Calendar No. 228

93D CONGRESS 1st Session | SENATE | REPORT No. 93-240

# RENEGOTIATION AMENDMENTS OF 1973

JUNE 22 (legislative day, JUNE 18), 1973.—Ordered to be printed

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

## REPORT

[To accompany H.R. 7445]

The Committee on Finance, to which was referred the bill (H.R. 7445) to amend the Renegotiation Act of 1951 to extend the Act for two years, having considered the same, reports favorably thereon 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, 1973. H.R. 7445, as passed by the House, extends the Act for two years, or until June 30, 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 Departments of Defense, 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, renegotiation 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, and they may be concerned with many different 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. Thus, in effect, the Board in its judgment must consider all of these factors, and the producer, where these factors are present to the greatest extent (e.g., is most efficient or makes the greatest 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 exemption, 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 contracts 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. Two-year Extension of the Act

In the absence of legislation, the Renegotiation Act would expire as of June 30, 1973. The committee agrees with the House 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 the national defense and space efforts. This is a renegotiation of a contractor's fiscal-year aggregate profits on these contracts; thus, it is completely difficult from price adjustments or redeterminations with respect to individual contracts. The renegotiation process therefore 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 90 percent of the value of the Defense Department's military procurement in fiscal 1972, which was a continuation of the increase in percentage from 82 percent in fiscal 1965 to 87 percent in fiscal 1967 and to 89 percent in fiscal 1970. In addition, negotiated NASA contracts represented 99 percent of the value of NASA's procurement in fiscal 1972, as compared to 91 percent in fiscal 1961.

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 $44.9 billion in fiscal 1967; military procurement then declined slightly to $43.8 billion in fiscal 1968 to $42 billion in fiscal 1969 and to $34.5 billion in fiscal 1971, before increasing to $38.3 billion in fiscal 1972. Although the military procurement level has declined somewhat during 1968–71, the level of overall defense-related procurement is expected to remain relatively high.

Moreover, in view of the normal timelag between the time a contract is awarded and the time renegotiation filings are made with respect to the contract or subcontract, the amounts from military procurement awards made during the Southeast Asia conflict will continue to be reported in Renegotiation Board filings during the next 2 years. For example, although total military and space procurement declined from fiscal 1967 to fiscal 1971, the level of renegotiable sales reviewed by the Board increased substantially from $33.1 billion in fiscal 1967 to $48.5 billion in fiscal 1969 and to $51.6 billion in fiscal 1971.[1]

The timelag also is reflected by the increase in the number of filings above the $1,000,000 floor received by the Board—from 3,737 in fiscal

[1] The Board reported that the total of renegotiable sales reviewed in fiscal 1972 amounted to $31.3 billion; however, they noted that 263 filings, "which under the usual procedures would probably have been screened in fiscal 1972," were not fully processed in that year. These filings represented approximately $11 billion in renegotiable sales, or a total of about $42.4 billion for fiscal 1972.

1967 to 5,030 in fiscal 1969, 5,085 in fiscal 1970, and 5,267 in fiscal 1971, before declining somewhat to 4,874 in fiscal 1972. 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 since 1958. The fiscal 1972 level of $40.2 million was higher than the prior years since 1958 except for 1971.

The committee agrees with the House that in view of the extent of our defense effort and the nature of much of defense and space-related procurement the Renegotiation Act should be extended for a 2-year period, from June 30, 1973, to June 30, 1975. The nature of the renegotiation process and its inherent reliance on human judgment are factors that lead the committee to consider it desirable to have periodic congressional review of the renegotiation process.

The committee and the House are 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; and to decrease the minimum floor to $100,000 or $250,000. These recommendations suggest quite different courses for the renegotiation process in the future. The committee agrees with the House that further analysis is needed of these recent reports in order to properly evaluate the recommendations. However, no significant review can be completed before the present termination of the Act, June 30, 1973. This two-year extension of the Act as provided in the committee's bill will give Congress time to evaluate these recommendations and to review the recent administrative changes that the Board has made to modify some of its procedures and regulations. In addition, it is expected that within the next two years the backlog of cases resulting from the procurement for Vietnam will be largely eliminated. The committee believes that with this factor largely out of the way, it will have a better perspective to determine the character and extent of the future role for renegotiation.

### C. Study of Renegotiation Process

As indicated above, the two-year extension of the Renegotiation Act will allow Congress further opportunity to review the renegotiation process. At least two congressionally sponsored reports have been made recently containing recommendations with respect to the Renegotiation Board.[2] In addition, the General Accounting Office (GAO) has conducted a review of the Renegotiation Board and renegotiation process and just recently submitted its report to Congress.[3]

[2] House Committee on Government Operations, *The Efficiency and Effectiveness of Renegotiation Board Operations*, Dec. 16, 1971 (House Report No. 92-758, 92d Cong., 1st sess.), and Commission on Government Procurement, *Report*, vol. 4, December 1972.

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

The committee agrees with the House that so much of this two-year extension period as is needed should be utilized to thoroughly analyze these and other reports on the renegotiation process. The committee therefore has requested an analysis of these reports and recommendations with respect to the renegotiation process to be made in a study by the staffs of the Renegotiation Board and the Joint Committee on Internal Revenue Taxation. The committee expects this study to be completed in sufficient time prior to the expiration of the Renegotiation Act, as extended by this bill, to allow the committee to fully review the renegotiation process.

## 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 of 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 2-year extension of the act provided by the bill (which in effect requires new cases to be filed with the Board for an additional 2 years) will result in estimated additional costs of $10 million. Because the cases to which this 2-year extension applies are likely to be processed by the Board about 2 years after the years to which the cases relate, it is probable that this additional $10 million of expense will be incurred in the period from 2 to 3 years beyond the fiscal year 1975.

On the other hand, based on experience in recent years, the committee estimates that the 2-year 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 2-year period of from $50 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 $25 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 was ordered favorably reported by the committee without a roll call vote and without objection.

## V. CHANGES IN EXISTING LAW

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 italic, 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) * * *

* * * * * * *

(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, [1973] *1975*.

* * * * * * *

○