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EXTENSION OF RENEGOTIATION ACT OF 1951

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

REPORT

together with

MINORITY VIEWS

[To accompany H.R. 12061]

The Committee on Finance, to whom was referred the bill (H.R. 12061) to extend the Renegotiation Act of 1951, having considered the same, report favorably thereon, with amendments, and recommend that the bill as amended do pass.

I. GENERAL STATEMENT

The Renegotiation Act of 1951, which authorizes the Government to recapture excessive profits on certain Government contracts and related subcontracts, is scheduled to expire as of June 30, 1962. H.R. 12061 extends the act for 2 years, that is, until June 30, 1964.

The bill also makes certain other amendments to the act. One of these amendments prohibits the departments from inserting certain profit limitation provisions in contracts, another makes the standard commercial article exemption (and the related exemptions for "like" articles and for classes of articles) applicable to receipts or accruals from leases, and another amendment broadens the scope of appellate review of Tax Court decisions in renegotiation cases. These amendments are explained further below.

II. EXPLANATION OF THE BILL

Section 1. Extension of the Renegotiation Act.—The President, in his budget message to Congress earlier this year, recommended that the Renegotiation Act be extended. The Renegotiation Board subsequently transmitted to Congress a draft of proposed legislation

to implement that recommendation, and recommended that the period of the extension be 4 years. The Joint Committee on Internal Revenue Taxation, in the report made by it to the House and to the Senate on January 31, 1962, pursuant to a directive contained in the 1959 legislation by which the act was last extended, also recommended that the act be extended, but recommended that the period of extension by 2 years. (See "Report on the Renegotiation Act of 1951," H. Doc. 322, 87th Cong., 2d sess.)

Your committee is aware, as was pointed out by the Renegotiation Board in its letter transmitting the draft of proposed legislation to extend the act, that the defense procurement program has involved "the expenditure of vast sums of money for the purchase of many different types of weapons and related materials * * *." The Board stated that "For the fiscal year 1962, it is estimated that expenditures for national defense will aggregate approximately $46.8 billion; and for the fiscal year 1963, it is estimated that such expenditures will be at least as great or greater."

Your committee is also aware, as was pointed out by the Board, that the defense procurement program requires the procurement of many highly specialized items of an unprecedented nature, as to which past production and cost experience is not always available for forecasting accurately the cost of such items. The Renegotiation Act provides one technique for eliminating excessive profits under contracts for the procurement of such items. For these reasons, your committee concluded that the Renegotiation Act must be extended.

This bill would extend the act for 2 years, as recommended by the Joint Committee on Internal Revenue Taxation, rather than for the 4 years originally recommended by the Renegotiation Board. Your committee has been advised that the newly constituted Renegotiation Board is now conducting a reexamination of the renegotiation process and that other departments in the administration are reviewing certain renegotiation matters with which they are concerned. Your committee believes that under these circumstances the act should be extended for only 2 years.

Section 2. Nonstatutory profit limitations.—Section 2 of the bill amends the act so as to prevent the departments named in the Renegotiation Act from requiring the insertion of certain profits-limitation provisions in contracts (or subcontracts) which are subject to the Renegotiation Act, or would be subject to the act except for the exemption provisions of the act.

This amendment is essentially the same as a provision previously passed by the Senate in 1959 (sec. 2 of H.R. 7086, 86th Cong., 1st sess., as passed by the Senate). Although the provision previously passed was eliminated in conference, the conferees made it clear in their report that no adverse inference was to be drawn from its not being agreed to and directed that the amendment be made a part of the study of renegotiation by the Joint Committee on Internal Revenue Taxation. It was concluded in that study that "the procurement agencies have been using, and desire to continue using these nonstatutory profit limitations to achieve results which are precisely those which it is the policy of the Renegotiation Act to prevent." It was further concluded in that study, after careful reexamination of the subject, that the reasons which led to Senate adoption of the

provision in 1959 are as applicable now as they were then. Those reasons, as stated in the Senate floor debate in 1959, are set forth below.

> This amendment is designed to prevent the Government agencies from employing certain profit limitation devices which undermine the will of Congress as expressed in the Renegotiation Act of 1951.
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> There are at least three instances in which administrative agencies, through regulatory action, are subjecting contracts to these profit limitations even though the same contracts are subject to renegotiation.
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> (1) The Federal Maritime Administration (and Federal Maritime Board) requires that all ship repair contracts contain a clause (art. 41) which requires a contractor to repay to the Federal Maritime Administration any profits on the contract which exceed 10 percent of the contract price.
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> (2) The Navy Department follows the practice of inserting an escalation clause (art. 6(e)) in ship construction contracts which permits the contracting officer to deny the agreed upon escalation payments if he finds that the payment "is not required * * * to enable the contractor to earn a fair and reasonable profit" under the contract.
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> (3) The Federal Maritime Administration (and the Federal Maritime Board) also employs an escalation clause in shipbuilding contracts (sec. 5) which provides that escalation payments will not be made if the payments would yield the contractor a profit of more than 10 percent of the contract price.
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> A brief consideration of the nature of renegotiation shows that these types of profit limitations are inconsistent in several respects with the type of profit limitation decided upon by Congress when it adopted renegotiation. The Renegotiation Act empowers the Government, acting through an independent agency known as the Renegotiation Board, to require a contractor to repay to the U.S. Treasury any profits earned on renegotiable Government contracts which, in the judgment of the Board, are excessive for the fiscal year involved. This type of profit limitation differs radically from that involved in the provisions described above.
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> (1) Renegotiation is not conducted on a contract-by-contract basis but on an overall fiscal year basis. In other words, if a contractor holds several renegotiable Government contracts the question of whether he has earned excessive profits is not determined by reference to each individual contract but is determined with respect to his aggregate profits during a fiscal year on all the contracts, with the result that losses or deficiencies in reasonable profits on one contract may be offset against excessive profits on another contract.
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> (2) In the renegotiation process, the determination of excessive profits is not made by a contracting officer or any other official in the contracting agency, but is made by an independent official on the Renegotiation Board. The Renegotiation Act itself fortifies this procedure by prohibiting

the Board from delegating any of its powers to any person in any agency who is responsible for making procurement contracts for that agency.

(3) Under renegotiation, amounts which are determined to be excessive profits are required to be paid into the surplus fund of the U.S. Treasury and not to the agency which made the contract. The requirement that excessive profits be paid to the Treasury rather than to the contracting agency involved has the desirable effect of preventing contracting officers from relying on renegotiation or any other after-the-fact profit limitation device in establishing the original terms of the contract.

(4) Renegotiation does not establish an arbitrary flat rate profit limitation on all contracts but requires the Renegotiation Board, in determining excessive profits, to take into account numerous factors which may vary among different contracts and contractors.

When Congress adopted renegotiation, it had before it a considerable amount of prior experience with other forms of profit limitations similar to some of those described above which are currently being employed by regulatory action of administrative agencies, and in view of the various shortcomings of such other forms of profit limitations it rejected them in favor of renegotiation. For example, the Merchant Marine Act of 1936 and the Vinson-Trammell Act of 1934 contained flat rate profit limitations of 10 and 12 percent of the contract price in the case of ship construction and aircraft construction contracts, respectively, and required contractors holding such contracts to repay any profits in excess of the limit to the contracting agency involved. Congress provided, however, in section 102(e) of the Renegotiation Act that the profit limitation provisions of those two acts be suspended so long as renegotiation is in effect. Despite the fact that Congress expressly indicated its intention to suspend such other types of profit limitations and despite the fact that the other types of profit limitations described above are inconsistent with the renegotiation process, some of the administrative agencies have, in effect, nullified the congressional policy by employing profit limitation devices other than renegotiation, even though the contracts to which the other profit limitations are applied are, at the same time, subject to renegotiation.

In order to prevent the renegotiation authority from being weakened and to prevent the will of Congress from being circumvented by such administrative action, this amendment prohibits use of the type of profit limitations described above so long as the Renegotiation Act is in effect.

Your committee believes that those considerations are still sound. Because of these considerations and the various considerations developed in the course of the study referred to above, your committee has adopted the provisions of section 2 of this bill.

Section 3. Application of standard commercial article exemptions to leases.—Section 3 of the bill amends the act so as to make it clear that the standard commercial article exemption (and the related exemp-

tions for "like" articles and for classes of articles) is to be applicable to receipts or accruals from leases of such articles, as well as those from sales of such articles. Under existing law, as currently interpreted by the Renegotiation Board, receipts or accruals from transaction in such articles, are exempt if the transaction is a sale, but not if it is a lease.

Your committee concluded, after careful consideration of this matter, that there is no sound reason for denying exemption where the receipts or accruals happen to be from leases rather than from sales. The Government's protection against excessive profits in this area lies in the carefully drawn definition of what is a "standard commercial article," and once an article has met all the requirements laid down by the law for being exempt as a "standard commercial article," your committee feels that the exemption should not be denied, merely because the transaction in which the article was disposed of happens to be a lease instead of a sale. For these reasons, section 3 of your committee's bill amends paragraphs (4) and (5) of section 106(e) of the act, at the appropriate places, to make those provisions applicable to receipts and accruals from leases.

Section 4. Appellate review of Tax Court decisions in renegotiation cases.—Section 4 of the bill amends the act so as to broaden the scope of appellate review of Tax Court decisions in renegotiation cases.

The provisions of present law relating to appellate review of Tax Court decisions in renegotiation cases have been sharply criticized by many within the past several years. Although the courts have interpreted provisions of the Internal Revenue Code, which relate generally to appellate review of Tax Court decisions, as allowing some measure of appellate review of its decisions in renegotiation cases, the scope of review thus allowed by the courts has been quite limited, and considerably narrower than that accorded with respect to Tax Court decisions in tax cases. The problems and uncertainties presented by the present provisions of law concerning scope of appellate review of Tax Court decisions in renegotiation cases have been the subject of careful congressional study for several years, and on the basis of that study, your committee has concluded that the measure of appellate review now available is unduly restricted. With certain important exceptions, your committee believes that Tax Court decisions in renegotiation cases should be subject to appellate review in the same manner and to the same extent as its decisions in tax cases.

Accordingly, section 4 of your committee's bill provides for review by the U.S. courts of appeals (and by the Supreme Court of the United States upon certiorari) of Tax Court decisions in renegotiation cases, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury, subject, however, to certain important limitations. The first limitation is that in no case shall the question of the existence of excessive profits, or the extent thereof, be reviewed, and, further, that findings of fact by the Tax Court shall be conclusive unless such findings are arbitrary or capricious. Your committee believes that the ultimate question of the extent of excessiveness of profits or of the existence thereof, requires the exercise of judgement which is of such a nature that the appellate courts should not be permitted to substitute their judgment for that of the Tax Court.

For this reason, your committee's bill also imposes other limitations on the power of the appellate courts in the provisions of subsection (b) of section 108A as amended by the bill. Under these provisions, the powers of the appellate courts are limited to affirming the decision of the Tax Court, or to reversing such decision on questions of law and remanding the case for such further action as justice may require. The appellate courts, moreover, are not permitted to reverse and remand the case for an error of law which is immaterial to the decision of the Tax Court.

There is also a provision in section 4 of the bill which deletes the provision of existing law (the last sentence of sec. 105(b)(2) of the Renegotiation Act) which stops the accrual of interest provided for under the act after 3 years from the date of filing a petition for redetermination with the Tax Court in any case in which there has not been a final determination by the Tax Court with respect to the petition within such 3-year period.

In order to make the amendments made by section 4 of the bill prospective in effect, provision has been made in section 4 that the amendments made thereby shall apply only with respect to cases in which the petition for redetermination is filed with the Tax Court after the date of enactment of the bill.

III. CHANGES IN EXISTING LAW

In the opinion of the committee, it is necessary, in order to expedite the business of the Senate, to dispense with the requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill, as reported).

MINORITY VIEW

In addition to extending the Renegotiation Act for a period of 2 years, that is, until June 30, 1964, this bill would amend the act in three signficant respects, as indicated in the majority report. While I have no objection to extending the act for a period of 2 years, I strongly oppose the adoption of the proposed amendments to the act and do so for the following reasons.

First, it should be pointed out that the staff of the Joint Committee on Internal Revenue Taxation concluded in House Report No. 1447, after an extensive and exhaustive study that, except for extending the act 2 years, "the staff does not believe it would be advisable to suggest any basic changes in the act while the Renegotiation Board is conducting its reexamination of the renegotiation process."

(1) More specifically the staff, while recognizing that considerable criticism has been directed to the limitations imposed by present law on appellate review of Tax Court decisions in renegotiation cases and to the litigation necessitated by the uncertainties under present law regarding the scope of appellate review, nevertheless concluded in its report that—

> It is the opinion of the staff that no change should be made at this time in those provisions of present law concerning the scope of appellate review of Tax Court decisions in renegotiation cases.

Acknowledging the many objections which may have been raised on the question of the scope of appellate review in renegotiation cases, it appears inadvisable to adopt amendments at this time which may have far-reaching effects and possibly create more uncertainties in the law without first conducting public hearings on the question of appellate review and of the issues raised by the other amendments.

This is especially true because the Supreme Court in the *California Eastern Line* case has ruled that the scope of review of renegotiation decisions of the Tax Court is fixed by the same provision of the Internal Revenue Code that defines the scope of review of tax decisions of that court. It follows that under present law the same right of review exists with respect to decisions of the Tax Court in renegotiation cases as in tax cases arising in that court, with the single exception that a Tax Court determination of the amount of excessive profits is not subject to review. Since the decision of the Supreme Court in 1955, there have been 11 cases in which various courts of appeals have assumed jurisdiction to review questions of law in renegotiation cases decided by the Tax Court. In four cases such jurisdiction has been refused. Since the proposed amendment would, on its face, merely codify the existing law as declared by the Supreme Court, it does not appear to me to be necessary.

(2) Section 3 of the bill extends the standard commercial article exemption to the leasing of articles.

The basic premise of the standard commercial article exemption is that, since such articles are sold in the competitive marketplace, the

prices are reasonable and therefore there is no likelihood of excessive profits. The same economic conditions, however, do not surround the leasing of articles. For example, there are instances where equipment is rented simply because the lessee wants that type of equipment, and price is not the governing factor. Moreover, in the past it is well known that certain leasing arrangements under the patent system have tended toward monopolistic practices and have been ways in which monopolies have operated. Rental arrangements may tend to generate higher profits than sales of the same articles. While those profits may not necessarily be excessive, the Board should have jurisdiction to review them.

The leasing of equipment is an expanding development in American business and only recently it was estimated that annual receipts on such leasing may amount to $1 to $2 billion a year. Many types and varieties of equipment now are subject to lease. For example, in the Government's fiscal year 1962 more than $225 million was spent by the Government in leasing electronic data-processing machines (much of which is used in missiles, etc.) and in punchcard systems equipment. The committee has no information of the degree of profits realized in fiscal year 1962 on this huge amount of Government money spent for leasing these complex data-processing machines. It should not precipitously exempt them from renegotiation. The proposed amendment would have far-reaching effect, and in view of the fact that this practice is in a state of flux it would be unwise to grant the exemption at this time.

After a survey, the Budget Bureau last year issued a circular to Government agencies which made it clear that the purchase of equipment, under certain ground rules, was to be preferred to leases. This is so because, in the long run, it is generally cheaper to buy equipment than rent it. For example, Bureau of the Budget Circular A–54, dated October 14, 1961, showed that on a representative data-processing machine the cost to the Government over a 6-year period for purchasing and maintaining the machine would be $900,000. On the other hand, if the Government leased the same machine and paid the maintenance, it would cost the Government over the same 6-year period $1,200,000. A portion of this $300,000 difference is additional profit to the company. The Renegotiation Act, by exempting sales and not exempting leases of such equipment, is consistent with Government policy in this area. The proposed amendment would in my judgment be against the public interest.

(3) Section 2 of the bill would amend section 104 of the Renegotiation Act to prohibit profit limitation provisions in Government contracts.

In Government ship-construction and ship-repair contracts, there have been provisions which limit profits under price escalation clauses. The Maritime Administration believes that this practice is sound and is beneficial to the Government. The practice should not be upset without more consideration than has been given to this question by the majority.

PAUL H. DOUGLAS.

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