93D CONGRESS 2d Session } SENATE { REPORT No. 93-927

RENEGOTIATION AMENDMENTS OF 1974

JUNE 13, 1974.—Ordered to be printed

Mr. LONG, from the Committee on Finance,
submitted the following

REPORT

[To accompany H.R. 14833]

The Committee on Finance, to which was referred the bill (H.R. 14833) to amend the Renegotiation Act of 1951 to extend the Act for eighteen months, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

I. SUMMARY

The Renegotiation Act of 1951, as amended, authorizes the Government to recapture excessive profits on certain Government contracts and subcontracts. In the absence of legislation, this Act would expire as of June 30, 1974. H.R. 14833 extends the Act for 18 months, or until December 31, 1975. The committee accepted the House-passed bill without change.

II. GENERAL STATEMENT

A. THE RENEGOTIATION PROCESS

The Renegotiation Act of 1951, in general, provides that the Renegotiation Board is to review the total profit derived by a contractor during a year from all of his renegotiable contracts and subcontracts in order to determine whether or not this profit is excessive. Contractors with renegotiable sales exceeding the $1,000,000 statutory "floor" for a fiscal year must file a report with the Renegotiation Board. "Renegotiable" contracts and subcontracts are those with the following agencies: the Department of Defense, the Departments of the Army, the Navy, and the Air Force, the Maritime Administration, the Federal Maritime Board, the General Services Administration, the National Aeronautics and Space Administration, the Federal Aviation Administration, and the Atomic Energy Commission.

The Board is empowered to eliminate those profits found to be excessive in accordance with certain statutory factors. Thus, renego-

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tiation is determined not with respect to individual contracts but with respect to all receipts or accruals from renegotiable contracts and subcontracts of a contractor during a year. These contracts vary in form from cost-plus-fixed-fee to firm fixed-price contracts. Some may be prime contracts, while others are subcontracts. They also cover a wide range of services and products. With respect to any given year they may also reflect only partial payments made on the contracts.

For purposes of renegotiation, profits generally are defined and determined in much the same way as for tax purposes. This similarity is also reflected in that provision is made in renegotiation for a 5-year loss carryforward, as well as the offsetting of losses and profits on different contracts within the year.

The Act provides, in general terms, that the Renegotiation Board in determining whether profits are excessive is to give favorable recognition to the efficiency of the contractor with particular regard to attainment of quantity and quality production, reduction of costs, and economy. The Board must also consider the reasonableness of costs and profits, the net worth (with particular regard to the amount and source of public and private capital employed), the extent of the risk assumed, the nature and extent of the contribution to the defense effort, and the character of the business. The Board in making its determination must consider all of these factors, and the producer, where these factors are present to a greater extent (e.g., is more efficient or makes a greater contribution to the defense effort), is permitted to retain more profit than the producer who satisfies these factors to a lesser extent.

Various types of contracts are excluded from the Act: some on a mandatory and others on a permissive basis. The mandatory exemptions include contracts with a State, local, or foreign government, those dealing with certain agricultural commodities, those dealing with unprocessed minerals, or timber and related products, certain competitively-bid construction contracts, those with certain regulated common carriers or public utilities, those for standard commercial articles or services, those with tax-exempt organizations, and certain contracts determined not to have a direct and immediate connection with the national defense. There is a partial mandatory exemption for certain contracts for new durable productive equipment (i.e., machinery, tools, etc.) which have an average useful life of more than 5 years.

The permissive exemptions, at the Board's discretion, may include contracts performed outside of the territorial limits of the continental United States or in Alaska, those where the profits can be determined with reasonable certainty when the contract price is established, those where the Board feels the provisions of the contract are otherwise adequate to prevent excessive profits, those where the renegotiation of which would jeopardize secrecy required in the public interest, and subcontracts where the Board considers it not administratively feasible to determine and segregate the profits attributable to renegotiable subcontracts from the profits attributable to nonrenegotiable subcontracts.

B. The Need for Renegotiation

The committee concluded that the continuation of the Renegotiation Act is in the national interest. The renegotiation process allows an

after-the-fact review of the profits on renegotiable contracts and subcontracts relating to national defense and space efforts. It is a renegotiation of a contractor's fiscal-year aggregate profits on these contracts: thus, it is completely different from price adjustments or redeterminations with respect to individual contracts. The renegotiation process provides a further check on the reasonableness of the prices (and the related overall profits of the contractor) that the Government has to pay in order to maintain its defense commitments.

Modern military and space procurement is characterized by changing technical requirements and increasing complexity. The nature of the procurement often means that there is a lack of established market costs or prices to guide procurement officers. Accordingly, negotiated contracts are used for the bulk of the dollar amount of these procurements. This includes contracts negotiated with sole-source suppliers as well as contracts negotiated with some degree of market price competition. Negotiated Department of Defense military contracts accounted for almost 90 percent of the value of the Defense Department's military procurement in fiscal 1972 and more than 89 percent in fiscal 1973, which was a continuation of the increased level of negotiated procurement—from about 82 percent in fiscal 1965 to 87 percent in fiscal 1967, and to 89 percent in fiscal 1969 and 1970.[1] In addition, negotiated NASA contracts accounted for between 98 and 99 percent of the value of NASA's procurement during fiscal years 1968–1973, as compared to 91 percent in fiscal 1961.[2]

A second factor which indicates the need to extend the Renegotiation Act is the relatively high level of defense-related procurement in recent years. Total military procurement rose from $28 billion in fiscal 1965 to a peak of $44.6 billion in fiscal 1967. Military procurement then declined slightly to $43.8 billion in fiscal 1968 and to $42 billion in fiscal 1969. It then declined further to $34.5 billion in fiscal 1971, before increasing to $38.3 billion in fiscal 1972 and declining slightly again in fiscal 1973 to $36.9 billion.[3] Although the military procurement level has declined somewhat during 1968–73, the level of overall defense-related procurement is expected to remain relatively high. The DOD's current forecast for fiscal 1974 is $39.5 billion and $41.1 billion for fiscal 1975.[4]

Moreover, in view of the normal timelag between the time a contract is awarded and the time renegotiation filings are made with respect to those contracts or subcontracts, the amounts from defense and space-related procurement awards made during recent years will continue to be reported in Renegotiation Board filings during the next 18 months.

Furthermore, the level of excessive profit determinations made by the Board rose during 1967–71—from $16 million in fiscal 1967 to $21.4 million in fiscal 1969, $33.5 million in fiscal 1970, and to $65.2 million in fiscal 1971, the highest level since 1958. The fiscal 1972 level of $40.2 million was the second highest level during 1961–1972. The fiscal

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[1] Office of the Secretary of Defense (Comptroller), *Military Prime Contract Awards and Subcontract Payments or Commitments,* annual reports for each year.

[2] National Aeronautics and Space Administration, *Annual Procurement Report,* for each year.

[3] Office of the Secretary of Defense (Comptroller), *supra.*

[4] Letter of May 16, 1974, from the Department of Defense, Office of the Assistant Secretary of Defense (Installations and Logistics), Director, Procurement Analysis and Planning.

1973 level was $28 million; however, during the first 9 months of fiscal 1974, the Board has made determinations of $59.8 million.[5]

C. EXTENSION OF THE ACT

In the absence of legislation, the Renegotiation Act would expire as of June 30, 1974. The committee believes that in view of the extent of our defense effort and the negotiated nature of much of defense and space-related procurement, the Renegotiation Act should be extended.

The committee is aware that a number of recommendations have been made to amend the Renegotiation Act further at this time. These include recommendations to place renegotiation on a permanent basis or extend the Act for 5 years; to extend the coverage of the Act to all Government agencies; to increase the minimum floor for filing from $1 million to $2 million or $5 million; to decrease the minimum floor to $100,000 or $250,000; to eliminate various exemptions, such as the one for standard commercial articles and services; to clarify and revise the statutory factors; to change the accounting standards; to renegotiate on a product line basis; to revise the penalty provisions regarding filing of reports; and to increase Board staffing. These recommendations suggest quite different courses for the renegotiation process in the future. Other proposals have also been made to discontinue the Renegotiation Act as no longer needed because of improvements in Government procurement and pricing policies.

At the time the Renegotiation Act was last extended in 1973, both the House Committee on Ways and Means (House Report No. 93–165, accompanying H.R. 7445) and the Senate Committee on Finance (Senate Report No. 93–240, accompanying H.R. 7445) requested that the staffs of the Renegotiation Board and the Joint Committee on Internal Revenue Taxation analyze three congressionally-sponsored reports on the renegotiation process. These reports were made by the Subcommittee on Government Activities of the House Government Operations Committee,[6] the Commission on Government Procurement,[7] and the General Accounting Office.[8]

As the House and Senate Reports indicate, it was contemplated that a comprehensive study by the staffs of the Renegotiation Board and the Joint Committee on Internal Revenue Taxation would be conducted over a period of two years. Further, it was expected that the study would be completed in sufficient time prior to the expiration of the Renegotiation Act in 1975, to allow Congress to review fully the renegotiation process at that time. However, H.R. 7445 was amended on the floor of the Senate (which amendment was accepted in conference and approved by both Houses) to extend the Renegotiation Act for one year instead of two. This significantly reduced the time available both for an indepth study and review of the far-reaching recommendations contained in the three reports referred to above and

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[5] The Renegotiation Board, Office of Planning and Analysis.

[6] *The Efficiency and Effectiveness of Renegotiation Board Operations*, 6th Report by the House Committee on Government Operations, 92d Congress, 1st Session (House Report No. 92–758, December 16, 1971).

[7] *Report of the Commission on Government Procurement* (Vol. 4, Part J, Ch. 4, December 1972).

[8] *The Operations and Activities of the Renegotiation Board*, A Report to the Congress by the Comptroller General of the United States (General Accounting Office Report No. B–163520, May 9, 1973).

for hearings to give all interested parties and the general public the opportunity to make their views known regarding any conclusions reached by the Board and the Joint Committee staff with respect to the recommendations of the three reports.

In addition, the staff of the Renegotiation Board was unable to go on record prior to the House hearing in any official discussion of the specific recommendations contained in the aforementioned reports because of delays in receiving approval by the Office of Management and Budget for the Board's position on the recommendations for substantive legislative changes contained in these reports. Faced with the prospect of no combined report by the Joint Committee and Board staffs in time for the public hearing scheduled by the Committee on Ways and Means, the staff of the Joint Committee decided to publish a preliminary report [9] independently of the staff of the Renegotiation Board in order that the members of the Committee on Ways and Means and Committee on Finance and the public could have the benefit of a summary of the main issues raised and recommendations contained in the reports. This preliminary report gives a brief summary of the renegotiation process and its legislative history, plus a review of the recommendations made in the three aforementioned reports.

Since there was not sufficient time during this past one-year extension of the Renegotiation Act for the study to be completed, the committee agreed with the House that the Renegotiation Act should be extended through the end of the First Session of the next Congress. This is to provide sufficient time for the Joint Committee staff to complete its analysis of the renegotiation process and also to allow sufficient time both for public hearings on the various recommendations made as well as for the committee to thoroughly review the entire renegotiation process. The 18-month extension of the Act as provided in the committee's bill will give Congress the time that is needed to evaluate these recommendations and also to review the recent administrative changes that the Board has made modifying some of its procedures, as well as recent changes in their regulations. In addition, it is expected that within the next 18 months the backlog of cases resulting from the procurement for Vietnam will be largely eliminated.[10] The committee believes that with this factor out of the way it will also have a better perspective to determine the character and extent of the future role of renegotiation as it evaluates the various recommendations with respect to the renegotiation process.

D. Continued Staff Study on the Renegotiation Process

For the above reasons, the committee has requested that the staff of the Joint Committee on Internal Revenue Taxation complete its

[9] *Staff Review of Recommendations made on the Renegotiation Process: A Preliminary Report,* A report by the staff of the Joint Committee on Internal Revenue Taxation for the use of the House Committee on Ways and Means and the Senate Committee on Finance (May 14, 1974).

[10] For example, the bulk of the excessive profit determinations made during the first 9 months of fiscal 1974 were applicable to renegotiable contracts of fiscal 1967–1969. Most of the Board's fiscal 1975 determinations would probably be from contractor fiscal years 1968–70, with fiscal 1976 determinations probably concentrated in contract fiscal years 1970–71. The Board's fiscal 1974 determinations thus far have been largely in ordnance, tents, uniforms, et cetera used in Vietnam. (The Renegotiation Board, Office of Planning and Analysis.)

analysis of the recommendations which have been made, continuing their consultation with the staff of the Renegotiation Board, and report back with their recommendations to the committee in sufficient time to enable the committee to conduct hearings and make an in-depth reexamination of the renegotiation process during the First Session of the next Congress. It is contemplated that the hearings will be held well before the expiration of the Act, as extended by the bill.

At the same time, the Renegotiation Board is requested to report its legislative recommendations early in 1975 to give sufficient time for them to be considered by the staff of the Joint Committee prior to the committee's hearings on the renegotiation process. The Renegotiation Board is further requested to continue its review of the statutory factors used in determining excess profits in order to clarify the application of the factors in different cases. The committee believes that this effort is important in considering future legislative changes.

Although the Renegotiation Board presented several recommendations to Congress, the committee decided only to extend the Renegotiation Act for another 18 months without any other amendments. The committee believes that while some of the proposals made by the Board do have merit, it would be better to consider these proposals with the committee's full review of the renegotiation process after the final staff report is completed. The staff report would comment on these and any other recommendations made by the Board.

III. COSTS OF CARRYING OUT THE BILL AND EFFECT ON THE REVENUES OF THE BILL

In compliance with section 252(a) of the Legislative Reorganization Act of 1970, the following statement is made relative to the costs to be incurred in carrying out this bill and the effect on the revenues as a result of enacting the bill. The committee estimates that the Renegotiation Board's administrative expenses in carrying out its functions under the Renegotiation Act will be approximately $5 million a year. Accordingly, it is estimated that the 18-month extension of the Act provided by the bill (which in effect requires new cases to be filed with the Board for an additional 18 months) will result in estimated additional costs of about $7.5 million.

On the other hand, based on experience in recent years, the committee estimates that the 18-month extension of the Renegotiation Act provided by the bill will result in excessive profits determinations by the Renegotiation Board in cases filed with the Board during the 18-month period of from $90 million to $100 million in total. After allowance of the credit for Federal income taxes previously paid on the profits, the amount actually recovered by the Government will be approximately one-half of this amount, or from $45 million to $50 million.

IV. VOTE OF COMMITTEE IN REPORTING THE BILL

In compliance with section 133 of the Legislative Reorganization Act, as amended, the following statement is made relative to the vote of the committee on reporting the bill. This bill (H.R. 14833) was

ordered favorably reported by the committee without a roll call vote and without objection.

V. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with subsection (4) of Rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italics, existing law in which no change is proposed is shown in roman):

SECTION 102 OF THE RENEGOTIATION ACT OF 1951

SEC. 102. CONTRACTS SUBJECT TO RENEGOTIATION

(a) * * *

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(c) TERMINATION.—

(1) IN GENERAL.—The provisions of this title shall apply only with respect to receipts and accruals, under contracts with the Departments and related subcontracts, which are determined under regulations prescribed by the Board to be reasonably attributable to performance prior to the close of the termination date. Notwithstanding the method of accounting employed by the contractor or subcontractor in keeping his records, receipts or accruals determined to be so attributable, even if received or accrued after the termination date, shall be considered as having been received or accrued not later than the termination date. For the purposes of this title, the term "termination date" means [June 30, 1974] *December 31, 1975.*

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