotiation Board in connection with the renegotiation of Boeing Airplane Co. for the year 1955—

there is one exception—

excluding therefrom, however, any Federal income tax data of the character described in Renegotiation Board regulations section 1480.3.

We are not disposed to admit Boeing Airplane to membership in the Renegotiation Board, and they will be notified in due course.

The CHAIRMAN. You are opposed to section 4(b), is that it?

Mr. COGGESHALL. What doubts I had have been resolved against it.

The CHAIRMAN. Resolved against it?

Mr. COGGESHALL. Yes.

The CHAIRMAN. Does that mean you are opposed to it?

Mr. COGGESHALL. I have not had a chance to consult with my Board, but so far as I am concerned, personally, I am opposed.

I will go on.

The remaining provisions of the bill do not affect the operations of the Board; they relate only to the further proceedings available to the contractor who chooses not to enter into an agreement with the Board for the elimination of excessive profits.

Section 5 adds certain specifics to the existing provision of the act that the proceeding in the Tax Court shall not be one to review the determination of the Board, but shall be a proceeding de novo. It states that the petitioner in such proceeding shall have the burden of going forward with the case; that only evidence presented to the Tax Court shall be considered by that court; and that no presumption of correctness shall attach to the determination of the Board. These recitals are believed by the Board to be declaratory of the existing law and practice in the Tax Court. However, doubts have arisen in some quarters that the Tax Court procedure is truly de novo. The amendment should help to settle these doubts and to insure the de novo character of Tax Court proceedings.

Also included in section 5 of this bill is a requirement that the determination of the trial judge be reviewed by a special division of the Tax Court consisting of not less than three judges. This provision is designed to achieve fuller participation by the membership of the Tax Court in renegotiation cases. It is entirely acceptable to the Board.

Section 6 of the bill confers upon the contractor a limited right of appeal from the decision of the Tax Court to the U.S. Court of Appeals for the District of Columbia. Under existing law, as declared by the courts, the contractor appears to be entitled to appeal on constitutional or jurisdictional grounds only. The bill authorizes appeals on questions of law generally, probably including the sufficiency of the evidence to support the Tax Court's determination of the amount of excessive profits, but it does not empower the court of appeals to modify that determination and to substitute its own judgment of the extent, if any, to which the contractor's profits are excessive. The history of the decided cases in the Tax Court suggests that a contractor will be hard to obtain a reversal on the ground of insufficient support in the evidence for the amount of excessive profits determined by that court, but the Board is agreeable that he be permitted the opportunity.

Once more, I have listened not only to Mr. Vinson's statement, but I have listened to the lawyers on this subject back and forth—I am

not a lawyer—Government lawyers, Department of Justice and Department of Defense lawyers, and my own counsel, and so forth, and I must admit that my head, with no legal training, got somewhat confused at times. But Mr. Vinson's statement was something new to me, which I discussed with counsel. And secondly, this whole support that we gave was predicated on the assumption that the proposal was agreeable to Chief Judge Murdock. And you put into the record yesterday, Mr. Chairman, his letter where he has raised very express opposition. My support was based exclusively upon our understanding that it had the support of Chief Judge Murdock. And so, both on the ground of Chairman Vinson's statement and Judge Murdock's letter, I feel that my statement written before must at least be qualified.

The CHAIRMAN. Do you mean that you withdraw approval?

Mr. COGGESHALL. I can't endorse the proposal at his time, I would certainly have to stand by and listen to further discussion, possibly in executive committee.

The CHAIRMAN. Do you want some more time to study it?

Mr. COGGESHALL. No. Again I must speak for myself, my Board might turn me down, but so far as I am concerned, I would say I withdraw my approval. I can't have the approval stand under the circumstances.

The CHAIRMAN. And you withdraw your approval?

Mr. COGGESHALL. Yes, sir.

The CHAIRMAN. You are opposed to that amendment?

Mr. COGGESHALL. I withdraw my approval. We don't make the law, Mr. Chairman, it is up to this committee.

The CHAIRMAN. You are here to give advice to this committee, and that is what we are seeking.

Mr. COGGESHALL. I will give you my own advice and my own decision, and my Board members—if you want to poll them right here.

The CHAIRMAN. I thought you were here to speak for the Board.

Mr. COGGESHALL. This was a new development, Mr. Vinson's statement and Judge Murdock's letter.

The CHAIRMAN. Do you want to take it back to the Board? The record should show where you stand.

Mr. COGGESHALL. That might be desirable. I don't want to be presumptuous. Such powers as I have as spokesman I derive from the Board. I have one vote.

The CHAIRMAN. We have to depend on somebody, we can't go and take a canvass of all the members of the Board.

Mr. COGGESHALL. All right, Mr. Chairman, I will get word to you very promptly.

The CHAIRMAN. As I understand it, with two exceptions you approve of the amendments adopted by the House, is that correct?

Mr. COGGESHALL. Yes.

The CHAIRMAN. And you don't agree with Congressman Vinson in his statements that the House amendments greatly weaken the Renegotiation Act?

Mr. COGGESHALL. I was disturbed and distressed by his remarks, and I think there would certainly have to be language in the report making clear that no such construction as he suggests could be put on these other amendments.

The CHAIRMAN. Do you agree with his closing statement:

I sincerely hope that this committee, and the Senate of the United States, will see fit to strike everything after section 1 of this bill and simply extend the act for 4 years.

Mr. COGGESHALL. I can't go that far at this stage.

The CHAIRMAN. How far will you go?

Mr. COGGESHALL. I have withdrawn my support of the two principal amendments.

The CHAIRMAN. And you then approve of all the amendments except these two?

Mr. COGGESHALL. I think the rest, to the extent that questions have been raised, could be handled in the report, the legislative report of the Senate Committee on Finance.

The CHAIRMAN. How do you want the record to show your position on section 4(b)?

Mr. COGGESHALL. I agree with those others.

The CHAIRMAN. I didn't understand.

Which is the one that you want definitely to oppose?

Mr. COGGESHALL. To both the court of appeals and what Chairman Vinson referred to as "search and seizure."

My counsel can tell you the numbers.

Mr. FENSTERSTOCK. Section 4.

The CHAIRMAN. 4(a) and 4(b), is that correct?

Mr. FENSTERSTOCK. Sections 5 and 6, Mr. Chairman, are the sections that Mr. Coggeshall is referring to.

The CHAIRMAN. And you are opposed to both these sections, is that correct?

Mr. COGGESHALL. Yes.

The CHAIRMAN. Subject to reversal by the Board, you are opposed to the appeal section?

Mr. COGGESHALL. Yes.

The CHAIRMAN. But you favor the other House amendments?

Mr. COGGESHALL. Yes.

The CHAIRMAN. And you don't agree with Congressman Vinson that they weaken the administration of the law?

Mr. COGGESHALL. If it were felt by the committee that they do, I think it should be covered by report, as long as he has raised doubts.

Mr. FENSTERSTOCK. Mr. Chairman, may I supplement the remark I made a moment ago? Mr. Coggeshall's opposition goes not only to sections 5 and 6 of the bill, but also to section 4(b).

The CHAIRMAN. That is what I said at the beginning.

Mr. FENSTERSTOCK. Right, sir.

Mr. COGGESHALL. I didn't have the bill before me.

I have just one little closing statement.

Senator BUTLER. I have a question in connection with that.

Do you feel that your objection to section 4(b) could be cured by language inserted in the report?

Mr. COGGESHALL. No, I don't think it could. Such doubts as I previously had were increased the minute this correspondence began coming in. In other words, although we were willing—we knew it was going to make it administratively difficult, but it literally opens Pandora's box.

Senator BUTLER. Do you have objection to section 2(b)?

Mr. COGGESHALL. No, I have no objection to that.

Senator BUTLER. But you think there should be something in the report similar to the statement in the House report that it is a mere perfecting amendment?

Mr. COGGESHALL. Yes, very definitely.

The CHAIRMAN. I want the record to be clear. This is a complicated matter, and the committee couldn't be expected to understand all these complications without your advice. You favor this legislation as passed by the House with the two exceptions which you have mentioned?

Mr. COGGESHALL. That is it, sir.

The CHAIRMAN. You think the other amendments will not weaken the administration bill?

Mr. COGGESHALL. I think providing the report—the report makes clear the intent.

The CHAIRMAN. Usually it is better to make it clear in the law.

Mr. COGGESHALL. Yes, sir.

The CHAIRMAN. This is your position pending any further consideration by the Board?

Mr. COGGESHALL. Yes.

The CHAIRMAN. The Board favored the appeal?

Mr. COGGESHALL. Yes, sir.

The CHAIRMAN. And you favor it?

Mr. COGGESHALL. We were brought to favoring it.

The CHAIRMAN. But since you heard Congressman Vinson, you are opposed to it?

Mr. COGGESHALL. Along with Chief Justice Murdock's letter. Mr. Slam and I dealt with the Chief Judge at Mr. Mills' request.

The CHAIRMAN. You understood Judge Murdock to favor the appeal provision?

Mr. COGGESHALL. All the provisions leading up to the appeal.

The CHAIRMAN. When you made your recommendation?

Mr. COGGESHALL. Yes. There are changed circumstances. I have on final page.

In closing, and in anticipation of a question from your committee, I should like to place before the committee the financial record of the Board's activities to the present time. From its organization under the 1951 act through March 31, 1959, the Board made determinations of excessive profits in the total amount of $817,400,492 before Federal tax credit. In addition, renegotiation proceedings with assigned contractors disclosed voluntary refunds and price reductions amounting to $1,016,751,395. Thus, the total amount of recoveries and disclosed price reductions directly attributable to the existence and influence of the renegotiation law, from the inception of the Board through March 31, 1959, aggregated $1,834,151,887. During the same period the administrative expenses of the Board totaled $28,949,905, or 1.58 percent of such savings. Both total have shown comparable increases to the present date.

The CHAIRMAN. Are there any questions?

Senator DOUGLAS. Mr. Chairman, I would like to ask Mr. Coggeshall this question. It relates to section 4(b), which, as the witness knows reads:

At or before the time such statement is furnished, the Board shall make available for inspection by the contractor or subcontractor, as the case may be, all

reports and other written matter furnished to the Board by a department relating to the renegotiation proceedings in which such determination was made.

Now, I can imagine what is the reason why Mr. Vinson and you object to this provision. But that would be surmise on my part. And I wondered if you were willing to give the reason for your objection for the record.

Mr. COGGESHALL. Well, it has a long history, Senator.

Until 2 years ago this question was never raised. We have a regulation that we inherited from the War Contracts Board in the war, at which time renegotiation, as Chairman Vinson said, was handled by—there was no Department of Defense—but by the War Department, the Navy Department, the Treasury, the War Shipping Administration. And we were part of the defense setup. And it was understood that these communications, under the Criminal Code, could not be disclosed in dealings with contractors. And there was never any question—I was connected with the wartime act, and in 1948 again, with the Defense Department, Military Renegotiation Policy and Review Board and when we became an independent agency, we always treated these reports as coming to us in confidence just as they had in the past, and they were written with the understanding that they were to be treated in confidence.

Some couple of years ago the hue and cry was raised about having these documents put before the contractor. We resisted—our regulations, we had the same regulation, we inherited the same one from the War Contracts Board—we disclosed documents only when we considered it in the public interest, and we considered it against the public interest to disclose such reports. Four or five attempts were made in the Tax Court to subpena such records—I think one of my predecessors faced such a subpena—and I faced three or four—and we resisted each time, and the Department of Justice and the Tax Court regularly ruled in our favor.

There was an upset this fall. The Boeing people—I can refer to this, it is all a matter of public record—the Boeing people got a subpena from the Tax Court without notifying the Department of Justice that they intended to seek such a subpena, it was granted forthwith, and the first I knew was when a couple of marshals showed up in my office with a subpena for me to deliver such and such records to the judge in the Tax Court out in Seattle.

By advice of counsel, and by consultation with the Department of Justice and the Attorney General, we resisted the subpena. The Tax Court, it turned out, had no power of contempt, and, therefore, the matter was taken by the Boeing people to the district court.

The district court granted summary judgment in my favor in December, and then by some legal ramification that my simple mind can't follow, Boeing maintained that when the Tax Court trial was resumed in January, because the Government used certain Air Force officials who hadn't written the reports and hadn't been concerned with them, used them as witnesses, that that gave them the right to have the subpenaed documents produced. In the meantime they had taken the case to the court of appeals. They then took it back from the court of appeals for a new order in the district court, on both the performance reports and all our internal documents.

And it ended up with a split decision ordering the chairman, myself, to deliver the departmental reports, but ruling against the company on the internal documents. That may go back to the court of appeals. We may appeal against the side we lost, and they may appeal against the side they lost.

They also served a subpena on the Secretary of the Air Force to deliver such documents, and he resisted. The Attorney General's office has a committee on executive privilege, and they advised me that I was quite within my rights in the public interest to assert executive privilege.

Senator DOUGLAS. That is a historical account of the incidents which have arisen. But I would like to get at the reasons for your position. Is it because you fear that the inspectors or accountants or subordinate officers or civilian employees of the department would be exposed to undue pressure from the big contractors if the nature of their communications were known?

Mr. COGGESHALL. I think Mr. Dechert gave expression to that partly, because when this was discussed in the House Ways and Means Committee, he said he would prefer the bill to say "hereafter," so they would know that the reports would be made public. But the Ways and Means Committee did not accept the word "hereafter."

Senator DOUGLAS. Is the answer to my query yes?

Mr. COGGESHALL. Yes. What you have said is part of it. I filed with the House a rather long statement on this subject, if I may take the liberty of reading from it, because it was carefully prepared.

Mr. FENSTERSTOCK. I might point out, Senator Douglas, that the statement which Mr. Coggeshall is about to read was directed toward a provision appearing in a bill then pending before the Ways and Means Committee, and the provision was broader than the provision that was eventually recommended to the House and passed by the House.

That provision now appears in the bill before this committee, and is limited to performance reports furnished to the Board by the procurement departments. The statement that Mr. Coggeshall was about to read was addressed to a broader provision, but essentially the arguments are there.

Mr. COGGESHALL. But at least industry has moved right back to this position. The minute you give an inch, they ask for a mile. Here is what I said, in part, to the Ways and Means Committee:

Page 63:

The amendment call for the production of "all data relating to the renegotiation proceeding." The major part of such data is the financial and other information furnished by the contractor itself and therefore not an issue under the proposed amendment. But the amendment would also make available to the contractor, and therefore subject to public disclosure, the following types of information and data:

(1) Data pertaining to competitors of the contractor: This information includes not only the financial data submitted by competitors of the contractor in connection with their own renegotiation proceedings, and the results of such proceedings, but also various details of technical processes which such competitors have developed, their methods of operating, their management techniques, and other highly confidential information. Renegotiation cannot function effectively without the cooperation of contractors in submitting this type of confidential information. If the Board were compelled to divulge it to others, contractors would refuse to submit it. A requirement of the type proposed would depart from the traditions of free competitive enterprise by making the

trade secrets and operating techniques of one contractor available to another and by revealing financial data which contractors desire to keep confidential. No law to compel contractors to supply such information in renegotiation would be an adequate substitute for the voluntary cooperation upon which renegotiation relies at present.

Senator DOUGLAS. Forgive me if I say this. Thus far your statement seems to be directed to the objection to having the details concerning contractor A disclosed to contractors B, C, D, and so forth.

Mr. COGGESHALL. Comparisons are made in reports, you see.

Senator DOUGLAS. But the question I was asking, is why do you object to contractor A knowing about the reports which have been submitted about contractor A?

Mr. COGGESHALL. That is the next point, Senator, I have covered that, too.

(2) Reports and analyses of Government employees: It is fundamental that subordinate employees should not be placed in the position of having to take the responsibility which by law is placed upon their superior, in this instance the Board itself. The proposed amendment is contrary to this basic concept. By making the reports of employees available to contractors, it would expose the employees themselves to the most rigorous kind of pressure and counteraction, even though their reports are significant only if and when they are adopted by the Board as its own.

Such a rule would tend to destroy the the decision-making process. It would become difficult, if not impossible, to elicit from employees, whether in the Renegotiation Board or some other department of the Government, the candid reports and analyses necessary to the formuation of decisions. It is the responsibility of the Board to arrive at the facts and then to make a decision and support its judgment with sound reasons. The destructive effect of shifting this responsibility in part to subordinates cannot be overestimated.

(3) Reports on subcontractors by prime contractors or higher-tier subcontractors: At present the Board obtains a limited amount of information from these sources. It is furnished on a purely voluntary basis but can be useful in a given case. Such sources of information would hardly continue to be available if the proposed amendment were adopted. It is safe to say that members of the business community would not be likely to subject themselves voluntarily to the possible ill will of those with whom they have business relationships by cooperating with the Renegotiation Board. And again, information from such sources actually is irrelevant unless the Board adopts it in shaping its decision.

Senator DOUGLAS. Do you have at present any reciprocal powers to require the production of private memorandums and so forth from within the companies?

Mr. COGGESHALL. No, sir. And I had a shock, and I am sure the Department of Defense must have had a shock, when in the Boeing trial, the full transcript of which was 3237 pages, with score upon score of exhibits, and stipulations developed at great length, the Department of Justice did move in the Tax Court and they did subpena records, and they found that in the case of one of the great contracts—I think it was the B-47, running over $500 million in total—that the original proposal by the contractor to the Air Force, with a great deal of experience back of it, on a CFFF basis, of estimated costs broken down by material subcontractors, engineering, overhead, and so forth, of something in the neighborhood, as I recall, of $540 million.

The Department of Justice discovered by subpena that there was a private estimate, what they called a project estimate, in the company's own records, of $450 million of costs. When they got through with the negotiations the final target costs were something like $500

million. The Air Force thought they did a very good job in getting the costs reduced by something like 10 percent. But there was a 10 percent differential between the company's internal estimate and what was agreed upon between them and the Air Force.

Senator DOUGLAS. I want to get the facts clear, because this is a very important statement that you have made. Are you saying that the Boeing company in its published statement of costs fixed the cost as $500 million, but it had a private statement of $450 million for the identical thing?

Mr. COGGESHALL. That was introduced over the violent opposition of Boeing into the trial. Of course, we knew nothing about that in renegotiation, and we would have no access to any such information. But it was produced in litigation. And it so happened, I would say, Boeing made a very beautiful estimate of just about what their costs would be, because it so happened they had an underrun on the $500 million of about 10 percent, and they came out with the actual costs of $450 million, and then by the provisions of the incentive bonus, over and above the 8 percent profit they got $10 million of the underrun.

Senator DOUGLAS. Does this make you dubious about the incentive profit?

Mr. COGGESHALL. We have been somewhat skeptical. We have learned from the Mahon committee and Mr. Vinson's committee how difficult it is to estimate at all accurately in advance on these things. I think a very hard effort is made, and I have noticed that with increased experience on the part of the Air Force and Navy with the passing of years, I think they come much closer in their negotiations than they did in 1951 and 1952 and 1953, when there were a mass of contracts let out in the course of the Korean war, and I think they have paid attention to what we have done in renegotiation. And we have always given the contractor the opportunity to explain the difference between his estimate on material, and where he came out, his estimate on subcontracting and where he came out, his estimate on labor and engineering, and we haven't had very valid explanations or convincing explanations.

Senator DOUGLAS. I want to ask you a further question. Suppose we do what Congressman Vinson recommends. Suppose we continue the act in its present form. Would the Defense Department still have the power to negotiate incentive profits in contracts?

Mr. COGGESHALL. That is where the bulk of the Air Force business has been; with the missiles they have moved to CPFF for a time, but they say they intend to go on with the incentive contracts.

Senator DOUGLAS. And you object to that recommendation?

Mr. COGGESHALL. Yes, to Congressman Vinson's recommendation.

Senator DOUGLAS. Then may I ask what is the need of changing the language on this point if it is already working satisfactorily?

Mr. COGGESHALL. I would see no need—on the other hand, I see no objection, because we have had it in our regulations. That is the approach that we take. I was thoroughly opposed to the proposed exemption of incentive contracts, the proposed exemption of incentive bonus, or the proposal that we take a certificate from the Secretary of the Navy or the Air Force or the Army at the end saying in his opinion there were no excessive profits.

I say, we couldn't be a rubber stamp in such case, to take the responsibility before the Congress on just somebody's word.

Senator DOUGLAS. Your position, then, is that this language dealing with incentive type contracts doesn't do any good and probably doesn't do any harm?

Mr. COGGESHALL. We would intend in our Board to administer it exactly the same way. But if industry felt that we were given a direction by Congress to treat it differently from how we have in the past, I would deplore it.

Senator DOUGLAS. You are depending on the reports for protection?

Mr. COGGESHALL. Yes.

Senator DOUGLAS. But reports do not have exclusive weight before courts, and though they may be taken into consideration in connection with the legislative history of the bill, they don't override the text of the bill itself.

Mr. FENSTERSTOCK. The idea in putting it into the statute, Senator Douglas, was that the contractor would in that way be assured that this matter would be taken into consideration without any power on the part of the Board by changing its present regulations to exclude it from consideration.

Senator DOUGLAS. You say you have no intention?

Mr. FENSTERSTOCK. We have no intention of doing it.

Mr. COGGESHALL. No intention.

Mr. FENSTERSTOCK. But to insure the permanence of that thought, the idea was proposed that it be put into the statute, and the Board went along with that idea, they had no objecion to it.

May I also round out one answer that Mr. Coggershall made to an earlier question that you put. You were asking about the power of the Board to obtain information from contractors. In section 105(e) of the act the Board is given power to require certain information from contractors. The section provides that every contractor must furnish in such form and detail as the Board shall by regulation prescribe a report or financial statement; that is the filing that every contractor must make with the Board. In addition, the section provides that the Board may require any contractor to furnish any information, records, or data which are determined by the Board to be necessary to carry out the title, and which the Board specifically requests such person to furnish.

I should say, too, there is a provision empowering the Board to audit the books and records of any contractor, using for the purpose the facilities of the Internal Revenue Service. That provision has never been availed of.

Mr. COGGESHALL. And the Internal Revenue Service asked us not to request audits—we make no audit, we rely on the contractor's figures, though we do get reports from the Comptroller General. The one thing the Comptroller General has been able to touch in his reports has been the subcontracting, that is the only thing that lends itself to audit. The rest is a matter of estimates. When they say that a subcontract costs $38 million and it turns out to be $33 million, that is disclosed in audit; other costs are a matter of judgment in weighing the probabilities. I don't think you could say that we find excessive profits in all these contracts, but in the airframe industry the ex-

cessive amount of profits on the whole has been found under incentive contracts.

Senator DOUGLAS. Do I understand, then, that you are unable by law to go behind statements submitted by the contractor?

Mr. COGGESHALL. Within any reasonable limitation. For instance, our forms have to be approved by the Bureau of the Budget; the forms filed are discussed with the Bureau of the Budget, we certainly wouldn't go beyond them. We wouldn't have any power to say, "Have you got a private estimate as to what your costs will be?"

We must rely upon the good faith of the contractor. And I am happy to say that in the years I have been connected with renegotiation we have found, generally speaking, that it is a very cooperative undertaking, it is not in our eyes an adversary proceeding. Only when and if we have to issue an order and the contractor decides to go to the Tax Court does it become an adversary proceeding at that level. We pay just as much regard to the right of the contractor to retain fair and reasonable profits as we do to recover excessive profits for the Government. And we have had wonderful support from industry in general.

In the first place, we have no audit, and to conduct an audit within a reasonable time—in any case that goes to the Tax Court the Federal Bureau of Investigation goes in, and they check all the figures, and it takes them anywhere from 6 months to a year to complete an audit, sometimes longer. The statements come from the contractor with the certificates of the certified public accountants, accountants of standing, and we presume that they are given to us in good faith.

Senator DOUGLAS. And yet this accumulation of reports by the Comptroller General which I read into the record——

Mr. COGGESHALL. Yes, sir.

Senator DOUGLAS. Has not shaken your confidence in the statements?

Mr. COGGESHALL. Well, it has certainly disturbed me, just as I assume it must have disturbed the Defense Department in the first instance. And I will say that where we have had a finding of excessive profits, we know that any profits which were gained improperly have been included in our finding of excessive profits for that particular year, even though we didn't know it was improper, just by applying what we call the statutory factors on reasonableness of profits.

Senator DOUGLAS. Let me ask you this question. On these cases upon which the Comptroller General reported, had you previously found that excessive profits existed?

Mr. COGGESHALL. Yes.

Senator DOUGLAS. In every case?

Mr. COGGESHALL. In almost every case, all the big cases. I sent a copy of our annual report to the Congress to the Comptroller General 2 years ago, and he very kindly called me up, he had read our annual report and he thought we might like to have copies of his reports. I must pay tribute to Comptroller General Campbell. From what we knew of the GAO in the past, in wartime, their reports involving renegotiation were 2 or 3 years behind the event, and they were mostly very minor nit picking.

Senator DOUGLAS. The ones from the Maritime Commission are certainly exempt from that statement.

Mr. COGGESHALL. The ones we saw from the Commission——

Senator DOUGLAS. And on the Detroit automobile and truck situation.

Mr. COGGESHALL. We didn't have those in renegotiation. Those reports were perfectly wonderful, Senator. And he supplies us with two copies, the minute he sends them to Congress they come to me, and I have them go right through our headquarters organization and send a copy to the field organization which is conducting the renegotiation with the cotractor. And I can say that in practically every instance to date, all the big ones, we found that there had already been findings of excessive profits.

Senator DOUGLAS. Did you make these determinations after the Comptroller General made his reports?

Mr. COGGESHALL. General, they were made before most of them were made before, others were still pending and have been taken into account in connection with renegotiation proceedings. Of course, if they have made reimbursement to the Government, to the Air Force, or to the Navy, we give recognition to that, that is a reduction of profit.

Senator DOUGLAS. This is the question that arises in one's mind. I am perfectly aware of the fact that the Comptroller General can study only a fraction of the cases of the contractor.

Mr. COGGESHALL. We know that.

Senator DOUGLAS. Now, if in these cases, which are a relatively small sample, he finds such tremendous abuses, what has happened in the large volume of cases that he does not have time, personnel, or money to investigate? Are you confident that you are able to catch them all?

Mr. COGGESHALL. No.

Mr. FENSTERSTOCK. We don't have the time or the money or the personnel either.

Mr. COGGESHALL. We operate with 300 people, 130 in Washington, and 170 in three regional boards.

Senator DOUGLAS. Have you any suggestions as to how this might be improved?

Mr. COGGESHALL. I would assume that the companies involved in this are certainly going to turn over a new leaf. But in the first instance, it is the Department of Defense, it is their baby in the first instance.

Secondly, I would assume that they would certainly—that there would be a house cleaning inside of the companies named.

Senator DOUGLAS. Do you see any evidence of that, of any internal house cleaning?

Mr. COGGESHALL. Well, I think most companies—I noticed one didn't, one seemed to want to quarrel with the Comptroller General, you probably read that report—but most of them said they were very sorry, the operation was so big and these things can happen, and, of course, they will make immediate restitution to the U.S. Government. One company, in particular, didn't.

Senator DOUGLAS. What about this next time? Is this a permanent reformation, or is it a plea in mitigation?

Mr. COGGESHALL. It is beyond my power, Senator, I admit it.

Senator DOUGLAS. I wish you would give us more help.

Mr. COGGESHALL. We are doing the very best we can. And what I am impressed with—and I hope you will notice these figures—is that in the figures of our determinations of excessive profits, we are seeing an increasing amount of voluntary refunds on the part of the contractors. The total is something over a billion dollars of voluntary refunds and price reductions made direct to the services outside of the terms of the contracts. They know about what our thinking is, about the line, generally speaking, we take in individual cases, they know. And they have decided, while the Renegotiation Act is on the books, to make voluntary refunds and price reductions outside of the terms of the contracts. I think it is the most salutary influence of renegotiation. I told the House Appropriations Committee this year, the subcommittee that deals with us, that I would be happy to come around some year and say that we made no determinations of excessive profits this year, but that I am really proud to point out that something like $400 or $500 million voluntary refunds and price reductions were made by the contractors that came before us in renegotiation. I think that would be ideal. It probably never will be achieved.

Senator DOUGLAS. Do you expect that?

Mr. COGGESHALL. No, I do not fully expect it. I am a follower of the William James philosophy of pragmatism.

The CHAIRMAN. Are there any further questions?

Thank you very much.

Mr. COGGESHALL. Thank you, Mr. Chairman.

The CHAIRMAN. For the record, we have a letter from the Chamber of Commerce of the United States.

(The letter referred to is as follows:)

CHAMBER OF COMMERCE OF THE UNITED STATES,
LEGISLATIVE DEPARTMENT,
Washington, D.C., June 2, 1959.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: The Chamber of Commerce of the United States opposes extension of the Renegotiation Act.

We take this position because:

1. Renegotiation is an arbitrary process and is neither necessary nor desirable in our free enterprise economy.

2. It places a premium on inefficiency and unsound procurement administration because the military services have adequate procurement techniques for controlling profits at all contracting levels.

3. It undermines the basic philosophy of our free, competitive enterprise system.

4. The proposed amendments offer no solution to the basic problems inherent in the renegotiation process.

A more detailed discussion of the reasons why the chamber takes this position appears on pages 304–310 of the House Ways and Means Committee hearings on H.R. 7086.

In the event your committee decides to extend the Renegotiation Act, instead of permitting it to expire on June 30, the chamber strongly recommends that:

1. You limit any extension of the law to not more than 12 months.

2. During such time, the Congress undertake the "broad review of the entire subject of renegotiation" which was scheduled, but never made, when Congress voted to extend the act until June 30, 1959.

I would appreciate your making this letter a part of the Senate Finance Committee hearings on H.R. 7086.

Cordially yours,

CLARENCE R. MILES.

The CHAIRMAN. The next witness is Mr. John K. Holbrook, New York, N.Y.

STATEMENT OF JOHN K. HOLBROOK, ATTORNEY, NEW YORK, N.Y.

Mr. HOLBROOK. My statement was strongly supported by two questions yesterday. Senator Butler inquired as to whether companies may not have small earnings for a period of years and then have a concentration of profit in a good year. Mr. Dechert fully agrees, but answered that it was too difficult to handle. I can't agree with the answer, but I readily agree that the loss carryforward provision does not seriously approach the problem.

In answer to a question from Senator Frear, Mr. Coggeshall stated that in the years that loss carryforward has been in the act it has been used twice, and there are 4,500 filings annually.

I do not mean to overlook Senator Douglas' questions; indeed, I can thank him for being held over until today and spending a pleasant evening in Washington.

I have one other preliminary to make to my formal statement, and that is that in the House committee's report in the minority views was this statement:

> As adequate consideration is given to the experience of a defense contractor in years prior to being renegotiated, and to the factor in prospect for subsequent years, with the result that the isolated experience in a single year fails to take into account development years of little or no profits.

That appears on page 27 of the House committee report.

I am general counsel to small companies in various fields of industry, with sales volumes of between $2 and $15 million annually.

I urge that in any extension of the Renegotiation Act, it be provided that a factcor to be considered is the extent to which there is concentrated in the year under renegotiation review, profits resulting from the development and improvement of a product during prior years of lesser profits.

I ask this committee to give recognition to the cyclical pattern of small company operations when induced by development and improvement work for Government end-use. By present carryover provisions of the Internal Revenue Code, Congress has recognized that for income tax purposes a company's business often operates in cycles. As recently as 1938 the law provided for no carryover of losses. Now, the combination of 5 years carryover and 3 years carryback provisions, is acknowledgement that a company's cycle may extend over a period of even 9 years. The tax laws give the inventor the apportunity to spread concentrated income. These small companies are like inventors dedicated to the benefit of the armed services and the treatment I ask would be akin to that available to an inventor under the tax laws who has worked a period of years developing his invention and then receives most of the avails in 1 year.

I am interested in reducing the inequities which result when a long program of design and development engineering culminates in a concentration of profits in a single year or so, after several years in which there were no profits worthy of renegotiation attention. Failures to make provisions in the Renegotiation Act for this recurring phenomenon has borne heavily on small companies, and the situ-

ation has not been remedied by the loss carryforward provisions of the extension bill passed by the House. If the small company has to operate in the "red" during a development period, it might never reach the concentration of profit stage. Companies in big business with a variety of products all merged in an overall renegotiation, may take care of their cycles in their own way, but not the small, one-major product company. Accordingly, I propose this relief primarily for the small company. It would bring it within very conservative limits if it is granted only with respect to a cycle in which there has been development and improvement in a product manufactured for Government end-use whose maximum profitable volume has been reached in the year under renegotiation. I propose that before any profits are labeled excessive, the Renegotiation Board be authorized to give consideration to the profit situation during the development years. If in applying the present standards of the act, the Board should find prima facie excessive profits, the Board should then test them for adjustment downward by applying a factor related to the product development and improvement years of the cycle.

For illustration, I can refer to the experience of one of the companies with which I have worked for 20 years. Allied Control Co. was organized in 1938 primarily to develop and engineer relays. A relay in an electronic switch which opens and shuts off current when activated magnetically or otherwise. Relays are small but highly essential items in the most critical devices and equipments of national defense. Guided missiles, early warning systems, and warcraft all contain hundreds of them. The importance of a relay may be indicated from a recent news report in connection with the near fatal 29,000-foot dive of a jet airliner. At a hearing before the CAB, an engineer testified that there was malfunctioning due to shock in a hermetically sealed relay which was part of the automatic pilot. This comment is indication of the importance of relays and also of why relays are subjected to what might be called total inspection and testing.

Jukeboxes have relays, but Allied's are not jukebox relays. They are quality relays that were and are used in the top priority war and defense devices, many covered by its patents.

Of Allied's relays, approximately 90 percent are manufactured for Government end use in defense. Since its organization Allied has specialized in the design and engineer of its own relays. Its business is definitely cyclical in its renegotiation aspects. Its first cycle covered the design years 1938–40 and continued through the war to 1945. Its profits came under renegotiation only in 1942. It had no previous profits of consequence and by 1943 and 1944 it had been extended to plants in New York, Connecticut, Chicago, and elsewhere, to produce the volume of relays required of it by the armed services, with the result that in the later war years, for a small company, it had really too much on its hands to operate very profitably. Allied's war cycle ended abruptly with a 100-percent contract cancellation in August 1945.

Allied's key engineers stayed faithfully with it through its reorganization in 1946 and 1947 and got its second cycle underway with new relay improvements which our armed services found essential in Korea. In that period Allied's designs were again in such demand

that to add to its own production it engineered its relays into a division of General Electric Co. as its subcontractor-producer. Allied's profits were such as to attract renegotiation attention only in the year 1951 of this cycle.

A third cycle started in 1952 in which emphasis was placed on miniaturization in relays—reduced space, reduced weight, and increased efficiency. Allied was a leader in this program. It designed and filed patent applications on its miniature relays by 1954. It was the first to receive Wright Field approval. Research, design, engineering modification, prototype manufacture, tooling, sample production, testing, orders, and finally, substantial production, marked its 1952–57 cycle of miniature relays. A production peak of the cycle covered the last part of 1956 and continued until the sharp cutback in Government procurement which accompanied the commencement of the recession in late 1957. Allied is now in the development stage of a subminiature cycle featuring also an advanced reliability program in which Allied has been selected for leadership.

Allied's cycles are illustrated by the relays I can exhibit to this committee. This is a sample of the first World War II relay [exhibiting small object] and in Korea the relay is smaller, and also covered. This is the miniature relay, showing the decrease in size and weight. And, finally, the subminiature relay may hardly be seen, it is three-eighths of an inch.

Each relay reflects a cycle which contains design and development years for the improved relay which attains a year or so of peak profitable volume. Of course, the relay designs of one cycle are also produced in the next but Allied might then be competing against Chinese copies of its own designs.

Let us now apply renegotiation plus carryover and income-spreading theories to these cycles. In the World War cycle of 1938–45, Allied made no renegotiable profit except in 1942. In the Korea cycle of 1946–52, it made no renegotiable profit except in 1951. That it would be inappropriate to find excessive profits under any reasonable carryover or income-spreading policy in either 1942 or 1951 may be seen from the fact that for the years from 1941 to 1957, which include all our World War II years and most of Korea, Allied paid the Federal Government more in aggregate taxes on income than its aggregate net profit for the period. In other words, its net result was a contribution of its capital.

The next year for which Allied has had a renegotiation assessment was 1956 when the sales and production of its miniature relay came to a peak. A profit allowance to a company for any regulated year may be translated into a percentage on its sales volume for the year. In respect to Allied's 1952–57 cycle, the average actual profits for the entire period were within the profit percentage allowed to Allied in connection with its 1956 renegotiation.

In this age of rapid technological advance and accelerated obsolescence, Allied's experience is similar to that of many small companies which design critical products for end use in defense. Certainly, the cycle of design, development, production, and then concentration of volume profit in a year or so, occurs in numerous instances.

Recognition of the cyclical phenomenon in renegotiation requires greater departure than has yet taken place from renegotiation of

the profits of one fiscal year without regard to the developments of other years. The Renegotiation Acts were originally adopted to meet an extraordinary situation, that is, profiteering in shooting wars. In such circumstances, the principal test had to be workability. If, however, renegotiation is to be a permanent part of cold war, it should be permitted to conform more closely to the business fact that no one year is wholly separable from another. Renegotiation should not be bound to the single fiscal year.

I am not suggesting any elaborate formula, or, in fact, any formula of any kind. The Renegotiation Board is a body of extensive experience and seasoned judgment. It will be sufficient, I am sure, if the act as extended provides that the Board is to give consideration to this cyclical phenomenon without applying concepts of normal or so-called historical earnings which are inapplicable in such situations. May I comment that when in a renegotiation I see the expression "historical earnings," I feel for the small company. I work with one in the chemical field that has not needed renegotiation treatment in recent years. Since 1954 it has (*a*) lost two of its top people, (*b*) lost its inventory uninsurable in the 1955 flood, (*c*) covered the initial losses in 1956 of a newly acquired plant, (*d*) shared in the 1957 recession, and (*e*) accepted in 1958 for goodwill the return from its largest customer of a staggering amount of goods which the customer could not convert to the Navy's requirements. Conceivably, its developments could now produce well earned profits which would appear excessive under an historical earnings approach.

In conclusion, I suggest that section 103(e) which states the factors to be considered in renegotiation, be amended to include as a further factor, any significant concentration in the fiscal year under review, of sales and profits resulting from development and improvement over prior years, of a product for ultimate Government use, and the extent to which as respects such profits, allowance may equitably be made by reason of the lesser sales and profits of such prior years.

Thank you, sir.

The CHAIRMAN. The committee will recess until 2:30.

(Whereupon, at 12:50 p.m., the committee recessed, to reconvene at 2:30 p.m., the same day.)

AFTERNOON SESSION

Senator COTTON. The committee will be in order.

Senator Byrd will be here shortly, and I think perhaps the Chairman of the Renegotiation Board had best wait until Senator Byrd returns, and it will only be a moment, anyway, but to save time we will have Mr. Kenneth Hughes, Electronic Representatives Association, give us his testimony. I can assure you there will be others here shortly.

STATEMENT OF KENNETH E. HUGHES, KENNETH E. HUGHES CO., INC., REPRESENTING ELECTRONIC REPRESENTATIVES ASSOCIATION

Mr. HUGHES. Thank you, sir.

Mr. Chairman and gentlemen of the committee, my name is Kenneth E. Hughes, and I am an independent manufacturer's represen-

tative in the electronics field. My appearance is on behalf of the Electronic Representatives Association, a trade association of independent technical sales representatives all across the country.

With me is the chairman of our legislative committee, Mr. Henry Lavin, an electronic representative from Meriden, Conn., and our executive secretary, Mr. William C. Weber, Jr., of Chicago.

The membership of ERA is over 600 member firms, with about 2,500 employees. Like myself, a great number of these owners and employees have engineering backgrounds, including an increasing number who are professional engineers, and/or who have engineering degrees ranging through a doctorate.

We would like to tell you what we do and how we do it. We are not "5 percenters."

Taken together, these independent sales agents represent over 1,000 electronic manufacturers, supplying components, equipment, and electronic hardware partially for our defense effort; and I might add, a typical example is the Allied Controls Co., who had a man here just before your recess.

Because of this fact, and the background and characteristics of our members, we are proud of the part we play as small business organizations in aiding our country's defense activities.

Why do we say "small business organizations"? Because our firms are the field sales and engineering force for two or more electronic manufacturers, working independently under a contractual relationship. As such, we perform functions similar to those performed by the technical field sales engineers directly employed by some companies, except that we underwrite the expenses involved, instead of our manufacturers whom we represent doing so. I say "similar functions" rather than "identical functions" because in many ways we serve the manufacturers we represent in greater capacity than ordinary salesmen employed by only one company.

In rendering technical and engineering assistance to our customers, for example, we often aid in the design of the product, and assist the customer—often a supplier to the Defense Department—in making application of various products to his various needs. Because we handle a number of complementary lines of products, and have extensive technical and engineering knowledge, we can, in some instances, suggest modifications on an already existing product, thereby saving the costs involved in designing a new one.

In our technical liaison between manufacturer and defense customer, we perform other such time-saving services as on-the-spot drafting—as no expense to either party—field testing of components conducted with our own test equipment, and immediate repair service performed by highly skilled technical personnel in our service departments.

Many of us maintain demonstration rooms, laboratories, and mobile display rooms, obviating the necessity for expensive trips to the factory by customers, or the equally costly process of shipping to the customer equipment which may provide not to be applicable to the particular need.

Our sample inventories enable our customers' engineering departments to expedite the design and testing of prototypes and first articles, a vital and timesaving service to the Government.

Where indicated, we also maintain warehouse quantities of given items so as to forestall delays in meeting production schedules. Technical bulletins on product application, specification data sheets, and our experience and engineering knowledge is immediately available to our Government and other customers.

On the other hand, we supply marketing counsel to the manufacturers we represent, keeping them abreast of defense industry requirements, both present and future. It is precisely because we handle more than one line of products that we often uncover important applications for products other than the particular one we are selling at a given time.

I, myself, have had repeated experiences in which I have helped design engineers to use an already existing component where they had been considering an entirely new design. This occurred because of being invited in to discuss an entirely different product and, in the course of conversation, learning of their other need.

These experiences, duplicated daily across the country, have meant a savings in time and money, both to the customer—the Government—and to our principals—the manufacturers. Because we are independent small business organizations, faced with some of the same technical management problems besetting our manufacturers, we are called upon to furnish management counsel to them, particularly in the areas of sales and engineering policies.

By performing these marketing and technical functions for our manufacturers, we reduce their overhead. More importantly, through our ability to perform these services on a "pooled" basis for several manufacturers, we are able to do this far less expensively than could each of these manufacturers if required to establish his own sales engineering department. This factor, of necessity, reduces the ultimate price of the commodity to the final customer—in many cases, the Government.

It is with this background, gentlemen, that we come before you to ask that we be accorded the same status under renegotiation as the sales engineer who is employed by only one factory on a direct basis. Such people, many of whom are also on some sort of a commission basis, are not included under the act, and their compensation is not subject to renegotiation; rather, their compensation is included as part of the manufacturer's cost.

The cost to a manufacturer of his sales representatives takes the place of compensation for directly employed salesmen, and should be included as a part of his normal cost. The primary reason for using our services instead of directly employed sales engineers is to do a better job at a lower cost to the Government or any other customer.

Other independent business firms, who have a contractual relationship with manufacturers, such as law firms, accounting firms, advertising agencies, management consultants, and so forth, are also exempted from possible renegotiation. Since we have similar contractual relationships with the manufacturers, we request, gentlemen, that we be accorded the same status as they under the renegotiation act.

We request most respectfully that an amendment be added to the renegotiation act specifically exempting bona fide manufacturers' representatives from its provisions. By "bona fide," we refer to the defi-

nition of the Defense Department—page 6 of "How To Sell to the Defense Department"—which reads:

Established commercial or selling agencies maintained by the contractor (manufacturer) for the purpose of securing business, even though paid on a commission basis.

This will simply accord us, as the contractual sales engineering offices for manufacturers selling directly or indirectly to the Government, equal treatment with the other selling, engineering, technical, and professional firms and persons used by these manufacturers, whether employed directly or used on a contract basis.

If, however, this committee feels that all independent business firms who have a contractual relationship with manufacturers, including, among others, law firms, accounting firms, advertising agencies, management consultants, sales representatives, and so forth, should be placed under the jurisdiction of the act, we respectfully request that an amendment be placed in the act to grant similar treatment to that accorded manufacturers years ago.

The act has been amended twice—once in 1953 and again in 1956—to raise the "floor" on a manufacturer's sales volume before he would become subject to the provisions of the act, from the original $250,000 to $1 million, its present form.

(At this point, Senator Byrd assumed the chair.)

Mr. HUGHES. We now ask that the $25,000 "floor" on commission paid to an independent contractor representative before he is subject to the act be raised in identical ratio to $100,000. The reasons for raising the manufacturers' limit are well known to the committee, and I will not take your time to repeat them. For many of these same reasons, and because we are an established and integral part of the manufacturing operation in numerous instances, we ask this amendment.

We also request that any commission amounts paid to bona fide manufacturers' representatives on sales to the Government which are paid at commission rates not in excess of those paid on nongovernmental business for similar items, be automatically excluded from the provisions of the act.

Such an exclusion should, of course, apply only when comparable quantities are involved.

Lastly, werespectfully request amendment of the act to provide that only those commission amounts paid on renegotiable business which are in excess of the "floor"—at which renegotiation can begin—be subject to possible renegotiation, and that the amount of commission up to the "floor" be exempted.

These amendments, we feel, will serve as a stimulus to many of our members who may seek commercial—or nongovernment—business in preference to Government business because of possible renegotiation. This is particularly true because many of our sales are to contractors, or subconstractors, and the representative has an extremely difficult time determining how much of the products sold will be used on items subject to renegotiation—so difficult that some of them prefer not to go to the time and expense involved.

During the testimony presented to the House Ways and Means Committee in April, part of the statement of the Renegotiation Board was:

Renegotiation has ceased to be a problem to the small business community.

This statement will be completely accurate only when the burden of renegotiation has been lifted from independent manufacturers' representatives. The Board followed its statement with an enumeration of the relief already granted to small manufacturers. Even more significantly, the Board also stated:

> A contractor's renegotiable sales up to $1 million are free from renegotiation on the theory that profits therefrom, however, unreasonable, cannot be large enough to warrant action by the Government.

Mr. Chairman, we respectfully submit that this same theory, applied to the even smaller dollar amounts received by manufacturers' representatives, gives further weight to our contention that bona fide representatives can be justifiably excluded from the provisions of renegotiation, even as other business firms operating on a contractual relationship with the manufacturer are already exempted.

At the very least, the words of the Board reassure us that the amendments we ask as an alternative to complete exemption are entirely within reason. It seems highly probable that the Board might well have proposed these charges had it specifically considered the problems of independent manufacturers' representatives.

Mr. Chairman, if I may depart from my prepared text for a moment, I would like to call the committee's attention to a spot check we have made among our members in New York, New England, Chicago, Indianapolis, Denver, Los Angeles, and the Pacific Northwest, to determine the number of renegotiation refunds since 1951. This spot-check uncovered one case of a refund in New England among our 45 member firms there, and this particular representative refunded a total of $10,000 in the years 1952, 1953, and 1954.

Two out of an 80-plus membership in the Los Angeles area have paid refunds. One of these refunded approximately $6,000 in 1951; the second approximately $5,100 in 1951, and $4,200 in 1952.

We could discover only one refund of a member in the Pacific Northwest, and this was for $2,500 in 1951.

The New York area turned up only one case of refund, and this amounted to approximately $5,000 over the 2-year period of 1952 and 1953.

In other words, Mr. Chairman, a total of nine refunds totaling not quite $27,000. The most recent of these occurred 5 years ago. I respectfully submit, Mr. Chairman, that it cost the Renegotiation Board much more than this $27,000 to recover this money.

At the same time, hundreds of independent small businessmen, manufacturers' representatives, each have had to spend $300 to $1,000 per year more to keep the necessary records.

I cannot believe, Mr. Chairman, that the Renegotiation Board itself would oppose granting relief to the bona fide manufacturers' representatives who are so heavily laden with this recordkeeping; and that if the Board felt it could not endorse complete exemption, it would not oppose an increase in the present floor of $25,000.

A proportional increase to $100,000 would afford relief to the great majority of those now burdened with the dual problems of extra records, and the too often failure of the manufacturers whom they represent to advise them which of these sales are subject to renegotiation.

The members of our association are categorically opposed to excess profits, particularly when they are incurred at the expense of the taxpayer. The action which we request is, as I see it, in complete accord with the philosophy of the Renegotiation Board—getting the most out of the tax dollar.

As a representative of our members who are responsible small business organizations, I ask this consideration, completely convinced that its net effect will be to assist, not hinder, our vital defense effort.

Thank you very much, Mr. Chairman and gentleman of this committee, for the opportunity to present these views.

If you have questions, I will make every effort to answer them.

The CHAIRMAN. Thank you.

Are there any questions?

(No response.)

The CHAIRMAN. Thank you, Mr. Hughes.

Mr. Coggeshall, do you care to make a statement?

STATMENT OF THOMAS COGGESHALL, CHAIRMAN, RENEGOTIATION BOARD—Resumed

Mr. COGGESHALL. Yes, Mr. Chairman.

Mr. Chairman, in my testimony this morning in response to a request from the chairman, I stated that I was withdrawing my approval of sections 4(b), 5, and 6 of the bill pending before this committee. I made this withdrawal on my own personal behalf, and not on behalf of the Renegotiation Board as a body, and I did so because of the developments that have occurred since the Board gave its approval of the entire bill to the chairman of the House Ways and Means Committee.

Those developments are found in the emergence of certain grave dangers and difficulties arising from:

1. The letter of the chief judge of the Tax Court to the chairman of this committee bearing upon the provisions of sections 5 and 6 of the bill.

2. The immediate demand of certain industry sources that the provisions of section 4(b) be expanded to require the Board to make available for inspection by subcontractors the reports on their performance submitted by prime contractors to the Board.

I limited my withdrawal this morning to myself, because I had not had an opportunity to consult with my colleagues on the Board on these new developments.

Since that time, during the noon recess, we have met and discussed these matters. I am pleased to advise the committee, Mr. Chairman, that my colleagues on the Renegotiation Board unanimously agree with the views I expressed this morning, and that, for the reasons stated above, the Board is formally opposed to sections 4(b), 5, and 6 of H.R. 7086.

Thank you.

The CHAIRMAN. That includes the appeal?

Mr. COGGESHALL. Yes, sir; and what Chairman Vinson referred to as search and seizure.

The CHAIRMAN. Thank you very much.

Mr. COGGESHALL. Thank you.

(The following was subsequently received for the record:)

THE RENEGOTIATION BOARD,
Washington, D.C., June 4, 1959.

HON. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: You will recall that at the committee hearing yesterday on H.R. 7086, having had an opportunity during the noon recess to consult with my colleagues on the Renegotiation Board, I made a brief statement in the afternoon session advising that the Board was unanimously opposed to sections 4(b), 5 and 6 of the bill. I pointed out that the Board had been compelled to take this position by certain new developments occurring since May 19, 1959, when the Board expressed to the chairman of the House Ways and Means Committee its approval of the entire bill, including the provisions referred to above.

My statement yesterday afternoon was necessarily brief. Since it represents a change from the position previously assumed by the Board, I believe that the committee and the record will be aided by a fuller explanation of the views of the Board on these controversial provisions of the bill.

SECTION 4(b)

Section 4(b) of H.R. 7086 requires the Board to permit the contractor to inspect performance reports and other written data furnished to the Board by the procurement departments. Since the time when the Board gave its approval to this provision in the House, complaints have been voiced in various quarters that it is discriminatory. It offers the prime contractor an inspection of the Department's comments on his performance without providing a similar opportunity to the subcontractor to inspect the prime contractor's comments on his performance. This latter privilege was considered by the Ways and Means Committee, but was rejected. Obviously, the disclosure of comments by one private person about another private person is affected by different considerations from those affecting the disclosure of Government reports. Cries of discrimination, nevertheless, have quickly arisen, as have other suggestions and attempts to enlarge the scope of the inspection privilege.

By these instantaneous reactions the Board has been made acutely aware that the inspection provision of section 4(b), however well intentioned, is destined almost inevitably to produce more controversy than benefit, more harm than good. The Board has therefore reconsidered its position on this issue and has reverted to its original view that performance reports should not be divulged. The Board will continue, of course, even if section 4(b) is not enacted, to pursue its traditional practice of making the substance of such reports known to both prime contractors and subcontractors, both orally and in its statements of facts and reasons, and of soliciting in such manner any rebuttals or explanations that may be appropriate in the circumstances.

SECTIONS 5 AND 6

In opposing sections 5 and 6 of the bill, which relate to the conduct of proceedings in the Tax Court and to appeals from the decisions of that court, the Board acted entirely upon the basis of the letter dated June 1, 1959, from the chief judge of the Tax Court to you. That letter indicated that, in the opinion of the judges of the Tax Court, the provisions of sections 5 and 6 of the bill were likely to increase the litigation load of renegotiation cases in the Tax Court to the point where the court could not continue to hear such cases in addition to its primary duty of deciding tax cases. The chief judge therefore presented to the Congress the alternative of striking sections 5 and 6 from the bill or of relieving the Tax Court from its jurisdiction over renegotiaton cases and providing for direct appeals from the determinations of the Renegotiation Board to the court of appeals. The latter alternative would necessitate subjecting the Board to the requirements of the Administrative Procedure Act and thus converting the informal renegotiation procedures into formal, trial-type adversary proceedings. This, as the Board and others have pointed out, would bog renegotiation down and render it untenable.

If, as a result of these representations from the Tax Court, the Congress is in fact confronted with the alternative of formalizing renegotiation at the Board

level or of retaining present Tax Court procedures and eliminating the appeal provision, let there be no doubt where the Renegotiation Board stands. In such circumstances the Board most assuredly would recommend against the new procedures proposed in the bill for the mere handful of litigating contractors, in favor of retaining the flexibility and effectiveness of the existing renegotiation system as it applies at the Board level to all contractors. That is what I meant, speaking for myself yesterday morning and for the Board in the afternoon, when I expressed opposition to sections 5 and 6 of the bill and based that opposition upon the position newly asserted by the chief judge of the Tax Court.

Notwithstanding that opposition, it would still be the hope of the Board that the Tax Court, if unable to endorse the appeal provision of section 6, could see its way clear to accommodating itself at least to the provision of section 5(b) for a three-judge review of any decision in a renegotiation case. In our opinion, this would go a long way toward providing the additional judicial scrutiny obtainable on appeal to a higher court.

I trust, Mr. Chairman, that these views will be of assistance to your committee.

Sincerely yours,

THOMAS COGGESHALL, *Chairman.*

The CHAIRMAN. The next witness is Mr. Charles W. Stewart, Machinery & Allied Products Institute.

Proceed, Mr. Stewart.

STATEMENT OF CHARLES W. STEWART, PRESIDENT, MACHINERY & ALLIED PRODUCTS INSTITUTE

Mr. STEWART. My name is Charles W. Stewart. I am president of the Machinery & Allied Products Institute, which is a national organization representing capital goods and allied equipment manufacturers. We appreciate the opportunity to appear on this important subject.

I should like first to ask if the statement presented to the committee in advance of my oral remarks might be incorporated in the record in its full text.

The CHAIRMAN. So ordered.

Mr. STEWART. Prior to the testimony which was presented to the committee yesterday and today, I had planned to proceed with my written statement and interpolate a little bit as I went along. I find myself now, if it please the committee, in the position of being more concerned about some broader questions which are implicit in the testimony adduced and in the questions posed, particularly by Senator Douglas. I am constrained, therefore, to move away a little bit from the prepared statement and say a few things on a more or less extemporaneous basis. Please bear in mind that our basic position is that renegotiation should not be extended in any form, as detailed in our statement to the Way and Means Committee.

I am concerned, Mr. Chairman, about the fact that we have dealt into this subject some very broad and serious problems, including general procurement policy, the question of advertised bids, the question of the relative negotiating strengths of contractors and Government representatives, and so forth—questions which we in MAPI have felt, for some time, have a definite bearing on the subject of renegotiation, but which can hardly be given full treatment in the short space of time available to witnesses and, I am sure, to this committee.

I am constrained to observe further that there are some connotations or implications which run from some of the questions and some of the testimony which concern me equally seriously.

I think, therefore, I might make my most effective contribution and perhaps be of most assistance to the committee if I spotlight these concerns.

It is generally true that renegotiation is a part of the procurement process. It should not be examined in a vacuum. It cannot be effectively examined in a vacuum. The questions which have been raised with respect to these collateral issues evidence this conclusion.

It is high time, if I may respectfully underline this suggestion, that the Congress and the Government agencies together undertake the kind of thorough overall study on the subject of procurement policy, its efficiency, the extent to which it is in the national interest, that was contemplated by the Ways and Means Committee when it enacted its 6-months extension last year. This study was never completed or really ever undertaken.

I recognize that this committee and the Ways and Means Committee, asked your very able staff director, Mr. Stam, to hold certain preliminary discussions and that some informal discussions took place. But the whole range of questions which are involved in this subject have not been subjected to the very serious, concentrated, and objective study which, in my judgment—and I gathered in the judgment of the Congress when it enacted the last extension of this legislation—is absolutely prerequisite to intelligent legislation on the subject.

The testimony and the questioning which have taken place during the last 2 days, the failure to answer certain questions to the satisfaction of the committee, the connotations which run from some of the comments which have been made with respect to conduct by industry, and to some extent by Government, merely serve to underline the seriousness of my concern about this subject.

I am particularly concerned about it at a time when this committee has before it a bill which purports to extend renegotiation authority for a 4-year period. I ask that the committee think seriously as to whether it is in the full sense responsible for the Congress, through the last extension act, to direct in effect a study which has never taken place, or at least has only begun, and then, in the face of that failure to complete the kind of inquiry which was contemplated, to legislate a 4-year extension.

This is not to argue the case one way or the other. I think there is a good deal to be said at times on both sides of difficult procurecurement questions. But I do not believe that the Congress is in a position to proceed to enact a 4-year extension in this very important field at the present time. The reasons, beyond the generalizations I have offered here, are outlined in some detail in my prepared statement. I shall not burden the committee with a repetition of them in oral testimony.

It is particularly important to recognize that in the Senate there has been appointed a special Armed Services Subcommittee to examine into certain proposed legislation on advertised bids and negotiated procurement, and a number of other amendments to the Armed Services Procurement Act. In the House there will be an overall

study of Federal taxation as announced by Chairman Mills. I do not see how you can deal with any of those subjects without having before you the issues that are involved in renegotiation.

A 4-year extension at this time would fully foreclose from consideration by those committees the issues of renegotiation.

So, gentlemen, that, in terms of the substance of this bill, is the most important issue before you. I hope you will think seriously about the implications of a 4-year extension under these circumstances.

Now a few details about the bill itself, assuming you enact a further extension.

There has been a good deal of discussion on the matter of carryover, the extent to which the Renegotiation Board ought to look beyond 1 year in determining the position of a contractor so far as profits are concerned. I think the questions have failed to bring about a real meeting of the minds on the issues involved.

Under the proposed bill, there is a 5-year carryforward (sec. 3), which is not opposed by the Renegotiation Board Chairman. (I am frank to confess I have a little difficulty following where the Renegotiation Board stands at any particular time on various provisions in this bill.) At any rate, as I understand it, as of today the 5-year carryforward is not subject to Board objection.

It has been pointed out today by a prior witness, Mr. Holbrook, that one of the problems, particularly for the smaller company, is that renegotiation looks at 1 year, at least theoretically it does, and that contracts run over a period of time and there may be artificial peaking of profits in a single year.

Frequently during the early years of the contract or during the latter years, whichever way the ball may bounce, the return of the contractor is not what it might be in other years. With that in mind, I am sure, the Ways and Means Committee offered a 5-year carryforward and pointed to the parallel between the carryforward in the code for general tax purposes, and this carryforward under renegotiation.

I think the committee should give serious consideration to following the code one step further and adopting a 3-year carryback.

I have never been impressed, frankly, with the technical objections which have been raised to a carryback under renegotiation. They are not insuperable, and if we worked hard at them from a technical standpoint mechanical problems could be solved.

In connection with section 4, which is now under objection by the Renegotiation Board, I had in mind proposing that the effective date not turn on the question of when the determination had been made, but whether or not the case was closed.

The right which section 4 would convey is just as important to a company which may contemplate an appeal from a Board determination already made as it is to a company situation where there has not yet been a determination.

In connection with section 5, I think there has been a good deal of misunderstanding. I am disappointed and shocked to find the Board withdrawing its support from the provisions of section 5 after apparently concurring in them during Ways and Means hearings and executive sessions.

I do not believe that Senator Douglas and others who questioned the relative positions of Government and industry in this field are fully aware of the lack of due process in a legal sense which obtains both in proceedings of the Board, in judicial proceedings before the Tax Court, and in the absence of an adequate appeal above.

As I stated to the House Ways and Means Committee and as my testimony develops in detail in the House record, without burdening you with a detailed repetition of it, under present rules, as a contractor, you are in the position of dealing with a case at the Board level where you do not know the actual grounds and documents which underlie the determination as made.

Under present rules, you then go to the Tax Court and, under such cases as the Vaughn case which is cited and discussed in my House testimony, you carry a burden of offsetting a presumption of correctness in the Board's decision, which decision you cannot take apart because you do not have the documents and the facts to deal with it.

How anyone as interested in due process as I know the distinguished Senator from Illinois and others of you on the committee are, could countenance this kind of a position for the contractor, I cannot fathom. I must say, however, that I have not had the opportunity to read Judge Murdock's objections, which may go to technical questions.

I would like, however, an opportunity to study them and, if the institute has a contribution to make, we will file a supplemental letter.

(The following was subsequently received for the record:)

MACHINERY & ALLIED PRODUCTS INSTITUTE,
Washington D.C., June 10, 1959.

Hon HARRY F. BYRD,
Chairman Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: As you will recall, I testified on behalf of the Machinery & Allied Products Institute and its affiliate, the Council for Technological Advancement, during recent public hearings before the Finance Committee on H.R. 7086 to extend the Renegotiation Act. In the course of oral testimony on that occasion, I registered my surprise at the opposition to certain provisions of the bill voiced by Chief Judge Murdock of the U.S. Tax Court in a letter to the committee dated June 1, 1959.

Since the time of the Finance Committee hearings on the renegotiation extender bill we have had an opportunity to review Judge Murdock's letter in detail and we should like to comment on the Tax Court's criticism of H.R. 7086 before the Finance Committee begins its executive sessions on the proposal.

We recognize that Judge Murdock's letter is addressed for the most part to the provisions of section 5 of H.R. 7086 and our comments which follow are directed primarily to his criticism of that section; however, we submit that section 5 cannot be considered alone and without reference to other sections of the bill which bear equally upon the all-important question of due process. We are constrained to observe that the resistance encountered to procedural reform of the act both from the Renegotiation Board and from the Tax Court tends to confirm our long-held view that the renegotiation process is of such a character as virtually to defy procedural due process in the customary sense of the term—in short we continue to believe that the act should be permitted to expire forthwith. In view, however, of the proposal to make of renegotiation a quasi-permanent administrative process and particularly in view of Judge Murdock's comments with reference to procedural improvements contained in H.R. 7086 we are taking advantage of this opportunity to comment briefly on Judge Murdock's letter of criticism. We very much appreciate the committee's courtesy in receiving this additional statement.

BACKGROUND

A brief statement of the background of those provisions of H.R. 7086 to which Chief Judge Murdock has objected may be useful in setting this question in a somewhat broader perspective. The present act provides that appeals from Renegotiation Board determinaitons to the Tax Court are not to be considered as appellate reviews, but rather as proceedings de novo. Despite this statutory provision the experience of numerous contractors tends to the conclusion that such appeals have in fact if not in law amounted to judicial review of the Board's determinations. Moreover, the Tax Court's conception of its own jurisdiction has borne this out.[1]

The Ways and Means Committee of the House of Representatives has given recognition to these complaints by proposing a revision of the act's appeal provisions to include a restatement of the de novo character of Tax Court proceedings and, further, a declaration that no presumption of correctness shall attach to the determination of the Renegotiation Board. Beyond that, the Ways and Means Committee has proposed in H.R. 7086 that Tax Court determinations under the Renegotiation Act shall be reviewed by a special division of the Tax Court consisting of no less than three judges, subject to a further appeal to the U.S. Court of Appeals for the District of Columbia.

THE PROCEDURAL DEFECTS OF THE RENEGOTIATION ACT

The amendments proposed to the appeals provisions of the Renegotiation Act by the House Ways and Means Committee were obviously intended to strengthen procedural safeguards afforded contractors by the Tax Court—an objective which achieves special importance in view of the almost unlimited discretionary powers confided in the Board by the act itself.

Nowhere have we found a better brief statement of the act's shortcomings from a due process viewpoint than that contained in the statement of Mr. Karl H. Spriggs, chairman, public contracts committee, administrative law section, American Bar Association, received by the House Ways and Means Committee during its recent public hearings on the extension of the Renegotiation Act (and reproduced at pp. 381–384 of the printed hearings). In brief, Mr. Spriggs' statement lists the due process defects of the renegotiation process both before the Renegotiation Board and the Tax Court:

1. The Board is required to make determinations which are not based upon any measurable objective standards. This objection to the legislation is emphasized by the fact that the Board publishes no decisions, rulings, or other precedents for guidance other than very infrequent staff bulletins on particular subjects.

2. The Board bases its determination, in part, upon procurement information secured from Department of Defense officials and from other sources. This evidence is not made available to the contractor and, since the affected party is not given an opportunity to examine and refute such evidence, the resultant orders are arguably invalid on the ground that they involve a denial of procedural due process.

3. The Board uses title 18, United States Code, section 1905 (prohibition against disclosure of confidential information) as a reason for almost complete nondisclosure despite the fact that section 111 of the Renegotiation Act provides that section 3 of the Administrative Procedure Act (publication of information, rules, opinions, orders, and public records) shall apply to "* * * the functions exercised under this title * * *."

4. Administrative, procedural, and other defects of the renegotiation process are not cured by a trial de novo in the Tax Court since (1) the burden of proof is on the contractor in all renegotiation cases and (2) the Tax Court generally refuses to substitute its own judgment for that of the Board (the expertise of the Board). In addition, and assuming a full and fair hearing in the Tax Court, it can be argued that due process is denied by a deferral of such hearing until after the end of a long journey through the numerous stages of renegotiation, at none of which is the evidence against the contractor available to him.

A basic deficiency in the present procedure seems to be the lack of a written record to support, and of a detailed statement of the facts and law underlying, a Renegotiation Board determination.

[1] See cases cited in footnote 6, p. 383, hearings before the Committee on Ways and Means, House of Representatives, Apr. 27–29, 1959.

It seems to us to have been the clear intent of the House Ways and Means Committee to undertake at least a first step toward correction of the procedural inadequacies that Mr. Spriggs' letter has so well identified. Curiously, Judge Murdock's letter of criticism seems to avoid completely the procedural defects of the act and concentrates instead upon the sharply increased burden of work which he foresees for the Tax Court in the event that the amendments proposed are adopted.

JUDGE MURDOCK'S LETTER

In his letter of June 1, Chief Judge Murdock of the U.S. Tax Court has raised three objections to section 5 of H.R. 7086 and in addition has advanced a recommendation in the alternative with reference to the same section of the bill. In brief, Judge Murdock argues that adoption of section 5 of H.R. 7086 would have these results:

1. Contractors would be encouraged to bring additional renegotiation cases to the Tax Court, thus increasing further the heavy workload of that court;
2. These proposed amendments would accomplish nothing so far as the procedure of the Tax Court is concerned; and
3. The provisions of section 5(b) of the bill—providing for a compulsory review of a single Tax Court judge's determination by a special division of not less than three Tax Court judges—would constitute an additional burden for the Tax Court with no discernible corresponding benefits.

In addition to these specific objections Judge Murdock recommends that the procedural amendments proposed by section 5 of H.R. 7086 be rejected or, alternatively, that the Tax Court be relieved of jurisdiction in renegotiation cases, suggesting that this latter alternative might be accomplished by providing for direct appeal from the Renegotiation Board to U.S. courts of appeal as is now provided with respect to the final determination of many Federal administrative agencies.

INSTITUTE COMMENTS ON JUDGE MURDOCK'S LETTER

Our general comments on Judge Murdock's letter which follow are keyed to his specific objections and his single recommendation outlined above.

Overloading of the Tax Court docket.—Judge Murdock's case for rejection of proposed amendments appearing in section 5 of H.R. 7086 would appear to be grounded primarily on his conviction that the already overloaded docket of the Tax Court would be further extended by reason of a new wave of appeals from determinations of the Renegotiation Board. Having no direct knowledge of the facts in the case, we must of course accept Judge Murdock's proposition as a fair statement of the situation.

We are altogether sympathetic with Judge Murdock's concern at the possibility that the docket of an already overburdened court may be further extended. We do not believe, however, that this possibility should be argued in justification of rejecting the amendments here proposed which are obviously designed to solve problems in an area of the law where serious doubts have been raised as to the protection of litigants' rights.

We are disappointed that Judge Murdock at no point in his letter of June 1 has commented on the adequacy or inadequacy of procedural safeguards contained in the present act. However, the fact that he anticipates an increase in appeals to the Tax Court if the amendments as proposed are adopted, strongly implies a recognition by the Tax Court of widespread contractor dissatisfaction with Tax Court renegotiation proceedings. If Tax Court proceedings as authorized by the present act were wholly satisfactory for the protection of the contractor's rights, then we could see no possible reason for expecting an unusual increase in future appeals to the Tax Court.

Unsatisfactory character of present Tax Court procedure in recent renegotiation cases.—Judge Murdock asserts that procedural amendments proposed in the renegotiation extender bill would accomplish nothing so far as the procedure of the Tax Court is concerned.

The testimony of numerous witnesses during recent House Ways and Means Committee hearings on this subject would seem to make it unmistakably clear that there is widespread dissatisfaction with Tax Court handling of renegotiation cases. Most of this dissatisfaction appears based on the fact that, although present law requires a de novo proceeding by the Tax Court in renegotiation cases, a long line of Tax Court decisions in this field has tended increasingly to thrust upon appellant contractors the burden of proving the Renegotiation

Board's excessive-profits determinations to be erroneous. This line of decisions is highlighted by the recent Vaughn Machinery case, 30 T.C. 100, in which the court declared that it must be affirmatively proved by petitioner that the Board has failed to give proper consideration and weight in reaching its determination to all evidence favoring the petitioner, including (the factors listed in section 103(e) of the act).

In arriving at his conclusion that section 5 of H.R. 7086 would accomplish nothing so far as present Tax Court procedure is concerned we are constrained to enter the respectful suggestion that in writing the letter Judge Murdock had not yet fully considered the effects of the amendatory language proposed. Under the language of section 5(a) of the bill now before the committee the contractor in Tax Court proceedings would have the burden of going forward with the case; i.e., with the burden of presentation of evidence to indicate that his profits for the year under consideration were not in fact excessive. However, "*no presumption of correctness shall attach to the determination of the Board.*" [Italic supplied.]

It would appear from these two sentences—when read in conjunction one with the other—that the contractor's burden would be limited to the introduction of evidence to prove his case that profits were not "excessive" but that his burden of proof would not include a requirement that he rebut the specific basis of the Board's "excessive profits" determination since that determination would not be in issue in de novo Tax Court proceedings. It is the Tax Court's requirement that the contractor assume this letter additional burden which evoked so much criticism in Ways and Means Committee hearings. Obviously, there is no way in which the contractor can refute the Board's determination in a proceeding before the Tax Court because there is no way in which the record of the Board's proceedings can be placed before the court.

Further, it would appear that the language of section 5(a) as now drafted is intended to insure the de novo character of Tax Court proceedings by forcing the court to make its own independent evaluation of the section 103(e) factors bearing on "excessive" profits.

Review by a special division of the Tax Court.—Judge Murdock objects further to section 5(b) of H.R. 7086 which provides for review of a single Tax Court judge's renegotiation determination by a special division of three Tax Court judges. His objection to this provision of the bill rests on the proposition that it would impose an additional burden on the Tax Court without any corresponding benefit. He goes on to observe that this special division review would be substituted for the present review by the chief judge of every case decided by an individual judge.

Under present procedure, if the chief judge decides it would be appropriate he may refer the opinion written by an individual member of the court to review by the full 16-judge membership of the Tax Court. While the provision for full court review at the option of the chief judge may be appropriate in tax cases, there are equally good reasons why a compulsory special division review would be helpful in renegotiation cases inasmuch as they represesnt a class of cases requiring special expertise. The Tax Court's determination of excessive profits must depend upon its evaluation of the necesarily vague and indefinite factors described by section 103 of the act and for that reason the combined decision of three judges as contrasted to that of a single judge would be most useful.

Judge Murdock's recommendations.—In concluding his letter of June 1 Judge Murdock recommends that section 5 of H.R. 7086 be rejected, or, alternatively that the Tax Court be relieved of its jurisdiction over renegotiation cases. He advances the suggestion that this latter alternative might well be accomplished by allowing direct appeal from the Renegotiation Board to U.S. courts of appeal.

As we have observed previously, we think it unfortunate that Chief Judge Murdock has not seen fit to comment on whether or not there is adequate protection of the rights of the contractor at the Tax Court level. Moreover, there is no comment by the Tax Court with respect to the important question of whether or not the contractor has an opportunity to develop an adequate written record before the Tax Court for purposes of the limited appeal afforded to U.S. courts of appeal under the presesnt law, or with respect to whether the contractor has an adequate opportunity to rebut adverses attempts and to cross-examine hostile witnesses.

If the Tax Court is in fact too busy to provide a de novo proceeding in renegotiation cases, which is adequate from a due process standpoint, then it may be appropriate for Congress to consider provision for such de novo proceedings in the Court of Claims or in the U.S. district courts.

Judge Murdock's suggestion for allowing direct appeals from the Renegotiation Board to the U.S. courts of appeals seems to us a particularly unfortunate one for the obvious reason that, under the present act, there is no record developed at the Renegotiation Board level which would be adequate in any sense for the purpose of an appellate judicial review.

GENERAL CONCLUSIONS

We have attempted thus far to confine our comments to a review of Judge Murdock's criticisms of section 5 of H.R. 7086 relating to renegotiation proceedings before the Tax Court of the United States. In our judgment, however, any consideration of the substance of Judge Murdock's letter cannot—and should not—be separated from a review of section 4 of the bill which relates to proceedings before the Renegotiation Board itself. Within this broader context, then, we have set out below a series of conclusions as to the situation in which the contractor finds himself under the present law. These conclusions are, in our judgment, altogether germane to the matters here under discussion, particularly in view of the unprecedented 4-year extension of renegotiation voted by the House:

1. Under present Board procedures the contractor has no information relating to the Board's determination other than the wholly inadequate statement of facts and reasons. Moreover, he has no access to much of the evidence upon which the Board's determination was based.

In brief, there is an almost total absence of due process at the Renegotiation Board level. This cannot be waved aside by arguing the illusory proposition that renegotiation is a nonadversary proceeding in which the Government and contractor reach a mutual agreement as a result of a conference. This simply is not the fact. Nor can it be waved aside by arguing that to offer the contractor minimum due process in terms of making available to him reports of procurement agencies is to afford him search and seizure privileges, which is the strained and wholly improper charge placed on section 4 of the bill by Congressman Vinson and echoed by Chairman Coggeshall.

2. The contractor before the Tax Court under present law is placed in the position of sustaining a burden of proof involving a requirement to rebut a presumption of correctness in the Board's determination, which burden of proof it is absolutely impossible to sustain because of the inadequacy of the record in the Renegotiation Board proceeding.

3. Under present law there is no provision for appeal to the regular judicial system of the United States except on very narrow grounds.

In sum, therefore, we have a total lack of due process at the Renegotiation Board level; we have a proceeding in the Tax Court which offers the contractor no real opportunity whatsoever to prevail; and, finally, we have no general appeal privilege to the regular judicial system of the United States.

In the face of this recitation of facts, as to which there can be no question upon close study, we are obliged to reach this conclusion: If a Government process or procedure, such as renegotiation, is such that the simple elements of due process cannot be made a part of that procedure then in the name of equity and sound administrative and legislative considerations that process must fall as a whole. If, in the alternative, some semblance of due process under the procedure can be developed it not only is desirable, it is the duty and obligation of the executive branch and the Congress to formulate and to legislate minimum due process guarantees.

Finally, we should reemphasize our sympathetic consideration for the special problems which Chief Judge Murdock envisions. Onerous as the burden may become, however, we cannot believe that Judge Murdock would argue seriously that due process should be sacrificed to juridical convenience. We believe that a real problem of due process exists with respect to renegotiation proceedings before the Tax Court—that H.R. 7086 seeks to ameliorate that problem—and that adoption of either of Judge Murdock's alternative suggestions would contribute nothing to its solution. Accordingly—and subject to the suggestion that Congress may wish to provide for transferring jurisdiction over renegotiation from the Tax Court to the Court of Claims or the U.S. district courts—we urge that his recommendations be rejected.

This concludes our comments on Judge Murdock's letter of June 1. We appreciate your courtesy in receiving this additional expression of institute

views. If we can be of any further service to the committee, we should be pleased to assist in any way possible.

Respectfully,

CHARLES W. STEWART, *President.*

Mr. STEWART. The final detailed point is on section 6, where Senator Kerr questioned the jurisdiction, the exclusive jurisdiction given to the court in the District of Columbia. We think the point he was making has validity. A further examination of section 6 may be desirable so as to widen appellate jurisdiction to the various circuit courts throughout the United States.

Gentlemen, may I now turn for a few minutes to the broader question which is raised by the evidence in the record presented by Senator Douglas, by some of the responses which the General Counsel of the Department of Defense made to questions, including his response that one of the DOD problems is that industry "withholds information," and deal with those points in order to set the record straight on what I consider to be a rather serious matter.

In his testimony, the distinguished chairman of the House Armed Services Committee, Mr. Vinson, made this statement:

> But in practice the superior information of the contractor's negotiator always seems to outwit the Government.

I want to give you a few examples of how that process takes place.

In the U.S. District Court for the Western District of Missouri, western division, there was recently handed down an opinion in the case of *United States of America* v. *A. C. Reinking* dated September 10, 1958. The last order of the court was a stipulation dismissing the Government's appeal, the Government having lost its case. It is a complicated set of facts, but I want to read one paragraph from the conclusion of the court in its opinion:

> The manner in which the Air Force contracting officers attempted to gain advantage of the defendant [the contractor] is grossly inequitable and bespeaks of fraud which cannot be countenanced.

I do not offer this as a typical case, but I do offer it in an effort to get some balance into the record with reference to the relative positions of industry and Government in these matters.

A good deal has been said about the Comptroller General. I happened to come across this morning an opinion (B–138405) of the Comptroller General dated April 8, 1959, in which he reversed action by a military service on the grounds that the contracting officer had deluded the contractor into accepting an award on the theory that the contract would be amended at a later date as to price and, after making this commitment, refused to amend the contract. The Comptroller General held with the contractor.

I have a case before me in the Armed Services Board of Contract Appeals which the General Counsel of the Air Force, I am sure, will remember very well, the Gar Wood Industries case, in which the Armed Services Board of Contract Appeals held that approximately $750,000 in costs were improperly disallowed by the U.S. Government in this contracting situation, and that they should be allowed and the contractor should be reimbursed in that amount. (See ASBCA Nos. 2329, 2328, 2327, and 2330.)

I will give you further information on how strong the position of the contractor is.

After this ASBCA decision, the U.S. Revenue Service has been contending that, despite the fact that the Government, through one of its instrumentalities had originally disallowed the costs and claimed that they were not payable by the Government, the contractor should nevertheless have treated these finally reimbursed costs as income on a retroactive basis.

The contractor is now being asked to pay taxes on a retroactive basis, plus interest for the interim period.

I could go on with this, Mr. Chairman, reading from various Armed Services Board of Contract Appeals cases. I have in my briefcase a CCH Reporter on them. I do not think it is in the interests of the committee or time to do so, except that I want to make one point very clear. That is that the impression which this committee may have received or the public present may have received, that this is a onesided proposition where the Government is always looking down the barrel of a gun held by these "experienced, talented, sophisticated industrial representatives," is, to say the least, an exaggerated impression.

Let us carry this point one step further.

The position of the Government in the area of procurement policy is a greatly strengthened one. I have been watching procurement policy for 20 years, and I think I know something about it.

I seem to have a good deal more admiration for the talent that is available to the Government service in this field, and for the manner in which that talent is applied, than the Government representatives who testified before this committee have. Moreover, you should be reminded that there is a whole range of procurement devices and safeguards available to the Government.

In connection with the cases cited by Senator Douglas, the Government has tools which enable it to deal with the problem of insufficient cost information. I received in the morning mail today a copy of a "certificate" which the Air Force is now requiring individual contractors to sign, with reference to the currency of costing information that is furnished. Where there is fraud or actionable misconduct the Government can and should prosecute.

I do not criticize this situation. I merely call attention to the "certificate" as a technique which is now being availed of by the services in order to plug some of the holes which were underlined by the Senator from Illinois and by the Comptroller General.

The Government has a whole range of procurement techniques available to it, price redetermination, termination for the convenience of the Government, and so forth. The Government is taking proprietary data from contractors under proprietary data regulations and handing it out to some extent, at least, to competitive industry.

The Government has compulsory licensing provisions in the atomic energy field. (See my letter of May 6, 1959, to the Joint Committee on Atomic Energy which I offer as a background appendix to this statement.) It denies realistic methods of depreciation as a cost in atomic energy contracting, despite what this committee and the Congress legislated in the 1954 code.

These few points are selected at random and I could go on, but I think we need to bear one thing in mind: The procurement agencies are not helpless in this field. If Congress would spend more time

dealing with the problem of how the Government can more effectively use the tools which are available to it through advertised bidding, through more skilled use of costing information, and so forth, the renegotiation supporting argument would fall by the wayside.

We have often heard renegotiation referred to as a crutch. I do not think you could have a better example of the fact that renegotiation is a crutch than yesterday when, in response to the criticisms by Senator Douglas, the only answer we could get from the Government representatives was, "This is why we need renegotiation."

A further point. I think it is very important that we look at this subject of renegotiation in terms of the industries or product lines which are most directly affected by defense contracting business in large volume.

For a couple of years I have been trying to elicit from the Renegotiation Board, either by requesting it of the Ways and Means Committee in public hearings or by other means, information on the extent to which renegotiation affects individual product lines.

As I read the testimony, as I have listened to the Chairman of the Board refer to the hundred contractors that are the biggest defense contractors being the biggest problem in this field, as I listened to these Comptroller General cases, as I listened to Mr. Mills argue the case on the floor, I have come to the conclusion that the number of product lines which are heavily involved in the renegotiation field today is quite limited; that if you take missiles, space vehicles, special devices manufactured for the Atomic Energy Commission, and DOD, and subcontracts thereunder, you have the bulk of defense procurement which is the so-called "problem area" that Chairman Vinson referred to.

I have often wondered why there is so much difficulty in narrowing this process of renegotiation, if we need have it at all, to that small area of procurement which seems to cause so much concern. I suggest that the Congress undertake this job in line with my detailed recommendations to the House committee.

I apologize, Mr. Chairman, for overextending my remarks. Thank you very much.

The CHAIRMAN. Thank you very much.

Senator COTTON. Just one question, Mr. Chairman, because of my ignorance of technical terms.

What do you mean when you refer to what you call proprietary data that the Government has? You mean business secrets?

Mr. STEWART. Usually it involves design, processes, methods of manufacture. It is usually distinguishable from what is patentable, but it does involve valuable industrial know-how. I threw that out, not to argue that case before this committee, because we have had the privilege of arguing before DOD officials for a couple of years. We still are not completely satisfied with the revised DOD regulations, section 9 of ASPR. I made the reference to indicate that there are in the tool kit of the Pentagon a whole range of devices which are being employed, in their view, in the interests of the Government.

We think this one is being overemployed. What is being done in many instances where the proprietary data clause is included in a contract is that the proprietary data is taken by the Government as a part of the contract, and then depending on whether there is a re-

stricted or unlimited clause, it may be made available to others, including competitors.

Thank you.

The CHAIRMAN. Thank you very much, Mr. Stewart.

(Mr. Stewart's prepared statement follows:)

STATEMENT OF THE MACHINERY & ALLIED PRODUCTS INSTITUTE ON THE PROPOSED EXTENSION OF THE RENEGOTIATION ACT OF 1951

We appreciate this opportunity to present the views of the Machinery & Allied Products Institute and its affiliate organization, the Council for Technological Advancement, on the proposed extension for a 4-year period of the Renegotiation Act of 1951 as embodied in H.R. 7086.

As you know, the institute represents the capital goods and allied equipment manufacturing industries of the United States. I should emphasize that the institute membership is not primarily engaged in defense contract work; the bulk of its production is commercial in character.

During recent hearings before the House Ways and Means Committee on a proposal for extending the Renegotiation Act of 1951 for a period of 27 months we commented at length on the proposal's inherent defects, recommending, as we have in the past, that this legislation be permitted to expire. Failing that, we urged a limited extension and a variety of amendments calculated to restrict the application of the renegotiation process to those areas of procurement involving novel weapons and devices the continuing and enlarging procurement of which appears now to be the sole justification—either administrative or legislative—for further extension of the Renegotiation Act of 1951.

Recognizing the limitations of time and the committee's busy schedule we have no intention of reiterating here arguments advanced in detail in the past and now available in the printed record of Ways and Means Committee hearings on this subject.[1] A brief summary of arguments before that committee has, however, been appended to this statement and with the chairman's permission we should like to have that summary of argument inserted in the record of this hearing.

So much for what has gone berore. The circumstances surrounding the proposal for extension of renegotiation have been substantially and radically altered since our appearance before the House Ways and Means Committee.

First, the House, after considering a Defense Department proposal for a 27-month extension of the act has chosen instead to draft legislation extending it for 4 years.

Second, this unprecedented extension is offered without the benefit of an overall study of the theory and process of renegotiation as proposed by House Report No. 2466, prepared in connection with the most recent extension of the Renegotiation Act on September 6, 1958.

Third, since the issuance of House Report 364, May 14, 1959, to accompany H.R. 7086, which would extend renegotiation for a 4-year period, the chairman of the House Ways and Means Committee on May 18, 1959, has announced the committee's plan for a broad-scale study aimed at revision of the Federal tax system.

Fourth, and finally, the legislative record of the proposal now before the committee would seem amply to confirm the institute's long-held conviction that there is a tendency within the Department of Defense to apply to all forms of procurement contracts—e.g., cost-type contracts, negotiated fixed-price contracts, advertised bids, etc.—precisely the same standard of administrative control, including cost reimbursability and profit allowance.

In our statement which follows we expect to deal briefly with each of these points, and make certain suggestions with reference to further amendment of the act provided it is the decision of the Congress to continue the legislation in question.

[1] MAPI testimony appears at pp. 126–170, Ways and Means Committee hearings on extension of the Renegotiation Act, Apr. 27, 28, and 29, 1959.

THE PROPOSED 4-YEAR EXTENSION OF THE RENEGOTIATION ACT

The 2d session of the 85th Congress extended the Renegotiation Act of 1951 for a period of 6 months or until June 30, 1959. It was the intent of the committee that an extension for a longer period of time was unjustified until a searching study had been completed.

In requesting the current extension the administration originally recommended that the act be extended for 2 years and 3 months, or until September 30, 1961. This lengthening in committee of the extension period, although agreed to by the Department of Defense, makes the proposal a quite different one than that presented to the House Ways and Means Committee and upon which the institute has commented at length in hearings before that committee. Moreover, it seems to be somewhat incongruous to enact the previous 6-month extension to permit a full study, fail to complete the study as we point up in the following section, and then legislate an unprecedented 4-year extension.

The proposed extension would appear to represent a long step toward making of statutory renegotiation—heretofore considered and invariably advanced by its proponents as temporary legislation—a permanent part of the Federal Code. Although we do not favor extension of renegotiation in any form we are particularly opposed to an extension which seems necessarily to give this legislation the character of at least quasipermanency. Moreover, we believe that a system of excess profits taxation by which rates are established and levies imposed almost wholly in accordance with the discretion of administrative officials, is not only wrong in principles even in a time of emergency but would be a singularly unfortunate precedent in a Federal revenue system which, by announcement of cognizant congressional committees, now requires searching review and a thoroughgoing overhaul.

NO OVERALL STUDY OF THE THEORY AND PROCESS OF RENEGOTIATION

As indicated above, in connection with last year's 6-month extension of the Renegotiation Act the House Ways and Means Committee proposed a broad review of both the theory and process of renegotiation with further legislation in the area to be based upon the findings of that study. As we understand it, an informal study of the question was undertaken by the staff of the Joint Committee on Internal Revenue Taxation in advance of current Ways and Means Committeee hearings on proposed extension. The fact is that no thoroughgoing inquiry of the character obviously intended by the committee has yet been accomplished. Even the informal sessions conducted by the joint committee staff were not completed, no study report was available to witnesses at hearings, and apparently no final study report was even available to the committee.

A colloquy on the floor of the House on May 26, 1959, between Mr. Curtis of Missouri and Mr. Mills of Arkansas (Congressional Record, Tuesday, May 26, 1959, pp. 8238–8239) bears out completely our conviction that the study of renegotiation previously ordered was never really undertaken and that even informal discussions are not yet complete.

"Mr. CURTIS. I call the attention of the chairman of the committee to this statement. He made a statement I wanted to modify in his original presentation when he said: 'A lot that we go on was on the basis of studies that were conducted by our staff of the Joint Committee on Taxation.'

"The correction I wanted to make was that our staff told us their studies were incomplete.

"Mr. MILLS. That is true. They had not made a complete study.

"Mr. CURTIS. That is correct. They wanted to go further in their studies and we wanted to have them go further in their studies, particularly in light of the fact the executive department has not done its job in coming before the committee and the Congress so that we could make a real report on this thing. Even our own staff which we had go into this matter has not completed its studies on the thing. In light of that, I certainly think it is ill-advised for the Congress to extend the act for as long as 4 years. As a matter of fact, in my opinion 2 years is too long. I think we ought to extend it for a year in order to get these studies in and find out just what the situation is."

We are completely in agreement with Mr. Curtis' observation that it is ill advised for the Congress to extend the act for as long as 4 years in the absence of a study which the committee itself deemed necessary and advisable before further extension in any form.

As for further extension, there is one further development, apparent from the printed record of hearings before the Ways and Means Committee, which deserves brief comment. It seems apparent that the chairman of the Renegotiation Board heading the administrative tribunal to which administration of the act is confided has switched from a position of neutrality on the question of extension to a position of advocacy. It seems clear to us that the chairman of the Renegotiation Board is now actively endorsing further extension and has lent his best efforts to the development of a record toward that end. In our judgment this is unfortunate both in terms of the overall administrative process and insofar as any objective consideration of the proposal now before the committee is concerned. We emphasize the point not in any spirit of rebuke to the present chairman of the Renegotiation Board, but rather to underline our conviction that this legislation is well on the way to becoming a permanent part of the Federal Code unless this committee calls a halt to that process.

REVISION OF THE FEDERAL TAX SYSTEM

We have already adverted to the recent announcement by the chairman of the House Ways and Means Committee of plans for "an extensive inquiry into the opportunities for constructive reform of the Federal tax system," and to the generally conceded proposition that renegotiation is an excess profits tax without a rate book.

Not only are we wholly in accord with the general purposes in the study announced by Chairman Mills, but we think three of the specific objectives of the inquiry, as announced in his release on this subject, have special relevance to the legislative proposal now before the Committee on Finance. We quote in part from Mr. Mills' release of May 18:

"* * * tax reform must seek, among other things, (1) a tax climate more favorable to economic growth; * * * (5) a tax system which interferes as little as possible with the operation of the free-market mechanism in directing resources into their most productive uses; and (6) greater ease of compliance and administration."

As we have suggested before, the extension of renegotiation proposed by H.R. 7086 is unprecedented in length. It would seem to us particularly unfortunate to extend extraordinary legislation of this character for such a period of time as to give it at least the color of permanency when the committee most directly involved is at the same time considering general revision of the revenue code. We submit that extension of renegotiation in any form and for any period of time will serve almost inevitably to confound and frustrate those objectives of the Ways and Means Committee's overall study which we have quoted above.

At the risk of seeming repetitious we cannot believe that a statute which permits the laying and collection of taxes in accordance with the substantially unfettered judgment of administrative officials can ever lead to "a tax climate more favorable to economic growth." Indeed, the relative paucity of private investment in the defense industries upon which renegotiation bears most heavily—a fact which proponents of renegotiation have so frequently cited in support of further extension of the process—may be in large part attributable to renegotiation and to the existence of other profit-limitation legislation which has for so long inhibited economic growth in this vital sector of our economy.

The chairman of the Ways and Means Committee in the broad-scale study which his committee now plans seeks "a tax system which interferes as little as possible with the operations of the free-market mechanism in directing resources into their most productive uses." Our comment with reference to the effect of renegotiation on this objective is both a corollary to and an extension of our prior statement with reference to renegotiation's effect on economic growth. Given the mobility of capital in a private enterprise system we cannot conceive of legislation better calculated to interfere with the operation of the free-market mechanism than is a statute such as renegotiation which informs the investor in advance that his earnings will be subject to a special impost over and above those imposed on the earnings of other investors.

Finally, Mr. Mills has announced his committee's intention of achieving "greater ease of compliance and administration," under the Federal revenue laws. Nevertheless, the Ways and Means Committee in H.R. 7086 proposes now to extend for a further period of 4 years an act which requires a wholly separate apparatus of administration and demands of compliance involving a fantastic expenditure of time and effort by industry—all of which, incidentally

are tax deductible. For further elucidation of this point we refer you to our discussion of "The cost of renegotiation" in our statement to the House Ways and Means Committee on this subject (p. 136 of the printed hearings).

In sum, we repeat our suggestion that we think it altogether unfortunate to consider a 4-year extension of renegotiation concurrently with the scheduled review and revision of the entire revenue system, and with this in mind we urge that the Congress, if it regards a further temporary extension of renegotiation in some form as necessary, limit that extension to the shortest period of time consistent with sound legislative and administrative action, but in no case more than 1 year.

THE DEFENSE DEPARTMENT'S "BASKET" APPROACH TO MILITARY PROCUREMENT

As in the past, the recommendations of the administration for further extension of renegotiation emphasize the unusual character of weapons now being purchased and the inadequacy of present pricing policies and contracting techniques to protect against excessive profits in all cases. This justification for further extension of renegotiation reappears in substantially this language at pages 1 and 2 of House Report 364 accompanying H.R. 7086. See also Chairman Mills' references exclusively to "missiles" and "highly technical instruments for present-day defense" as the area of concern, page 8228, Congressional Record, May 26, 1959.

Assuming without admitting the desirability of extending renegotiation on the basis of this justification, it would seem logically to follow that advertised bids and competitively negotiated fixed-price contracts involving the procurement of standard commercial items or items adapted only slightly from commercial specifications to meet military requirements ought to be exempted forthwith from the process of renegotiation. Yet this logical corollary to the administration's case is deducible only by inference; at no point has the administration affirmatively recommended the exemption of those contracts whereby the Department of Defense's own admission pricing policies and contracting techniques cannot be considered other than wholly adequate to protect against excessive profits. Moreover, the standard commercial article exemption has been riddled by narrow regulation and administration. (See p. 139 of our testimony and p. 150 of appendix C in the House printed hearings.)

This lumping of contracts into a kind of administrative hotchpot is characteristic of similar and parallel tendencies discernible elsewhere in current military procurement policy and practice. For example, the Pentagon now seeks to bring all contracts under a common and inflexible standard of cost reimbursement. It seeks by administrative regulation to hold within very narrow limits realizable profit on research and development contracts, the expeditious and efficient performance of which are so critically important to national security, and, presumably, it seeks to continue to impose on those contractors who have successfuly run the gantlet of administrative profit control within the Pentagon the process of renegotiation irrespective of the form and character of the original agreement.

LOSS CARRYOVER AND CARRYBACK

Assuming the Congress deems it necessary to continue statutory renegotiation in some form, we endorse the proposal contained in H.R. 7086 to enlarge the loss carry-fordward provision (section 103(m)) from 2 years to 5 years. In addition, we suggest that the act be amended to provide for a loss carryback provision equal to that now provided under pertinent provisions of the Internal Revenue Code, viz: 3 years.

It is our understanding that prior suggestions for inclusion of loss carryback authority in the Renegotiation Act have been objected to by administrative officials on the grounds of technical difficulties, the character of which we never have understood. We cannot foresee, in any event, that technical difficulties arising from insertion of a loss carryback provision in the renegotiation statute would involve any greater administrative problems than those present under a similar and altogether equitable provision of the Internal Revenue Code itself. We urge this committee to reconsider the possibility of such an amendment and draw its attention particularly to the observations of Congressman Alger, of Texas, on this point appearing on page 8241 of the Congressional Record, May 26, 1959.

EXEMPTION OF ADVERTISED BIDS FOR RENEGOTIATION

We should like to renew our repeated suggestion that the proceeds of contracts let by advertised bid be exempted from the process of renegotiation. Surely in those situations where the military departments have seen fit to award procurement contracts by advertised bid there can be no question of inadequate pricing policies. Again, the claim of an inadequate contracting technique will not lie where the contracting technique employed is the one prescribed by statute and employed by the military forces throughout all the years of their existence. It does not seem necessary to argue at length in support of this recommendation, which is generally consistent with one provision of identical bills introduced by a number of members of the House Select Committee on Small Business (H.R. 6382–6387). Such action would be no more than a logical extension of the present exemption of construction contracts let as a result of advertised bids.

NARROWING THE SCOPE OF RENEGOTIATION

In its written request for further extension of the Renegotiation Act the Department of Defense refers to the inadequacy of the present contracting policy and pricing techniques to protect against excess profits in all cases, and especially those cases where the Government must procure specialized items of an unprecedented nature where past production and cost experience is inadequate to permit the accurate forecasting of costs. The testimony of defense witnesses and the statement of Chairman Mills of the Ways and Means Committee on the floor of the House of Representatives (pp. 8227–8228, Congressional Record, May 26, 1959) both emphasize the novel character of weapons and devices to which these special problems apply. Reference is made particularly to certain types of aircraft, missiles, space craft, etc.

In addition, the Department of Defense has argued, and the Ways and Means Committee has apparently agreed, that defense expenditures under current world conditions are now and for the foreseeable future will continue at unprecedented levels for peacetime conditions.

Taking these two considerations together, and assuming that Congress deems it necessary to continue statutory renegotiation in some form, we suggest that the scope of the renegotiation process should be limited by clear statutory language to the proceeds of contracts affirmatively designated by the Department of Defense as involving products of an unusual character for which no reliable cost and pricing information exist. May we venture to suggest that the committee call upon the Renegotiation Board for an analysis of its refund determinations over the last 2 fiscal years by product line. Such an analysis would, in our opinion, almost certainly reveal a high degree of concentration of refund determinations in a relatively small number of product lines, and it is precisely those product lines with which the Department of Defense and the House Ways and Means Committee appear to be particularly concerned.

LIMIT EXTENSION TO A MAXIMUM OF 1 YEAR

We have already outlined our reasons for believing that a 4-year extension of renegotiation would be, in Mr. Curtis' phrase, "illadvised." In no case, in our judgment, should Congress extend the act for more than 1 year until the overall study of the subject proposed by the House Ways and Means Committee last year is completed and reviewed by Congress.

AN OVERALL STUDY OF RENEGOTIATION

It was the clear intent of the House Ways and Means Committee at the time last year's 6-month extension to conduct a thoroughgoing review of the theory and processes of the renegotiation procedure. As our prior testimony suggests, no such study has been undertaken, much less completed. We think it essential that such a study be made before any extension of the character here proposed is considered.

In our opinion such a study would include review of the entire profit limitation area, including renegotiation, the profit limitation provisions of the Vinson-Trammell and Merchant Marine Acts, and similar provisions of other procurement statutes and procurement regulations. In conducting such an all-embracive review of profit limitation as it applies to defense contracts, we suggest that the committee charged with conduct of such an investigation hear testimony not only from Government officials but from Defense contractors and subcon-

tractors who have had practical experience with the process of statutory renegotiation. As a particularly instructive example, we suggest for consideration the Vaughn Machinery case, 30 T.C. 100 (July 31, 1958). (See pp. 143 and 159 of the printed hearings in the House.)

OTHER RECOMMENDATIONS

Let us turn now to other provisions of the bill, H.R. 7086, as passed by the House. We have already commented on section 1, Extension, and section 3, 5-Year Loss Carryforward. We endorse section 4, Statements Furnished by Renegotiation Board, etc., and section 5, Proceedings Before the Tax Court in Renegotiation Cases, as well as section 6, Review of Tax Court Decisions in Renegotiation Cases. Although certain of these provisions do not go as far as MAPI recommendations on Board procedure, Tax Court proceedings, and appellate review in the form presented to the Ways and Means Committee, in general they represent improvements that should be adopted if the act is extended.

Finally, may we urge that the committee review those other institute recommendations made in the past and which appear in the summary of our testimony to the House Ways and Means Committee which has been appended to this statement.

This concludes our statement on H.R. 7086 to extend the Renegotiation Act of 1951 for an additional 4-year period or until June 30, 1963. Assuming that the record of this hearing will be held open to receive additional statements for at least some further period of time, we may elect—with the chairman's permission—to file a supplemental statement of institute views, this depending of course upon testimony developed in the course of the hearing.

Once again I should like to express the appreciation of the institute for this opportunity to appear and present its views on the question of further extension of the Renegotiation Act. I should like also to express our particular gratification at the chairman's decision to consider further in public hearings this most important proposal. I will conclude by saying that if the institute, its staff, or its member companies can be of any assistance to the Committee on Finance, we are of course at your disposal.

THE PROPOSED EXTENSION OF THE RENEGOTIATION ACT OF 1951

BRIEF SUMMARY OF STATEMENT

1. Renegotiation needs to be reappraised critically in full perspective.

A. Does renegotiation really contribute to or does it affect adversely efficient and economical defense procurement?

B. Do the concept and the process of renegotiation afford reasonable due process and are they consistent with the American system of government, particularly during periods of other than all-out emergencies?

2. Analysis of the Department of Defense request for extension of renegotiation:

A. Primary DOD concern has been expressed with respect to procurement problems in areas of unique and novel military technologies such as aircraft, missiles, space, etc.

B. The reference to problems in the subcontract area is largely overstated. The argument represents a carryover from early days of renegotiation when price redetermination, audit, and other protective devices were not extended below the prime contract level.

3. The request for extension of renegotiation (in the light of repeated extensions previously and of the reasoning upon which the current extension is based) is tantamount to a request for indefinite or permanent extension of renegotiation.

4. Analysis of advantages and disadvantages of renegotiation:

A. Its advantages are peculiar to a period of all-out war effort when economic conditions require extraordinary devices, when procurement is large scale and conducted under tremendous timing urgencies, and to past periods when procurement techniques were not sufficiently developed to protect the Government's interest.

B. Disadvantages:

(1) The inducement it offers for careless procurement.

(2) The very serious impairment of incentives to economy and efficiency.

(3) The arbitrariness of its results.

5. Detailed analysis of the Administration's case for the extension of renegotiation:

A. General economic conditions are not and cannot be cited as the basic reason—see appendix B.

B. Consideration should be given to the procurement apparatus of U.S. procurement agencies and the wide range of procurement devices available to protect the Government's interest, which render renegotiation unnecessary.

6. Detailed analysis of renegotiation's effect on productive efficiency, the burdens which it imposes on industrial management, its cost to Government and industry, and the inescapable arbitrariness of the renegotiation process.

7. Specific recommendations:

A. The Renegotiation Act of 1951, as amended, should be permitted to expire on June 30, 1959, as presently provided for.

B. If it is the judgment of Congress that statutory renegotiation should be extended in some form, the act should be extensively amended as suggested below:

(*a*) Certain present exemptions and exclusions should be perfected and extended.

(1) By further clarifying amendments to the act the Renegotiation Board should be directed to carry out the full intent of the Congress in broadening the coverage and simplifying the application of the standard commercial article exemption as contained in the 1956 amendments to the act.

(2) Elimination from the coverage of the act of certain "fringe agencies" already initiated by the Congress should be expanded. The procurement of the following additional agencies should be removed from the applicability of the Renegotiation Act: the General Services Administration, the public works procurement of the U.S. Army Corps of Engineers, and nonmilitary procurement of the Atomic Energy Commission.

(3) The present exemption of construction contracts let as a result of advertised bids should be expanded to cover all contracts let as a result of advertised bids and subcontracts thereunder.

(4) The present provision providing for transfer of losses from one year to another, now limited to a loss carryover, should be expanded to provide for a loss carryback and also to permit, in effect, a carryover and carryback of "inadequate" profits.

(*b*) Additional new exclusions and exemptions should be adopted.

(1) With reference to those areas of procurement not expressly exempted or excluded by statute, interested procurement agencies should be required affirmatively by law to designate those product categories which in their judgment must be subjected to renegotiation in order adequately to safeguard the Government's interests. The statute should lay down broad criteria which outline the areas of procurement in which these product categories would fall. The enumeration of such criteria should of course be consistent with statements of the DOD indicating that renegotiation is most necessary where "specialized" items, many of unprecedented nature, and particularly in the aircraft, missile, and space fields, are involved.

(2) Remove, insofar as possible, duplication between renegotiation and the application of price redetermination.

(*c*) A semblance of due process in renegotiation procedures and other improvements in the procedures of the Board and courts should be written into the act.

(1) Improvement of Board procedures should be directed in order to enable the contractor to deal with important issues during the course of the renegotiation proceedings and to assure development of a better record for appellate purposes.

(2) The renegotiation process in the Tax Court by statute should be declared a full de novo proceeding, including a guarantee to the contractor of an opportunity to rebut all information and evidence, such as contractor efficiency reports, accounting analyses, etc., employed by the Board in arriving at its determination.

(3) A contractor should be accorded the right to appeal Tax Court excessive profits determinations to the U.S. Court of Appeals, and the scope of such appellate review should be broadened. This broadened right of appeal should apply to all Tax Court decisions rendered after June 30, 1958, in accordance

with this committee's recommendation at the time of the last extension of the act.

(d) Other recommendations.

(1) There should be an adoption and full implementation—presumably in conjunction with other cognizant committees of Congress—of the recommendation contained in the Joint Committee on Internal Revenue Taxation 1956 renegotiation study that Congress review the entire profit-limitation area including the profit limitations of the Vinson-Trammell Act, the Merchant Marine Act, the Armed Services Procurement Act, price redetermination procedures, etc.

(2) Limit any extension of renegotiation to a period no longer than 1 year.

MACHINERY & ALLIED PRODUCTS INSTITUTE,
Washington, D.C., May 6, 1959.

Hon. CHET HOLIFIELD,
Chairman, Subcommittee on Legislation,
Joint Committee on Atomic Energy, Congress of the United States,
Washington, D.C.

DEAR MR. HOLIFIELD: We have received Mr. Ramey's letter of April 25 indicating that the record of recent hearings on atomic energy patent matters is to be held open until May 7 and extending to the institute the opportunity of filing a statement of its views for inclusion in that record. We appreciate your courtesy in this matter.

As you may know, the Machinery & Allied Products Institute is an organization of capital goods and allied equipment manufacturers, national in scope, which includes within its membership many of the principal Atomic Energy Commission contractors, subcontractors, and licensees as well as numerous manufacturers of reactor components and related equipment used in the rapidly developing atomic energy industry. Our affiliate organization, the Council for Technological Advancement, is especially concerned with national policies which inhibit technological advance.

This statement is addressed primarily to broad policy questions and attempts to point up basic principles which we feel should govern national policy and legislation in the area of atomic energy patents. We have, however, consulted with patent experts in industry on those questions which involve technical patent problems. We feel compelled to make known our views on this subject because of convictions as to basic principle. It should be added, however, that many capital goods companies have made heavy commitments in the atomic energy program and we therefore have a reservoir of experience upon which to draw.

For future use we are engaged in a rather detailed survey of member companies involved in the atomic energy program, with a view to obtaining, among other things, additional information on the impact on those companies of chapter 13 of the Atomic Energy Act of 1954. Unfortunately this study will not be completed in time to meet the subcommittee's May 7 deadline, but based on information already furnished us we believe it will confirm the views and experiences reported here. We are therefore availing ourselves of your invitation to present the general views of the institute on certain aspects of the problem which we believe have not been fully ventilated in committee hearings, and, in addition, we undertake to make certain specific recommendations for legislative consideration.

OUR APPROACH TO THE PROBLEM

We concede at the outset that the special character of the subject matter and the unusual security problems surrounding the origin of the atomic energy program undoubtedly required certain statutory safeguards of an unprecedented character. It is perfectly true, moreover, that the development of the atomic energy program since the days of the Manhattan Engineer District has been very largely financed from public moneys.

As a further part of the institute's approach to this question, we think it must be conceded that the Atomic Energy Commission, exercising the mandate given it by section 141b of the Atomic Energy Act, has done an altogether commendable job of disseminating technological and scientific information developed under AEC contract work. Finally, we are inclined to concede without argument that, for the present at least, a statutory prohibition against the issuance of

letters patent on any device or invention useful solely in atomic weapons is a proper and desirable requirement.

These general observations are important to our statement only insofar as they provide a background for the institute's approach to the present problems.

In addition to these general observations—and consistent with the stated purposes of the act as they apply to the subject here under study—we should like to pose certain fundamental questions which we believe provide a necessary framework for consideration of the atomic energy patent provisions:

1. Is not the most important question now before the committee how best to attain maximum technological advance, particularly for peacetime applications, in the atomic energy field?

2. Do the patent provisions of the act in their present form and in the form proposed for extension carry out or impede this overriding objective?

3. To what extent do these patent provisions tie in with developments in other government areas? In other words, are these provisions part of a developing pattern which has serious implications for technological progress in other new fields such as astronautics—or in technologies as yet unimagined—in which the Government has a direct and proper interest?

THE AMERICAN PATENT SYSTEM AND THE PATENT PROVISIONS OF THE ATOMIC ENERGY ACT

As other witnesses have suggested in open hearings before this subcommittee, and as our own questions above also suggest, it would be inappropriate to consider chapter 13 of the Atomic Energy Act of 1954 without relating its provisions to the long-established American patent system. The essence of the American patent system has consisted in the incentive it provides to invention and creation because of the rewards offered under a limited patent or copyright monopoly. The patent provisions of the Atomic Energy Act represented an abrupt departure from that tradition. The administration now proposes, however, to continue these differences in philosophy for at least another 5-year period and perhaps indefinitely into the future.

This basic difference in philosophy is emphasized, moreover, by adoption of the National Aeronautics and Space Act of 1958 providing patent provisions similar to those in the Atomic Energy Act. We acknowledge that, insofar as the patent provisions of the National Space Act and the Atomic Energy Act require the Government to take full title to inventions developed under Government research, they are generally consistent with the recommendations of the 1947 report of the Attorney General to the President on this subject.[1]

The Atomic Energy Act, in addition, contains a special feature—that of compulsory licensing under which a holder of a basic atomic patent may be directed by the Commission to license other commercial firms to practice the invention. Both of these unusual features of the Atomic Energy Act's patent provisions are to be contrasted with the well-established administrative policy of the Department of Defense, which permits the granting of letters patent to an inventor—even under Government-sponsored research projects—subject only to the reservation to the Government of a nonexclusive royalty-free license to practice or cause to be practiced the subject invention by or for the U.S. Government throughout the world.

We suggest this difference between the Atomic Energy Commission and Department of Defense policies only to emphasize our conviction that the Department of Defense has adopted the most practical long-run approach to the problem. By exercising restraint in its demands for the acquisition of full title to inventions developed under defense contracts the military agencies have succeeded in doing their job of securing the national defense without at the same time destroying contractor incentive for further scientific and technical advances.

We have not always been completely in agreement with the Department of Defense policy in this field, particularly insofar as it involves acquisition by contract of patented or unpatentable background know-how, but we believe the general patent policy of the Department of Defense is better calculated to serve the public interest over the long pull than is that set out in the Attorney General's report and now embodied in the atomic energy and space statutes. Because of our conviction on this point, we believe the question of whether or not the time has now arrived to place the Atomic Energy Act upon the same or a

[1] "Patent Policies and Practices of Government Departments and Agencies Relating to Inventions of Their Employees and Contractors."

similar path by appropriate amendment of chapter 13 is quite possibly the most important question now before the subcommittee. The consideration of legislative timing is made even more critical by the fact that legislative action at this time may have the most profound and far-reaching effects on the future course of developments in a whole range of explosively expanding technologies in which the Government is interested for reasons of national security and national prestige.

THE PRESERVATION OF PRIVATE INCENTIVE

We think no one will seriously dispute the proposition that the American patent system has been one of the foundation stones of our unprecedented industrialization. To hobble, perhaps in the long run to destroy, this source of private incentive as it applies to an industry of such magnificent peaceful potential as atomic energy is a step not to be taken lightly, and we ask more respectfully that the members of this subcommittee consider further the possible effect on private incentive of the action here proposed.

In adopting the full-title-to-patents or compulsory-licensing provisions of the Atomic Energy Act, the committee evidently proceeded on the theory of attempting to avoid a preferred position for certain large Atomic Energy Commission contractors. We acknowledge that there may have been some basis for such action 10 years ago, but we are inclined to believe that the risk—as the Commission and certain testimony conceive it—is a continually diminishing one. On the other hand, there is a real possibility that a different kind of preferred position may be created in the absence of real patent protection. We shall have considerably more to say on the so-called preferred position argument at a later point in our statement.

It has been argued by Government witnesses that the compulsory licensing provisions of the Atomic Energy Act are no more than a reserve power and have in fact never been employed by the Commission. Moreover, it is argued that the Government has available to it the possibility of relief under existing antitrust legislation—where there has been found to be an unlawful combination in restraint of trade—and that the existence of this more general authority reduces the significance of the compulsory licensing provision. We must respectfully disagree. Let us consider these arguments separately.

Relief by injunction under antitrust legislation.—Assuming a legislatively proscribed combination in restraint of trade, the Government may obtain as one form of affirmative relief a court-directed licensing of patents involved. This is, of course, general legislation and, assuming the existence of all conditions necessary to such an action, may be employed by the Government in any appropriate situation. By contrast the compulsory licensing provision of the Atomic Energy Act, although not yet used, comes very close to constituting class legislation and to that extent a special disincentive to further advancement of the art and to attraction of capital necessary for the private exploitation of atomic energy's industrial potential.

Atomic energy patents as a bar to further progress.—The Government in testimony before this subcommittee acknowledges that the compulsory licensing provisions of section 153 of the act are not necessary for the Government because it may "use any patented invention and the owner's sole remedy is to sue for reasonable royalty or just compensation in the Court of Claims * * *" This clearly protects the Government so far as its use of a patent is involved; in addition, in the case of private parties there is the relief mentioned above.

As for the possibility of a holder of a patent in the atomic energy field blocking further progress in the art, it seems to us that the almost inevitable inhibition of incentive arising from this provision will serve to frustrate the very purpose for which the provision was created in the first place. The whole record of industry's ingenuity in designing around supposedly basic patents would seem to raise doubt as to how basic such patents actually were—and particularly in such a relatively new field as atomic energy.

Further—and having in mind the first of our general questions on this subject—would not the forcing of new avenues of approach to problems covered by basic patents lead to a healthier condition in the industry and a more broadly based technology?

Continuance of section 153 in its present form would, in our judgment, serve further to reduce the incentive of Atomic Energy Commission contractors or subcontractors to contribute at private expense to the advancement of the art and it would seem to close the door almost completely to the customary incentive for

actual or potential competitors to develop a process or device which accomplishes the end in view by a simpler, cheaper, or more efficient method.

The record of patents issued.—We are asked to believe that the compulsory licensing provision of section 153 has had no disincentive effect because the power has never in fact been exercised. An examination of the record of patent applications filed and patents issued in the reactor field—a field with which the institute by the nature of its membership has direct contact—raises serious doubt about the validity of the argument. From August 1, 1946, through 1957, 555 applications for patents in the reactor field have been filed by persons—including corporations—other than the Atomic Energy Commission. During this same period of time covering somewhat more than 11 years not one single patent has been issued in the reactor field to a person other than the Atomic Energy Commission.[8] Obviously the reserve power of compulsory licensing could not have been applied in the absence of the very thing to which it applies. Even as to those areas of technology in which patents have been issued the argument that the compulsory licensing authority has not been used evades the merits of the question.

The "preferred position" argument.—Among the arguments advanced for a 5-year retention of a slightly modified chapter 13 is the suggestion that any basic change in the present statute—or to be more precise a return to the traditional American patent system—would tend to insure a preferred position for a relatively small group of large Atomic Energy Commission contractors. We have already taken note of this argument, and we propose now to examine it in detail.

There may be some risk of a preferred position, but if the risk exists it is a risk created by the actions of the Government itself as well as by the industrial facts of life. The Atomic Energy Commission at the outset of our nuclear energy program contracted, quite logically, with the fairly limited number of manufacturers in the chemical and power equipment fields since the preexisting technologies of those industries—developed by private capital—were best suited to the expeditious development of atomic energy. To this extent Government capitalized on private know-how; atomic energy technology has been grafted onto prior industrial knowledge in such fields as chemistry, metallurgy, and boilers.

It is now argued that the extension of section 153 would leave such companies in a preferred position in respect to basic patents, technical "know-how," and the possession of technically trained and practically experienced staffs. All of these assets were necessary to the performance of contracts let by the Atomic Energy Commission, and the Government now stands in the position of charging such contractors with occupying a preferred position—which if it exists at all exists as a result of the Government's own acts.

Beyond this we are not at all certain that the present circle of Atomic Energy Commission contractors and subcontractors is quite so small as the Commission would have us believe; indeed our own experience with interested members of the machinery institute would indicate that there is a continually enlarging number of contractors and subcontractors working for the Atomic Energy Commission on all types of projects. Moreover, the Commission's own very commendable policy in the declassification and dissemination of scientific and technical information in the field has done much to provide for an equalization of knowledge in this field.

Prior art.—Among the several disincentive features of chapter 13 of the Atomic Energy Act none constitutes a more formidable disincentive, in our judgment, than section 155, which bars the granting of a patent on any device for the production or utilization of special nuclear material or atomic energy where information pertaining to the device is in the possession of the Atomic Energy Commission, but has not been published or patented for reasons of security. Obviously no private enterprise is anxious to commit risk capital to the development of new art when it faces the prospect of losing all rights in its invention by reason of a possible future claim of prior art. In our specific recommendations which follow we have suggested what we believe to be a reasonable method of removing this substantial drag on further progress.

We strongly recommend that the subcommittee give this issue special study.

The effect of chapter 13 on smaller businesses.—We are convinced that continuance of chapter 13 of the Atomic Energy Act in its present form will have

[8] These figures have been taken from pp. 59–60, vol. 1, of "Selected Materials on Atomic Energy Patents," published by the Joint Committee on Atomic Energy, March 1959.

some of its most serious effects on small and medium-sized manufacturing companies interested in the atomic energy field and that the preferred position of present large contractors and subcontractors—if indeed they occupy such a position—will in fact be enhanced. This danger arises in our judgment from two sources, one statutory and one administrative. Present law, by discouragement of incentive under Atomic Energy Commission sponsored work and the uncertainties it creates in attempting to obtain clear title to a patent in the field, has effectively destroyed the one position—a strong patent position—from which small and medium-sized manufacturers can hope to compete effectively with the very large corporations. This is not to say we believe smaller companies should have any special preference accorded them under our patent system; we do, however, object to extension of a statute which effectively deprives them of equal opportunity under that system.

Secondly, the procurement policy of the Atomic Energy Commission—a policy which consistently demands and obtains contract performance at considerably less than true cost—can lead only to an ever-narrowing circle of participants in the atomic energy program. This circle will be composed entirely of those with the greatest financial resources. As to this procurement policy of the Commission—about which we have no slightest doubt on the basis of extensive member company experience—it is, we think, a shortsighted policy because of its almost inevitable effect in driving small and medium-sized companies out of the business, and it is a particularly mischievous one because its administration in the past has been sweetened by assurances that in accepting loss contracts manufacturers would obtain valuable know-how in an important new field of technology. Now the possession of such know-how is cited as a preferred position justifying further extension of the statute.

The availability of capital for the private exploitation of atomic energy.—Our political and economic system assumes the exploitation by private capital of technologies useful for peaceful ends and, as we have pointed out above, one of the foundation stones of the entire structure is the American patent system.

The holder of a basic patent which gives promise of profitable exploitation is granted an exclusive right to practice the invention patented for a period of 17 years. The fact is of course that such is the ingenuity of industry that within a relatively short period of time—assuming the genuine usefulness of the device patented—competitive but noninfringing devices will have entered the market by the process of designing around the original patent. At most the patentee has 17 years in which to recoup his development costs, earn a return on capital invested, and place himself in a position to manufacture his own invention thereafter on a competitive basis; as a practical matter—such is the speed with which competition outmodes processes and products—the period will probably be far shorter.

Consider the situation which we have outlined above as it is affected by chapter 13 of the Atomic Energy Act. The commitment of private capital to further development in atomic energy is faced with a whole series of pitfalls built into the basic legislation itself. The Commission may under some circumstances claim full title to the invention developed at private expense. Alternatively, it may direct the inventor—if he does finally succeed in obtaining a patent—to license the practice of his invention by a competitor, thus reducing or eliminating completely the period of time in which he might have expected to recover his development costs and to make a return on the capital initially invested. Again, he may be faced with a claim of "prior art." In sum, the several disincentive features of the present act to which we have referred tend to reduce or obliterate any incentive for private capital to bring about a rapid, competitive, and profitable exploitation of atomic energy's industrial potential.

Such is the long-range promise of atomic energy that numerous companies have already invested substantial sums of private capital in development of new art and acquisition of know-how either by way of direct investment in research and production facilities or by subsidy of the Atomic Energy Commission program through assumption of losses on Commission contracts. Although substantial by individual company standards—and, indeed, remarkably substantial in view of the statutory disabilities faced by the investors—these investments are wholly insufficient to accomplish a rapid, competitive and profitable exploitation of atomic energy's industrial potential. Moreover, even this source of investment may tend to dry up if chapter 13 of the Atomic Energy Act is continued in its present form and, as for additional private investment in an amount

necessary to accomplish a broad scale exploitation of atomic energy, we think this would be most unlikely.

PRIVATE VERSUS PUBLIC DEVELOPMENT OF ATOMIC ENERGY

One of the stated purposes of the Atomic Energy Act of 1954 is to "strengthen free competition in private enterprise." With this statement of purpose we are wholeheartedly in agreement. We call attention to it because of the belief that further extension of chapter 13 of the act in its present form would not serve that purpose and would, in fact, render a distinct disservice.

We cannot believe that the subcommittee would intentionally advance the cause of public ownership of productive resources—including patent rights—or that it would seek purposefully to place impediments in the path of industrial development of atomic energy by private enterprise. The effects of continuing this departure from the normal patent system are such, however, particularly when viewed in the broader perspective of events taking place elsewhere in Government, that we are seriously concerned at the possibility of our backing unintentionally into a form of basic industry that is at best hybrid in character—part Government and part industry controlled—and at worst might be almost wholly dominated by the Government.

We have already mentioned the patent provisions of the National Aeronautics and Space Act, patterned for the most part on similar provisions of the Atomic Energy Act, adopted in a most unusual manner with no recorded legislative history and without public hearings. Having this in mind it should be remembered that the Atomic Energy Act's patent provisions broke new ground in departing from the traditional patent system of the United States. Those provisions, with some additions, have been once extended. To extend them further might lead in the future to a virtual subversion of the American patent system.

THE PROBLEM OF FOREIGN PATENTS

The Commission has indicated that it not only does not discourage U.S. nationals from filing patent applications in foreign countries, but that it urges such foreign filings as soon as possible. Although this statement may reflect official Commission policy, as a practical matter there are a number of disabilities—resulting both from the express terms of the statute and the realities of business life—which stand in the way of filing applications for foreign patents.

If we may, we would like briefly to review the procedures which must be followed by an American company which "makes an invention or discovery useful in the production or utilization of special nuclear material or atomic energy." Initially, a report covering such an invention or discovery must be filed with the Commission, under the provisions of section 151c of the act. At about the same time the company will probably file an application for a U.S. patent with the Patent Office. Section 152 of the act requires the Patent Office to refer information regarding such an application to the Commission, which may acquire title if it deems such invention to have been made or conceived under any contract, subcontract, arrangement or other relationship with the Commission. The Commission, of course, has the authority to waive title under such circumstances as it deems appropriate.

Accordingly, the company is faced with a very difficult decision. It may go forward and file foreign patent applications and incur the substantial expense connected therewith, subject to a substantial possibility that it may be required to assign title to such foreign patents to the Commission. On the other hand, the company may withhold foreign filings until the title question is settled by the Commission. It should be noted at this point that the Commission will not often waive its rights under section 152 until the patent is ready to issue. It seems clear therefore that a very considerable amount of time, probably a number of years, may elapse before the company may apply for foreign patents with any degree of assurance that it will be able to attain title to such patents. In the meantime there is the obvious risk that a foreign company will independently conceive the same invention and thus bar the American company from gaining any foreign patents. Moreover, the International Convention for the Protection of Industrial Property requires that a prospective patentee who has filed his application in the United States shall have a period of 1 year in which to apply for patent protection to any other convention country.

As a practical matter, then, the American company is forced to enter the foreign market without patent protection. At this time such a company may be

able to sell its products in spite of greater manufacturing costs, because of superior American technical skills, at least with respect to certain applications, as reflected in product design. But it is common knowledge that foreign nuclear equipment manufacturers are fast catching up with existing American design superiority. Thus, with a few years at the most, the American company, without a patent position and its resultant exclusive rights, will have no effective bargaining apparatus with which to secure a position by sale, license agreement, or otherwise in that foreign market. As a practical matter, then, chapter 13, by its uncertainties and its "reserve powers," prevents an American manufacturer from establishing a secure market position abroad quite as effectively as it does for the same reasons in the United States. For these reasons we respectfully request the subcommittee to make an intensive study of the effects of the statute as it now stands—including the virtually unlimited dissemination worldwide of technological and scientific information—upon incentives for American companies with respect to foreign markets. Furthermore, it should be noted that the arguments which the Commission makes regarding the necessity for Government ownership of patents in the domestic market (the validity of which we do not concede) obviously do not apply to the foreign situation simply because the Commission would not be risking possible infringement suits against it if it did not hold title to foreign patents.

Specific Recommendations

Our specific recommendations for amendment of chapter 13 of the Atomic Energy Act appear below.

Our primary concern, as indicated above, lies with the substantive provisions of chapter 13 of the Atomic Energy Act of 1954, as amended. We also suggest, however, that the subcommittee consider the problems of uncertainty that are created for atomic energy industry generally, because of the frequently vague and indefinite language contained in chapter 13, and more particularly in sections 151 and 152.

Military utilization (sec. 151)

This provision broadly prohibits the granting of patents for any invention or discovery which is useful solely in the utilization of special nuclear material or atomic energy in an atomic weapon. In addition, under subsection "c" persons, who might make an invention or discovery useful in the production or utilization of special nuclear material or atomic energy generally, are required to report such inventions or discoveries to the Commission.

We recommend that section 151 be amended as follows:

1. The word "useful" as employed in reference to the "utilization of special nuclear material or atomic energy" is obviously vague. It is possible to conceive of any number of items which are essentially standard commercial items in character and which are not primarily concerned with atomic energy but which, nevertheless, are useful in connection with atomic energy. We suggest that this criterion be changed to read "any invention or discovery which employs special nuclear material or atomic energy." Such language would, in our judgment, encompass that category of items with respect to which reporting to the Commission might be deemed desirable.

2. Under subsection "c" reports are requested from any person who has made any such invention or discovery. Industry has encountered difficulty with the use of the term "made," which has no particular significance in general patent law. There is no further indication in the statute of when an invention is made. We suggest that the word "made" be deleted in favor of "first reduced to practice." Moreover, first reduction to practice might be defined to include, in the alternative, either first successful operation of the invention or discovery, or first filing of a patent application on an invention or discovery with the Patent Office.

3. We concur in the Commission's recommendation that the required report covering any such invention or discovery be submitted within 180 days rather than within 90 days as under present law.

4. We also concur with the Commission's recommendation that a new subsection "e" be added to section 151, which would require that reports filed with the Commission pursuant to that section be kept confidential. However, we note that under these recommendations information concerning such reports might be released under "such special circumstances as may be determined by the Commission." We suggest that consideration be given to the insertion of

suitable statutory criteria to furnish guidance to the Commission with respect to any such determination.

INVENTIONS CONCEIVED DURING COMMISSION CONTRACTS, SUBCONTRACTS, ARRANGEMENTS, OR OTHER RELATIONSHIPS (SECS. 152 AND 159)

Under this provision any atomic energy invention made under any contract, subcontract, arrangement, or other relationship with the Commission, regardless of whether there has been any expenditure of Government funds, is deemed to have been made or conceived by the Commission. The Commission, however, is granted the authority to waive its claim to any such invention under such circumstances as it may deem appropriate.

The Atomic Energy Commission has wisely, in our judgment, recommended to the subcommittee some limitations on this extremely broad grant of authority which has been well described by its sponsor as going much further than was ever intended.[3] However, the Commission's recommendations do not go nearly far enough. It is difficult to conceive of justification for Commission acquisition of title to inventions resulting from an AEC relationship, when there is no use of either Commission funds or property. It must be remembered that patents are only granted for a particular contribution of the inventor over prior art. It seems clear that the only rationale for Commission acquisition of title to contractor patents occurs when there has been a use of AEC funds or property in connection with the circumstances which gave rise to the invention.

Assuming then that the Commission should take title to patents on inventions made through the use of Government funds, we make the following minimum recommendations for amendment to section 152:

1. The first sentence of the section, which was intended merely to establish a procedural device for quick title determinations with respect to patents, should be deleted. Adequate authority would remain under section 159 and the general provisions of the act for the Commission to continue to acquire patents to research and development contractor inventions.

2. The term "useful" should be deleted in favor of the term "employs," as explained in the discussion under section 151.

3. The terms "made or conceived in the course of, in connection with, or under the terms of any contract" contained in the second sentence of section 152 should be amended to conform with the corresponding language "made or conceived under any contract" as contained in the first sentence of that section.

4. The wording "any contract, subcontract, arrangement, or other relationship with the Commission regardless of whether the contract or arrangement involved the expenditure of funds by the Commission" should be deleted and in its place should be substituted the following language: "under any contract for the performance of experimental, developmental or research work, on under any subcontract for the performance of experimental, developmental or research work." The words "experimental, developmental or research work," appear, of course, in the Armed Services Procurement Regulation and are reasonably well understood by both Government and industry.

We feel that the amendments suggested above are sufficient to protect the public interest if the Congress decides that the Commission should continue to acquire title to patents on AEC research and development contractor and subcontractor inventions.

In this connection we are fully cognizant of the 1947 recommendations of the Attorney General that the Government should own patents on work for which it has paid. The difficulty with the 1947 recommendations, we feel, results from the fact that the ultimate objectives of national patent policy have not been fully clarified. Certainly, it may be argued that the Government-contractor relationship in a technical sense is somewhat analagous to the employer-employee relationship under which the employer may be entitled under an employment agreement to his employee's inventions. It should be noted, however, that in the absence of an express agreement the employer would normally be entitled only to a royalty-free nonexclusive license for employee inventions within the scope of his employment.

The basic question is not whether the Commission is legally entitled to its contractor inventions—rather is it wise in the public interest to have it acquire absolute title? We cannot overemphasize our view that the prime necessity in

[3] W. Sterling Cole, "Patenting Nuclear Developments," Nucleonics, January 1955 through April 1955 (reprint).

atomic energy today is to develop the field as quickly and as economically as possible. We feel that as a matter of national policy the experience of the Department of Defense regarding contractor inventions is crucial. That experience, going back over many years, includes the present-day procurement of highly novel weapons systems and the Department clearly feels that the mere reservation of an irrevocable royalty-free license is sufficient to protect the Government's interest.[4]

We are sure you will recall the very interesting testimony of Admiral Mills, stating the reasons for this policy, before the Joint Committee in its June–July 1953 hearings on "Atomic Power Development and Private Enterprise."[5] The basic question, we submit, is the same for both the Commission and the Department of Defense—what policy will lead to rapid development and improvement of inventions and discoveries? We feel sure that our industrial history indicates that it is the policy of granting patents to the inventor who will, through the exclusivity attached to his patent rights, exploit his invention as effectively as possible.

For these reasons we recommend repeal of both sections 152 and 159 of the act.

COMPULSORY LICENSING AND MONOPOLISTIC USE OF PATENTS (SECS. 153 AND 158)

The Commission has recommended that the present provisions under which it may declare atomic energy patents to be affected with a public interest, and direct compulsory licensing of other private parties, be extended until September 1, 1964. These provisions are currently due to expire on September 1 of this year.

The Commission bases its recommendation on the fact that compulsory licensing tends to preclude "the possibility of enlarging the preferred position of a limited number of companies, many of whom have developed their experience [in the atomic energy field] at public expense." The "preferred position" argument and our objections to the compulsory licensing provision are dealt with at length above in our general comments.

We should reiterate, however, that it seems evident that the very real concern expressed by industry respecting compulsory licensing is not fully understood. The basic question here, as it is with title to contractor patents, is one of incentives. However, there are also very strong considerations of equity that should not be disregarded. When a company conceives or makes an atomic energy invention with its own funds, under present law it normally may secure a patent on this invention. However, section 153 inhibits exploitation of such inventions to a very significant degree. The fact that the inventor may be compelled by the Commission to license other parties to use his invention clearly may control that inventor's basic decisions with regard to further development and subsequent marketing of the invention.

The basic issue is this. The invention has been made or conceived in most instances only through the investment of a considerable amount of private capital. If the inventor, once he has obtained a patent, may not rely upon the exclusivity attached to his patent (which is the case when he may be subjected to compulsory licensing) he will not in most cases be in a position to sell his invention or products based upon that invention at a price sufficient to enable him to recover his "development" investment over the period of the 17-year life of his patent. This serious disincentive feature of AEC compulsory licensing has been aptly described by Mr. Casper W. Ooms of the AEC Patent Advisory Panel as a "violation of the essential conception of a patent system."[6] Moreover, you will recall, we feel sure, the very serious doubts that have been expressed regarding the constitutionality of section 153 by, among others, former Joint Committee Chairman W. Sterling Cole on the floor of the House.[7]

If the subcommittee decides as a matter of policy that section 153 should be extended, we strongly urge that such extension be limited to 2 years. In view of the very serious potential effects of section 153, which we have attempted to indicate above, we feel that 2 years at most will be sufficient to clarify the problems which will arise from the existence of this provision.

[4] Armed Services Procurement Regulation, sec. IX, pt. 1.
[5] See hearings, p. 192.
[6] "Selected Materials on Atomic Energy Patents," vol. I, p. 80.
[7] See 100 Congressional Record A5356.

Monopolistic use of patents.—The obvious connection between section 153, discussed above, and section 158 leads us to a brief discussion of the latter section at this point. The Commission has recommended repeal of section 158. With that recommendation we concur. Moreover, we are constrained to suggest that the availability of relief under antitrust legislation, adduced by the Commission as a sufficient reason for the repeal of section 158, applies equally to the problems sought to be overcome by section 153. Hence, we renew our recommendation for repeal of section 153 as well as 158.

PRIOR ART (SEC. 155)

The present statute states that the fact that an invention or discovery was known or used before, even though such prior knowledge of use was under secrecy within the atomic energy program of the United States, shall be a bar to the patenting of such invention or discovery.

The Commission has recommended certain amendments to this provision which we feel do not meet the real issue. Under the provision as presently worded, companies may spend thousands of dollars on research and development in a particular field in atomic energy and discover, upon filing of a patent application, that the basic patentable information was already owned by the Atomic Energy Commission. Under the security program of the Commission, however, this company would be in no position to know prior to the expenditure of its funds that it might be barred from acquiring a patent on any resulting inventions. We emphasize that we are concerned here with the expenditure of private and not Government funds.

Clearly, this provision as presently worded presents a severe obstacle to the expenditure of private funds on atomic energy development.

There is no apparent reason why the Commission should not be able to rely on its own efficient patent branch to evaluate the technical information received under chapter 13 of the act, and to file patent applications on behalf of the Government where desirable (which it may do even though the information involved is classified for security reasons). The Commission would then have a defense against possible infringement suits and the public interest would be adequately protected.

For these reasons we recommend that section 155 be repealed. The objectives of this policy can be reasonably accomplished through the existing section 102 of the Patent Act of 1952, together with the reporting requirements of an amended section 151c of the Atomic Energy Act of 1954. Upon repeal of section 155, an inventor will be unable to obtain a patent only when it would be reasonably possible for him to ascertain that his invention is already known.

This concludes our statement on the patent provisions of the Atomic Energy Act now under study by the subcommittee. May we again express our appreciation for your courtesy in holding the record open to receive this and other statements on this question. Let me assure you also of the institute's desire to cooperate in any way possible in the subcommittee's study of the atomic energy patent problem.

Respectfully,

CHARLES STEWART, *President.*

The CHAIRMAN. Mr. George P. F. Smith, National Association of Manufacturers.

STATEMENT OF GEORGE P. F. SMITH, VICE CHAIRMAN, NATIONAL DEFENSE COMMITTEE, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. SMITH. Mr. Chairman and members of the committee, my name is George P. F. Smith. I am vice chairman of NAM's National Defense Committee, and I am speaking today for the association.

This statement is filed on behalf of the National Association of Manufacturers, and relates to the proposed extension of the Renegotiation Act of 1950. The association consists of some 20,000 members, of which it may be of interest to note that 83 percent have less than

500 employees, and 28 percent have less than 50 employees. Therefore, we speak for small, medium, and larger producers as well as a cross section of all types of defense enterprises.

Mr. Chairman, in the interest of saving your time, and with your permission, I will be glad to file a copy of my complete statement with the reporter, and only deal with the highlights.

The CHAIRMAN. Thank you, Mr. Smith.

Mr. SMITH. The National Association of Manufacturers is of the firm belief that the best interests of the public and industry will be served by the total elimination of profit limitation laws from defense contracting. To that end it is urged that the Renegotiation Act, as well as the profit limitation provisions of the Vinson-Trammell Act and of the Merchant Marine Act, be repealed, either through expiration or otherwise.

Our position in flat opposition to the continuance of the profit limitation provisions contained in the above acts is based on the answers to the two fundamental questions confronting us today:

First, is the extension of renegotiation and other profit control laws now in the interests of our national defense?

Secondly, are the Government agencies adequately protected against excessive profits without this form of device?

In answer to those two vital questions, we feel:

1. The act discourages efficiency and reduces the incentive of contractors engaged in defense work. It is a form of cost-plus on a grand scale whereby the efficient are penalized and the inefficient rewarded.

2. Inevitably, any standard by which it is sought to determine so-called "excessive profits" results in an arbitrary and frequently unjust determination. This follows regardless of whether the statutory factors are applied broadly or whether an attempt is made narrowly to achieve accuracy by hair-splitting judgments, percentage factors, and the like.

3. Industry's recordkeeping and administrative burdens are both time consuming and expensive, and are an added burden to an already heavy paperwork load. The related costs are reflected in prices of products sold to the Government and in reduced income taxes. This administrative burden contributes nothing to the quality or quantity of weapons acquired.

4. Delays in processing cases mean that the contractor does not know what his profits are until his case finally clears the Renegotiation Board. This may be anywhere from 2 to 4 years after the year in question. For several years, therefore, a contractor is in the dark as to just what his defense profit situation really is for planning purposes and other vital company decisions.

Let us now turn to the question raised as to whether or not the public is adequately protected against "excessive" profits without renegotiation.

We submit that the Congress has already provided the armed services with the tools with which to meet such problems and prevent excessive profits through the Armed Services Procurement Act which has been implemented by the armed services procurement regulation. The number of different types of contracts provided for in that regulation are more than adequate to meet all special needs. The armed services

procurement regulation specifically provides many different types of contracts, examples of which are:

1. Firm fixed price.
2. Fixed price with escalation.
3. Fixed price with price redetermination provisions.
4. Fixed price with incentive provisions.
5. Straight cost.
6. Cost sharing.
7. Cost plus fixed fee.
8. Cost plus incentive fee.
9. Time and materials.
10. Labor-hours.

Many of these types of contracts are available not only at the prime contract level but also at the subcontract level. Variable-price type contracts providing for close following of contractor's cost experience and adjustment of price on the basis of experience are almost always applied in the case of new types of weapons and equipment, such as missiles, when previous cost experience is not available.

Under these contract forms, there is little or no risk of the contractor earning more profit than was originally contemplated between the contractor and the armed services. May we note with reference to the Defense Secretary's request for profit limitation in relation to specialized items that at least three of the mentioned contractual forms have completely adequate built-in controls.

The National Association of Manufacturers is apprised of the several legislative proposals that currently seek to amend the Renegotiation Act. In addition to the amendment which would extend the expiration date, among the more important are those that would raise the "floor" to $5 million, modify the existing exemption of certain types of contracts, permit further appellate review, broaden the "standard commercial article" concept, liberalize the treatment of profits and losses over fiscal time periods, add a profit percentage standard factor, broaden the exemption of some contracts, and make mandatory the stock item exemption.

A detailed consideration of the merits of each of these proposals is beyond the scope of this written statement. Even the best of these proposals are open to the basic objection that they all represent abortive attempts to repair an obsolete vehicle which should long ago have been retired to the scrape pile. As a matter of fact, the particular amendment which seeks to establish a percentage standard of "agreed profits" represents a shocking backward step in the renegotiation concept.

To extend renegotiation for another period, regardless of how brief, amounts to an unwise postponement of an important decision affecting the Nation's defense effort.

Apparently there is a considerable difference of opinion as to the extension of the Renegotiation Act for a longer period.

The Joint Committee on Internal Revenue Taxation, in their report relating to the extension of the Renegotiation Act, included a statement, and I quote:

> The evaluation of renegotiation in its operation and results leads to the conclusion that renegotiation should not become a permanent part of the law.

In the 86th Congress, the House Ways and Means Committee, in reporting out the bill to extend the Renegotiation Act for 6 months, stated, and I quote:

> The bill limits the extension of renegotiation to a period of 6 months because it is the intention of your committee to undertake a broad review of the entire subject of renegotiation early in the next Congress. At that time consideration will be given to the scope, objectives, and procedures of renegotiation, and to possible amendments, including those proposed at the hearing on the present bill.

It would certainly appear as though the present bill providing for a 4-year extension of the act is not consistent with the two statements which I have quoted.

We have attached to the prepared statement a summary of answers which a broad cross section of our membership gave to our questionnaire we put out on this subject last year. I will not bother to read those. They are available.

I think that concludes my statement.

The CHAIRMAN. Do you wish it to be inserted in the record?

Mr. SMITH. What is that?

The CHAIRMAN. Do you want those questions and answer inserted in the record?

Mr. SMITH. The answers are attached as an appendix to the prepared statement.

The CHAIRMAN. Thank you very much, Mr. Smith.

Mr. SMITH. Thank you, sir.

(Mr. Smith's prepared statement follows:)

STATEMENT OF GEORGE P. F. SMITH, NATIONAL DEFENSE COMMITTEE, NATIONAL ASSOCIATION OF MANUFACTURERS, BEFORE THE SENATE FINANCE COMMITTEE ON RENEGOTIATION

Mr. Chairman and members of the committee, my name is George P. F. Smith. I am vice chairman of NAM's National Defense Committee, and am speaking today for the association.

This statement is filed on behalf of the National Association of Manufacturers and relates to the proposed extension of the Renegotiation Act of 1950. The association consists of some 20,000 members of which it may be of interest to note that 83 percent have less than 500 employees, and 28 percent have less than 50 employees. Therefore, we speak for small, medium, and larger producers as well as a cross section of all types of defense enterprises.

The National Association of Manufacturers is of the firm belief that the best interests of the public and industry will be served by the total elimination of profit limitation laws from defense contracting. To that end it is urged that the Renegotiation Act, as well as the profit limitation provisions of the Vinson-Trammell Act and of the Merchant Marine Act be repealed, either through expiration or otherwise.

Our position in flat opposition to the continuance of the profit limitation provisions contained in the above acts is based on the answers to the two fundamental questions confronting us today:

First, is the extension of renegotiation and other profit control laws now in the interests of our national defense?

Secondly, are the Government agencies adequately protected against excessive profits without this form of device?

In answer to those two vital questions, we call your attention to the fact that during the past several years, the improved procurement policies and practices of the armed services have been instrumental in bringing down prices and profit margins on defense sales to the diminishing-returns point—lower than ever before, particularly as compared to commercial business. The day of hasty procurement, based upon incomplete cost information, has been supplanted by sound defense purchasing in a competitive atmosphere. Furthermore, to the extent that procurement today lacks these characteristics, existing con-

trols other than renegotiation furnish proper protection to the public. In fact, the improved procurement policies and practices of the armed services have created a serious problem to industry. The incentive for participating in defense business has been so diluted by the many profit limiting devices of the armed services, in addition to renegotiation, that many contractors are either devoting their efforts entirely to commercial business or are sharply limiting their participation in the defense effort. We question whether the profit margins presently available on defense contracts are sufficient to permit industry at large to set aside adequate reserves for the maintenance of facilities, research and development, and business growth.

Contributing to the growing reluctance in recent years of many contractors to engage in support of the defense effort, either at the prime contract or subcontract level, are factors inherent in the Renegotiation Act itself and the administration thereof; namely:

1. The act discourages efficiency and reduces the incentive of contractors engaged in defense work. It is a form of cost-plus on a grand scale whereby the efficient are penalized and the inefficient rewarded.

2. Inevitably, any standard by which it is sought to determine so-called excessive profits results in an arbitrary and frequently unjust determination. This follows regardless of whether the statutory factors are applied broadly or whether an attempt is made narrowly to achieve accuracy by hairsplitting judgments, percentage factors, and the like.

3. Industry's recordkeeping and administrative burdens are both time consuming and expensive and are an added burden to an already heavy paperwork load. The related costs are reflected in prices of products sold to the Government and in reduced income taxes. This administrative burden contributes nothing to the quality or quantity of weapons acquired.

4. Delays in processing cases mean that the contractor does not know what his profits are until his case finally clears the Renegotiation Board. This may be anywhere from 2 to 4 years after the year in question. For several years, therefore, a contractor is in the dark as to just what his defense profit situation really is for planning purposes and other vital company decisions.

PROTECTION AGAINST EXCESSIVE PROFITS WITHOUT RENEGOTIATION

Let us now turn to the question raised as to whether or not the public is adequately protected against excessive profits without renegotiation. The administration's support for continuation of the Renegotiation Act is predicated on the size of the defense budget and the presence of sufficiently heavy defense procurement as to create high prices and unjustifiably high profits. This argument has been stated by the Defense Department in 1958 and again now in the Defense Secretary's request to Congress for the extension of the Renegotiation Act. In his statement the Defense Secretary said:

"Defense expenditures are expected under current world conditions to continue at or somewhat near their present high rate for the foreseeable future. For fiscal year 1959 expenditures of the Department of Defense are estimated to be $40.8 billion. Approximately one-half of such expenditures represents amounts for the procurement of goods and services which would be subject to the provisions of the act.

"The purpose of renegotiation is to eliminate excessive profits from defense contracts and subcontracts thereunder. In large-scale procurement programs involving the purchase of many different types of specialized items, many of unprecedented nature, past production and cost experience are not always available for accurately forecasting the costs of such items. Today, particularly, we are witnessing rapid developments in the aircraft, missile, and space fields. Pricing policies and contracting techniques of the procuring agencies cannot guarantee in all cases against excessive profits.

"Experience has shown that the renegotiation authority is an effective method of preventing excessive profits. It has a salutary effect in contract pricing and has proved particularly effective in the subcontracting areas where maintenance and pricing controls is extremely difficult."

It is respectfully submitted that the Defense Secretary's conclusions expressed do not justify the continuation of renegotiation. The factor of large-scale procurement has been with us for several years. That factor alone, unaccompanied by others, does not justify the existence of profit limiting statutes unless we are to accept the philosophy of renegotiating permanently. Moreover, we

do not subscribe to the proposition that a constantly evolving state of military technology prevents firm cost estimates and consequently firm profit allowances.

We submit that the Congress has already provided the armed services with the tools with which to meet such problems and prevent excessive profits through the Armed Services Procurement Act which has been implemented by the armed services procurement regulation. The number of different types of contracts provided for in that regulation are more than adequate to meet all special needs. The armed services procurement regulation specifically provides many different types of contracts, examples of which are:

1. Firm fixed price.
2. Fixed price with escalation.
3. Fixed price with price redetermination provisions.
4. Fixed price with incentive provisions.
5. Straight cost.
6. Cost sharing.
7. Cost-plus-fixed-fee.
8. Cost-plus-incentive-fee.
9. Time and materials.
10. Labor-hours.

Many of these types of contracts are available not only at the prime contract level but also at the subcontract level. Variable-price type contracts providing for close following of contractor's cost experience and adjustment of price on the basis of experience are almost always applied in the case of new types of weapons and equipment (such as missiles) when previous cost experience is not available. Under these contract forms, there is little or no risk of the contractor earning more profit than was originally contemplated between the contractor and the armed services. May we note with reference to the Defense Secretary's request for profit limitation in relation to specialized items that at least three of the mentioned contractual forms have completely adequate built-in controls.

CONCLUSION

The National Association of Manufacturers is apprised of the several legislative proposals that currently seek to amend the Renegotiation Act. In addition to the amendment which would extend the expiration date, among the more important are those that would raise the "floor" to $5 million, modify the existing exemption of certain types of contracts, permit further appellate review, broaden the "standard commercial article" concept, liberalize the treatment of profits and losses over fiscal time periods, add a profit percentage standard factor, broaden the exemption of some contracts, and make mandatory the stock item exemption.

A detailed consideration of the merits of each of these proposals is beyond the scope of this written statement. Even the best of these proposals are open to the basic objections that they all represent abortive attempts to repair an obsolete vehicle which should long ago have been retired to the scrap pile. As a matter of fact, the particular amendment which seeks to establish a percentage standard of "agreed profits" represents a shocking backward step in the renegotiation concept.

To extend renegotiation for another period, regardless of how brief, amounts to an unwise postponement of an important decision affecting the Nation's defense effort. The fundamental inequities of the Renegotiation Act affecting the many different types of contracts are so varied that amendments cannot change the fact that the entire renegotiation concept is now not only uneconomical and injust, but an emphatic deterrent to our defense effort, particularly in view of the safeguards otherwise available to procurement agencies to prevent excessive profits through the Armed Services Procurement Act and existing regulations.

NAM RENEGOTIATION QUESTIONNAIRE—ANSWERS, 1958

Pusuant to NAM's continual study of the administration of renegotiation laws, during the past year a questionnaire was sent to the 250 defense contractors comprising the Association's National Defense Committee. The business concerns represented included varying types of small contractors as well as larger companies handling procurement of complex weapons systems.

The quotations as categorized below are the most typical excerpts from answers to the questionnaire.[1] In similar language, these statements were repeated many times by the polled defense contractors.

[1] Emphasis supplied.

PENALIZES EFFICIENCY

"The major objection to profit-limiting devices is that is *penalizes efficiency and destroys incentive.*"

"Federal profit-limiting devices are incentive limiting. They also tend to *discourage close cost control and efficiency* as generally speaking, the most efficient companies and those with lowest cost will reflect a higher margin of profit, little or none of which might be retained under profit-limiting devices."

"Inefficient contractors aided."

"Profit-limiting control by the Federal Government, as we all recognize tends to eliminate the advantage of efficient production. It puts contractors on a basis where their ability to secure business by efficiency is not effective."

THE PRICE OF REDUCED PROFIT

"At times *it causes reputable companies to walk away from Government business* because of lack of incentive, the time consuming and expensive record-keeping chore, etc."

"*We find that prices are moving lower to such an extent that we are bidding less Government work.* Federal profit-limiting devices are an obstacle to research, plant modernization and to financing."

"If the purpose of renegotiation is to reduce Government procurement costs, the profit element, on which attention is so closely focused is the tail and not the dog. By concentrating on the profit element—whether it should be 8 percent, 10 percent, 12 percent, etc.—sight seems to be completely lost of the total cost to the Government which is the important consideration. A strong case can be made that as you reduce or eliminate profit you *reduce or eliminate incentive* and instead of reducing total cost you *raise* it."

CAN THE LAW AND ADMINISTRATION BE FAIR?

"It is a form of cost plus on a grand scale, whereby the efficient are penalized and the inefficient rewarded."

"As a result of a number of hours of conversations between the examiners and the Regional Board and the various officials of our company in an attempt to determine the examiners and Board's position, we can only come to the conclusion that *their position is strictly arbitrary.* In the last renegotiation proceeding, the only reason that they gave us for the renegotiation, in spite of the fact that they readily admitted that the profit was due to our general operations, that they did not consider our figures as to cost to be entirely reliable because we did not have automatic IBM machine equipment or similar equipment that would maintain on a day to day theoretical basis all elements of cost. They did admit that they could find no real flaw in our methods of cost-keeping but, nevertheless, they had to give us some kind of an answer and they hung their hat on this rather slim defense. In other words, if we had bought some expensive bookkeeping cost accounting systems which would not on an overall basis be of benefit to us after the added volume of occasional large contracts are completed, we would have increased our costs sufficiently as the result of such purchase and operation so that we probably wouldn't have had any money to be renegotiated. We called their attention to the weakness of this argument and that there was little reason for their action, but we received no consideration as result of our protest. As a matter of principle, we probably in this last renegotiation should have taken it to Washington as we feel even though it would perhaps have cost us a substantial amount of what the renegotiation refund was, we think that their case was so weak that undoubtedly we could have won. On the other hand, we run the chance of fighting the case and still have to pay the refund."

"A major objection to the Renegotiation Act is the Renegotiation Board itself and its erroneous interpretation of the intent of the law. Specifically, the Board's *failure to look at overall profits* on defense business and its efforts to find *one segment* of a business yielding higher than average profits and use that segment as a lever to make an excessive profit determination—low profit levels or losses in other segments notwithstanding."

"Some big profit makers excused by 'floors'."

"We have the experience of a long-term contract running for 4 years and having to show the profit in the final year when low costs are present. This is not given defined consideration by the Board. *The tax laws themselves specifically allow a fairer carryforward-carryback administration.*

PRESENT PROCUREMENT PRACTICES ARE SUFFICIENT

"Our experience has been that the Government is doing a much more efficient job in its procurement policies—both as to administration and pricing. In fact, the present 'buyers' market has given them a terrific bargaining leverage which they have fully exploited."

"In other words, in view of the present competitive market it should not be necessary to renegotiate the profits of those products that are sold to the Government year after year, the pricing of which has withstood the rigors of competition."

"The number of competitors in the industry makes it virtually impossible to have larger profits. Currently company profits are almost at a vanishing point. One of our major concerns is that under the Renegotiation Act there is no provision possible to provide for such a period. Here the Government *takes away company profits but does not share company loss periods.*"

"A fundamental point prevails in our direct repudiation of the profit motive, the core, the very essence of our capitalistic system."

"In order to be competitive with other bidders for prime contracts with Government agencies, *we must accept profit margins of approximately one-half our normal margins on commercial production.*"

"We have experienced a decrease in profit margins in recent years on renegotiable business. One of the prime reasons has been that an increasingly larger percentage of our total renegotiable business is being secured under CPFF contracts, on which profits are abnormally low. We have also experienced lower margins earned on our Fixed Price and Price Redetermination-Target Incentive type business."

"Our experience is that under today's competitive conditions closer pricing is definitely necessary, on Government inquiries, resulting in a *decrease in profit margins*, if business is to be realized. As a matter of fact, on recent bids our prices have been ridiculously low and we still lose the business."

"Our experience has been that our *profit margin is kept down already to the bare minimum.* Also, Government auditors are the ones who make sure that our profit is not excessive. The Renegotiation Board is of on value for our business. The Army Audit Agency is doing the necessary work for the Government."

"In our experience in recent years, Government procurement policies have resulted in much closer pricing with corresponding substantial decrease in profit margins."

"We believe the Government's current procurement practices at least in our case are sufficient to insure close pricing of contracts * * * there is available in the Armed Services Procurement regulation, a sufficient variety of contractual instruments to protect the Government in respect to special individual cases."

"We believe that such profit-limiting devices are no longer necessary in the aircraft industry due to the general use of incentive-type contracts and *more efficient procurement practices.*"

"The bulk of our Government contracts business is on negotiated fixed price contracts. Our bids on all important contracts during the past two years have been subjected to audit and detailed review before the contract was negotiated. Detailed bills of material have been reviewed for both quantities and price. Labor estimates have been reviewed for both hours and rates. Overhead and G. & A. rates have had to be substantiated by detailed schedules. The estimated profit margin has been subjected to very close scrutiny. A 'CPFF viewpoint' has been adopted in making these audits and reviews of our bids."

"During the past year approximately 80 percent of our sales were under cost-plus-fixed-fee-type contracts. It is considered that the *low percent of fee allowed and the strict Government audit properly control profit on this type of contract.*"

"Most of our fixed price contracts contain price redetermination clauses, which should make overall renegotiation unnecessary."

"Absolutely no need for renegotiation in case of the Company. We have never been allowed profits (on CPFF contracts by negotiation, on FP contracts by competition) that put us in area where renegotiation would be suitable."

"Procurement policies in recent years have definitely *resulted in closer pricing and a decrease in profit margins. The amount of costs data required when submitting bids has increased.* Competition during the past years has become much more severe and in many cases, *Government contracts can only be secured at a nominal profit and sometimes at a loss after lengthy renegotiation.*

"CPFF type and redeterminable type contracts are closely audited by the auditors of the various Government departments—on the spot, throughout the life of each renegotiable contract. And the larger the contract amount the more intensive is the *audit control* likely to be. As to fixed price type contracts they are generally obtained by competitive bidding with the *lowest* responsible bidder receiving the award; they would not be fixed price type unless they involved products on which adequate comparative cost history had been built up."

EFFECT ON INDUSTRY

"Profit-limiting devices destroy the incentives and the stimulus for maximum efficiency, lower costs, and greater output."

"Imposes unfair penalties for effective and economical utilization of Government-owned facilities."

"Profit-limiting devices hinder the economic climate conducive to the attraction of capital necessary to the support of the industry."

"It takes money that could otherwise be used for business expansion (*making more jobs*), and vital research."

"It prevents earnings sufficient to provide for necessary facilities, requirements, and vital research and 'state of the art.'"

"During the years of delay, it is impossible to present to stockholders the amount of dollars remaining to be utilized for:

"A. Capital for expansion.

"B. Capital for increased inventories and expanding businesses.

"C. Capital for R. & D.

"D. Capital to be set aside for contingencies.

"E. Return on investment to stockholders."

"Independent research for military products penalized."

"The long delays in determining excess profits in any year are a *serious hindrance in proper corporate planning, particularly in regard to investments in fixed assets.*

The CHAIRMAN. Mr. Barron K. Grier. Proceed, Mr. Grier.

STATEMENT OF BARRON K. GRIER, REPRESENTING THE AEROSPACE INDUSTRIES ASSOCIATION

Mr. GRIER. Thank you, sir.

Mr. Chairman, my name is Barron K. Grier. My address is 1001 Connecticut Avenue NW., Washington, D.C. I am here representing the Aerospace Industries Association, which was formerly known as the Aircraft Industries Association.

I have a prepared statement, Mr. Chairman, which I will follow to the extent I can, but, with your permission, I would like to depart from it from time to time to comment on some of the things which have been said by other witnesses today.

There appears to be a widesread misconception about renegotiation—what it is, how it works, what it can do, and what it cannot. Furthermore, there also appears to be a misconception in the minds of some as to the position of the Aerospace Industries Association with respect to the extension of the Renegotiation Act of 1951. To the extent that I am able to do so, I want to clarify these matters to this committee.

Let me say first that the Aerospace Industries Association does not oppose the extension of the Renegotiation Act of 1951.

I had thought that our position had been made clear, but apparently it has not, because some rather irresponsible statements have appeared in the public press and elsewhere about the position of this industry on renegotiation.

We are well aware of the size of the defense budget and of the heavy tax burden necessary to carry it. We are as anxious as any

good citizen should be that no one profiteer from our defense spending, and for this reason we concede that there may be a need for some after-the-fact review of the results of that spending.

The purpose of renegotiation is, of course, to provide that after-the-fact review and to eliminate excessive profits. However, the elimination of excessive profits is supposed to be in accordance with the statutory provisions of the Renegotiation Act of 1951.

The Honorable Carl Vinson, the chairman of the House Committee on Armed Services, succinctly stated the purpose of renegotiation during the debate in the House on the enactment of the Renegotiation Act of 1951. At that time he said:

> Renegotiation does no more than prevent or eliminate profits that are clearly excessive and unreasonable on an overall basis—profits that it would be clearly unconscionable for a contractor to retain from his dealings with his Government in circumstances which precluded proper initial pricing.
>
> The sole objective as well as the net result of a renegotiation proceeding is to make certain that the Government has paid no more to a contractor, directly or indirectly, than he should in good conscience be entitled to receive in the circumstances. * * *

The Aerospace Industries Association has no quarrel with the objectives of renegotiation as expressed by Mr. Vinson. It does contend, however, that the operation of the Renegotiation Board is not in harmony with those purposes.

Apparently we have not always been alone in this belief. On July 23, 1956, the Subcommittee for Special Investigations of the Committee on Armed Services of the House of Representatives released its report on aircraft production costs and profits. The report was based on a study of 12 aircraft companies and was signed by the Honorable Carl Vinson. I hope that you can find the time to read the full report, but for the present I will read some pertinent excerpts therefrom.

On page 3115, under the heading "Renegotiation Act of 1951," the report said:

> The financial data assembled by the subcommittee commenced with the year 1952. That year was chosen for the purpose of eliminating from consideration any influence which action of the Renegotiation Board under the Renegotiation Act of 1951 might have on the books and accounts of these companies.
>
> At the time the subcommittee's questionnaires were issued in August of 1955, all statutory renegotiation for years prior to 1952 had been completed. It was our purpose, therefore, to have before us financial statements and the book profits unaffected by and prior to statutory renegotiation.

Again on page 3115 the subcommittee said:

> The subcommittee is concerned over some aspects in the application of the Renegotiation Act to these particular companies.

On page 3117 the subcommittee said:

> There seems to be some uncertainty over renegotiation not so much in principle but in application under the act of 1951 as well as renegotiation as it has heretofore been applied by the Renegotiation Board.
>
> Elsewhere in this report we have indicated that the concern of the subcommittee extended to maintaining this airframe industry upon a sound fiscal basis so that it would be continuously available to the Government as a source "in being" for defense production. In this report, we have called attention to the fact that this industry, to keep pace with the progress of the art, has committed itself to future capital expenditures on the order of some $350 million. Such a plant must be financed. We believe the ground rules relating to earnings and profit must be more certain so that such long-range expenditures can be made with a degree of assurance.

We are concerned with the Renegotiation Board regulations which provide that their prior actions are not "controlling precedents," and the "formula of an overall evaluation." Why these factors are not capable of explanation has not been satisfactorily answered, as far as we are concerned.

The Department of the Air Force, in its prepared statement, argues that the continuance of the Renegotiation Act is necessary because "the fact of large volume procurement can be to distort the cost factors which form the basis for individual contract negotiations." But the fixed-price incentive-type contract, calling for a sharing of savings by reason of reduction in costs, must be considered in the application of this abstract principle; and this type of contract predominates in those contracts which we reviewed and is widely boasted as an advantage to the Government.

We think it inexcusable to allow statutory renegotiation to be 4 years behind. If more help is needed, it should be requested and granted. To delay timely determination of profits for as much as 4 years is unfair to the Government and unfair to the contractors who are expected to plan for the future.

Planning is particularly important in the case of an art which is progressing as fast as aerodynamics and all of its counterparts. Vast sums are being expended in design competition and technical research, and to have statutory renegotiation impending for long periods is, in our opinion, a serious handicap to the progress of this industry as an arm of national defense.

Therefore, we believe that Congress must immediately initiate a restudy not of the principle of recovering excessive profits but of the application of the statutes and the regulations and conduct of the Board itself.

Mr. Chairman, that was Mr. Vinson and his full subcommittee speaking in 1956. We could not have written it better ourselves.

How, in the face of that report, Mr. Vinson could say this morning, "Here is an 8-year-old act admittedly accomplishing its purpose, doing the job for which Congress designed it and to which there has been no complaint or suggestion of faulty administration"—how he could say that in the face of his own subcommittee report is beyond my comprehension. It certainly seems clear that in 1956 the Subcommittee for Special Investigations of the House Armed Services Committee was not wholly satisfied with the operation of the Renegotiation Board.

The Renegotiation Act of 1951 was extended last year for a period of 6 months, to June 30, 1959. In explanation of the short extension the Ways and Means Committee report said:

The bill limits the extension of renegotiation to a period of 6 months because it is the intention of your committee to undertake a broad review of the entire subject of renegotiation early in the next Congress. At that time consideration will be given to the scope, objectives, and procedures of renegotiation and to possible amendments including those proposed at the hearing on the present bill.

Neither the study which Mr. Vinson's subcommittee said it believed the Congress should initiate regarding the application of the statutes and the regulations and the conduct of the Board itself, nor the broad review of the entire subject of renegotiation covering the scope, objectives, and procedures which the Ways and Means Committee said it would undertake early in this Congress has been made. This is clear from the statements made by Mr. Curtis and agreed to by Mr. Mills during the debate in the House on H.R. 7086—pages 8238—8239, Congressional Record, May 26, 1959. Neverthless, your committee now has before it a bill which would extend the Renegotiation Act of 1951 for an unprecedented 4-year term.

Because the Congress has not studied the scope, objectives, and procedures of renegotiation, we urge that the act be extended for no longer than 1 year. We also urge that the Congress make a thorough

investigation of these matters during the year's extention and then decide what, if anything, should be done about further extensions.

Now, Mr. Chairman, I would like to comment on a few specific provisions of the bill.

Section 2: That deals with factors to be considered in determining excessive profits.

One of the most troublesome problems in renegotiation has been the profits earned under incentive contracts. Briefly, these are contracts under which a target cost and a target profit are negotiated by the parties. The contracts provide that if the contractor is able to reduce costs below those stated in the contract he and the Government will share in the savings, generally at the rate of 80 percent to the Government and 20 percent to the contractor.

Conversely, if costs exceed those stated in the contract, the Government bears 80 percent of the additional cost and the contractor bears the remaining 20 percent. The objective, of course, is to encourage the contractor to seek ways to save on costs and to reward him by paying an extra profit for such savings.

Contractors within the airframe industry who have earned incentive profits have found that the Renegotiation Board almost invariably demands a refund of so-called excessive profits which would eliminate virtually all of such incentive earnings. In some cases the demanded refunds have exceeded these earnings.

There is obviously no sense in providing an incentive if in the final analysis the contractor has to give it back through renegotiation. Therefore, section 2 of H.R. 7086 would amend the Renegotiation Act so as to require the Board to give favorable consideration to contractual pricing provisions and the objectives sought to be achieved thereby.

The purpose of this amendment is to assure that the contractor will not be penalized for having been efficient, reducing costs, and thereby earning additional profits. The unfortunate result of renegotiation heretofore has been a penalty on such efficiency.

Mr. Chairman, you may have before you a copy of the hearings held in the House on this matter. On page 218 of those hearings is a graph showing the portion of profits which represent incentive earnings, and the total amount taken back by the Renegotiation Board from four large airframe companies with respect to the years designated on the graph.

The CHAIRMAN. Is that page 218?

Mr. GRIER. Yes, sir.

The parallel black mark illustrates where the incentive profits begin, and the vertical black column illustrates the amount of so-called excessive profits the Board is attempting to recapture.

You will see with respect to Boeing, in 2 out of the 3 years the Board asked for more back than the company had in incentive earnings. The same is true with North American; 1 year for Lockheed, and both years for Douglas.

Mr. Dechert said yesterday, if I recall correctly, that we were wrong in saying that the Renegotiation Board had attempted or had in fact recovered incentive earnings as excessive profits. He explained that somehow the attempted recapture of so-called excessive profits were really not incentive earnings but some other profits, but what kind I could not understand.

This morning Mr. Coggeshall said, if I heard him correctly, that most of the excessive profits his Board had found with respect to some of these companies were their incentive earnings.

In contrast to that, I would like to read you what Mr. Coggeshall said last year. On page 167 of the hearings before the Committee on Ways and Means held on July 29, 1958, appears this statement:

> It may sometimes happen that a determination of excessive profits by the Board either approximates or exceeds the amount of the contractor's incentive profits. Apparently the association—

that is this association—

> believes it useful as a forensic expedient to charge that in any such case the Board has taken away the entire amount of the contractor's incentive profit. This is a snare and a delusion. Incentive profits as such are not eliminated. The Board does not and indeed could not consistently with the act isolate profits resulting from the operation of contract incentive provisions and consider such profits separately and apart from the target profits realized on such contract. The Board determination is based upon an evaluation of the contractor's entire profits under incentive contracts during the fiscal year, not just the profits realized under the incentive formula, and upon a review of profits from all other renegotiable business performed by the contractor under other types of contracts. Indeed, in more than one case the excessive profits realized under incentive type contracts have been offset in the Board's determination by deficient profits realized on other segments of the contractor's business.
>
> One must not be misled by any numerical similarity between incentive profits and excessive profits. If it exists, it is purely coincidental.

That seems to me to be diametrically opposed to what he said this morning.

Mr. COGGESHALL. Mr. Chairman, may I intervene? I did not say it was from incentive profits; incentive contracts and other contracts. Any time there is a $5 million finding of excessive profits, that means we find $4 million in the target price and $1 million in the bonus. If we took all the bonus, if we found all the bonus unearned, we will say, in Boeing, they would have had $50 million refund instead of $10 million.

Mr. GRIER. Mr. Chairman, I will let the record speak for itself. I do not propose to debate the point with Mr. Coggeshall this afternoon. The facts are in the record, and I hope the committee will consider them.

Now, departing again for a moment from my prepared statement, Mr. Vinson made a great point this morning of the change made in the so-called net worth factor by eliminating therefrom the words "with particular regard to."

Quite frankly, I do not think this amendment will change anything, but I would like to be on Mr. Vinson's side on at least one point in the matter, so we suggest that here you leave the statute just like it is.

Another amendment made by section 2 is to require the Board to give favorable consideration to economies achieved by subcontracting with small business concerns. In spite of the fact that it has been national policy for some time to encourage small business, the Renegotiation Board has consistently used the amount of subcontracting done by a contractor as an excuse to support its demands for refunds of so-called excessive profits. Mr. Chairman, there is in the record of the hearings of the House, both in April of this year and July of last year, so-called statutory letters issued by the Board to several

large airframe companies. I commend their reading to you and to the other members of this committee in support of the statement I have just made.

Now, section 4: Statements furnished by Renegotiation Board, and so forth.

Another matter which has plagued contractors is the fact that they cannot find out why the Board considers that they have earned excessive profits. The Board make no reports on individual cases, and thus there are no precedents established which can be used as a guide.

Furthermore, the Board has consistently refused to reveal to contractors the factual data considered by it even with respect to the contractor's own case.

Common, ordinary fairness would seem to require that the Board give the contractor the facts upon which it made its decision. These facts are generally encompassed in reports made by the Government contracting agency in the case of prime contractors or by other contractors in the case of subcontractors.

Section 4 of H.R. 7086 would amend the Renegotiation Act so as to require the Board to—

> * * * make available for inspection by the contractor or subcontractor, as the case may be, all reports and other written matter furnished to the Board by a department relating to the renegotiation proceedings in which such determination was made, the disclosure of which is not forbidden by law.

The amendment goes on to say that it does not authorize the disclosure of any information referred to in section 1905 of title 18 of the United States Code—

> * * * in respect of any person other than the contractor or subcontractor (as the case may be) unless such information properly and directly concerns such contractor or subcontractor.

Section 4 also provides that this amendment shall apply only in the case of determinations made by the Renegotiation Board after the date of the enactment of this act.

It seems to us that this amendment is deficient in two major particulars. There is no logical reason why the disclosure should be limited to written information submitted by a department. If the Board has information from other sources and on the basis of that information seeks to recover moneys from the contractor being renegotiated, it seems only fair that the contractor should know and be given the opportunity to refute or explain that information.

Furthermore, we cannot understand why this revelation of information should be limited to determinations made after the effective date of H.R. 7086. There may be some logic from an administrative standpoint in not disclosing factual data to contractors who have agreed to make refunds, but there can be none, in our view, for refusing to make it available to those contractors who have not agreed and whose cases are still open in the Tax Court.

Additionally, the effective date will work inequitably as between contractors for reasons of pure happenstance. For example, the Board has already made determinations of excessive profits with respect to some contractors for the year 1955, but it has not with respect to others for the same year. As the proposed amendment is now worded, some contractors will be able to know the facts used as a

basis for a determination of excessive profits with respect to their 1955 operations and others will not.

We suggest, therefore, that section 4 be amended so as to afford a contractor all factual data bearing on the renegotiation proceeding in which he is involved, and that this right extend to all open cases.

Mr. Chairman, I am not suggesting here, as has been argued by others who have appeared before you, that we want to get the intramural memorandums prepared by subordinates or employees of the Renegotiation Board for consideration by their superiors. I do not think we are entitled to that. But I do think that, since the performance of the contractor is the very heart and soul of renegotiation and is the basic standard by which the Board judges whether or not a contractor has excessive profits, the contractor is entitled to know the facts by which he is being judged.

Furthermore, this is the only regulatory agency that I know of, I believe it is the only one, which is not required to proceed on the record under the Administrative Procedure Act.

There may be good reasons why the Administrative Procedure Act should not be applied to renegotiation. But that is not to say that a contractor is not entitled to know the facts.

And, Mr. Vinson to the contrary notwithstanding, it will not make the contractor a member of the Board or put a window in the heads of the Board members so that the contractor can ascertain their mental processes.

All in the world we ask is, What are the facts upon which the Board based its decision?

Furthermore, Mr. Vinson spoke as if this provision were the only one permitting a person to get at the facts. Apparently he has not been advised about the rules of discovery which permit litigants to go in under the power of the court and virtually rifle the files of the other party.

There is considerable support in the legislative history—to go on now with section 5, proceedings before the Tax Court in renegotiation cases—there is considerable support in the legislative history that Congress intended the Tax Court to conduct a de novo renegotiation proceeding, and to make up its own mind on the basis of pertinent facts wherever found as to the amount, if any, of excessive profits earned by the contractor.

In other words, that the Tax Court's function would be more administrative than judicial, and specifically that it would not be judicial in the sense of an appellate court reviewing the record of a case brought up from a lower court.

As it has developed, however, the Tax Court has functioned judicially in renegotiation cases, and more and more in the role of a court of review, while at the same time insisting that such proceedings are de novo.

This puts a contractor before the Tax Court in something of a dilemma and at a decided disadvantage. He is required by the Tax Court rules to give clear and concise assignments of each and every error which the petitioner alleges to have been committed by the Board. But if he alleges matters pertaining to Board proceedings, records, and so forth, the Tax Court will strike it out on the ground that such matter is not relevant in a de novo proceeding.

Furthermore, for the same reason, the court will not receive evidence as to the errors committed by the Board. At the same time, the Tax Court appears to proceed on the assumption that the Board's determination of excessive profits is correct, and has several times sustained such a determinaiton on the ground that the contractor has failed to prove it wrong. This is more in keeping with appellate review than with a de novo proceeding.

Section 5(a) of H.R. 7086 would amend the Renegotiation Act to make it clear that the proceedings before the Tax Court are de novo by providing that although the contractor in a Tax Court proceeding has the burden of going forward with the case, the Tax Court shall consider only evidence presented to it and that no presumption of correctness shall attach to the determination of the Board.

Section 5(b) provides that determinations by any division of the Tax Court in renegotiation cases shall be reviewed by a special division of that court which shall be constituted by the chief judge and shall consist of not less than three judges.

This amendment was not proposed by any of the witnesses that I heard appearing before the Ways and Means Committee, and that committee's report does not explain the reason for the amendment. Presumably its purpose is to provide a composite judgment of what amount, if any, of excessive profits may have been earned by a contractor.

Mr. Chairman, I have heard reference made today to a letter which you have received from Chief Judge Murdock regarding this and the next section of the bill. I have not had an opportunity to see that letter, so I do not know what objections, if any, the chief judge may have to these amendments.

I would like permission to review that letter and, if a statement appears appropriate, to file one for the record.

The CHAIRMAN. Without objection.

(The following was subsequently received for the record:)

LAW OFFICES OF MILLER & CHEVALIER,
Washington, D.C., June 15, 1959.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: I appreciate the opportunity to comment on the letter to your committee from the chief judge of the Tax Court regarding certain proposed amendments to the Renegotiation Act of 1951.

The chief judge's principal objection seems to be to section 5(a) of H.R. 7086 which would add the following sentence to section 108 of the Renegotiation Act of 1951:

"The petitioner in such proceeding shall have the burden of going forward with the case; only evidence presented to the Tax Court shall be considered; and no presumption of correctness shall attach to the determination of the Board."

The critical clause of the quoted sentence is:

"* * * and no presumption of correctness shall attach to the determination of the Board."

The chief judge correctly points out that the Renegotiation Act already provides that proceedings before the Tax Court in renegotiation cases "* * * shall not be treated as a proceeding to review the determination of the Board, but shall be treated as a proceeding de novo."

The simple, uncomplicated meaning of "a proceeding de novo" is that the matter will be considered anew and as if nothing had happened before.

That the Tax Court has not given "de novo" this meaning is evident both from the decided cases and from the chief judge's letter where he said:

"The final amount determined by the Renegotiation Board has no significance in the trial before the Tax Court *except that if the evidence introduced before the Tax Court does not enable it to reach a conclusion as to excessive profits then the Tax Court must leave the parties as it found them which means that the amount determined by the Renegotiation Board will not be disturbed by the Tax Court.* It is absolutely necessary in any litigation that the moving party have the burden of proof, and the Tax Court has taken care of this by rule 32." [Emphasis supplied.]

It is obvious from the foregoing that renegotiation cases are not being considered as if nothing had happened before. In practical effect the Tax Court presumes that the Board's determination is correct and will not disturb it unless the contractor proves that the Board erred. This is an impossible task because the Tax Court will not admit evidence of Board actions on the ground that such evidence is not pertinent in a de novo proceeding. In other words, Tax Court procedure requires the contractor to prove the Board wrong but denies him the means of doing it.

The basic question before the Tax Court is: "Does the contractor have excessive profits and, if so, in what amount?" In our view, the resolution of this question does not require that either party must carry the burden of proof in the same sense as is required in ordinary litigation. Since it is not possible to "prove" by any measurable standards whether or not the contractor has earned excessive profits, the burden of proof should extend no further than to require each party to prove the evidentiary facts offered. Thereafter the Tax Court should weigh those facts as would a jury and come to a new and independent conclusion regarding the existence of excessive profits, if any. If the evidence produced in the Tax Court does not enable it to reach a conclusion as to excessive profits, then the Tax Court should leave the parties in their original position, which would mean that there would be no excessive profits. It seems to us that this must be the result if the statutory requirement that Tax Court proceedings be de novo is to be given effect.

If there is to be a burden of proof, then it should rest on the Government because it is seeking, by administrative fiat, to recapture profits legally paid a contractor for work done under valid contracts.

The situation in the tax laws which is most nearly analogous to a renegotiation proceeding is the imposition of the accumulated earnings tax provided in sections 531–534 of the Internal Revenue Code of 1954. There, the tax is imposed when earnings and profits have been permitted to accumulate beyond the reasonable needs of the business. What constitute the reasonable needs of a business is not susceptible of exact proof. Therefore, under the conditions prescribed in the statute, the Government has the burden of proving the allegation that the business it is seeking to tax does not have a reasonable need for its accumulated earnings and profits. Similarly, if the Government alleges that valid contracts have produced profits which are greater than can be considered reasonable, it ought to have the burden of proving it.

The chief judge concludes his letter by asking either that no amendments be made to section 108 of the Renegotiation Act or that the Tax Court be relieved of jurisdiction in renegotiation cases. He suggests that the latter alternative might be accomplished by providing for a direct appeal from the Renegotiation Board to the court of appeals, as is the case with respect to many other administrative agencies. This could be done, of course, but it poses at least two problems which the committee may want to consider.

If the appeal is to be directly from the Renegotiation Board to the courts of appeal, then proceedings before the Renegotiation Board must be on the record and in accordance with the Administrative Procedure Act. Otherwise, there will be nothing for the court of appeals to review, and there will be a serious question regarding the constitutionality of the Renegotiation Act.

The other consideration is the fact that a number of renegotiation cases are already pending before the Tax Court. Presumably the chief judge's suggestion for divesting the Tax Court of jurisdiction, if adopted, would be prospective only. This would mean that pending cases would be disposed of by the Tax Court under its present requirements that the contractor must prove the Board wrong. If the Congress means that Tax Court proceedings are to be de novo, then pending cases should be handled in that manner irrespective of a change in procedures with respect to future cases.

An alternative to the chief judge's suggestion would be to vest jurisdiction in the Court of Claims and permit all cases pending in the Tax Court which have not reached the evidence-taking stage to be transferred to the Court of Claims.

Respectfully,

BARRON K. GRIER.

Mr. GRIER. Offhand, I cannot see how anyone can object to a fair court hearing. It is beyond my comprehension.

The next section, section 6, provides that Tax Court decisions in renegotiation cases may be reviewed by the U.S. Court of Appeals for the District of Columbia, and that such court shall have the power to affirm or reverse and remand the decision of the Tax Court.

The stated purpose of confining appeals from Tax Court decisions to the Court of Appeals for the District of Columbia is to achieve uniformity of decisions under this law. We have no special objection to this except to point out that it will work a hardship in varying degrees on all companies who wish to take advantage of this appellate procedure, and may effectively deny the procedure to those companies which cannot afford the time and expense of prosecuting an appeal at some distance from their home location.

It may be—I believe that the only administrative proceeding which is not appealable to some regular court is the renegotiation proceeding. It may be that there is one other having to do with section 722 proceedings relating to the excess profits tax. But it is certainly not the fact that this is something new and unheard of and a departure from normal proceedings. By and large litigants can go in to the U.S. District Court or to the court of appeals, as the case may be, after an administrative proceeding, as a matter of course and as a matter of right.

Mr. Vinson again apparently was not correctly advised when he seemed to imply that this proposed amendment is something which litigants in renegotiation cases will have and which nobody else will have.

Mr. Chairman, I said earlier that I wanted to comment on what I believe are some misconceptions about renegotiation.

To begin with, the procedures followed in renegotiation are in no sense another negotiation of the contract price, and any thought that the members of the board and representatives of contractors sit around a table and negotiate back and forth is totally erroneous.

Instead, after the contractor has submitted his figures and facts, the board announces what it considers to be the amount of excessive profits earned by the contractor, and does so on a take it or leave it basis. The contractor is left with the alternative of agreeing to the board's pronouncement, or not agreeing and having the board order him to refund the stated amount of excessive profits. The very high percentage of cases which the board has concluded by agreement was accomplished in just this manner, and should not be construed as a meeting of the minds of two free bargainers.

Contractors will often agree to and make refunds rather than go to the time and considerable expense of trying to get a redetermination in the Tax Court.

There may be some thought, and I have heard it expressed by members of this committee and others, that renegotiation can and does eliminate excessive profits on individual contracts. It cannot do so legally. The act requires that the profits earned by a contractor each

year from all of his defense business be viewed and judged as a whole. Thus, the result is that high profits on one portion of a contractor's business may be offset by losses or low profits on other business.

To illustrate, assume that a contractor is performing under two contracts in the year 1958. On one contract he made a profit of $1 million, which we will stipulate is excessive. But on the other contract he lost $1 million, and thus ended the year with no profits. Renegotiation cannot legally recapture any of the profit on the first contract which, viewed alone, was admittedly excessive.

In that connection, I am glad that Senator Douglas read excerpts from certain General Accounting Office reports into the record of this hearing yesterday. I had heard that such reports existed, and I have felt for some time that they were being used to justify the continuation of this act in substantially unamended form. However, this is the first time we have had an opportunity to speak directly to the point.

The General Accounting Office, as I understand it, maintains a permament staff at the plants of most large contractors to review and audit all aspects of Government contracts. When errors are found, as they most certainly always will be, the General Accounting Office issues reports to the procuring agency and makes a copy available to the contractor. As you have heard from what Senator Douglas read, these reports cover a wide range of subjects.

I do not concede the correctness nor do I maintain the incorrectness of the General Accounting reports which were read here, but I want to make it absolutely clear that I am not here to defend or condone wrongdoing by anybody. If fraud is involved, that is a matter for the Department of Justice. If inadvertent error has been discovered in cost data, it ought to be, and I believe is, corrected selectively on a contract-by-contract basis.

But I also want to make it clear that renegotiation is not a cure for, and cannot correct, the matters reported on by the Comptroller General.

In support of that statement, I want to read a portion of section 105 of the Renegotiation Act:

> The Board shall exercise its powers with respect to the aggregate of the amounts received or accrued during the fiscal year—by a contractor or subcontractor under contracts with the departments and subcontracts, and not separately with respect to amounts received or accrued under separate contracts with the departments or subcontracts. * * *

It must be apparent from this statutory provision that the Renegotiation Board cannot pick out an individual contract and recover excessive profits earned from it, no matter what gave rise to such profits. So far as I know, the Board does not claim that it has the power to correct the errors complained of by the Comptroller General.

Furthermore, I have never seen any statement by the Board in support of its findings of excessive profits which included an allegation that the costs of incentive contracts were incorrectly established.

And yet, yesterday Mr. Dechert, in answer to questions by Senator Douglas, said that the matters reported on by these General Accounting Office reports were the very reason why we need renegotiation.

The things reported on by the Comptroller General are matters which, I believe, he is equipped to discover and act on. The Renegotiation Board is not. Therefore, I hope that this committee will

not be influenced in its consideration of this legislation by the thought that the Renegotiation Board can correct the errors on individual contracts pointed out by the General Accounting Office.

In conclusion, Mr. Chairman, we believe that the amendments contained in H.R. 7086 as it passed the House will tend to improve the administration of renegotiation in the Tax Court and beyond. We are disappointed, however, that the Congress has thus far not seen fit to make an investigation into the operations of the Board and to legislate in the light of its findings.

It is our earnest belief that a greater degree of due process of law is required in Board proceedings. In the case of *Lichter* v. *U.S.*, 334 U.S. 472, which held the World War II Renegotiation Act to be constitutional, the Supreme Court said, among other things:

> In procedure which affects property rights as directly and substantially as that authorized by the Renegotiation Act, the governmental action authorized, although resting on valid constitutional grounds, is capable of gross abuse. The very finality of the administrative determinations here upheld emphasizes the seriousness of the injustices which can result from the abuse of the large powers vested in the administrative officials. We do not minimize the seriousness of complaints which thus may be cut off without relief in the name of the necessities of war and for the sake of the defense of the Nation when its survival is at stake. We reemphasize that, under these conditions, there is great need both for adequate channels of procedural due process and for careful conformity to those channels.

Mr. Chairman, in our view the Renegotiation Board has consistently blocked all channels of procedural due process in its consideration of renegotiation cases. It not only has refused to make known to the contractor the factual basis for its determinations of excessive profits, but it has refused to comply with subpenas issued by the Tax Court in an effort to get such information for use by the Tax Court.

Board proceedings are devoid of any vestige of procedural due process, and no amount of rhetoric or mathematical computations can obscure the fact that contractors are being deprived of their property by the Board in proceedings which are becoming more and more adversary and in which all the power rests in the hands of the Board.

I join Mr. Stewart in his concern over the implications of questions and answers developed in this hearing. It has been implied that all contractors are venal and all Government negotiators are stupid.

I do not subscribe to either theory, and I resent both implications.

It has also been inferred that because of the above factors, incentive contracts are undesirable and unreliable. Nothing has been said about the overruns of cost which contractors experience, and the fact that nothing will be done by the Government to adjust the price under these conditions.

It is a fact, I am told, that contractors do sometimes exceed the target, and thereby reduce the profit they would otherwise earn. They do not always earn incentives. It is not a builtin and guaranteed profit such as Mr. Vinson stated this morning.

I was told during the noon recess of one instance of a company which overlooked, I think it was about a hundred thousand hours of engineering time which went into the particular contract. The value of this item was several hundred thousand dollars. The target was already agreed to when it was discovered that the contractor had

made an error against his interests, but when he tried to get it adjusted, the Government negotiator refused to do so.

You never hear about these things. You only hear about the other side.

Mr. Chairman, in our judgment this situation, as it now exists—which has been pointed out by Mr. Vinson's subcommittee, and by the Ways and Means Committee—will not improve until the Congress conducts an investigation as it has several times said was needed, ascertains what is being done, and moves to correct it.

Thank you, Mr. Chairman, for this opportunity to appear.

The CHAIRMAN. Are there any question?

The committee will adjourn.

(By direction of the chairman, the following is made a part of the record:)

H & B AMERICAN MACHINE CO., INC.,
Beverly Hills, Calif., May 29, 1959.

HON. HARRY FLOOD BYRD,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD:- We wish to call to your attention what we consider to be a defect in H.R. 7086 as passed by the House. H.R. 7086 amends and extends for 4 years the Renegotiation Act of 1951, as amended. Section 4(b) of H.R. 7086 provides in part that: "At or before the time [the statement of the facts and reasons supporting the Board's determination] is furnished, the Board shall make available for inspection by the contractor or subcontractor, as the acse may be, all reports and other written matter furnished to the Board *by a department* relating to the renegotiation proceedings in which such determination was made, the disclosure of which is not forbidden by law." [Italic added.]

The effect of the underscored language is to deny the benefits of this amendment to subcontractors, since the information pertaining to a subcontractor is normally suplied by other comanies, rather than by a Government deartment. We feel that this is an unwarranted discrimination. All comanies which are subject to renegotiation proceedings should be allowed to examine and, to the extent possible, refute evidence which forms the basis for a determination that part of its profit on Government contracts or subcontracts is excessive. Section 4(b) of H.R. 7086 indicates a general concurrence in this opinion on that part of the House of Representatives, and we feel sure that the position is a basically fair one. Accordingly, we believe that section 4(b) of H.R. 7086 should be amended by deleting the words "by a Department" therefrom.

Several arguments may possibly be made against amending this section, namely: (1) that the Board would have difficulty in soliciting information from private companies if they could not promise that the information would be kept confidential; (2) that the Board has in fact given such promises with respect to information which would have to be made available to subcontractors if the proposed amendment were adopted; and (3) that the subcontractors will have an opportunity to meet and refute the evidence against it in the Tax Court, which under section 5(a) of H.R. 7086 would consider only evidence presented to it, and would accord no presumption of correctness to the determination of the Board. We do not find any of these arguments convincing.

In the first place, the Board would probably have little difficulty in procuring information from private companies even if they could not promise that it would be kept confidential, since such companies would in almost all cases themselves be subject to renegotiation. If such difficulty is considered likely to arise, however, the remedy is to lay a statutory duty on such companies to supply the information, rather than to deny companies concerning whom information is supplied the right to examine and refute the evidence on the basis of which the Board makes its determinations. And even if the Board has in the past promised that it would keep such information confidential, we would still maintain that the Board had no right to promise (in effect) not to reveal evidence to the party against whom it was used, and that the interest served by nondisclosure is distinctly inferior to the interest which calls for disclosure.

Any contention that the information will be disclosed in the Tax Court seems similarly deficient. The Renegotiation Board's Annual Report for 1958 indi-

cates (at pp. 8 and 11 thereof) that as of June 30, 1958, only 70 of the 3,202 determinations handed down by the Board had been made the subject of petitions to the Tax Court. Furthermore, it seems clear on principle that a subcontractor should not be forced to pursue his case to the Tax Court before becoming aware of the evidence supporting the Board's determination. And finally, since Tax Court litigation is of an adversary character, the Government would be completely justified in introducing only that information in the Board's files which supports the Government's position.

We urge you to consider carefully, therefore, our proposal that the words "by a department" should be stricken from section 4(b) of H.R. 7086. We think that this provision should be amended to at least that extent.

Even if amended as above proposed, section 4 of H.R. 7086 leaves much to be desired. For instance, it does not require a regional board to furnish a statement of the grounds for its determination, or allow a contractor or subcontractor to examine the evidence on which such a statement is based. Nor would it allow a contractor to procure copies of material in the Board's files which the contractor would like to introduce in evidence before the Tax Court. Because of these defects, it is our belief that section 3 of the King bill (H.R. 5123) is a sounder provision than section 4 of H.R. 7086. Were section 3 of H.R. 5123 to be adopted, however, some provision should probably be made to protect classified information from disclosure (if such protection is not already afforded by some more general law). Such a provision should make it clear that only information whose revelation would injure the national interest is protected from disclosure, and that in all other cases the provision is intended to authorize the disclosure of any information considered by the Board whose disclosure might otherwise be prohibited by title 18, section 1905 of the United States Code. Section 4(b) of H.R. 7086 seems somewhat confusing on this point.

If the Renegotiation Act of 1951 is to be extended for 4 years at this time, it would seem imperative, as the American Bar Association resolved on February 20, 1956, that Congress enact legislation " * * * (a) recognizing the adversary character of proceedings before the Renegotiation Board and (b) providing a greater degree of procedural due process for contractors who are parties thereto." H.R. 7086 evidences a congressional purpose to do just this, and we feel strongly that the amendments we have proposed to H.R. 7086 would further that purpose without imposing any undue hardship on the Renegotiation Board. We hope, therefore, that they will have your careful and favorable consideration.

Very truly yours,

DAVID E. BRIGHT,
Chairman of the Board.

WASHINGTON, D.C., *June 2, 1959.*

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: In connection with the consideration the Committee on Finance is now giving to the matter of extending the Renegotiation Act (H.R. 7086), I am enclosing a copy of a background paper entitled "What Is Appropriate Public Policy for Profit Renegotiation." This paper was prepared by Mr. Sumner Marcus of the University of Washington, and submitted in connection with a recent renegotiation seminar conducted by the Graduate School of Business Administration of the University of California. This is the best background paper I have read on public policy on renegotiation. Therefore, I respectfully recommend that you and the members of your committee read Mr. Marcus' paper before taking any final action on H.R. 7086.

Senator Byrd, in the past I have given you in length my views on renegotiation administration and legislation, hence you know that I am more opposed to the administrative policies of renegotiation than to the legislation. This may sound odd since normally administration should fit within the framework of the statute. But, in the case of actual renegotiation application administrative devices have evolved which are not consistent with the policies established by the act, nor even consistent with the Board's own regulations which do bear some resemblance to a carry-forward effort within the policies of the act. However, I will not belabor this point any further, at this time: instead I respectfully suggest the following additional amendments to H.R. 7086 as an endeavor to

reconcile, to some extent the application of renegotiation with the traditional free enterprise system:

Amend section 103(e) of the present law by adding the following new factors to be taken into consideration:

1. The lack of reasonable profits derived in prior years from contracts with the Departments and subcontracts.

2. Comparisons of quality differences that may be important basis for price premiums, competitive conditions, product pricing as between companies and commercial and renegotiable business.

The first proposed statutory factor amendment would require the Board to take into consideration low profits in the early stage of a manufacturing cycle. The second factor proposed would require consideration of product reliability, areas where the normal economic and competitive forces operate freely although a company's sales may be 80 to 90 percent renegotiable, and a comparison of product prices as between competitors selling in the defense market and those selling in the commercial market.

With kindest personal regards, I am,

Sincerely yours,

WILLIAM T. DARDEN.

WHAT IS APPROPRIATE PUBLIC POLICY FOR PROFIT RENEGOTIATION?

By Sumner Marcus

(A background paper submitted in advance of the conference to be held on May 18 and 19 at the Graduate School of Business Administration of the University of California at Los Angeles.)

INTRODUCTION

Public policy discussions concerning defense profits have revolved almost entirely around ways of improving and limiting the renegotiation process. It has come to be assumed that some form of renegotiation is inevitable during a period of national emergency. At the same time, the advocacy of renegotiation as the best way to curb defense profits has always been accompanied by the recognition that renegotiation is a displeasing technique with many drawbacks and one that would not and should not be used for very long.

The fact is, however, that renegotiation has been employed in connection with defense contracts for over 17 years and that a definite date has not yet been set for its end. Rather, it appears that renegotiation may be here to stay since the need for it is said to result today from the disturbed state of our relationship with the Soviet Union. This is expected to continue for a long time.

Under these circumstances, an appraisal of the renegotiation process which failed to assume the continuation of renegotiation for an indefinite period would not be completely realistic. Still, it is desirable to consider all the possible alternatives in making a study of public policy in any area. We must ask ourselves, therefore, whether renegotiation need be continued at all.

Such an inquiry involves a consideration of, first, the reasons why renegotiation was adopted initially; second, whether these reasons have as much force today as they once did; and, finally, the comparative advantages and disadvantages of renegotiation and of possible alternative techniques for accomplishing what renegotiation is designed to accomplish. In making these comparisons, it will be helpful to consider renegotiation not only as it is now but also as it might be if desirable improvements were made in it. From all this, it will perhaps be possible to determine how well renegotiation is suited to cope with the defense profits problems of the 1960's and, assuming that renegotiation is to be continued, what improvements should be made in it.

THE OBJECTIVES OF RENEGOTIATION

From its inception, it has been asserted that the renegotiation process has two main purposes. One is to secure fair prices for the articles and services which the Government must buy for defense.[1] The other is to prevent individual suppliers to the Government from reaping unconscionable, or, as they have come to be called technically, excessive profits. Fair prices are desired in order

[1] See, for example, "Report of the Joint Committee on Internal Revenue Taxation Relating to Renegotiation," S. Doc. No. 126, 84th Cong., 2d sess. (1956), 7–8; 97 Congressional Record 587 (1951).

to reduce the financial burden upon the Government in time of national emergency and to help prevent inflation. It is believed that excessive profits should be prevented because of what has been described as the public obsession about profiteering[3] that develops when the activities of many individuals are curtailed as the result of the scarcity of materials and military conscription. Profiteering is considered objectionable under such circumstances whether it be intentional or accidental.[3]

Renegotiation is designed to accomplish these major objectives in two ways. By requiring firms to make refunds, renegotiation reduces both the net price paid by the Government for the articles supplied and the profits of the firm making the refund. By holding out to defense suppliers the promise that they will fare better in renegotiation if they keep their prices at a reasonable level when they make their sales to the Government or upper-tier contractors, renegotiation also discourages unfair pricing and excessive profits in the first instance.

There can be little quarrel with the desire to keep governmental expenditures at a minimum and to avoid some of the injustices in the distribution of income that occur in a national emergency. At the same time, it is necessary in considering public policy in this area to inquire whether these objectives are as important today as they were, say, in 1942. Let us study each of the objectives of renegotiation from this point of view.

Changes in the conditions surrounding the purchase of defense materials and services since the beginning of World War II have made the objective of price reduction less important than it originally was. A much smaller portion of the economy is devoted to defense. There is a greater probability, therefore, that fair prices can be achieved through ordinary market processes. This is not true necessarily of purchases by the services of military items such as aircraft and missiles which constitute the major portion of the output of the producing industries.[4] But, even here the military departments are more efficient than they were at the beginning of World War II. Their purchasing officials are more experienced. There is usually more time to investigate and to negotiate. There are new techniques available for more efficient purchasing.

Nevertheless, some representatives of the military departments engaged in purchasing are still of the opinion that, in significant areas, there is no insurance that the Government will obtain the price benefits that would normally accrue from competition among suppliers.[5] This is particularly true in regard to subcontracts, it is claimed.

It must be concluded then that renegotiation still may help reduce the price of defense purchases, although this role is clearly more limited than it was originally.

It also appears that the urgency of preventing excessive profits is not as great now as it has been in the past. As has been recognized for some time, there is no need for the renegotiation of standard articles because competitive forces presumably will prevent a seller from realizing extraordinary profits from their sale. So long as all suppliers have equal access to raw materials, profits that are made from the sale of standard articles under defense contracts will necessarily approximate the profits made from selling to the civilian sector of the economy.

Even contracts for nonstandard articles are not so likely to yield the kind of profits that would shock the public, such as those which prompted the adoption of renegotiation in the first place. The same forces that have increased the likelihood of fair prices have decreased the likelihood of excessive profits. But even when an individual firm earns very substantial profits, it is unlikely that the morale of the Nation is substantially damaged. Although it is true that conscription is still in effect, there is not the same preoccupation with profiteering that exists when a very large number of the people are being adversely affected by the rigors of war and when many, not just a few, may be reaping windfall profits.

Here, again, a primary objective of renegotiation has become less important as the result of changing conditions and the role of renegotiation has necessarily been diminished.

It is also argued on behalf of renegotiation that contracting officials need the aggregate financial data gathered by the renegotiation agency in the course of its

[3] W. K. Hancock and M. V. Gowing, "British War Economy" (1949), 157.
[3] See John P. Miller, "Pricing of Military Procurements" (1949), 256.
[4] Ibid., 237.
[5] "Extension of the Renegotiation Act," hearings before the Committee on Ways and Means, U.S. House of Representatives, 85th Cong., 2d sess. (1958), 2.

operations in order to perform their job well. Although there can be little question that such data may be helpful in negotiating future prices,[6] it is significant that the Air Force places renegotiation data 10th on a list of data to be used by contracting officials in price analysis and says of it merely that it is primarily of historical interest but may be one test of the past reasonableness of contractors' estimates.[7] In any event, if this were the only reason for renegotiation, the collection and analysis of overall data of suppliers could be performed better by those engaged in purchasing.

APPROPRIATENESS OF OTHER TECHNIQUES TO ACCOMPLISH THESE OBJECTIVES

Before attempting to determine how well renegotiation performs the functions assigned to it, it will be helpful to consider other devices which have been or might be adopted to reduce prices and prevent excessive profits.

Quite a few of these contractual techniques have been developed, including incentive type contracts, price redetermination provisions, and escalation provisions. They seek to accomplish their purpose by postponing the establishment of even a tentative price until something can be learned about the cost of manufacture of an item from the experience of the supplier with it. Some of these arrangements go farther and offer the supplier an opportunity to increase his profits under the contract by reducing the cost of manufacture below an original cost estimate or target. The supplier and the Government are said to share, under such an arrangement, cost savings which the supplier's efficiency has presumably brought about.

These arrangements certainly accomplish at least some of the things that renegotiation is said to accomplish. To the extent that they defer the establishment of the contract price until more is known about costs, they reduce the possibility that the price is not fair or that the supplier will derive unexpected excessive profits from the contract. Admittedly, they do not eliminate the possibility of these unwanted results altogether.

The techniques that go farther and provide a clear and definite incentive to the supplier to be efficient are likely to be more effective than renegotiation in reducing the cost of the article to the Government. The type of contract which is most calculated to stimulate contractors to reduce their costs is the fixed-price contract, since the contractor knows, that he will be able to retain any portion of the contract price that he doesn't expend in the performance of the contract. The incentive type contract is designed to accomplish the same purpose without committing the Government to a fixed price at the beginning. The firm knows that if it cuts its costs under a specified amount, its profits will increase. No such assurance is given it when renegotiation is employed to reduce costs. It is true that the renegotiation statutes and regulations have always provided that firms would be given favorable consideration in renegotiation for economy and efficiency but there is little in the recorded history of the renegotiation process to assure a firm that it will be rewarded for its efforts in this direction. Even assuming that the renegotiation agency is conscientious in carrying out the announced aims of the statute and regulations, the firm being renegotiated can never be certain that it will be suitably rewarded, or, for that matter, that it has been, since the renegotiation agency does not assign weights to the various factors considered by it in arriving at its determinations. Accordingly, even when a firm performs its contracts with the knowledge that its profits are subject to being refunded in renegotiation, the incentive to reduce costs that is provided by renegotiation is quite conjectural. When a firm has reason to believe that its overall profits will not be sufficiently high to be recaptured in renegotiation, then clearly renegotiation provides no incentive at all to reduce costs. In theory renegotiation should provide an incentive to a firm to reduce costs whenever the firm is likely to realize a substantial profit from its renegotiable contracts. In practice, however, the renegotiation agencies have been inclined to permit defense contractors to retain a substantial profit, however poor performance of the contract may have been. It must be concluded, therefore, that incentive type contracts offer a much greater incentive to reduce costs than renegotiation does.

But, it may be argued, even assuming that incentive contracts do a better job than renegotiation in keeping down the prices of articles purchased by the Government, why not use both? After all, a contractor who is very successful in reducing the costs under an incentive contract may realize large profits.

[6] See, for example, Miller, op. cit., 180.
[7] "Air Force Procurement Instructions," sec. 3–808.2(d)(10)

Aside from the possible unfairness involved in the Government's giving a bonus for good performance with one hand and taking it away with the other, renegotiation may be undesirable here because in some cases it tends to destroy the very incentives to reduce prices which incentive contracts presumably furnish. This will be the case whenever the supplier believes that his overall operations have placed him near the high-water mark of permissible profits.

None of the foregoing applies, of course, to subcontracts which are not subject to the special contractual arrangements that have just been discussed. To the extent that prices and profits are not controlled there by the self-interest of he prime contractors who make the purchases, renegotiation is still probably the best device available for squeezing the water from prices and profits. It is significant that during World War II, the Government of the United Kingdom developed an informal process similar to renegotiation that it applied to subcontractors alone. It required subcontractors to submit an annual "overall trading report," and, in appropriate cases, to make refunds of a part of their profits.[8]

So far we have addressed ourselves to the merits of techniques other than renegotiation for eliminating excessive profits once realized and reducing prices already established. The proponents of renegotiation, however, argue further that the importance of renegotiation lies in the effect which it has upon the pricing of contracts in the first instance. "This process of self-renegotiation is the most significant and important byproduct of renegotiation," according to Chairman Coggeshall of the Renegotiation Board.[9] Although it is impossible to measure this asserted effect of renegotiation, it is obvious that renegotiation can at best have the desired effect only when the supplier has complete control over his prices and considers that his overall situation in respect to Government contracts places him well within the excessive profits area. Even in such a situation he cannot be certain, for the reasons discussed above, that his restraint in pricing will benefit him ultimately in his renegotiation proceedings. Because little is known about this matter, it would be helpful to learn from contracting officials of the military departments and from upper-tier contractors how effective the threat of harsh treatment in renegotiation has been in producing lower contract prices. Until such an investigation is made, it will not be possible to judge the relative merits of renegotiation and alternative devices in accomplishing the asserted objectives of renegotiation.

Are there other devices besides the contractual techniques already noted which might be substituted for renegotiation to accomplish its basic objectives? Some of the renegotiation's functions conceivably could be reserved for the Congress itself. Specifically, the problem of determining whether the profits of individual defense contractors are too large might be handled by congressional committees, which even now occasionally dabble in this area. The large diversity of defense suppliers do not make this procedure any more feasible or attractive than it was in 1942 when renegotiation was adopted. It is customary for the Congress to assign to an administrative agency rather than to one of its own committees the responsibility for developing policy on a case-by-case basis when the Congress is unable to establish precise standards in advance. Notwithstanding that the Congress has a more intimate relationship with its own committees than with an administrative agency like the Renegotiation Board, it is not likely that the handling of the defense profits problem by a congressional committee would be any more uniform or satisfactory than it would be by the Renegotiation Board.

It has been demonstrated so far in this paper that the ends which renegotiation is intended to serve have become less important under present conditions and those that are foreseeable in the immediate future and that other techniques are adequate partial substitutes for renegotiation in achieving these goals. At the same time, as we have seen, there are still some functions which renegotiation alone can perform.

It does not inevitably follow from this, however, that renegotiation should be continued. Like any regulatory tool, it must justify itself on balance. Renegotiation's best friends concede that it is not a perfect device. If its disadvantages under present conditions outweigh any accomplishments that, in the best possible light, could be reasonably anticipated for it, then it should be discontinued, or at the very least, suspended. Let us proceed then to an analysis of what is wrong with the renegotiation process.

[8] W. Ashworth, "Contract and Finance" (1953), 101–105.
[9] "Extension of the Renegotiation Act," op. cit., 23.

WHAT IS WRONG WITH RENEGOTIATION?

It is proposed now to catalog the objections that have been made to the renegotiation process and to weight the evidence which has been adduced in support of them.

At least four major types of objections have been made. In the first place, renegotiation has an adverse effect upon firms subject to it. Renegotiation, it is said, is costly and time-consuming. There can be little question that this is so, but every form of Government regulation requires the expenditure of some time and money by affected firms.

What makes renegotiation unique in its demands upon the resources of the firm being renegotiated is that only the top executivese of the firm are competent to deal with the governmental representatives concerned as long as there is a possibility that the firm will be required to make a refund. This is because an integral part of the renegotiation process is the attempted justification of the profits that the firm has made in the light of such elements as its efficiency, its contribution to the defense effort, and the special risks it has assumed. Although lawyers, accountants, and other experts are useful in making this presentation to the renegotiation agency, a firm is not well advised to leave the entire job to them. The executives who are most familiar with the firm's achievements and best able to answer the renegotiators' questions about them are expected to be available for such questioning. This means that the top management of the firm must devote a substantial amount of its time to the preparation and presentation of the renegotiation case, particularly when the renegotiation proceeding progresses through several echelons of the renegotiation agencies.

A second major objection that has been made to renegotiation is that it is bad for the officials of the Government who are engaged in making contracts subject to renegotiation. It has been claimed that in setting prices originally these officials tend to rely upon renegotiation's recouping from the contractor amounts which they might have prevented the contractor from receiving in the first instance if they had priced more closely. The answer which is customarily made to this objection is that, inasmuch as contracting officials are normally making contracts and setting prices within the budgetary limitations imposed upon them, it is to their advantage to establish prices at as low a level as possible. This is particularly so since amounts refunded by way of renegotiation are not returned to the departmental appropriations allotted to the contracts producing excessive profits but, rather, are returned directly to the Treasury. There is no evidence, except perhaps at the beginning of World War II, that any laxness in pricing of which contracting officers may have been guilty resulted from their dependence upon renegotiation as a backstop.[10]

It is also said that renegotiation conflicts with other governmental objectives. It is asserted in the first place that renegotiation impedes technological progress in the field of defense. The basis of this objection is that the moneys refunded in renegotiation are not available for plowing back for necessary research to bring new weapons systems into operation and that renegotiation thereby results in "poorer and more costly defense."[11] The Renegotiation Board has vigorously challenged this contention suggesting among other things that firms in industries such as the aircraft industry presumably can meet renegotiation payments without any interference with technological progress, since they have been able to meet more substantial tax and dividend payments over the years.[12] The documentation of these opposing points of view will presumably be made in other papers. It is enough to point out here that money refunded to the Government obviously cannot be spent on research by firms subject to renegotiation even if they should so desire.

It has also been asserted that renegotiation in peacetime hampers production for defense because of the unwillingness of some firms to subject themselves to renegotiation and their consequent refusal to take renegotiable contracts. Doubtless some firms which have had it within their power to decide whether or not to take renegotiable contracts have chosen to deal exclusively with civilian customers. However, there is no evidence that renegotiation has in fact interfered with military production in any significant respect.

Another policy with which renegotiation may come into conflict is that in favor of encouraging the growth of small business firms. Although renegotiation does

[10] Miller, op. cit., 181.
[11] "Extension of the Renegotiation Act," op. cit., 49.
[12] Ibid., 188.

not impinge on the great majority of small business firms, it does affect certain firms which are expected to benefit from the small business policy of the Government, namely new firms which have demonstrated an ability to compete with existing large firms in fields important to the national defense. These firms have the greatest difficulty in obtaining requisite financing during their growing period. And yet it is at this very time that their efforts to secure more capital may be hampered by the requirement that they refund part of their profits. Even if they are ultimately cleared in renegotiation, they may nevertheless suffer in securing financing from the threat of a refund hanging over them for a long period.[13]

There is one further objection that is often made to renegotiation, namely that the procedure for carrying on renegotiation is calculated to produce unjust and arbitrary results. Specifically, it is claimed that the criteria for renegotiation are too vague; that the statements of the Board justifying their rulings are too general and that there are likely to be wide differences between the rulings made by various renegotiation agencies in regard to similar cases. It has been asserted indeed that "by its very nature the process of determining excessive profits is fundamentally and inescapably arbitrary."[14] It is also claimed that renegotiation can be unfair in its application to entire industries, since the members of the Renegotiation Board are given wide discretion and are not required in their determinations to follow the judgment of the Congress or of procurement officials in regard to what constitutes an appropriate profit level for a given industry. The exemption of many classes of contracts from renegotiation by the Congress and the Board in recent years has also contributed to a lack of uniformity in the application of renegotiation to various industries.

Not even the most enthusiastic advocate of renegotiation will deny the presence of arbitrary elements in the renegotiation process. Some of them will be discussed in detail below. The question here, as in the case of the other criticisms which have been noted, is whether the advantages to be secured from renegotiation outweight its manifest drawbacks.

How then shall we summarize the criticism of renegotiation? Certainly some of it does not have a substantial foundation. It is doubtful whether renegotiation makes contracting officials lax in the performance of their duties; it is doubtful whether the military departments have suffered or are likely to suffer for want of materials because of the unwillingness of qualified firms to take renegotiable contracts and thereby to subject themselves to the vicissitudes of the renegotiation process; it is possible that technological progress is substantially impeded because renegotiation takes place, but this remains to be demonstrated. On the other hand, some of the criticism of renegotiation is more serious. It is an arbitrary process; it is time-consuming and disruptive of the operations of defense firms; it is inconsistent with certain other objectives of the Government.

HOW MAY RENEGOTIATION BE IMPROVED?

Before passing final judgment on the question of whether and to what extent renegotiation should be continued, it is necessary to know how it may be improved. It is possible that a tentative decision to eliminate renegotiation might be changed if some of its present objectionable features were eliminated. In any event, if renegotiation is to be continued willy-nilly, then by all means its worst features should be corrected if possible.

One persistent criticism of renegotiation has been that the standards for determining what profits are excessive are too vague. This criticism must be evaluated in the light of possible alternatives to the present procedures of renegotiation. The antithesis of methods now being employed to determine whether a firm has realized excessive profits is the use of a rigid mathematical formula, such as that contained in the Vinson-Trammell Act. This is generally considered undesirable because it tends to destroy contractors' incentives to reduce costs in much the same way that a cost-plus-a-percentage-of-cost contract does. By virtue of its mechanical application to all contractors, such a formula cannot be used to reward individual contractors for their imaginative contributions to the defense effort. It is generaly conceded that changed procedures for carrying on renegotiation must retain at least some of the flexibility which the present ones possess. The question here is whether more precision is compatible with the retention of the flexibility that is required.

[13] This is discussed more fully in Sumner Marcus, "Renegotiation and Small Business," 45 Virginia Law Review, 37–38 (1959).
[14] "Extension of the Renegotiation Act," op. cit., 129.

There are several ways to combat this vagueness. In the first place, a more precise statement could be made about just what an individual renegotiation proceeding is designed to accomplish. At the present time, a reading of the renegotiation statute and regulations discloses merely that the "policy" of renegotiation is that "the sound execution of the national defense program requires the elimination of excessive profits from contracts made * * * in the course of said program." [15] True, the statute and regulations spell out certain factors that are to be taken into consideration in arriving at a determination of excessive profits, but nowhere do we learn what excessive profits are, or what their antithesis, nonexcessive or reasonable profits, are. We are able to glean a little more about the objectives of renegotiation from the public statements of those concerned with the drafting and administration of renegotiation statutes and regulations. Unfortunately, however, we find that these statements are not entirely consonant. One veteran renegotiator tells us that "we are attempting to put ourselves in the position of the contracting parties before a contract was let, and before performance under it was had, and set the contract price at a level that we would have set it had we known all the things we know at the time we are looking at it." [16] On the other hand, the chairman of the House Armed Services Committee tells us that "the sole objective as well as the net result of a renegotiation proceeding is to make certain that the Government has paid no more to a contractor, directly or indirectly, that he should in good conscience be entitled to receive in the circumstances—in a word, that from the efforts of the Government to maintain the common defense for the common good, he has not accumulated more than a fair return or overall price for what he has done." [17] At the same time, we are frequently told that renegotiation is a substitute for competition, which presumably means that the prices permitted the contractor after renegotiation are a rough equivalent of what he would have received had there been competition. The Renegotiation Board, in response to urgings by the aircraft industry, has recently suggested a still different objective for renegotiation in regard to certain kinds of contracts—namely to recapture profits from a contractor when he has received a bonus for performing the contract at less cost than originally anticipated and when these savings are not attributable to his efficiency.[18]

Clearly, the goals of renegotiation are not well defined, nor are they the same for all those concerned with the process. Assuming even that there was agreement about the kind of competition for which renegotiation is a substitute, it does not necessarily follow that a price determined to be one which competition would have produced is the same as one yielding a "fair return" to the supplier. A price which is determined to be the one that would have been negotiated if all the facts learned after the contract had been known at the time the contract was entered into is not necessarily the one which would have resulted had there been full competition. Nor is it necessarily the one that would yield a "fair return."

It is not surprising that there is so much apparent confusion concerning the purpose of the individual renegotiation proceeding. Economists have found it difficult to agree about the nature of profit itself. The renegotiators have attempted to formulate neither a common theory of profit nor a theory of excessive profits. The result is that each renegotiator must proceed on the basis of his own unformulated theories or, in the alternative, must follow some unwritten mathematical formula in arriving at his determinations.

Whatever course is being followed by renegotiators at the present time should be stated. Even though it be conceded that it may not have been possible to obtain consensus about the objectives of a renegotiation proceeding when renegotiation was first adopted, it should be possible to do so after 17 years of experience and thousands of cases. Admitting that it is frequently necessary to develop public policy in new areas by giving an administrative agency broad discretion rather than by the promulgation of definite standards at the outset,

[15] Sec. 101 of the Renegotiation Act of 1951, 50 U.S.C. App., sec. 1211 (1952).

[16] Independent Offices Appropriation for 1956, hearings before a subcommittee of the Committee on Appropriations, U.S. House of Representatives, 84th Cong., 1st sess. (1955), 41.

[17] 97 Congressional Record 587 (1951).

[18] "Favorable recognition must be given to the contractor's efficiency in operations with particular attention to the following * * *. Nature and objectives of incentive and price redeterminable contracts and subcontracts; with respect to such contracts or subcontracts, in which the contract prices are based on estimated costs, the Board will take in to consideration the extent to which any differences between such estimated costs and actual costs are the result of the efficiency of the contractor." Renegotiation Board Regulations, sec. 1460.9(b)(5).

there comes a time when these standards should be firmed up, as they presumably can be after the administrative agency has made policy in the course of its decision of many cases.[19] If the renegotiation agencies had been publishing their decisions and opinions over the years, as administrative agencies generally do, it is possible that no further statement of policy would be needed at the present time, since the Congress and those affected by the renegotiation statutes would presumably have been able to learn from those decisions what standards the Board was applying. In the absence of such guideposts, a more precise formal statement of policy should be required of those responsible for developing the public policy concerning defense profits.

A definition of these general objectives should be only the first step in the direction of greater clarity. Once the Board's objectives are known, it will be possible to proceed to the establishment of more meaningful standards to be applied to individual cases.

The standards now being used by the Renegotiation Board are not sufficiently meaningful even if it were assumed for the purposes of discussion that the ultimate objectives of the Board are well defined. The standards are a slightly expanded version of the "statutory factors," which were invented during World War II by the first renegotiation agencies, and which, with minor modifications, have been incorporated into successive renegotiation statutes. They offer a veritable smorgasbord of elements to the individual renegotiator from which he can select those which appeal to him most in a given case. The result is that the firm being renegotiated knows what factors may be taken into account but has no understanding of which of the many factors are considered by the Board to be the most important. And yet it is probable that there loom behind every determination made by the Board certain facts in the firm's operations which outweigh all others in importance. While it may be conceded that it is most difficult to comprehend the many different fact situations which arise in renegotiation within a formula, it is nevertheless high time that some attempts to do so be made. It is not within the scope of this paper to develop the kinds of meaningful standards that could or should be adopted. One can only wonder, however, why the Congress and the Board have not pursued the excellent suggestions for a more precise, albeit flexible, group of standards that were first made by Professors Weston and Jacoby many years ago.[20] The use of such standards is not likely to destroy any of the effectiveness that renegotiation may now have but would tend to make the renegotiation process more rational than it is at present.

A second common criticism of renegotiation is in regard to its procedures. It is contended in the first place that conducting a renegotiation proceeding for each fiscal year's operation of a firm is bound to result in injustice when the firm's profits fluctuate greatly from year to year. It is true that the income tax laws also employ a fiscal year basis. However, they provide for loss carryforwards and loss carrybacks. Carryforwards are available in renegotiation too but they do not entirely meet the objections to the fiscal year basis. First, there is no provision in renegotiation for carrybacks. Second, renegotiation is not meant to apply, as is the income tax law, to all profits, but merely to those which are excessive. What concerns the critics of renegotiation in this regard is that if a firm makes profits every year, it may be required to refund part of a year's profits even though its overall profits have been well below the allowable level. An analysis of the current procedures of the Renegotiation Board, however, suggests that the problem is more theoretical than real because of the devices which the Board has evolved for "peeking" at the results of fiscal years other than those being renegotiated.[21]

A second criticism of the renegotiation procedure is in regard to the nature of the hearing given the firm being renegotiated. Some would like to see the Board adopt the more comprehensive hearing procedures that are followed by other administrative agencies. The customary answer to this suggestion has been that there is no need for such procedures because any firm that is aggrieved by a ruling of the Renegotiation Board is entitled to a de novo hearing before the Tax Court of the United States, the proceedings of which resemble those of ordinary courts. Furthermore, it is argued that a major virtue of the renegotiation proc-

[19] "The function of discretion would not be then to displace rule but to prepare the way for it. On any other terms administrative discretion would be an anomaly." Ernst Freund, "Administrative Power Over Persons and Property" (1928), 102.

[20] J. Fred Weston and Neil H. Jacoby, "Profits Standards," 66 Quarterly Journal of Economics 224 (1952).

[21] Philip Nichols, Jr., "Equalizing Profit and Loss in Renegotiation," 45 Virginia Law Review, 60 (1959).

ess is the ability to reach settlement in the great majority of the cases after an informal, across-the-table meeting with representatives of the firm being renegotiated.

Here again, as in the case of the definition of the level of allowable profits, there has been a tendency to assume that there are only two possible courses of action. During the hearings on proposed renegotiation legislation last year, Machinery and Allied Products Institute suggested an intermediate approach. M.A.P.I. pointed out that, even though the administrative procedures found in many agencies are perhaps not suitable to renegotiation, still it would be possible to acquaint a firm more fully with the issues by giving it a hearing on the tentative findings and conclusions of the renegotiators assigned to its case before any final determination was made by the regional or statutory board.[22] Certainly at the present time the firm is often in the position of shooting in the dark when it holds its meeting with the members of the regional board because it does not know for certain what factors in its case are considered by them to be the most important.

A bill now under consideration by the Congress attempts to achieve much the same objectives by requiring all determinations of excessive profits, at the level of either the statutory or regional board, to be preceded, at the firm's request, by a statement of reasons for the determination and by the making available for inspection by the firm of all data relating to the renegotiation proceeding.[23] While this particular provision perhaps goes too far in the publicization of the informal files of the Renegotiation Board, its purpose is a good one—namely, to acquaint the firm with the thinking of those who are about to make a judgment on the firm's profits. The need for such a procedure is greater in a process like renegotiation because renegotiation standards are more vague than those of other fields in which administrative agencies act.

In view of the reduction of the caseload of the Renegotiation Board in recent years as the result of the large-scale exemption of contracts from renegotiation and of the increase of the minimum amount subject to renegotiation to $1 million, one might ask whether the Renegotiation Board could not accord the defense supplier as formal and complete a hearing as he would receive from other administrative agencies. In view of the great difficulty which the Board is still having in clearing up existing backlogs, this is probably not feasible. But, certainly, some formalization of the procedure is possible and desirable.

A third criticism of renegotiation procedure is leveled at what happens in the Tax Court when a firm chooses to appeal from the finding of the Renegotiation Board to that body. At the present time, the Tax Court starts a renegotiation case with the presumption that the decision of the Renegotiation Board is correct. Such presumption can be rebutted only by clear and convincing evidence to the contrary.[24] At the same time, a firm which is dissatisfied with the treatment it has received from the Renegotiation Board is not entitled to introduce into evidence in the Tax Court hearings the proceedings and records of the Renegotiation Board underlying the Board's determination that is presumed to be correct.[25] The only document from the Board's proceedings that can be used is the summary statement of facts and reasons which the Board furnishes the firm being renegotiated.[26] Thus the Tax Court which has the responsibility to determine what are reasonable profits proceeds without all the relevant information. It is not surprising that the Tax Court has modified Renegotiation Board determinations only when it has found what it considered to be arbitrary or unreasonable actions; that it normally has found the same amount of excessive profits as the Renegotiation Board has; and that it has never cleared a contractor, whose profits the Board has determined to be excessive, on the grounds of an improper application of the statutory factors by the Board.[27]

The results of all this is that today the Tax Court neither reviews completely the proceedings of the Board to determine if error has been committed, as an appellate body normally does, nor does it give a fresh full-scale hearing to the firm that has been determined to have realized excessive profits. It is probable that such a result was not intended when the Tax Court was designated as the appellate court to review the Board's determinations.

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[22] "Extension of the Renegotiation Act," op. cit., 136.
[23] H.R. 5123, 86th Cong., 1st sess. (1959).
[24] John T. Koehler, "Renegotiation: Evidence and Burden of Proof in Appeal Proceedings," 45 Virginia Law Review 17 (1959).
[25] Ibid., 15.
[26] The Renegotiation Act prevents the Tax Court from using these as proof of the facts or conclusions stated therein. 50 U.S.C. App., sec. 1215 (1952).
[27] Koehler, op. cit., 20.

Any extension of renegotiation should take into account the deficiencies in the current procedures. An adequate hearing should be made available to the firm either initially or upon appeal. This should be done even though the Government ultimately is successful in sustaining the constitutionality of the Renegotiation Act of 1951, since, for the reasons discussed, there is an element of injustice in the way that renegotiation proceedings are now carried on. Moreover, so far as can be determined, no good reason has been advanced why the changes suggested should not be adopted.

Another area in which improvement is desirable is in the method of determining whether and to what extent renegotiation should be continued from year to year. There has been the tendency to rely too much upon the representations of the renegotiation agency itself concerning the future need for renegotiation. This procedure has at least two drawbacks. First, the renegotiation agency is not in a position to determine how effective procurement would be in the absence of renegotiation. At best, it has available the records of renegotiation proceedings relating to periods in the past, often several years in the past, from which to infer that renegotiation will accomplish the purposes set for it. It would be more helpful to require the contracting officials to demonstrate with specific examples how renegotiation has assisted them in carrying out their contracting activities and how it is likely to aid them in the future. It is somewhat anomalous that after more than 17 years of experience with emergency-type procurement and with renegotiation, the only arguments which were advanced by representatives of the military departments in support of an extension of renegotiation in 1958 were a priori and general arguments of the kind advanced in 1942. For example, the principal argument of the Defense Department in 1958 was that it is difficult to forecast costs when there are rapid technological improvements in defense weapons, and that the price benefits normally accruing from competition are not likely to be realized when there are limited sources of supply and the work is experimental in nature.[28] While these observations doubtless continue to be valid, it would appear that the public and those affected by renegotiation are by now entitled to a more sophisticated consideration of the entire subject.

The second disadvantage of present procedures for ascertaining the need for renegotiation is that there is a tendency to rely upon the representations of individuals who have a personal stake in the continuation of the renegotiation process. No matter how objective they may try to be in advancing the public interest, their professional orientation inevitably will drive them toward a recommendation to continue renegotiation. To many very able people engaged in renegotiation, there is no more fascinating and congenial work. Certainly their views should be consulted on relevant matters of public policy in the field of defense profits. It should be realized, however, that they find it almost as difficult to be objective champions of the public interest when it comes to deciding whether to continue renegotiation as do the industries affected by renegotiation.

A possible solution to this problem would be to assign to a congressional committee the responsibility for making a constant review of the various matters that are relevant to the continuance of renegotiation. Periodic hearings could be held to elicit from contracting officials examples of how renegotiation is helping them in their work. The incidence of "unconscionable profits" would also be examined on a continuous basis. In this way, a better balancing of public policy considerations would be possible.

One of the most common methods of modifying the renegotiation process in the past has been the exemption. Whenever certain classes of contracts have seemed unlikely to yield excessive profits, they have been eliminated from the jurisdiction of the Renegotiation Board. This solution is superficially more attractive than it actually is, and, what is more, is bound, by its very nature, to become less effective, the more that it is used. At the present time, the exemption of incentive and redeterminable contracts, as well as those awarded pursuant to competitive bidding, is being urged by the industries primarily affected by renegotiation. Doubtless much can be said in favor of exempting such contracts. Excessive profits are probably less likely to appear in contracts which have been subjected to a review by the contracting activities or to the competitive process. But if excessive profits are a real danger, the use of these contracts does not insure that they will not be realized. The chief merit of the proposals to exempt these contracts, from the point of view of those

[28] "Extension of the Renegotiation Act," op. cit., 1–8.

making the proposals, is that they are less likely to encounter opposition than proposals to eliminate renegotiation altogether. The fact is, however, that the exemption of these contracts would be almost tantamount to the complete abolition of renegotiation. Under the circumstances, it would be more logical to air the subject thoroughly and decide once and for all whether renegotiation is worth continuing.

There remains the question of whether the renegotiation process should be continued in approximately its present state but returned to the contracting departments whence it came originally. The reason given for its transfer from the Department of Defense to an independent agency in 1951 was that "only the creation of a separate agency will insure the objectivity of business judgment and the uniformity of decision so essential to the fair and equitable administration of renegotiation." [29] It has also been suggested that the contracting officials of the Government are not proper judges of their own work.

These arguments do not carry a great deal of weight when they are subjected to careful analysis. If the contracting officials do not have "objective business judgment," they should not be permitted to enter into contracts for billions of dollars of supplies and services each year. Moreover, it is not necessary to make elaborate demonstration of why uniformity in result in renegotiation could be attained as well by a unified agency within the Department of Defense, like the Military Renegotiation Policy and Review Board under the Renegotiation Act of 1948, as by an independent agency like the Renegotiation Board.[30] Finally, to suggest that the contracting officials should not judge the results of their work is to imply that renegotiation's real function is to review the actions of procurement officials. Certainly, that was not its original purpose. And if that is now its purpose, renegotiation is not organized to carry it out. The actions of renegotiation agencies have traditionally been directed exclusively against suppliers who have made too much money, not against the Government agencies that have conceivably made this possible. Moreover, it would make little sense for the renegotiating agency to review the work of officials whose standards are not necessarily the same as their own.[31]

This is not to say that renegotiation would necessarily be improved by transferring it back to the Department of Defense which administered the Renegotiation Act of 1948 or to all the interested contracting departments in the manner of the wartime renegotiation statues. It is probable that the effect of such a move, even if accepable to the departments concerned, would not change present procedures very much. The inevitable professionalization of renegotiation that has already been noted makes it unlikely that its policies would be greatly affected by the contracting agencies even if renegotiation were made a responsibility of those agencies.

In conclusion, then, it may be stated that an improvement in the renegotiation process would result from a more precise, but still necessarily rough, statement of what constitutes excessive profits. A very substantial improvement might result from a better definition of the issues at the various stages of the renegotiation process and by affording the firm one full-scale hearing somewhere along the way. Finally, it would be most helpful to investigate thoroughly and regularly the necessity for continuing renegotiation.

WHAT IS APPROPRIATE PUBLIC POLICY FOR RENEGOTIATION?

Now that we have considered some of the more important factors which must be taken into account in formulating public policy concerning defense profits, it is possible to reach tentative conclusions about the desirability of continuing renegotiation in its present form and about alternative courses which might be followed.

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[29] Renegotiation Act of 1951, H. Rept. No. 7, 82d Cong., 1st sess. (1951), 3.

[30] It is recognized that placing the renegotiation agency wholly within the Department of Defense might not be appropriate in view of the fact that contracts of several other departments are now subject to renegotiation. If these agencies were not willing to have their contracts renegotiated by an agency within the Department of Defense, an arrangement similar to that which obtained during World War II might be instituted to provide representation for these agencies.

[31] Compare the discussion at pp. 16–17, supra, with the following: "While the public interest requires that excessive profits be avoided, the contracting officer should not become so preoccupied with particular elements of a contractor's estimate of costs and profits that the most important consideration, the total price itself, is distorted or diminished in its significance. Government procurement is primarily concerned with the reasonableness of a negotiated price and only secondarily with eventual costs and profit." Armed Services Procurement Regulations, sec. 3–807.

Confronting anyone who proposes doing away with renegotiation altogether are the statistics concerning refunds that are used so often by renegotiation's friends to defeat any such move. According to the Renegotiation Board, net refunds of over $500 million (after tax credit and expenses of maintaining the Board) have been made by or have been required of firms subject to renegotiation since the Renegotiation Board was organized in 1951. About half of this amount consisted of voluntary refund and price reductions.[32]

"There are several reasons why this should not be regarded as concluding the matter. While this amount is substantial, it is quite small in relation to the amounts spent for defense during the same period. Moreover, it is probable that this amount would have been smaller if the renegotiation process were modified in the manner described above. And finally the amount of refunds and required refunds does not take into consideration the cost of renegotiation to those affected by it, which has been estimated as at least 0.1 percent of renegotiable sales or approximately $235,000 up to the end of 1957.[33]

The foregoing is not intended to demonstrate conclusively either that renegotiation pays for itself or that it does not. Its purpose is merely to indicate that the statistics concerning renegotiation refunds are really not very helpful in reaching a decision of what to do about renegotiation.

The important considerations are those which have been discussed previously. The objectives of renegotiation, namely, price reduction and the prevention of windfall profits, do not in 1959 lend the same cogency to arguments for the continuation of renegotiation as they did in 1942. This is because of the many significant developments of the intervening period, and particularly the fact that defense purchasing has become relatively less important to the economy. At the same time, techniques have been developed in connection with contracting that in many areas do as good a job as, or a better one than, renegotiation. With all this, there appears to be not too great a need for a process such as renegotiation. When one considers the many drawbacks entailed in the use of renegotiation, there is good reason for abandoning it even though it may still be performing in some cases the role that has traditionally been expected of it.

If, however, renegotiation is to be continued for a while, it is important that its procedures be strengthened and that more rational methods be used for determining when to discontinue it. In the first place, the criteria for determining what constitutes excessive profits in a given case should be made more precise. This would have to be preceded by a more realistic appraisal by both the Congress and the Renegotiation Board of the objectives of renegotiation. Second, the firm being renegotiated ought to be given at some stage of its renegotiation proceedings before a decision is reached a meaningful statement of the important issues involved. The firm requires this in order to be able to present effectively the evidence and points of law which are relevant to its claim that it has not realized excessive profits or that it has not realized them in the amount specified by the renegotiation agency. Failure to give the firm this opportunity tends to make the renegotiation process even more arbitrary than it inevitably is. Third, assuming that the Tax Court is to continue to regard itself as a true appellate body which hears appeals from determinations of the Renegotiation Board, it should conduct its proceedings so that it will be able to decide whether error was committed by the Board. If its jurisdiction is *de novo*, then no effect should be given to the Board's determination. Finally, it should be recognized that, even though, on balance, the continuation of renegotiation may have been desirable so far, the competing considerations are by now so close that the burden of justifying the need for it in the future has shifted to its proponents. If, for example, it should be proved that present purchasing procedures which place responsibility upon the prime contractor to accomplish the purchasing necessary for the development of a weapons system are encouraging subcontractors to charge unreasonable prices, then obviously there is more reason to continue renegotiation than if such were not the case. The contracting officials should be required, however, to demonstrate that this is the situation and to indicate why it is impossible to correct this condition by the use of different purchasing procedures.

It will be argued that, even though the need for renegotiation may be doubtful just now, there is a substantial probability that it will be needed if the present emergency worsens and that at least a skeleton renegotiation agency should be

[32] "Renegotiation Board, Third Annual Report" (1958), 10.
[33] "Extension of the Renegotiation Act," op. cit., 132.

preserved for such a contingency. This implies that the renegotiators do something essentially different than those engaged in making contracts for the Government, and have thereby acquired special skills which are worth retaining. Only a thorough investigation of present contracting organizations and procedures of the Government can tell us whether this is so. Perhaps the answers to this and some of the other questions raised in this paper will emerge from the hearings on bills to extend renegotiation which began in April 1959. Obviously, it is not possible to make a final decision about the future of renegotiation without understanding just what are the limitations of present contracting procedures and how renegotiation supplements them.

WASHINGTON, D.C., *June 15, 1959.*

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: Thank you for you letter of June 3, 1959. I am happy that I had the background paper available and hope that it will be of value to the committee in reaching a decision concerning renegotiation.

Senator Byrd, as I have said to you before, the disturbing element in renegotiation lies in the administration rather than the statute. Particularly disturbing to me at this time is the increasing number of reports of favoritism on the part of the Renegotiation Board to contractors who cooperate with the Board. The consensus is that those who agree with the Board and enter into agreements to refund the amount determined excessive receive more favorable treatment in subsequent renegotiations, while those contractors who challenge the Board's determinations by petitioning the Tax Court can expect subsequent renegotiations to fall within the profit pattern established—by the Board—for the first excessive profit year, regardless of the favorable factors present in the later years.

Renegotiation being a judgment procedure, it is not easy to identify favoritism if it exists. However, little is left to the imagination when one looks at the airframe contractors who have petitioned the Tax Court for a redetermination in comparison with others in the same field who have accepted the Board's determination. To illustrate this point attached are two exhibits. Exhibit I covers the renegotiation of seven airframe contractors who have petitioned the Tax Court, and each is identified because the data are a matter of public record. In this exhibit I call your attention to the similarity of the profit to sales margins after renegotiation for each contractor. Exhibit II covers an airframe contractor who accepted the Board's determination for fiscal year 1952 and entered into an agreement to refund. In this case I call your attention to the contractor's margin of profit for the year 1953, which the Board considered reasonable and issued a clearance. The profit margin for the 1952 refund year was 5.9 percent after renegotiation, and on the following year, 1953, the Board issued a clearance at 6.7 percent, despite the fact that there was little difference in the sales and profits of the 2 years.

Another area of disturbance to contractors subject to renegotiation is the inconsistency one finds in the Board's policies and public statements. This is particularly important since the Renegotiation Board sits in judgment on profits which a contractor works 12 months to accumulate. We recently saw an example of this inconsistency before your committee, when the Chairman of the Board withdrew part of his "unqualified approval of H.R. 7086" which he had given the Committee on Ways and Means. This happened despite the fact that he came before the Committee on Finance with a prepared statement supporting every provision of H.R. 7086. Frankly, to satisfy myself I have gone back and compared the Renegotiation Board's statements, over a period of years, before the Committee on Finance, Committee on Ways and Means, Appropriation subcommittees of both branches of Congress, and the House Armed Services Subcommittee, and much to my surprise I find a continuous stream of inconsistencies emerges when comparisons are made.

Senator Byrd, there are many important aspects of renegotiation which remain unanswered; therefore, I hope that the Committee on Finance will extend renegotiation for 1 year and authorize Mr. Stam to undertake a study of the sub-

ject for the purpose of establishing the appropriate policy of renegotiation once and for all.

With kindest regards, I am,

Sincerely yours,

WILLIAM T. DARDEN,
Editor and Publisher.

EXHIBIT I

Airframe Tax Court litigants

Fiscal year	Before renegotiation			After renegotiation	
	Sales	Profits	Margins	Refunds	Margins
	Thousands	*Thousands*	*Percent*	*Thousands*	*Percent*
Lockheed Aircraft Corp.:					
1951	$206,568	$7,217	3.5	(1)	
1952	412,326	17,800	4.3	(1)	
1953	778,043	52,474	6.7	$6,000	6.0
1954	654,934	46,140	7.0	6,000	6.1
Boeing Airplane Co.:					
1951	330,304	16,986	5.14	(1)	
1952	717,686	54,567	7.6	10,000	6.2
1953	919,730	64,970	7	7,500	6.2
1954	1,046,748	75,425	7	10,000	6.2
Fairchild Engine & Airplane Corp.:					
1951	74,018	6,708	9.1	(1)	
1952	152,104	12,319	8.1	1,000	7.8
1953	168,876	15,362	8.1	2,000	7.9
North American Aviation, Inc.:					
1951	166,546	12,650	7.6	(1)	
1952	303,245	13,703	4.5	(1)	
1953	621,386	44,577	7	6,000	6.2
1954	658,261	55,316	8.4	14,000	6.2
Douglas Aircraft Co., Inc.:					
1952	449,269	26,414	5.8	(1)	
1953	769,848	49,173	6.3	6,000	5.6
1954	755,768	48,287	6.2	6,000	5.6
The Martin Co.:					
1952	101,540	4,636	4.5	(1)	
1953	230,863	17,918	7.7	3,500	6.2
1954	238,132	21,388	8.9	6,250	6.3
Temco Aircraft Corp.:					
1952	47,395	4,820	10.17	750	8.3
1953	66,649	9,069	13.61	3,500	8.3

[1] Cleared.

EXHIBIT II

Airframe contractor who accepted Board's determination

Fiscal year	Before renegotiation			After renegotiation	
	Sales	Profits	Margins	Refunds	Margins
	Thousands	*Thousands*	*Percent*	*Thousands*	*Percent*
1951	$130,441	$8,083	6.2	(1)	
1952	412,235	27,396	6.6	$3,591	5.9
1953	411,811	27,514	6.7	(1)	

[1] Cleared.

ELECTRONIC INDUSTRIES ASSOCIATION,
Washington, D.C., June 5, 1959.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: This letter is submitted on behalf of the Electronic Industries Association, the national association for the electronics industry. The association is composed of some 350 member-companies which are engaged in the development and manufacture of all varieties of electronic equipment. Approximately two-thirds of our members fall in the small business category.

We are vitally concerned with renegotiation legislation and in particular, with H.R. 7086 now pending before your committee.

The electronics industry is the fifth largest manufacturing industry in the country with annual gross sales in 1958 approaching $8 billion. Electronic manufacturing plants are located in every State in the Union except Alaska, and currently employ 700,000 persons.

On a dollar basis, more than half of the products manufactured by the electronics industry are sold to the military services. Accordingly, many members of EIA are Government contractors and subcontractors and as such, are familiar with and have often been subject to the renegotiation process. Therefore this association has a vital interest in the effects of the extension of the Renegotiation Act, and respectfully requests that its views—presented herein—be included in the record of the hearings being held by the Senate Finance Committee.

The members of EIA are absolutely and irrevocably opposed to unreasonable and excessive profits on Government contracts. This association is not, therefore, opposed to the extension of the Renegotiation Act of 1951, but it believes that it can be improved in many respects and that the renegotiation process can be made to operate more equitably.

In general, we believe that H.R. 7086 which was reported by the Committee on Ways and Means of the House of Representatives and passed by the House would provide certain of the improvements which we believe are urgently needed in the Renegotiation Act of 1951. However, we are in accord with the supplemental views of the minority members of the Ways and Means Committee urging that the Renegotiation Act be extended for a period of lesser duration than the 4-year extension now proposed. As the supplemental report points out, a 4-year extension of the act would tend to remove the subject of renegotiation from the scrutiny of the Congress for a protracted period and would retard the Defense Department's effort to further develop and use procurement methods which obviate the need for the renegotiation process.

EIA is pleased to note, that section 2(a) of H.R. 7086 requires the Renegotiation Board to take into consideration cost reductions achieved under incentive type contracts by which the contractor shares in the resultant savings.

It is our experience in the electronics industry that incentive type contracts can and do provide the Government with substantial savings and result in increased efficiency. Thus, when a procuring agency of the Government enters into an incentive-type contract in good faith, the Renegotiation Board should be required to honor this prior agreement by permitting the contractor to share in the savings rather than taking away his share under the guise of excessive profits.

Accordingly, EIA endorses section 2(a) of H.R. 7086 giving favorable recognition to cost reductions brought about by the efficiency of the contractor.

EIA endorses section 2(c) of the bill and its objective of providing contractors with more specific information as to the consideration given to efficiency as well as to each of the other enumerated factors. This provision should have the salutary effect of causing the Board to recognize that contractor efficiency is, in fact, an important factor which is beneficial to the Government, and one which should be taken into consideration when a determination is made.

Section 3 of H.R. 7086 provides for a 5-year loss carryforward as contrasted with the 2-year carryforward permitted under the present law. This provision is particularly important to the electronics industry in which the investment in engineering talent and manpower during the research and development cycle is exceedingly high and the resultant profits very low or nonexistent. Because of this situation, an electronics contractor needs to realize higher profits during the production stage to offset the lower or lack of profits realized during the research and development period. By extending the carryforward period to 5 years, section 3 of H.R. 7086 should relieve some of the hardships previously imposed on electronics contractors and subcontractors by the more stringent 2-year limitation.

In testimony before the House Committee on Ways and Means, EIA urged that the Renegotiation Act of 1951 be amended to require that a contractor be provided with a full exposition of the reasons for the determination of excessive profits by the Renegotiation Board and the facts used by the Board in arriving at its decisions prior to the issuance of an order.

EIA is pleased to note, therefore, that H.R. 7086 contains such a provision in section 4(a). It is only fair and equitable that a contractor should have a statement of the Board's reasons for its findings prior to the issuance of an order or prior to deciding whether to enter into an agreement.

EIA is in accord with section 5 of H.R. 7086 since it adds needed strength to the requirement that a proceeding before the Tax Court in a renegotiation case shall not be treated as proceedings to review the determination of the Renegotiation Board, but shall be treated as a proceeding de novo. This is the intent of existing law (sec. 108 of the Renegotiation Act of 1951) and the language of section 5(a) should remove any lingering doubts as to its meaning. In order to avoid any possible ambiguities we urge also that the second sentence of section 108 be amended by deletion of the word "finally."

In sum, with the exceptions noted above, the Electronic Industries Association endorses H.R. 7086 since we believe it will tend to achieve many improvements in the renegotiation process and make it more equitable. Nevertheless, EIA wishes to reiterate its recommendation that the Renegotiation Act of 1951, as amended previously and by this legislation, not be extended for 4 years. We sincerely believe that the Congress should once again review renegotiation within a shorter period of time.

We appreciate this opportunity to make our views known to you and trust they will be useful to you in your consideration of the renegotiation legislation now before the Senate Finance Committee.

Cordially yours,

D. R. HULL, *President.*

BOEING AIRPLANE CO.,
Seattle, Wash., June 4, 1959.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington 25, D.C.

MY DEAR SENATOR: My attention has been called to testimony affecting this company which was presented to the Senate Finance Committee by Mr. Thomas Coggeshall, Chairman of the Renegotiation Board, in connection with H.R. 7086, a bill to extend the Renegotiation Act of 1951.

In the course of his testimony, Mr. Coggeshall stated that during 1952 Boeing Airplane Co. submitted a cost proposal to the U.S. Air Force covering the production of B–47 aircraft, and that at that time Boeing's internal estimate of the cost of performing this work was approximately $50 million less than the amount which it represented to the Air Force as being its best cost estimate. Mr. Coggeshall stated that this was the testimony given in this company's renegotiation case involving 1952 which is now pending before the Tax Court. The fact that Mr. Coggeshall, or the Renegotiation Board of which he is Chairman, is the respondent in these Tax Court proceedings may explain his taking advantage of his appearance before your committee to assert a partisan position.

Unlike Mr. Coggeshall, Boeing Airplane Co. does not propose to try its renegotiation case before your committee. However, since Mr. Coggeshall's foregoing statements distort the evidence presented to the Tax Court and convey a false and misleading impression of the facts. I do wish to make the categorical statement that all cost estimates submitted by the company to the Air Force covering the production of B–47 aircraft, as referred to above, were submitted in good faith and represented the company's best estimate of the cost of performing the work at the time the estimates were submitted.

Sincerely,

WILLIAM M. ALLEN, *President.*

BARTON AND JOHNSON,
Washington, D.C., June 8, 1959.

Senator HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: As attorney for the Vaughn Machinery Co. in a renegotiation case decided by the Tax Court during the last half of 1958, I wish to call your attention to one phase of the amendment of section 108A of the Renegotiation Act by section 6 of H.R. 7086, which may result in a hardship to that company.

The Vaughn Machinery Co. is an Ohio corporation and on December 8, 1958, it took an appeal to the U.S. Court of Appeals at Cincinnati in which certain legal questions were raised. The record in the Tax Court has been printed and filed in the sixth circuit and so have printed briefs of the petitioner been filed.

Section 6 of H. R. 7080 amends section 108A of the Renegotiation Act by giving the U.S. Court of Appeals for the District of Columbia exclusive jurisdiction of petitions for review of decisions of the Tax Court in renegotiation cases. This would protect the Vaughn Manufacturing Co., however, it would require the company to file a new appeal to the U.S. Court of Appeals for the District of Columbia and incur additional expenses for printing the record and printing briefs in that court.

We believe that it would be equitable to permit courts of appeals to retain jurisdiction of cases already pending at this time. I am submitting for your consideration a proposed amendment, which I trust will meet with your approval.

Cordially yours,

WALTER E. BARTON.

Add to section 108A, following (b) (2) on page 9 of H.R. 7080, the following:

"(c) The exclusive jurisdiction of the U.S. Court of Appeals for the District of Columbia shall not extend to any petition for review of a decision of the Tax Court in a renegotiation case which is pending in some other U.S. court of appeals at the time the amendment of this section becomes effective. Such other U.S. court of appeals shall have the same jurisdiction and powers with respect to such pending petition for review as are granted to the U.S. Court of Appeals for the District of Columbia under the provisions of subsection (a) and (b) hereof."

HOUSE OF REPRESENTATIVES,
Washington, D.C., June 10, 1959.

Hon. HARRY FLOOD BYRD,
Chairman, Finance Committee, U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: Enclosed is my statement before your committee in behalf of raising the ceiling to $50,000 for renegotiation of the commissions of manufacturers' agents.

It is my understanding that this item was omitted from the House bill in error. However, at this time, I am most hopeful that this item will receive your careful consideration for inclusion in the Senate bill before presentation on the floor of the Senate.

Yours sincerely and respectfully,

JOE HOLT, *U.S. Congressman.*

STATEMENT OF HON. JOE HOLT, REPRESENTATIVE, 22D CONGRESSIONAL DISTRICT

Mr. Chairman, I appreciate the opportunity of presenting to this committee a statement in behalf of manufacturers' agents, as they are affected by the Renegotiation Act.

They feel that included in this act before it goes to the Senate floor should be a specific raise in the renegotiation ceiling for manufacturers' agents from the present $25,000 to $50,000.

As the ceiling has been raised several times for manufacturers, it would seem fair to allow this raise for manufacturers' agents. As so often happens, this matter was called to my attention, as Representative of the 22d Congressional District, which is a part of the city of Los Angeles and includes the San Fernando Valley, by a letter from the Jackson Edwards Co., 4101 Lankershim Boulevard, North Hollywood, Calif. This company is a national organization composed of highly qualified technical manufacturers' representatives in the electronics field. They offer a technical service, with technical people, and perform the function of assisting their customers in designing their products into their final assemblies.

While the renegotiation floor for manufacturers is $1 million per year in sales, whereas people like these have a floor of $25,000 in commissions.

I am most hopeful that this item will receive your serious consideration for inclusion in the act, and I thank you again for this opportunity to present this matter before your committee.

RIDGEWOOD, N.J., *June 11, 1959.*

Senator CLIFFORD P. CASE,
Senate Office Building, Washington, D.C.:

Urge Renegotiation Act be amended raising floor on commissions to $100,000.

FRANK BALLOU, BALLOU, INC.

ANGUS-SLOANE ASSOCIATES, INC.,
Moorestown, N.J., June 9, 1959.

Subject: Renegotiation Act.

HON. CLIFFORD CASE,
Senate Office Building,
Washington, D.C.

DEAR SENATOR CASE: Very shortly a bill will come up before Congress requesting that the Renegotiation Act of 1951 be extended.

As a small businessman in the State of New Jersey, we have been hoping that manufacturers' representatives, such as ourselves, would see the renegotiable commission rate raised from $25,000 to $100,000 per calendar year. Apparently there is the feeling that we are "influence peddlers," similar to Lamar Caudle. Nothing could be further from the truth.

As a sales engineering representative, we perform an important function to the overall defense picture and, in many cases, find that we save the Government considerable amounts of money by helping engineers better understand the specifics of the products we represent. In addition, we perform the same function as any direct employee for the companies we work for; but do not receive any financial support until such time as we actually take orders. In other words, all of us have had to go through a long period of financial sacrifice to obtain the type of organization any small businessman would be proud with which to be associated. To run our office on a day-to-day basis requires around $200, or $4,000 worth of orders. Calculated on a yearly basis, this then requires over a million dollars worth of orders; and, taking this one further step, at a 5 percent commission, amounts to $52,000. Under the present act, anything over $25,000 in commission is considered as excess profit.

We feel we could substantiate reasons for any extra amount, but feel that the burden of having to keep substantial records is not totally fair. First of all, it is difficult in many cases to find out whether or not a contract is renegotiable. Additional arguments could be given concerning the problems of keeping these records, and I am sure more of these are self-evident to you.

Lastly, and this is most important, our organization is a small one consisting of five people; and two of us have been trained at the service academies at the expense of taxpayers. We still maintain that some of this training is invaluable regarding the service we render to the specific companies we do business with. We maintain the highest integrity in our negotiations and feel that we perform a vital link in the engineering category. With the ceiling raised from $25,000 to $100,000, we feel we would then be treated fairly, since the manufacturers have recently had their ceiling raised from $250,000 to $1 million.

May we please hear your decision on what we have requested.

Very truly yours,

CHARLES C. SLOANE.

(Whereupon, at 4:15 p.m., the committee adjourned.)

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