RENEGOTIATION OF CONTRACTS

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

EIGHTY-SECOND CONGRESS

FIRST SESSION

ON

H. R. 1724

AN ACT TO PROVIDE FOR THE RENEGOTIATION OF CONTRACTS, AND FOR OTHER PURPOSES

JANUARY 31 AND FEBRUARY 2, 1951

Printed for the use of the Committee on Finance

UNITED STATES
GOVERNMENT PRINTING OFFICE
78955 WASHINGTON : 1951

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RENEGOTIATION OF CONTRACTS

WEDNESDAY, JANUARY 31, 1951

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to notice, at 10 a. m. in room 312 Senate Office Building, Senator Walter F. George (chairman) presiding.

Present: Senators George, Byrd, Hoey, Frear, Butler of Nebraska, Martin, and Williams.

Also present: Mrs. Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

We will proceed with the hearing on H. R. 1724, the Renegotiation Act of February 25, 1944, as amended.

(H. R. 1724 is as follows:)

[H. R. 1724, 82d Cong., 1st sess.]

AN ACT To provide for the renegotiation of contracts, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Renegotiation Act of 1951".

TITLE I—RENEGOTIATION OF CONTRACTS

SEC. 101. DECLARATION OF POLICY.

It is hereby recognized and declared that the Congress has made available for the execution of the national defense program extensive funds, by appropriation and otherwise, for the procurement of property, processes, and services, and the construction of facilities necessary for the national defense; that sound execution of the national defense program requires the elimination of excessive profits from contracts made with the United States, and from related subcontracts, in the course of said program; and that the considered policy of the Congress, in the interests of the national defense and the general welfare of the Nation, requires that such excessive profits be eliminated as provided in this title.

SEC. 102. CONTRACTS SUBJECT TO RENEGOTIATION.

(a) IN GENERAL.—The provisions of this title shall be applicable (1) to all contracts with the Departments specifically named in section 103 (a), and related subcontracts, to the extent of the amounts received or accrued by a contractor or subcontractor on or after the first day of January 1951, whether such contracts or subcontracts were made on, before, or after such first day, and (2) to all contracts with the Departments designated by the President under section 103 (a), and related subcontracts, to the extent of the amounts received or accrued by a contractor or subcontractor on or after the first day of the first month beginning after the date of such designation, whether such contracts or subcontracts were made on, before, or after such first day; but the provisions of this title shall not be applicable to receipts or accruals attributable to performance, under contracts or subcontracts, after December 31, 1953.

(b) RENEGOTIATION ACT OF 1948.—The Renegotiation Act of 1947 shall not apply with respect to any receipts or accruals subject to renegotiation under this title. If a contractor or subcontractor, during the same fiscal year in which he has receipts or accruals subject to renegotiation under this title, has other receipts

or accruals from contracts or subcontracts subject to renegotiation under the Renegotiation Act of 1948, the provisions of this title shall, notwithstanding subsection (a), apply to such other receipts or accruals if the Board and such contractor or subcontractor agree to such application of this title; and in the case of such an agreement the provisions of the Renegotiation Act of 1948 shall not apply to such other receipts or accruals of the fiscal year.

(c) 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, shall not apply to any contract or subcontract if any of the receipts or accruals therefrom are subject to this title.

SEC. 103. DEFINITIONS.

For the purpose of this title—

(a) DEPARTMENT.—The term "Department" means the Department of Defense, the Department of the Army, the Department of the Navy, the Department of the Air Force, the Department of Commerce, the General Services Administration, the Atomic Energy Commission, and such other agencies of the Government exercising functions in connection with the national defense as the President shall designate.

(b) SECRETARY.—The term "Secretary" means the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, the Secretary of the Air Force, the Secretary of Commerce, the Administrator of General Services, the Atomic Energy Commission, and the head of any other agency of the Government which the President shall designate pursuant to subsection (a) of this section.

(c) BOARD.—The term "Board" means the Renegotiation Board created by section 107 (a) of this Act.

(d) RENEGOTIATE AND RENEGOTIATION.—The terms "renegotiate" and "renegotiation" include a determination by agreement or order under this title of the amount of any excessive profits.

(e) EXCESSIVE PROFITS. The term "excessive profits" means the portion of the profits derived from contracts with the Departments and subcontracts which is determined in accordance with this title to be excessive. In determining excessive profits there shall be taken into consideration the following factors:

(1) Efficiency of contractor, with particular regard to attainment of quantity and quality production, reduction of costs, and economy in the use of materials, facilities, and manpower;

(2) Reasonableness of costs and profits, with particular regard to volume of production, normal earnings, and comparison of war and peacetime products;

(3) Reasonableness of return on net worth, with particular regard to the amount and source of public and private capital employed;

(4) Extent of risk assumed, including the risk incident to reasonable pricing policies;

(5) Nature and extent of contribution to the defense effort, including inventive and developmental contribution and cooperation with the Government and other contractors in supplying technical assistance;

(6) Character of business, including source and nature of materials, complexity of manufacturing technique, character and extent of subcontracting, and rate of turn-over;

(7) Such other factors the consideration of which the public interest and fair and equitable dealing may require, which factors shall be published in the regulations of the Board from time to time as adopted.

(f) PROFITS DERIVED FROM CONTRACTS WITH THE DEPARTMENTS AND SUBCONTRACTS.—The term "profits derived from contracts with the Departments and subcontracts" means the excess of the amount received or accrued under such contracts and subcontracts over the costs paid or incurred with respect thereto and determined to be allocable thereto. All items estimated to be allowable as deductions and exclusions under chapter 1 of the Internal Revenue Code (excluding taxes measured by income) shall, to the extent allocable to such contracts and subcontracts, be allowed as items of cost, except that no amount shall be allowed as an item of cost by reason of the application of a carry-over or carry-back. Such costs shall be determined in accordance with the method of cost accounting regularly employed by the contractor or subcontractor in keeping his books, but, if no such method of cost accounting has been employed, or if the method so employed does not, in the opinion of the Board, or, upon redetermination, in the opinion of The Tax Court of the United States, properly reflect such costs, such costs shall be determined in accordance with such method as in the opinion of the

Board, or, upon redetermination, in the opinion of The Tax Court of the United States, does properly reflect such costs. Irrespective of the method employed or prescribed for determining such costs, no item of cost shall be charged to contracts with the Departments or subcontracts or used in any manner for the purpose of determining such costs, to the extent that, in the opinion of the Board, or, upon redetermination, in the opinion of The Tax Court of the United States, such item is unreasonable or not properly chargeable to such contracts or subcontracts. In determining the amount of excessive profits to be eliminated, proper adjustment shall be made on account of the taxes measured by income, other than Federal taxes, which are attributable to the portion of the profits which are not excessive.

(g) SUBCONTRACT.—The term "subcontract" means—

(1) any purchase order or agreement (including purchase orders or agreements antedating the related prime contract or higher tier subcontract) to perform all or any part of the work, or to make or furnish any materials, required for the performance of any other contract or subcontract;

(2) any contract or arrangement covering the right to use any patented or secret method, formula, or device for the performance of a contract or subcontract; and

(3) any contract or arrangement (other than a contract or arrangement between two contracting parties, one of whom is found by the Board to be a bona fide executive officer, partner, or full-time employee of the other contracting party) under which —

(A) any amount payable is contingent upon the procurement of a contract or contracts with a Department or of a subcontract or subcontracts; or

(B) any amount payable is determined with reference to the amount of a contract or contracts with a Department or of a subcontract or subcontracts; or

(C) any part of the services performed or to be performed consists of the soliciting, attempting to procure, or procuring a contract or contracts with a Department or a subcontract or subcontracts.

Nothing in this subsection shall be construed (i) to affect in any way the validiy or construction of provisions in any contract with a Department or any subcontract, heretofore at any time or hereafter made, prohibiting the payment of contingent fees or commissions; or (ii) to restrict in any way the authority of the Board to determine the nature or amount of selling expense under subcontracts as defined in this subsection, as a proper element of the contract price or as a reimbursable item of cost, under a contract with a Department or a subcontract.

(h) FISCAL YEAR.—The term "fiscal year" means, except in the case of a partnership as defined in section 3797 (a) (2) of the Internal Revenue Code, the taxable year of the contractor or subcontractor under chapter 1 of such code. In the case of a partnership as so defined the term "fiscal year" means such period as the Board by regulations may prescribe.

(i) RECEIVED OR ACCRUED AND PAID OR INCURRED.—The terms "received or accrued" and "paid or incurred" shall be construed according to the method of accounting employed by the contractor or subcontractor in keeping his books, but if no such method of accounting has been employed, or if the method so employed does not, in the opinion of the Board, or, upon redetermination, in the opinion of The Tax Court of the United States, properly reflect his receipts or accruals or payments or obligations, such receipts or accruals or such payments or obligations shall be determined in accordance with such method as in the opinion of the Board, or, upon redetermination, in the opinion of The Tax Court of the United States, does properly reflect such receipts or accruals or such payments or obligations.

(j) PERSON.—The term "person" shall include an individual, firm, corporation, association, partnership, and any organized group of persons whether or not incorporated.

(k) MATERIALS.—The term "materials" shall include raw materials, articles, commodities, parts, assemblies, products, machinery, equipment, supplies, components, technical data, processes, and other personal property.

(l) AGENCY OF THE GOVERNMENT.—The term "agency of the Government" means any part of the executive branch of the Government or any independent establishment of the Government or part thereof, including any department (whether or not a Department as defined in subsection (a) of this section), any corporation wholly or partly owned by the United States which is an instrumentality of the United States, or any board, bureau, division, service, office,

officer, employee, authority, administration, or other establishment of the Government which is not a part of the legislative or judicial branches.

SEC. 104. RENEGOTIATION CLAUSE IN CONTRACTS.

Subject to section 106 (a), the Secretary of each Department specifically named in section 103 (a) shall insert in each contract made by such Department thirty days or more after the date of the enactment of this Act, and the Secretary of each Department designated by the President under section 103 (a) shall insert in each contract made by such Department thirty days or more after the date of such designation, a provision under which the contractor agrees—

(1) to the elimination of excessive profits through renegotiation;

(2) that there may be withheld by the United States from amounts otherwise due the contractor, or that he will repay to the United States, if paid to him, any excessive profits;

(3) that he will insert in each subcontract described in section 103 (g) a provision under which the subcontractor agrees—

(A) to the elimination of excessive profits through renegotiation;

(B) that there may be withheld by the contractor for the United States from amounts otherwise due to the subcontractor, or that the subcontractor will repay to the United States, if paid to him, any excessive profits;

(C) that the contractor shall be relieved of all liability to the subcontractor on account of any amount so withheld, or so repaid by the subcontractor to the United States;

(D) that he will insert in each subcontract described in section 103 (g) provisions corresponding to those of subparagraphs (A), (B), and (C), and to those of this subparagraph;

(4) that there may be withheld by the United States from amounts otherwise due the contractor, or that he will repay to the United States, as the Secretary may direct, any amounts which under section 105 (b) (1) (C) the contractor is directed to withhold from a subcontractor and which are actually unpaid at the time the contractor receives such direction.

The obligations assumed by the contractor or subcontractor under paragraph (1) or (3) (A), as the case may be, agreeing to the elimination of excessive profits through renegotiation shall be binding on him only if the contract or subcontract, as the case may be, is subject to this title. A provision inserted in a contract or subcontract, which recites in substance that the contract or subcontract shall be deemed to contain all the provisions required by this section shall be sufficient compliance with this section. Whether or not the provisions specified in this section are inserted in a contract with a Department or subcontract, to which this title is applicable, such contract or subcontract, as the case may be, shall be considered as having been made subject to this title in the same manner and to the same extent as if such provisions had been inserted.

SEC. 105. RENEGOTIATION PROCEEDINGS.

(a) PROCEEDINGS BEFORE THE BOARD.—Renegotiation proceedings shall be commenced by the mailing of notice to that effect, in such form as may be prescribed by regulation, by registered mail to the contractor or subcontractor. The Board shall endeavor to make an agreement with the contractor or subcontractor with respect to the elimination of excessive profits received or accrued, and with respect to such other matters relating thereto as the Board deems advisable. Any such agreement, if made, may, with the consent of the contractor or subcontractor, also include provisions with respect to the elimination of excessive profits likely to be received or accrued. If the Board does not make an agreement with respect to the elimination of excessive profits received or accrued, it shall issue and enter an order determining the amount, if any, of such excessive profits, and forthwith give notice thereof by registered mail to the contractor or subcontractor. In the absence of the filing of a petition with The Tax Court of the United States under the provisions of and within the time limit prescribed in section 108, such order shall be final and conclusive and shall not be subject to review or redetermination by any court or other agency. The Board shall exercise its powers with respect to the aggregate of the amounts received or accrued during the fiscal year (or such other period as may be fixed by mutual agreement) 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, except that the Board may exercise such powers separately with respect to amounts received or accrued by the contractor or subcontractor under any one or more separate contracts with

the Departments or subcontracts at the request of the contractor or subcontractor. By agreement with any contractor or subcontractor, and pursuant to regulations promulgated by it, the Board may in its discretion conduct renegotiation on a consolidated basis in order properly to reflect excessive profits of two or more related contractors or subcontractors. Whenever the Board makes a determination with respect to the amount of excessive profits, and such determination is made by order, it shall, at the request of the contractor or subcontractor, as the case may be, 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. Such statement shall not be used in The Tax Court of the United States as proof of the facts or conclusions stated therein.

(b) METHODS OF ELIMINATING EXCESSIVE PROFITS.—

(1) IN GENERAL.—Upon the making of an agreement, or the entry of an order, under subsection (a) of this section by the Board, or the entry of an order under section 108 by The Tax Court of the United States, determining excessive profits, the Board shall forthwith authorize and direct the Secretaries or any of them to eliminate such excessive profits—

(A) by reductions in the amounts otherwise payable to the contractor under contracts with the Departments, or by other revision of their terms;

(B) by withholding from amounts otherwise due to the contractor any amount of such excessive profits;

(C) by directing any person having a contract with any agency of the Government, or any subcontractor thereunder, to withhold for the account of the United States from any amounts otherwise due from such person or such subcontractor to a contractor, or subcontractor, having excessive profits to be eliminated, and every such person or subcontractor receiving such direction shall withhold and pay over to the United States the amounts so required to be withheld;

(D) by recovery from the contractor or subcontractor, or from any person or subcontractor directed under subparagraph (C) to withhold for the account of the United States, through payment, repayment, credit, or suit any amount of such excessive profits realized by the contractor or subcontractor or directed under subparagraph (C) to be withheld for the account of the United States; or

(E) by any combination of these methods, as is deemed desirable.

(2) INTEREST.—Interest at the rate of 6 per centum per annum shall accrue and be paid on the amount of such excessive profits from the date fixed for repayment by the order of the Board or by the agreement with the contractor or subcontractor to the date of repayment, and on amounts required to be withheld by any person or subcontractor for the account of the United States pursuant to paragraph (1) (C), from the date payment is demanded by the Secretaries or any of them to the date of payment. When The Tax Court of the United States, under section 108, redetermines the amount of excessive profits received or accrued by a contractor or subcontractor, interest at the rate of 6 per centum per annum shall accrue and be paid by such contractor or subcontractor as follows:

(A) When the amount of excessive profits determined by the Tax Court is greater than the amount determined by the Board, interest shall accrue and be paid on the amount determined by the Board from the date originally fixed by the Board for its repayment to the date of repayment and, in addition thereto, interest shall accrue and be paid on the additional amount determined by the Tax Court from the date of its order determining such excessive profits to the date of repayment.

(B) When the amount of excessive profits determined by the Tax Court is equal to the amount determined by the Board, interest shall accrue and be paid on such amount from the date originally fixed by the Board for its repayment to the date of repayment.

(C) When the amount of excessive profits determined by the Tax Court is less than the amount determined by the Board, interest shall accrue and be paid on such lesser amount from the date originally fixed for repayment by the Board to the date of repayment.

(3) SUITS FOR RECOVERY.—Actions on behalf of the United States may be brought in the appropriate courts of the United States to recover, (A) from the contractor or subcontractor, any amount of such excessive profits and accrued interest not withheld or eliminated by some other method under this subsection, and (B) from any person or subcontractor who has been directed

under paragraph (1) (C) of this subsection to withhold for the account of the United States, the amounts required to be withheld under such paragraph, together with accrued interest thereon.

(4) SURETIES.—The surety under a contract or subcontract shall not be liable for the repayment of any excessive profits thereon.

(5) INDEMNIFICATION.—Each person is hereby indemnified by the United States against all claims on account of amounts withheld by such person pursuant to this subsection from a contractor or subcontractor and paid over to the United States.

(6) TREATMENT OF RECOVERIES.—All money recovered in respect to amounts paid to a contractor from appropriations from the Treasury by way of repayment or suit under this subsection shall be covered into the Treasury as miscellaneous receipts. Upon the withholding of any amount of excessive profits or the crediting of any amount of excessive profits against amounts otherwise due a contractor, the Secretary shall certify the amount thereof to the Treasury and the appropriations of his Department shall be reduced by an amount equal to the amount so withheld or credited. The amount of such reductions shall be transferred to the surplus fund of the Treasury. All money recovered in respect of amounts paid to the contractor from corporate or other revolving funds (other than appropriations from the Treasury) by way of repayment, withholding, crediting, or suit under this section shall be restored to such funds. The Board is authorized to make regulations giving effect to the intent of this provision in respect of money recovered representing subcontract excessive profits not readily identifiable as to the public funds ultimately reflecting charges therefor.

(7) CREDIT FOR TAXES PAID.—In eliminating excessive profits, the Secretary shall allow the contractor or subcontractor credit for Federal income and excess profits taxes as provided in section 3806 of the Internal Revenue Code.

(c) PERIODS OF LIMITATIONS.—No proceeding to determine the amount of excessive profits for any fiscal year shall be commenced more than one year after the statement required under subsection (e) (1) of this section is filed with the Board with respect to such year, and, if such proceeding is not commenced prior to the expiration of one year following the date upon which such statement is so filed, all liabilities of the contractor or subcontractor for excessive profits received or accrued during such fiscal year shall thereupon be discharged. If an agreement or order determining the amount of excessive profits is not made within two years following the commencement of the renegotiation proceeding, then upon the expiration of such two years all liabilities of the contractor or subcontractor for excessive profits with respect to which such proceeding was commenced shall thereupon be discharged, except that (1) if an order is made within such two years pursuant to a delegation of authority under subsection (d) of section 107, such two-year limitation shall not apply to review of such order by the Board, and (2) such two-year period may be extended by mutual agreement.

(d) AGREEMENTS TO ELIMINATE EXCESSIVE PROFITS.—For the purposes of this title the Board may make final or other agreements with a contractor or subcontractor for the elimination of excessive profits and for the discharge of any liability for excessive profits under this title. Such agreements may contain such terms and conditions as the Board deems advisable. Any such agreement shall be conclusive according to its terms; and, except upon a showing of fraud or malfeasance or a willful misrepresentation of a material fact, (1) such agreement shall not for the purposes of this title be reopened as to the matters agreed upon and shall not be modified by any officer, employee, or agent of the United States, and (2) such agreement and any determination made in accordance therewith shall not be annulled, modified, set aside, or disregarded in any suit, action, or proceeding. Notwithstanding any other provision of this title, however, the Board shall have the power, pursuant to regulations promulgated by it, to modify any agreement or order for the purpose of extending the time for payment of sums due under such agreement or order.

(e) INFORMATION AVAILABLE TO BOARD.—

(1) FURNISHING OF FINANCIAL STATEMENTS, ETC.—Every person who holds contracts or subcontracts, to which the provisions of this title are applicable, shall, in such form and detail as the Board may by regulations prescribe, file with the Board, on or before the first day of the fourth calendar month following the close of his fiscal year, a financial statement setting forth such information as the Board may by regulations prescribe as necessary to carry out this title. In addition to the statement required under the

preceding sentence, every such person shall, at such time or times and in such form and detail as the Board may by regulations prescribe, furnish the Board any information, records, or data which are determined by the Board to be necessary to carry out this title. Any person who willfully fails or refuses to furnish any statement, information, records, or data required of him under this subsection, or who knowingly furnishes any such statement, information, records, or data containing information which is false or misleading in any material respect, shall, upon conviction thereof, be punished by a fine of not more than $10,000 or imprisonment for not more than one year, or both.

(2) AUDIT OF BOOKS AND RECORDS.—For the purpose of this title, the Board shall have the right to audit the books and records of any contractor or subcontractor subject to this title. In the interest of economy and the avoidance of duplication of inspection and audit, the services of the Bureau of Internal Revenue shall, upon request of the Board and the approval of the Secretary of the Treasury, be made available to the extent determined by the Secretary of the Treasury for the purpose of making examinations and audits under this title.

(f) MINIMUM AMOUNTS SUBJECT TO RENEGOTIATION.—

(1) IN GENERAL.—If the aggregate of the amounts received or accrued during a fiscal year (and on or after the applicable effective date specified in section 102 (a)) by a contractor or subcontractor, and all persons under control of or controlling or under common control with the contractor or subcontractor, under contracts with the Departments and subcontracts described in section 103 (g) (1) and (2), is not more than $100,000, the receipts or accruals from such contracts and subcontracts shall not, for such fiscal year, be renegotiated under this title. If the aggregate of such amounts received or accrued during the fiscal year under such contracts and subcontracts is more than $100,000, no determination of excessive profits to be eliminated for such year with respect to such contracts and subcontracts shall be in an amount greater than the amount by which such aggregate exceeds $100,000.

(2) SUBCONTRACTS DESCRIBED IN SECTION 103 (g) (3).—If the aggregate of the amounts received or accrued during a fiscal year (and on or after the applicable effective date specified in section 102 (a)) by a subcontractor, and all persons under control of or controlling or under common control with the subcontractor, under subcontracts described in section 103 (g) (3) is not more than $25,000, the receipts or accruals from such subcontracts shall not, for such fiscal year, be renegotiated under this title. If the aggregate of such amounts received or accrued during the fiscal year under such subcontracts is more than $25,000, no determination of excessive profits to be eliminated for such year with respect to such subcontracts shall be in an amount greater than the amount by which such aggregate exceeds $25,000.

(3) COMPUTATION.—In computing the aggregate of the amounts received or accrued during any fiscal year for the purposes of paragraphs (1) and (2) of this subsection, such computation shall be made without elimination of intercompany sales. If the fiscal year is a fractional part of twelve months, the $100,000 amount and the $25,000 amount shall be reduced to the same fractional part thereof for the purposes of paragraphs (1) and (2).

SEC. 106. EXEMPTIONS.

(a) MANDATORY EXEMPTIONS.—The provisions of this title shall not apply to—

(1) any contract by a Department with any Territory, possession, or State, or any agency or political subdivision thereof, or with any foreign government or any agency thereof; or

(2) any contract or subcontract for an agricultural commodity in its raw or natural state, or if the commodity is not customarily sold or has not an established market in its raw or natural state, in the first form or state, beyond the raw or natural state, in which it is customarily sold or in which it has an established market, but only if such contract or subcontract is with the producer of such agricultural commodity. The term "agricultural commodity" as used herein shall include but shall not be limited to—

(A) commodities resulting from the cultivation of the soil such as grains of all kinds, fruits, nuts, vegetables, hay, straw, cotton, tobacco, sugarcane, and sugar beets;

(B) natural resins, saps, and gums of trees;

(C) animals, such as cattle, hogs, poultry, and sheep, fish and other marine life, and the produce of live animals, such as wool, eggs, milk and cream; or

(3) any contract or subcontract for the product of a mine, oil or gas well, or other mineral or natural deposit, which has not been processed, refined, or treated beyond the ordinary treatment processes normally applied by producers in order to obtain the first commercially marketable product, but only if such contract or subcontract is with the owner or operator of the mine, well, or deposit from which such product is produced. The term "ordinary treatment processes" means, in the case of the product of a mine, well, or deposit with respect to which an allowance for percentage depletion is provided by section 114 (b) (3) or (4) of the Internal Revenue Code, those processes which are taken into account under such section in computing gross income from the property, and in the case of any other product such term means such similar processes as may be prescribed under regulations promulgated by the Board; or

(4) any contract or subcontract for timber which has not been processed beyond the form of logs, but only if such contract or subcontract is with the owner of the timber property or with the producer of the logs; or

(5) any subcontract directly or indirectly under a contract or subcontract to which this title does not apply by reason of this subsection.

(b) COST ALLOWANCE.—In the case of a contractor or subcontractor who produces an agricultural product and processes, refines, or treats such a product beyond the first form or state provided in paragraph (2) of subsection (a), or who produces the product of a mine, oil or gas well, or other mineral or natural deposit, or timber, and processes, refines, or treats such a product beyond the first commercially marketable state provided in paragraph (3) of subsection (a) or, in the case of timber, beyond the form of logs, the Board shall prescribe such regulations as may be necessary to give the contractor or subcontractor a cost allowance substantially equivalent to the amount which would have been realized by such contractor or subcontractor if he had sold the product in the form or state provided in paragraph (2) or (3) of subsection (a), or, in the case of timber, in the form of logs.

(c) PERMISSIVE EXEMPTIONS.—The Board is authorized, in its discretion, to exempt from some or all of the provisions of this title—

(1) any contract or subcontract to be performed outside of the territorial limits of the continental United States or in Alaska;

(2) any contracts or subcontracts under which, in the opinion of the Board, the profits can be determined with reasonable certainty when the contract price is established, such as certain classes of (A) agreements for personal services or for the purchase of real property, perishable goods, or commodities the minimum price for the sale of which has been fixed by a public regulatory body, (B) leases and license agreements, and (C) agreements where the period of performance under such contract or subcontract will not be in excess of thirty days;

(3) any contract or subcontract or performance thereunder during a specified period or periods if, in the opinion of the Board, the provisions of the contract are otherwise adequate to prevent excessive profits;

(4) any contract or subcontract the renegotiation of which would jeopardize secrecy required in the public interest;

(5) any subcontract or group of subcontracts not otherwise exempt from the provisions of this section, if, in the opinion of the Board, it is not administratively feasible in the case of such subcontract or in the case of such group of subcontracts to determine and segregate the profits attributable to such subcontract or group of subcontracts from the profits attributable to activities not subject to renegotiation.

The Board may so exempt contracts and subcontracts both individually and by general classes or types.

SEC. 107. RENEGOTIATION BOARD.

(a) CREATION OF BOARD.—There is hereby created, as an independent establishment in the executive branch of the Government, a Renegotiation Board to be composed of five members appointed by the President, by and with the advice and consent of the Senate. Not less than three members of the Board shall be appointed from civilian life. The President shall designate one member to serve as chairman of the Board. Each member shall receive compensation at the rate of $12,500 per annum. No member shall engage in any business, vocation, or employment other than that as a member of the Board. The Board shall have a seal which shall be judicially recognized.

(b) PLACES OF MEETINGS AND QUORUM.—The principal office of the Board shall be at such place as may be determined from time to time by the Board, but

it or any division thereof may meet and exercise its powers at any other place. The Board may establish such number of offices as it deems necessary to expedite the work of the Board. Three members of the Board shall constitute a quorum, and any power, function, or duty of the Board may be exercised or performed by a majority of the members present if the members present constitute at least a quorum.

(c) PERSONNEL.—The Board is authorized, subject to the civil-service laws and the Classification Act of 1949, to employ and fix the compensation of such officers and employees as it deems necessary to assist it in carrying out its duties under this title. The Board may, with the consent of the head of the agency of the Government concerned, utilize the services of any officers or employees of the United States, and reimburse such agency for the services so utilized. Officers or employees whose services are so utilized shall not receive additional compensation for such services, but shall be allowed and paid necessary travel expenses and a per diem in lieu of subsistence in accordance with the Standardized Government Travel Regulations while away from their homes or official station on duties of the Board.

(d) DELEGATION OF POWERS.—The Board may delegate in whole or in part any function, power, or duty (other than its power to promulgate regulations and rules) to any agency of the Government, including any such agency established by the Board; and may authorize the successive redelegation, within limits specified by it, of any such function, power, or duty to any agency of the Government, including any such agency established by the Board.

(e) ORGANIZATION AND OPERATION OF BOARD.—The Chairman of the Board may from time to time divide the Board into divisions of one or more members, assign the members of the Board thereto, and in case of a division of more than one member, designate the chief thereof. The Board may also, by regulations or otherwise, determine the character of cases to be conducted initially by the Board through an officer or officers of, or utilized by, the Board, the character of cases to be conducted initially by the various agencies of the Government authorized to exercise powers of the Board pursuant to subsection (d) of this section, the character of cases to be conducted initially by the various divisions of the Board, and the character of cases to be conducted initially by the Board itself. The Board may review any determination in any case not initially conducted by it, on its own motion or, in its discretion, at the request of any contractor or subcontractor aggrieved thereby. Unless the Board upon its own motion initiates a review of such determination within ninety days from the date of such determination, or at the request of the contractor or subcontractor made within ninety days from the date of such determination initiates a review of such determination within ninety days from the date of such request, such determination shall be deemed the determination of the Board. If such determination was made by an order with respect to which notice thereof was given by registered mail pursuant to section 105 (a), the Board shall give notice by registered mail to the contractor or subcontractor of its decision not to review the case. If the Board reviews any determination in any case not initially conducted by it and does not make an agreement with the contractor or subcontractor with respect to the elimination of excessive profits, it shall issue and enter an order under section 105 (a) determining the amount, if any, of excessive profits, and forthwith give notice thereof by registered mail to the contractor or subcontractor. The amount of excessive profits so determined upon review may be less than, equal to, or greater than, that determined by the agency of the Government whose action is so reviewed.

(f) DELEGATION OF RENEGOTIATION FUNCTIONS TO BOARD.—The Board is hereby authorized and directed to accept and perform such renegotiation powers, duties, and functions as may be delegated to it under any other law requiring or permitting renegotiation, and the Board is further authorized to redelegate any such power, duty, or function to any agency of the Government and to authorize successive redelegations thereof, within limits specified by the Board. Notwithstanding any other provision of law, the Secretary of Defense is hereby authorized to delegate to the Board, in whole or in part, the powers, functions, and duties conferred upon him by any other renegotiation law.

SEC. 106. REVIEW BY THE TAX COURT.

Any contractor or subcontractor aggrieved by an order of the Board determining the amount of excessive profits received or accrued by such contractor or subcontractor may—

(a) if the case was conducted initially by the Board itself—within ninety days (not counting Sunday or a legal holiday in the District of Columbia as

the last day) after the mailing under section 105 (a) of the notice of such order, or

(b) if the case was not conducted initially by the Board itself—within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the last day) after the mailing under section 107 (e) of the notice of the decision of the Board not to review the case or the notice of the order of the Board determining the amount of excessive profits,

file a petition with The Tax Court of the United States for a redetermination thereof. Upon such filing such court shall exclusive jurisdiction, by order, to finally determine the amount, if any, of such excessive profits received or accrued by the contractor or subcontractor, and such determination shall not be reviewed or redetermined by any court or agency. The court may determine as the amount of excessive profits an amount either less than, equal to, or greater than that determined by the Board. A proceeding before the Tax Court to finally 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. 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, review by the Tax Court of decisions of divisions, stenographic reporting, and reports of proceedings, as such court has under sections 1110, 1111, 1113, 1114, 1115 (a), 1116, 1117 (a), 1118, 1120, and 1121 of the Internal Revenue Code in the case of a proceeding to redetermine a deficiency. In the case of any witness for the Board, the fees and mileage, and the expenses of taking any deposition shall be paid out of appropriations of the Board available for that purpose, and in the case of any other witnesses shall be paid, subject to rules prescribed by the court, by the party at whose instance the witness appears or the deposition is taken. The filing of a petition under this section shall operate to stay the execution of the order of the Board under subsection (b) of section 105 if within five days after the filing of the petition the petitioner files with the Tax Court a good and sufficient bond, approved by such court, in such amount as may be fixed by the court. Any amount collected by the United States under an order of the Board in excess of the amount found to be due under a determination of excessive profits by the Tax Court shall be refunded to the contractor or subcontractor with interest thereon at the rate of 6 per centum per annum from the date of collection by the United States to the date of refund.

SEC. 109. RULES AND REGULATIONS.

The Board may make such rules, regulations, and orders as it deems necessary or appropriate to carry out the provisions of this title.

SEC. 110. COMPLIANCE WITH REGULATIONS, ETC.

No person shall be held liable for damages or penalties for any act or failure to act resulting directly or indirectly from his compliance with a rule, regulation, or order issued pursuant to this title, notwithstanding that any such rule, regulation, or order shall thereafter be declared by judicial or other competent authority to be invalid.

SEC. 111. APPLICATION OF ADMINISTRATIVE PROCEDURE ACT.

The functions exercised under this title shall be excluded from the operation of the Administrative Procedure Act (60 Stat. 237) except as to the requirements of section 3 thereof.

SEC. 112. APPROPRIATIONS.

There are hereby authorized to be appropriated such sums as may be necessary and appropriate for the carrying out of the provisions and purposes of this title. Funds made available for the purposes of this title may be allocated or transferred for any of the purposes of this title, with the approval of the Bureau of the Budget to any agency of the Government designated to assist in carrying out this title. Funds so allocated or transferred shall remain available for such period as may be specified in the Acts making such funds available.

SEC. 113. PROSECUTION OF CLAIMS AGAINST UNITED STATES BY FORMER PERSONNEL.

Nothing in title 18, United States Code, sections 281 and 283, or in section 190 of the Revised Statutes (U. S. C., title 5, sec. 99) shall be deemed to prevent any person by reason of service prior to January 1, 1954, in performance of duties or functions required by this Act, from acting as counsel, agent, or attorney for prosecuting any claim against the United States: *Provided*, That such person shall not prosecute any claim against the United States (1) involving any subject

matter directly connected with which such person was so employed, or (2) during the period such person is engaged in employment in a department or the Board.

TITLE II—MISCELLANEOUS PROVISIONS

SEC. 201. FUNCTIONS UNDER WORLD WAR II RENEGOTIATION ACT.

(a) ABOLITION OF WAR CONTRACTS PRICE ADJUSTMENT BOARD.—The War Contracts Price Adjustment Board, created by the Renegotiation Act, is hereby abolished.

(b) TRANSFER OF FUNCTIONS IN GENERAL.—All powers, functions, and duties conferred upon the War Contracts Price Adjustment Board by the Renegotiation Act and not otherwise specifically dealt with in this section are transferred to the Renegotiation Board.

(c) AMENDMENT OF THE RENEGOTIATION ACT.—Subsection (a) (4) (D) of the Renegotiation Act is amended by inserting at the end thereof the following: "A net renegotiation rebate shall not be repaid unless a claim therefor has been filed with the Board on or before the date of its abolition, or unless a claim shall have been filed with the Administrator of General Services (i) on or before June 30, 1951, or (ii) within ninety days after the making of an agreement or the entry of an order under subsection (c) (1) determining the amount of excessive profits, whichever is later. A claim shall be deemed to have been filed when received by the Board or the Administrator, whether or not accompanied by a statement of the Commissioner of Internal Revenue showing the amortization deduction allowed for the renegotiated year upon the recomputation made pursuant to section 124 (d) of the Internal Revenue Code."

(d) TRANSFER OF CERTAIN FUNCTIONS.—All powers, functions, and duties conferred upon the War Contracts Price Adjustment Board by subsection (a) (4) (D) of the Renegotiation Act, subject to the amendment thereof by subsection (c) of this section, are hereby transferred to the Administrator of General Services.

(e) FUNCTIONS AND RECORDS.—Each Secretary of a Department is authorized and directed to eliminate the excessive profits determined under all existing renegotiation agreements or orders by the methods enumerated in subsection (c) (2) of the Renegotiation Act in respect of all renegotiations conducted by his Department pursuant to delegations from the War Contracts Price Adjustment Board. The several Departments shall retain custody of the renegotiation case files covering renegotiations thus conducted for such time as the Secretary deems necessary for the purposes of this section, and thereafter they shall be made available to the Renegotiation Board for appropriate disposition. The renegotiation records of the War Contracts Price Adjustment Board shall become records of the Renegotiation Board on the effective date of this section.

(f) REFUNDS.—All refunds under subsection (a) (4) (D) of the Renegotiation Act (relating to the recomputation of the amortization deduction), all refunds under the last sentence of subsection (i) (3) of such Act (relating to excess inventories), and all amounts finally adjudged or determined to have been erroneously collected by the United States pursuant to a determination of excessive profits, with interest thereon in the last mentioned case at a rate not to exceed 4 per centum per annum as may be determined by the Administrator of General Services or his duly authorized representative computed to the date of certification to the Treasury Department for payment, shall be certified by the Administrator of General Services or his duly authorized representative to the Treasury Department for payment from such appropriations as may be available therefor: *Provided*, That such refunds shall be based solely on the certificate of the Administrator of General Services or his duly authorized representative.

(g) EXISTING POLICIES, PROCEDURES, ETC., TO REMAIN IN EFFECT.—All policies, procedures, directives, and delegations of authority prescribed or issued (1) by the War Contracts Price Adjustment Board, or (2) by any Secretary or other duly authorized officer of the Government, under the authority of the Renegotiation Act, in effect upon the effective date of this section and not inconsistent herewith, shall remain in full force and effect unless and until superseded, or except as they may be amended, under the authority of this section or any other appropriate authority. All functions, powers, and responsibilities transferred by this section shall be accompanied by the authority to issue appropriate regulations and procedures, or to modify existing procedures, in respect of such powers, functions, and responsibilities.

(h) SAVINGS PROVISION.—This section shall not be construed (1) to prohibit disbursements authorized by the War Contracts Price Adjustment Board and certified pursuant to its authority prior to the effective date of this section, (2) to affect the validity or finality of any agreement or order made or issued pursuant

to law by the War Contracts Price Adjustment Board or pursuant to delegations of authority from it, or (3) to prejudice or to abate any action taken or any right accruing or accrued, or any suit or proceeding had or commenced in any civil cause; but any court having on its docket a case to which the War Contracts Price Adjustment Board is a party, on motion or supplemental petition filed at any time within twelve months after the effective date of this section, showing a necessity for the survival of such suit, action, or other proceeding to obtain a determination of the questions involved, may allow the same to be maintained by or against the United States.

(i) RENEGOTIATION ACT NOT REPEALED.—Except as by this Act specifically amended or modified, all provisions of the Renegotiation Act shall remain in full force and effect.

(j) DEFINITIONS.—The terms which are defined in the Renegotiation Act shall, when used in this section, have the same meaning as when used in the Renegotiation Act, except that where a renegotiation function has been transferred by or pursuant to law the terms "Secretary" or "Secretaries" and "Department" or "Departments" shall be understood to refer to the successors in function to those officers or offices specifically named in the Renegotiation Act.

(k) EFFECTIVE DATE OF SECTION.—This section shall take effect sixty days after the date of the enactment of this Act.

SEC. 202. PERIOD OF LIMITATIONS FOR RENEGOTIATION ACT OF 1948

No proceeding under the Renegotiation Act of 1948 to determine the amount of excessive profits for any fiscal year shall be commenced more than one year after the mandatory statement required by the regulations issued pursuant to such Act is filed with respect to such year, or more than six months after the date of the enactment of this title, whichever is the later, and if such proceeding is not so commenced (in the manner provided by the regulations prescribed pursuant to such Act), all liabilities of the contractor or subcontractor under such Act for excessive profits received or accrued during such fiscal year shall thereupon be discharged. If an agreement or order determining the amount of excessive profits under such Act is not made within two years following the commencement of the renegotiation proceeding, then upon the expiration of such two years all liabilities of the contractor or subcontractor for excessive profits with respect to which such proceeding was commenced shall thereupon be discharged, except that (1) such two-year period may be extended by mutual agreement, and (2) if within such two years such an order is duly issued pursuant to such Act, such two-year limitation shall not apply to the review of such order by any renegotiation board duly authorized to undertake such review.

SEC. 203. AMENDMENT OF SECTION 3806 OF THE INTERNAL REVENUE CODE

Section 3806 (a) (1) of the Internal Revenue Code is hereby amended by striking out subparagraphs (A), (B), and (C) and inserting in lieu thereof the following:

> "(A) The term 'renegotiation' includes any transaction which is a renegotiation within the meaning of the Federal renegotiation act applicable to such transaction, any modification of one or more contracts with the United States or any agency thereof, and any agreement with the United States or any agency thereof in respect of one or more such contracts or subcontracts thereunder.
>
> "(B) The term 'excessive profits' includes any amount which constitutes excessive profits within the meaning assigned to such term by the applicable Federal renegotiation act, any part of the contract price of a contract with the United States or any agency thereof, any part of the subcontract price of a subcontract under such a contract, and any profits derived from one or more such contracts or subcontracts.
>
> "(C) The term 'subcontract' includes any purchase order or agreement which is a subcontract within the meaning assigned to such term by the applicable Federal renegotiation act.
>
> "(D) The term 'Federal renegotiation act' includes section 403 of the Sixth Supplemental National Defense Appropriation Act (Public 528, 77th Cong., 2d Sess.), as amended or supplemented, the Renegotiation Act of 1948, as amended or supplemented, and the Renegotiation Act of 1951, as amended or supplemented."

SEC. 204. SEPARABILITY PROVISION

If any provision of this Act or the application of any provision to any person or circumstance is held invalid, the validity of the remainder of the Act and of the

application of its provisions to other persons and circumstances shall not be affected thereby.

Passed the House of Representatives January 23, 1951.

Attest: RALPH R. ROBERTS, *Clerk.*

The CHAIRMAN. Mr. Roberts, we are pleased to hear you today on this matter. We would like for you to give us an analysis of this bill as compared with the old Renegotiation Act, as amended.

We have a comparative print that is before each member of the committee. You might proceed and let us have a general survey of this subject.

STATEMENT OF FRANK L. ROBERTS, CHAIRMAN, MILITARY RENEGOTIATION POLICY AND REVIEW BOARD, OFFICE OF SECRETARY OF DEFENSE, ACCOMPANIED BY SUMNER MARCUS, COUNSEL, NAVY RENEGOTIATION DIVISION, ARMED SERVICES RENEGOTIATION BOARD, AND ASSOCIATE COUNSEL TO THE MILITARY RENEGOTIATION POLICY AND REVIEW BOARD, AND HOWARD W. FENSTERSTOCK, COUNSEL TO THE AIR FORCE DIVISION OF THE ARMED SERVICES RENEGOTIATION BOARD

Mr. ROBERTS. Mr. Chairman and members, if I may, I would like to make the following statement, and I might say that any question that occurs to any member, or yourself, I will be glad to answer.

The CHAIRMAN. Interrupt during your statement, or after you have finished?

Mr. ROBERTS. During the statement.

The CHAIRMAN. Very well. You may proceed. We do not have a large number of the committee present, but the record will be here and we will be in session again on this matter Friday. So you may proceed, and your statement will be read by the members of the committee, of course, before we finally take any action.

Mr. ROBERTS. Thank you.

This bill, H. R. 1724, provides for the renegotiation of contracts, and for other purposes. It was passed by the House of Representatives by unanimous vote on January 23, 1951, after extensive hearings and consideration by the Committee on Ways and Means of that body.

In reporting the bill, the Committee on Ways and Means concluded that present procurement problems are substantially as great as those which brought about the enactment of similar legislation in World War II, and that the scope of the existing renegotiation law is not broad enough to insure the uniform and effective recapture on a fair and equitable basis of excessive profits which may be derived from the expanded defense effort.

World War II created problems of procurement and production unprecedented in scale and complexity. Renegotiation was devised as one means of meeting and overcoming some of these difficulties. The magnitude of this task, and the extent to which the renegotiation program succeeded, are evidenced by the fact that contracts subject to renegotiation under the World War II statute aggregated in excess of $200,000,000,000 and that gross amounts of more than $11,000,000,000 were recaptured through renegotiation. If we assume that applicable

tax rates would have resulted in the recovery of approximately 70 percent of this gross amount, the net recovery effected by renegotiation aggregated approximately $3,300,000,000.

The conditions of war production which made renegotiation necessary may be briefly stated.

The CHAIRMAN. You are still sticking to the old theory that you must renegotiate before taxes; is that right?

Mr. ROBERTS. Yes, sir, Mr. Chairman.

The CHAIRMAN. I had a great deal of difficulty with Mr. McIntosh and others under the old act. It always did seem to me that if you renegotiated after taxes, you could do it with a comparative handful of personnel, whereas you have got to have a very large staff doing it on the basis that this bill follows, and the old act, as well.

Mr. ROBERTS. Mr. Chairman, on that point, may I make this observation?

The CHAIRMAN. Yes, sir.

Mr. ROBERTS. I think there are things in this bill which provide for a different administration, and that there is no reason why the lessons learned in the administration of the former Renegotiation Act cannot serve to avoid the need for so many people.

The CHAIRMAN. I hope you can. While that is not primarily our responsibility, it is a direct responsibility on every committee of Congress, and the rapidity with which agencies are being built up now and the size of those agencies all over this country, is something staggering. When the whole picture is spread out before you, you can appreciate it. This is simply, of course, one of the agencies.

My recollection is that we were told, and I presume correctly informed and fully informed, that while renegotiation took place before taxes, nevertheless the ultimate tax liability was a factor that was always present in the minds of your organization, for instance.

I simply call your attention to that. I know the theory on which this bill is built, just as the old act was. You may proceed.

Mr. ROBERTS. Yes, sir. And, if the theory is followed that it is an attempt to secure retroactively and on an over-all basis the proper price, then it must of necessity come before taxes. I believe that later on this point is more fully developed. If it is not, I will be very happy to go into it further.

The CHAIRMAN. Very well.

Mr. ROBERTS. War materials of all kinds were required in enormous quantities with the greatest possible speed. Many contractors were asked to produce articles which had never been produced before and which were subject to frequent change. Others were asked to produce articles which were new to them. Virtually all were asked to produce articles in amounts far beyond their previous experience. Quantities needed, rates of delivery, and specifications had often to be revised in the light of experience and the demands of war. Shortages of material, priorities, and allocations increased the uncertainty of production. New facilities had to be obtained; new personnel employed and trained to new methods; and new sources of supply developed.

Under these circumstances, contractors and contracting officers found themselves unable to make accurate forecasts of costs on which to base prices. In many cases the original contract prices proved far too high when tested by actual experience.

Senator BUTLER. Were there any cases where they were found too low?

Mr. ROBERTS. Yes; there were cases where prices were found too low; yes, sir.

Senator BUTLER. Were they rectified?

Mr. ROBERTS. Not through the medium of renegotiation. Title II of the Second War Powers Act was in existence during World War II and has recently been reenacted by the Congress. It permits, in cases of hardship under carefully regulated conditions, the reopening of a fixed-price contract without consideration. And it is for that specific purpose that the legislation was passed.

Senator BUTLER. What effect do you think your experience in handling renegotiations in the past war would have in the case of another emergency of the same kind? Will it be more difficult to get contractors or easier?

Mr. ROBERTS. Let me say that under the present conditions we are letting a great many billions of dollars' worth of contracts for procurement, and we are experiencing no difficulty because of the existence of the renegotiation law that is presently on the books, which does cover all military procurement that is not advertised, but is negotiated under the terms of the Procurement Act of 1947.

Senator BUTLER. Thank you.

Mr. ROBERTS. The greater efficiency and the improvements in methods developed in the course of production, together with the ever-swelling volume of production, frequently brought profits far beyond those anticipated at the outset—profits far in excess of those intended or desired to be retained by the majority of contractors.

The result was the Renegotiation Act, first enacted in 1942, and later amended in full by the Revenue Act of 1943. That act was made inapplicable to the performance of contracts after December 31, 1945. Less than 2½ years later, when the Congress appropriated some $3,000,000,000 for a program of expanded aircraft construction and certain related purposes, it was deemed essential to reintroduce renegotiation in the form of the Renegotiation Act of 1948, which became law on May 21, 1948. Initially, that law applied only to contracts obligating funds appropriated or consolidated by the appropriation act of which it was a part. Later, within a matter of weeks, it was extended to cover the procurement of aircraft and aircraft parts when the contracts for those items obligated fiscal year 1949 funds. A year later, our military expenditures having continued to increase, the act was further broadened to cover all negotiated contracts entered into by the Department of Defense in the fiscal year 1950. Last year, this provision was reenacted to include the current fiscal year 1951 procurement.

The Renegotiation Act of 1948, as so extended, is still being actively administered. World conditions are such that we are once again in a position where a substantial proportion of our national income and energies must be expended to defend ourselves against aggression, both actual and threatened. The Congress has already appropriated vast sums of money for this purpose, and may well find it necessary to appropriate additional sums. In putting our gigantic national industrial machine to work again to build for defense, or for war, should that come, we are faced with substantially the same difficulties and uncertainties of procurement and production that existed 10 years

ago. The Renegotiation Act of 1948 is not broad enough in its coverage to furnish sufficient protection for the huge expenditures of public funds required by the current international crisis.

Thus, in general, the act of 1948 does not apply to contracts entered into prior to May 21, 1948, although some contracts entered into prior to that date are still in production.

I would like to state that I do not intend to give the impression that this act would apply retroactively to contracts entered into before that date, but merely to the receipts and accruals from such contracts that occur subsequent to January 1, 1951. It does not cover any contracts obligating fiscal 1949 funds for items other than aircraft and aircraft parts, although here again it is possible that some such contracts are still in production.

My previous remark includes any retroactivity that might be implied from what I have just said about 1949 contracts.

It does not cover most contracts entered into in the fiscal years 1950 and 1951 as a result of formal advertising and competitive bidding, being limited in scope to negotiated contracts entered into during those years. It does not attach to any contracts for $1,000 or less, notwithstanding the substantial dollar aggregate of such contracts. Finally, it does not cover contracts of any Government agencies other than the Department of Defense, which is a serious deficiency in view of the steadily increasing procurement activity of various other Government departments.

H. R. 1724 is patterned after the World War II statute and will close these gaps in the 1948 act.

Renegotiation is a broad, over-all operation. It is not a detailed process of audit and examination, contract by contract and dollar by dollar. Nor is it a device to remedy or repair errors or inequities in individual procurement transactions. The renegotiation authorities do not reset the price of each contract after completion of performance and payment. This type of individual price adjustment, which was contemplated in the earliest days of renegotiation and from which the process derived its name, gave way almost immediately, out of obvious necessity, to over-all review of a contractor's operations for his entire fiscal year.

This basic conception is indispensable to any understanding of what renegotiation is and the way it works. All of a contractor's receipts or accruals during his year from all of his contracts and subcontracts subject to renegotiation, including both his profitable and his nonprofitable ones, and all of his costs and expenses applicable thereto are considered at a single time in a single proceeding together, with all pertinent facts and figures, and a single over-all determination is made. It is entirely a judgment operation. There is no fixed formula or yardstick for the determination of excessive profits, nor is there any fixed maximum to the amount of profits which may be realized or retained by any contractor. If no excessive profits are found to exist, a clearance is granted to the contractor. If it is determined that excessive profits were realized, a determination of the amount thereof is made and this determination is embodied in an agreement or order.

As you gentlemen know, this procedure has several advantages. The consideration of all contracts and subcontracts as a group reduces cost accounting and allocations of cost to a minimum and saves time

for both contractors and the Government. The use of the fiscal period for renegotiation facilitates the use of the regular financial and accounting material maintained by contractors for tax purposes and avoids the preparation of such data on an entirely different basis. In addition, this method allows contractors to offset their losses on one or more contracts subject to renegotiation against their profits from other subject contracts during the same period.

At this point, I want to say that the record on the part of industry in cooperating with the renegotiation boards during World War II, and to date under the Renegotiation Act of 1948, is outstanding and, in the opinion of those administering the acts, deserves high praise.

Now, with your permission, and as the most orderly means of presenting the provisions of H. R. 1724 to you, I shall proceed to a section-by-section analysis of the bill.

The CHAIRMAN. We will be glad to have you do so.

Mr. ROBERTS. The bill is divided into two titles. Title I states the coverage of the renegotiation provisions, creates the Renegotiation Board, and establishes certain procedures, limitations, and exemptions. Title II abolishes the War Contracts Price Adjustment Board created under the World War II statute, transfers certain residual functions, powers, and duties of that Board to the Administrator of General Services, and transfers the remaining functions, powers, and duties of that Board to the new independent Renegotiation Board created under this bill.

TITLE I—RENEGOTIATION OF CONTRACTS

Section 101, declaration of policy

This section declares it to be the considered policy of the Congress that excessive profits from contracts made with the United States, and from related subcontracts, in the course of the national-defense program, be eliminated as provided in the bill.

Section 102, coverage of the act

Subsection (a) makes subject to renegotiation all contracts with certain named departments, and related subcontracts, to the extent of the amounts received or accrued thereunder on or after January 1, 1951. The departments specifically named in the bill are the Departments of Defense, Army, Navy, Air Force, and Commerce, the General Services Administration, and the Atomic Energy Commission. The subsection also makes subject to renegotiation all contracts with such departments as may be designated by the President, and related subcontracts, to the extent of the amounts received or accrued by a contractor or subcontractor on or after the first day of the first month beginning after the date of such designation. Renegotiation would apply to all such contracts and subcontracts whether made on, before, or after January 1, 1951, or the date of designation, as the case may be. Renegotiation is made inapplicable, however, to receipts or accruals attributable to performance after December 31, 1953.

The Renegotiation Act of 1948, as I have already indicated, is still in existence and is currently being administered. Unless this bill is made to provide otherwise, the 1948 act would apply to negotiated contracts entered into between January 1, 1951, and June 30, 1951. This situation is specifically dealt with in subsection (b) of the present

bill, which is designed to avoid the application of both the Renegotiation Act of 1948 and the present bill to the same receipts and accruals. The subsection provides that the 1948 act shall not apply with respect to any receipts or accruals subject to renegotiation under title I of this bill. In order to carry out this provision, it is necessary to apply the distinction made by the Committee on Ways and Means between amounts "subject to this title" and amounts "subject to renegotiation under this title." The committee considered that amounts subject to the title would not, for the purposes of this subsection (b), be subject to renegotiation under the title unless such amounts exceeded the $100,000 or $25,000 minimum limitation set forth in section 105 (f) of the bill.

We have given considerable thought to this provision of the bill since its adoption by the House. In order to obviate the necessity for this difficult and troublesome distinction, and at the same time to provide a more workable rule by establishing a fixed cut-off date for the application of the 1948 act, we have evolved a new provision which I should like to offer to this committee for its consideration in substitution of the provision now contained in subsection (b). Our proposed change is to strike out subsection (b) in its entirety and to substitute therefor the following:

(b) RENEGOTIATION ACT OF 1948.—The Renegotiation Act of 1948 shall not be applicable to any contract or subcontract to the extent of the amounts received or accrued by a contractor or subcontractor on or after the 1st day of January 1951, whether such contract or subcontract was made on, before, or after such first day. In the case of a fiscal year beginning in 1950 and ending in 1951, if a contractor or subcontractor has receipts or accruals prior to January 1, 1951, from contracts or subcontracts subject to the Renegotiation Act of 1948, and also has receipts or accruals after December 31, 1950, to which the provisions of this title are applicable, the provisions of this title shall, notwithstanding subsection (a), apply to such receipts and accruals prior to January 1, 1951, if the Board and such contractor or subcontractor agree to such application of this title; and in the case of such an agreement the provisions of the Renegotiation Act of 1948 shall not apply to any of the receipts or accruals for such fiscal year.

Mr. Chairman, that is something that we urge. We are trying to avoid having two sets of renegotiations going on at the same time, and the confusion that would result from a lack of clarity as to which act applies, and then that only one act may apply at one time.

The CHAIRMAN. That is provided as an agreement between the Board and the contractor?

Mr. ROBERTS. Yes, sir.

The CHAIRMAN. I see.

Senator BYRD. May I ask a question?

Mr. ROBERTS. Yes, sir.

Senator BYRD. At the bottom of page 7 you state:

Renegotiation is made inapplicable, however, to receipts or accruals attributable to performance after December 31, 1953.

Mr. ROBERTS. Yes, sir.

The CHAIRMAN. That is the end of the act.

Senator BYRD. Does that mean that a contract made, on which the corporation does not receive its receipts until after December 31, 1953, would be exempt from renegotiation?

Mr. ROBERTS. It would, under the terms of this cut-off provision.

Senator BYRD. I wonder if that is a wise thing. You may say that no contract let after December 31, 1953, would be subject to renegotia-

tion. Some of these receipts or accruals may come in a year or so after the contract was made.

Mr. ROBERTS. Yes, sir. May I point out this: that under the 1943 act, as amended on February 25, 1944, there was inserted what we refer to as subsection (h). Subsection (h) provided for the very point to which you refer. It gave the Board the right to reach out into succeeding periods [illegible]ring back both costs and receipts or accruals attributable to per[illegible]mance within the period subject to renegotiation. The bill before you is deficient in that it has no subsection (h) as I refer to it.

Senator BYRD. Suppose a contract was made a year before December 31, 1953; it would still be in process of performance, but the actual receipts were not paid to the company until after December 31, 1953. Those receipts would be exempted from renegotiation?

Mr. ROBERTS. Counsel has pointed out to me that if the performance is prior to December 31, 1953, and the receipt or accrual is subsequent, that it is still subject to renegotiation.

Senator BYRD. That language apparently does not say that. It states: "Renegotiation is made inapplicable, however, to receipts or accruals attributable to performance after December 31, 1953."

Mr. MARCUS. I think, sir, that the date limitation applies to performance, rather than to the receipts or accruals.

Senator BYRD. What about receipts?

Mr. MARCUS. I think that where it reads "receipts and accruals attributable to performance," which performance is after December 31, 1953, that is the intent of it. Perhaps there is an ambiguity.

Senator HOEY. If the contract is not completed during that time, then what happens after this date—would that be considered?

Mr. MARCUS. Renegotiation would not apply unless Congress chose to reenact a renegotiation law with respect to that subsequent period.

Senator BYRD. But everything that was delivered prior to December 31, 1953, would be subject to renegotiation, even though the company receives payment after that date?

Mr. MARCUS. Yes, sir.

Senator BYRD. That is not very clear to me.

The CHAIRMAN. What section are you referring to, Senator Byrd?

Senator BYRD. At the bottom of page 7 of the paper.

Mr. ROBERTS. That is, of my statement.

The CHAIRMAN. Of your statement, not in the bill?

Mr. ROBERTS. In the bill it is——

Mr. MARCUS. It is section 102 (a), the bottom of page 2 of the bill.

Senator HOEY. The bill is the same as the language which you quote.

Mr. ROBERTS. Yes, sir.

Senator BYRD. The statement leaves out "under contracts or subcontracts." Your statement left those words out.

Mr. ROBERTS. Under contracts or subcontracts?

Senator BYRD. Yes.

Mr. ROBERTS. May I read from the Ways and Means Committee report, a section-by-section analysis of the bill? This statement is made:

The provisions of this title are made inapplicable to receipts or accruals attributable to performance under contracts or subcontracts after December 31, 1953.

Senator BYRD. Your statement left out the words "under contracts or subcontracts."

Mr. ROBERTS. Yes, sir.

Senator BYRD. That refers to the contract, then?

Mr. ROBERTS. Yes, sir; contracts and subcontracts.

Senator BYRD. And does not refer to receipts?

Mr. ROBERTS. That is right.

Senator BYRD. That is different. I was confused by the fact that you left out those words, inadvertently, of course.

The CHAIRMAN. That seems to be clear enough when you look at the language of the bill.

Senator BYRD. I was referring to his statement, Mr. Chairman.

The CHAIRMAN. I was following the bill. All right, you may proceed.

Mr. ROBERTS. It will be noted that this provision states, as does the present subsection (b), that the Board and the contractor may enter into an agreement for a single renegotiation proceeding under the present bill in order to avoid the necessity for two separate renegotiation proceedings covering separate portions of a single fiscal year. In the event of such an agreement, the provisions of the Renegotiation Act of 1948 will not apply to the receipts or accruals prior to January 1, 1951, but the provisions of this bill will apply to all of the receipts and accruals of the contractor or subcontractor for the entire fiscal year involved.

Subsection (c) suspends the application of the Vinson-Trammell Act to any contract or subcontract if any of the receipts or accruals therefrom are subject to this title. This provision continues the policy adopted and now in effect under the Renegotiation Act of 1948.

The study of the operation of the Vinson-Trammell Act makes clear the fact that the two laws are not compatible at all, and I understand that, also, there is on the way to the chairman of the committee a letter from the Department of Commerce, the Maritime Administration, suggesting the suspension of the operation of the Merchant Marine Act, which is a similar profit-limitation provision in the shipbuilding field. We have coordinated it and are agreeable to the suspension of it, if the committee so desires.

Section 103. Definitions

This section defines various terms used in the bill.

The term "Department" is defined to mean the departments referred to above and such other agencies of the Government exercising functions in connection with the national defense as the President shall designate.

The term "excessive profits" is defined in substantially the same manner as it was defined in the World War II statute; namely, by specifying certain factors which must be taken into consideration in every case in determining excessive profits. These factors, briefly stated, are: efficiency of contractor, reasonableness of costs and profits, reasonableness of return on net worth, extent of risk assumed, nature and extent of contribution to the defense effort, character of business, and such other factors the consideration of which the public interest and fair and equitable dealing may require, as determined by the Board.

Profits derived from contracts and subcontracts subject to the title are defined to mean the excess of the amount received or accrued there-

under over the costs paid or incurred with respect thereto and determined to be allocable thereto. All items estimated to be allowable as deductions and exclusions under chapter I of the Internal Revenue Code (excluding taxes measured by income) are allowed as items of cost to the extent allocable to such contracts and subcontracts, except that no amount is allowed as an item of cost by reason of the application of a carry-over or carry-back, or if such item is unreasonable or not properly chargeable to such contracts or subcontracts. Federal income taxes are not allowable as items of cost, but credit is allowed for any such taxes paid with respect to the amount of any excessive profits determined by the Board.

Section 104. Renegotiation clause in contracts

The Secretary of each Department to whose contracts the provisions of this title are applicable is required by this section to insert in each contract a provision whereby the contractor agrees to the elimination of excessive profits through renegotiation, and agrees to insert a similar provision in each subcontract entered into by him. Every contract and subcontract to which the title is applicable is made subject thereto, whether such contract or subcontract contains a renegotiation clause or not.

Section 105. Renegotiation proceedings

In this section will be found a structural outline of the procedures for the determination and elimination of excessive profits.

Subsection (e) requires every person holding contracts or subcontracts subject to the title to file with the Board, on or before the first day of the fourth calendar month following the close of his fiscal year, a financial statement setting forth such information, and in such form and detail, as the Board may by regulations prescribe. The Board may also require the filing of any additional information, records, or data.

Renegotiation proceedings are commenced by the mailing of a registered mail notice to the contractor or subcontractor. The renegotiation is conducted on an over-all fiscal-year basis unless some other period or basis is agreed upon with the contractor or subcontractor. The Board is also authorized, in its discretion, by agreement, to conduct renegotiation on a consolidated basis in order properly to reflect excessive profits of two or more related contractors or subcontractors. In the proceeding, the Board endeavors to make an agreement with the contractor or subcontractor with respect to the elimination of excessive profits, if any. Any agreement so made is final and conclusive and, in the absence of fraud, malfeasance, or a willful misrepresentation of a material fact, may not be reopened or modified by the Government and may not be modified or set aside in any suit, action, or proceeding.

If no agreement is reached, the Board issues an order determining the amount, if any, of excessive profits and gives notice thereof by registered mail to the contractor or subcontractor. If requested by the contractor or subcontractor, the Board must furnish a statement of the amount of such determination, of the facts used as a basis therefor, and of its reasons therefor. Unless a petition is filed with The Tax Court of the United States within the 90-day period specified in section 108, such order is final and conclusive and not subject to review or redetermination by any court or other agency.

When excessive profits have been determined, either by agreement or order, the Board is required to authorize and direct the Secretaries or any one of them to eliminate such excessive profits by any one or more of the various methods described in subsection (b). These include payment, withholding, and directions to others to withhold for the account of the Government. When necessary, recovery may also be sought by actions in the appropriate courts of the United States. Interest at the rate of 6 percent per annum is payable on unpaid excessive profits from the due date thereof. Of course, as I have already stated, credit is allowed to the contractor or subcontractor for Federal income and excess-profits taxes as provided in section 3806 of the Internal Revenue Code.

Subsection (c) imposes certain time limitations upon both the commencement and completion of renegotiation proceedings. No proceeding to determine excessive profits for any fiscal year may be commenced more than 1 year after the financial statement required from the contractor or subcontractor for such year is filed with the Board, and every proceeding must be completed by agreement or order within 2 years after commencement; otherwise, all liabilities of the contractor or subcontractor for excessive profits during such year are discharged. The 2-year period may be extended by mutual agreement, and the 2-year limitation does not apply to review by the Board of an order made within such 2 years pursuant to any delegation of authority from the Board.

Subsection (e) confers upon the Board the right to audit the books or records of any contractor or subcontractor subject to title I, for which purpose it may request the services of the Bureau of Internal Revenue. Such services, if sanctioned by the Secretary of the Treasury, are to be made available to the extent determined by him.

The bill provides that no contractor or subcontractor shall be renegotiated for any year unless more than $100,000 subject to the bill has been received or accrued by him and all persons under control of or controlling or under common control with him, except that this minimum amount is fixed at $25,000 in the case of subcontractors whose income is derived from fees and commissions based upon subject contracts and subcontracts. In either case, no determination of excessve profits to be eliminated may be in an amount greater than the amount by which the aggregate receipts or accruals exceed this "floor" of $100,000 or $25,000, as the case may be.

Provision is also made in the bill that, if the fiscal year of a contractor or subcontractor is a fractional part of 12 months, the $100,000 or $25,000 floor shall be reduced to the same fractional part thereof. In this connection, in view of the change which I have proposed in section 102 (b), I suggest as a companion amendment that the following sentence be added at the end of subsection (f) (3) of section 105:

In the case of a fiscal year beginning in 1950 and ending in 1951, the $100,000 amount and the $25,000 amount shall be reduced to an amount which bears the same ratio to $100,000 or $25,000, as the case may be, as the number of days in such fiscal year after December 31, 1950, bears to 365, but this sentence shall have no application if the contractor or subcontractor has made an agreement with the Board pursuant to section 102 (b) for the application of the provisions of this title to receipts or accruals prior to January 1, 1951, during such fiscal year.

Section 106. Exemptions

The following contracts and subcontracts are, by this section, exempted from renegotiation:

(1) Contracts with Territories, possessions, States, or foreign governments.

(2) Contracts and subcontracts for agricultural commodities in their raw or natural state, or, if the commodity is not customarily sold or has not an established market in its raw or natural state, then in the first form or state beyond the raw or natural state in which it is customarily sold or has an established market. This exemption is conferred upon such contracts and subcontracts only if made with the producer of the agricultural commodity. In this respect the exemption is narrower than the exemption of agricultural commodity contracts contained in the World War II statute.

The CHAIRMAN. I just wondered why you did that.

Senator BUTLER. I was going to ask that question.

Mr. ROBERTS. That was done before the Ways and Means Committee, because in the hearings before the Senate Investigating Committee brought out the fact that the exemption under the World War II statute applied to people who acquired commodities and could let them age and increase in value and get the same exemption that was given to the man who was the producer of the commodity.

The CHAIRMAN. That is a very far-reaching provision, though. You would take in an ordinary cotton gin, that ginned during the cotton season only 500 bales of cotton, and under this low exemption of $100,000, because the bale of cotton and the seed are worth at least $200 a bale or more than that per bale, and this would militate, certainly, against the producer's price of cotton and cottonseed, peanuts, almost any other agricultural commodity that I know about, because if the man who is dealing in them is going to be subject to renegotiation, he will take it out of the farmer, the producer.

Mr. ROBERTS. May I make this observation, that this whole area of exemption is one that presents a great deal of administrative difficulty, no matter where it is put.

The CHAIRMAN. That is true. That is very true.

Mr. ROBERTS. Under the terms of this bill, there is a right of exemption that would permit the Board to exempt classes and types of contracts where administratively it was not feasible to renegotiate them. It may well be that the cotton dealer and others similarly situated should be exempted. Baled cotton is the first form or state suitable for industrial use, under our interpretation.

The CHAIRMAN. Generally, that is true; yes.

Mr. ROBERTS. Under the provisions, it may be that with these people who are factoring cotton, accumulating and buying it, it would not be administratively feasible to renegotiate them.

The bill, of course, provides for the creation of a board, and then confers upon it the right, as I say, in certain respects to make exemptions by classes and types. I believe it is for this very purpose that it is necessary for the Board to have the power to make that kind of exemptions.

The CHAIRMAN. I should think it would be necessary, but I do not know whether the Board would make those exemptions or not. That is where the pinch is.

Mr. ROBERTS. That is right.

The CHAIRMAN. Because I can see how you are going to cut the very life out of prices paid to the producer. This exemption is for $100,000. At the present high cost of these various products, your transactions run into $100,000 before breakfast. And if you are going to subject everybody who handles these raw farm products to renegotiation, you will have to have another provision inserted in the conscription law and you will have to get an army to do it. And the net result will be that everybody who is dealing with them will simply say to the producer of these articles, "Why, we are sorry, we just cannot give you a very liberal price. We have to be renegotiated, and we know it."

It will affect prices pretty adversely, it seems to me.

Was this $100,000 in the old act? The exemption, I mean. It started off with $500,000, did it not?

Mr. ROBERTS. The 1942 act, which was the first one, had a $100,000 exemption. The 1943 act raised the exemption to $500,000.

The CHAIRMAN. That is what I thought, as I remembered it. Well, now, you are putting it back to $100,000. There may be very good reasons for that. I am calling attention to the effect of it, however, particularly when you are dealing with raw farm products. That is a matter we will have to do some talking about.

Senator BUTLER. There is another item in connection with line 23, on page 24. The suggestion has come to me, which I think should be given some consideration; in the original bill, a cooperative association was exempted along with producers or association producers. That, apparently, is omitted in this bill that we have under consideration.

Mr. ROBERTS. The words, "cooperative association" were in the first renegotiation bill. Let me ask counsel what happened.

Senator BUTLER. If it is left as now written, I think it would interfere considerably with the operation of any such cooperative association, because it would be impossible for them to distribute their patronage dividends to their members until they found out how they would be renegotiated. In other words, the dividend would never be distributed.

Mr. ROBERTS. I might point out that we had some of those problems during the old renegotiation in World War II. Then, of course, it becomes a question of whether the patronage dividends are distributed before or after renegotiation. If renegotiation is to apply, and the amount left for distribution is somewhat reduced, then it is simply a matter of waiting until it is completed before they can distribute, as you point out.

Senator BUTLER. You will interfere with the transaction of business, very definitely.

Mr. ROBERTS. It will interfere with the prompt disbursement of it, I would say.

Senator BUTLER. Some place in this section, I think you cover contracts for services, exempting certain agencies that are already controlled, like utilities, and so forth.

Mr. ROBERTS. Yes, in the permissive exemptions, there is a right to exempt contracts, the minimum price of which is established by a public regulatory body. During World War II Renegotiation Act, as I indicated, utility sales, railroad freight rates, inland water transportation rates, were exempted from renegotiation.

Senator BUTLER. They are not exempted, are they, under this bill?

Mr. ROBERTS. Not until and unless the Board under the right granted in this bill takes such action.

Senator BUTLER. I think the suggestion should be made that the exemption covering communication and transportation, just as well as public utilities, should be included, because they are certainly controlled.

Mr. ROBERTS. Indeed, they are controlled. It is a question of the committee's judgment, whether it should be in what we call the mandatory exemptions with which we are dealing now, or whether it should be left to the Board under what we call the permissive exemptions. It is now under the language of the permissive exemptions.

The CHAIRMAN. Mr. Roberts, let me ask you this: If a taxpayer has a negotiated contract for 1 year, on which he makes a profit, and he has a negotiated contract for the subsequent year on which he has a loss, he is not allowed, you do not take into account nor allow any adjustment for that, if the loss occurs in two different years; is that correct?

Mr. ROBERTS. Mr. Chairman, the language of this bill says that there will be no carry-forward or carry-back of a loss. However, the bill provides standards, that is, seven standards which shall be used to evaluate or determine whether or not there exist excessive profits. Under those standards, a man's prior year's loss operation would certainly weigh on the mind of anybody making a determination of an excessive profit in a following year.

I wish to make this distinction, that there is no provision to mathematically add the 2 years together.

The CHAIRMAN. I know that is true. I was just thinking of, particularly, when you are dealing with raw farm products. The operation from one year, covering the same product, may show a profit, and the subsequent year or season may show a definite loss. There is such a vital connection, actually, in that economic picture of the producer of products, that is, raw farm products, there ought to be some leeway, some chance for that. You say these standards do permit you to look at that picture?

Mr. ROBERTS. Yes, sir.

The CHAIRMAN. They would do it?

Mr. ROBERTS. We have been against adding more than a year, adding 2 years or more together. During the late stages of World War II renegotiation, there was quite a body of thought that you should add all of the war years together and strike an average on them.

The CHAIRMAN. Yes.

Mr. ROBERTS. We concluded against that, and we are still of that opinion.

The CHAIRMAN. Can a contractor, a taxpayer, offset a loss for a nonrenegotiable contract against a gain from a renegotiable contract?

Mr. ROBERTS. No, sir; not the way we have applied the present renegotiation act.

The CHAIRMAN. You do not allow that?

Mr. ROBERTS. No, sir.

The CHAIRMAN. In figuring out cost, do you allow any adjustment for stepped-up depreciation or amortization; is that allowable under the bill?

Mr. ROBERTS. Under this bill, interpreting the cost allowances, it would be just as it was under the 1943 Act.

The CHAIRMAN. It would be?

Mr. ROBERTS. Yes, sir.

The CHAIRMAN. All right, thank you. You may proceed.

Mr. ROBERTS. I wish to qualify that, Mr. Chairman. I think that the people administering it would have the right to say that some portion of it was not allocable to the contracts. I merely want to state that if the same reasoning follows in the administration of this act as was followed in the wartime act, it would be allowed. I recall reading definitely the history of the hearings before the Senate in connection with the allowance of amortization, and the 1943 Renegotiation Act allowed it, after careful discussion with this body of the Congress.

The CHAIRMAN. Yes, sir; we did have that question up.

Can the Department under this bill renegotiate a contract which is not a defense contract, not related to that, not directly related to a defense contract?

Mr. ROBERTS. Under this bill, all of the contracts by a named department. Let us illustrate that, the Department of Commerce is a named department, and all of their——

The CHAIRMAN. All of its contracts——

Mr. ROBERTS. Are subject to this bill.

The CHAIRMAN. Are subject to renegotiation?

Mr. ROBERTS. Yes, sir.

The CHAIRMAN. Whether they relate directly to the defense or not?

Mr. ROBERTS. That is right.

The CHAIRMAN. I wanted to get that clear. All right. You may proceed now.

Mr. ROBERTS. (3) Contracts and subcontracts for the product of a mine, oil or gas well, or other mineral or natural deposit, which has not been processed, refined, or treated beyond the ordinary treatment processes normally applied by producers in order to obtain the first commercially marketable product. Here, again, unlike the World War II exemption of raw materials contracts, this exemption applies only if such contracts or subcontracts are made with the owner or operator of the producing property. In the case of mines, wells and deposits, the term "ordinary treatment processes" is defined to mean those processes which are considered in computing gross income from the property for the purpose of the percentage depletion allowance provided by section 114 (b) (3) or (4) of the Internal Revenue Code. In the case of other products, the term is stated to mean such similar processes as the Board may by regulations prescribe. In this respect the exemption of raw materials is narrower than that contained in the World War II Renegotiation Act.

Senator BUTLER. I was going to ask you that question. Apparently, the language of this bill is entirely different from the old law.

Mr. ROBERTS. Yes; in those respects.

Senator BUTLER. Do you tell us in your explanation just why that change?

Mr. ROBERTS. I will attempt to do it. It is a very difficult thing to do.

Senator BUTLER. It is natural to assume that during the process of the operation of the previous law, everyone affected got pretty well

accustomed to the rules and the regulations. So far as I know, they were adjusted so that business went along the same way. Now we are changing the rules. Will that be beneficial?

Mr. ROBERTS. I do not know that it will be beneficial. It will apply renegotiation to some processes that were not renegotiated under the World War II act. I believe what we are getting at is the difficulty that may be encountered in the administrative processes, laying aside the fact, of course, that no one wants to be renegotiated, what obvious objection would be there to any broadening of the coverage of renegotiation.

Senator BUTLER. We are getting ourselves into a rather complicated position, I think, as a Government. In my own State, which is not a mineral State, of course, we are now producing some oil, but speaking of the minerals in general, which we do not have, I am familiar with the fact that we are all of the time concerned about subsidies in order to get the production from our mines. We are turning right around here and providing new rules, so that if any of them happen to make any profits, it may all be taken away from them.

Mr. ROBERTS. I would like to point out that being subject to renegotiation should not imply that warranted profits would be removed in the process.

Senator BUTLER. In some of our bills we pass on mineral subsidies. It is provided that the payment from the Government is not taxable.

Mr. ROBERTS. Yes, sir.

The CHAIRMAN. We have made certain exemptions; yes, sir.

Mr. ROBERTS. The second point I would like to make on that is that we are also short of airplanes, also short of tanks. If that reasoning applies, why then perhaps we should not renegotiate those other categories of items.

Senator BUTLER. There are some critical items that we positively have to have. A situation could arise where it might be difficult, if not impossible, to get them from abroad. We have to develop our local resources to the limit, under the circumstances that face us today. I am concerned only to see that on the one hand we do not encourage production, and on the other hand we discourage it.

Mr. ROBERTS. To the extent renegotiation is feared, I would say that it would discourage production to anybody to which it applies; but I see no distinction between the maker of aircraft, tanks, guns, or other items, and the person producing a mineral. I wish to clarify that, if I may. My statement necessarily involves this proposition, that the renegotiation people will have enough ability and enough judgment to make due allowance for any consideration such as you have indicated.

The CHAIRMAN. Under the prior act, your renegotiation commenced, did it not, when the mineral was ready for industrial use?

Mr. ROBERTS. Yes, sir.

The CHAIRMAN. Now you are going back beyond that. Of course, you have to have new rules and regulations, and you write them all out. Is it not your opinion that that may retard the procurement of some of the necessary vital minerals and metals that we so badly need at this time? Did you have a great deal of trouble with the prior act on this question, on this point?

Mr. ROBERTS. No. I would want to be sure to make clear that it is not being moved back because of administrative difficulty in apply-

ing it at the former level. There were some administrative difficulties, of course.

The CHAIRMAN. There is that, in anything.

Mr. ROBERTS. I wish to be sure to make clear that it is operable at the old wartime level. It is moved back at the suggestion of people who have testified before the Senate committee investigating the national defense program. The concensus of opinion and, I believe, the recommendation of that committee, was that there should be very few, if any, exemptions from renegotiation in another emergency. They may have had in mind that if we get into an actual conflagration, such as we were in before—there may be a distinction there.

Senator MARTIN. Mr. Roberts, was pig iron exempted in the prior law?

Mr. ROBERTS. Pig iron was the first stage of industrial use, the first state of the operation that was considered, and so it was exempted up through pig iron.

Senator MARTIN. I notice in your statement here, and I was looking over the law—I have not had time to go into it as carefully as I should like to—but it would seem to me that, in this new law, pig iron would not be exempted.

Mr. ROBERTS. That is right.

Senator MARTIN. I was wondering whether that will not retard this. Pig iron is really a raw material. That is a process that you have to make it less expensive, and transportation, and so forth. I just wondered why the change was made.

Mr. ROBERTS. It was made before the Committee on Ways and Means. I would like to say this: The bill sent up to the Congress last summer, introduced by Mr. Vinson, which was the stand-by legislation, had no exemptions in it.

Senator MARTIN. I do not want to take the time of the committee now. I will make a little further study of it; but, from first impression—I just got hold of this in the last hour; I want to make a further study—but it seems to me that it probably would retard things, because pig iron is really a raw material. There is not any use that you can make out of pig iron until it is processed.

Senator BUTLER. Agricultural crops are raw materials, too, but they have them covered now.

Mr. ROBERTS. Up to their salable state, they are not subject to renegotiation.

Senator MARTIN. Pig iron is not salable except in use for making steel and various things that you would manufacture from it. The idea of making pig iron is to make it easier to transport and to handle, and so forth. I will not take any further time with it now, until I have had time to study it further.

The CHAIRMAN. I think it is very important here. Mr. Roberts, nobody wants people to make exorbitant and excessive profits out of the war effort. Everybody is agreed on that. We start in full agreement. And, yet, applying pure theory, you may defeat the very purpose of every type of legislation that we do enact to meet these emergencies; in other words, you may just so hamper the whole operation that you just will not get your production. That is what we have to keep in mind, also. You see, you are restricting it. You not only reduce the amount. I very well remember Judge Patterson, who appeared before this committee, the Secretary of War, who urged us

to up the exemption from $100,000, or suggested that we do it, to $500,000, for this important reason: that it would enable the renegotiators to devote more time to the large contracts where there is an immense amount of money involved and not spend so much time on little contracts where there could not be any tremendous amount of excess profits in individual contracts, although there might come, of course, the exceptional situations in cases where an aggregate of small contracts would run into an excess profits that ought not to be allowed.

Of course, under the old law, on this question of minerals, we started renegotiation at the time that the mineral or metal was ready for commercial use. And we did not limit, in the case of farm products and, to my recollection, mineral products, these products to the producer; these contracts did not exempt the contracts to the producer. We recognize that there were necessary operations beyond the producer, and before you got into the commercial use or industrial use of many of these things, especially raw materials and raw products. Now you are making it much narrower for the purpose, of course, I can very well see, in theory, of making it more difficult for somebody to make an excess profit; but, by the same token, you are making it very much more difficult to procure what you need to meet a real emergency.

I submit these things to you because we will be looking at them later on; and, if amendments are suggested, why, we want you to look at those amendments.

I have one here already suggested on this very question of minerals. It may be too broad, but it indicates, of course, the trouble that we may be running into.

You may proceed.

Mr. ROBERTS. The line of exemption provided by this bill is, in effect, the depletion line or its equivalent. The exemption line drawn by the World War II act was at the point where the material had not been processed, refined, or treated beyond the first form or state suitable for the industrial use. Such first form or state was considered for the purposes of World War II renegotiation to be the state at which a substantial portion of a product was used by the ultimate consumer or by industries other than the industry of origin. For example, in the case of iron ore, the first such form or state was pig iron, which is higher up the scale of processing than is the state taken into consideration for purposes of the depletion allowance.

(4) Contracts and subcontracts for timber which has not been processed beyond the form of logs—but, again, only if such contracts or subcontracts are made with the owner of the timber property or with the producer of the logs.

(5) All subcontracts directly or indirectly under contracts or subcontracts in any of the four categories just described.

In short, the subcontracts under those exempt contracts are likewise exempt.

To insure equitable treatment of integrated producers of exempted products, the Board is required in subsection (c) to prescribe by regulation a cost allowance substantially equivalent to the amount which would have been realized by them had they sold such products in their exempted form or state.

That is the same as the World War II and as the present practice. I might add, that is the only place where this problem really comes,

where a man is integrated in his operation to the point where we have to determine a value at a point prior to the place where there is a ready market. And this language suggested that the depletion line is that point.

In addition to these mandatory exemptions, this section also makes provision for certain permissive exemptions which may be granted by the Board, in its discretion, either individually or by general classes or types of contracts or subcontracts. All of these permissive exemption categories were contained in the World War II statute, with the exception of the following additional category: Any contract or subcontract the renegotiation of which would jeopardize secrecy required in the public interest. The categories carried over from the former law are as follows:

(1) Any contract or subcontract to be performed outside the United States.

(2) Any contract or subcontract where the profits can be determined with reasonable certainty when the contract price is established.

(3) Any contract or subcontract where the provisions are considered otherwise adequate to prevent excessive profits.

(4) Any subcontract where it is considered not administratively feasible to determine and segregate renegotiable profits from profits attributable to nonsubject activities.

Section 107. Renegotiation Board

The Renegotiation Board is created as an independent establishment in the executive branch of the Government and is to be composed of five members appointed by the President by and with the advice and consent of the Senate. Not less than three members of the Board must be appointed from civilian life. The President is to designate one member to serve as Chairman. Each member is to receive compensation at the rate of $12,500 per annum. No member may engage in any business, vocation, or employment other than that as a member of the Board. Three members of the Board are required for a quorum.

The CHAIRMAN. Going right back to these contracts that are not renegotiated by the Board, in the discretion of the Board, I observe that this bill omits section (4) (D):

> Any contract or subcontract for the making or furnishing of a standard commercial article, if in the opinion of the Board, competitive conditions affecting the sale of such article are such as will reasonably protect the Government against excessive prices; * * *

Was that intentionally omitted, or for any reason?

Mr. ROBERTS. Yes; it was omitted at the request of those of us appearing for this bill, because, in the administration of that particular provision, under the wartime operation there were a great many administrative burdens raised, and a great many applications were received, requesting exemption. Due to the large increase in the procurement on the sale of such items, the fact that they are standard and have an established market price does not preclude the making of excessive profits under their sale. Those were the reasons, Mr. Chairman, that we asked that it be omitted.

There is another omission to which I would like to draw attention.

The CHAIRMAN. I was going to draw attention to that. That is (e).

Mr. ROBERTS. Yes, sir.

The CHAIRMAN (reading):

Any contract or subcontract, if in the opinion of the Board competitive conditions affecting the making of such contract or subcontract are such as are likely to result in effective competition with respect to the contract or subcontract price and * * *.

Was that omitted for the same reason?

Mr. ROBERTS. It was; yes, sir. There is a further omission, Mr. Chairman.

The CHAIRMAN. Yes, sir.

Mr. ROBERTS. The tax-exempt operation.

The CHAIRMAN. Yes, sir.

Mr. ROBERTS. Those are the only ones, I believe.

The CHAIRMAN. Yes, I see, looking at the comparative print, that seems to be the only additional one.

If I may go back to what I was talking about a while ago, and what Senator Martin also had in mind when he was talking about the pig iron, and so forth, in the old law we had this provision:

In the case of a contractor or subcontractor who produces or acquires the product of a mine, oil or gas well, or other mineral or natural deposit, or timber, and processes, refines, or treats such a product to and beyond the first form or state suitable for industrial use, or who produces or acquires an agricultural product and processes, refines, or treats such a product to and beyond the first form or state in which it is customarily sold or in which it has an established market, the Board shall prescribe such regulation as may be necessary to give such contractor or subcontractor a cost allowance substantially equivalent to the amount which would have been realized by such contractor or subcontractor if he had sold such product at such first form or state.

Mr. ROBERTS. The present bill has an identical provision to that, but it stops right there.

The CHAIRMAN. You stop at the producer?

Mr. ROBERTS. That is right.

The CHAIRMAN. You cut out the "acquire"?

Mr. ROBERTS. That is correct, sir.

The CHAIRMAN. I give the House committee full credit for writing a good bill, but it does seem to me that it narrowed this bill on these points to a point where you are really undermining the main primary purpose of nearly everything we do to meet an emergency. And, also, you are adding terrifically to the burdens of the negotiators. It looks to me like you have an expanding agency down there.

Mr. ROBERTS. I hope not.

The CHAIRMAN. I do, too, but I have been reading some of the tentative set-ups on price controls and wage controls and the number of offices that are added all over this country. I just wonder where we are going to get the manpower for all of this.

Senator MARTIN. That is the thing that is worrying me. We want peace, and we can have peace in the world; but it is not the number of tanks and planes and divisions that America can produce, but it is the potential—it is the potential divisions.

The CHAIRMAN. Exactly.

Senator MARTIN. And the potential equipment.

The CHAIRMAN. You can never produce enough to meet all of your possible needs, and if you produce them this year they are inadequate later.

Senator MARTIN. Or probably obsolete.

The CHAIRMAN. Yes; obsolete.

Senator MARTIN. What I am getting at is this——

The CHAIRMAN. But, if your potential is there, why, you can always produce.

Senator MARTIN. Manpower, I think, is very important. One of the greatest things General Marshall has done so far is forming two divisions out of housekeeping soldiers. I had hoped he would make it six or eight.

The CHAIRMAN. I had hoped he would, too.

Senator MARTIN. We have to save manpower in America. You cannot have a push button in war. Just think what those Chinese have done, without equipment, but with manpower. You see, our fighting power is about 20 percent. And the men that you tie up in government for spervision and administration takes them out of the field. That is what is worrying me. We in America have to show a great potential manpower force to the rest of the world in order to preserve peace, because that is what they recognize. They do not recognize argument or justice, or anything else. We have got to work these things out so that we can save manpower in America. That is what this thing all hinges on.

The CHAIRMAN. All right, Mr. Roberts, you may proceed. You invited us to ask you these questions.

Mr. ROBERTS. I did, sir, and I am happy to have your observations.

Three members of the Board are required for a quorum.

The Board is authorized to delegate in whole or in part any function, power, or duty to any agency of the Government, and to permit successive redelegations. The Board cannot, however, delegate its power to promulgate regulations and rules.

In respect of the composition of the Board, H. R. 1724 differs from the proposed draft of bill originally submitted to the House by the Government agencies concerned with this legislation and also to this body. As so submitted, the original draft provided for a Board of seven members. Of these, three members were to represent the Department of Defense and were to be officers or employees of the Departments of the Army, the Navy, and the Air Force, and were to be appointed by the Secretaries of the Army, the Navy, and the Air Force, respectively, with the approval of the Secretary of Defense; one was to be an officer or employee of the General Services Administration and was to be appointed by the Administrator of General Services; one was to be an officer or employee of the Department of the Treasury and was to be appointed by the Secretary of the Treasury; one was to be an officer or employee of the Department of Commerce and was to be appointed by the Secretary of Commerce; and the other member, who was to be the Chairman, was to be appointed by the President with the advice and consent of the Senate.

I am informed by the Bureau of the Budget that a Renegotiation Board constituted in either of these two ways is acceptable to the executive branch of the Government.

Subsection (c) describes the operating procedures of the Board, both with respect to the initial conduct of cases, either by the Board itself or by a division or delegatee of the Board, and with respect to the review by the Board of determinations made in cases not initially conducted by it. On review, the Board is given power to determine excessive profits in an amount less than, equal to, or greater than the amount of the determination reviewed.

Subsection (f) requires the Board to accept and perform such renegotiation powers, duties, and functions as may be delegated to it under any other renegotiation law. This enables functions under the Renegotiation Act of 1948 to be transferred to the Board.

That provision is to insure that we do conserve manpower, and we do not preserve two sets of renegotiation officials.

Section 108. Review by the Tax Court

This section provides that any contractor or subcontractor aggrieved by an order of the Board determining the amount of excessive profits received or accrued by him may, within the time limitations prescribed in the section, file a petition with the Tax Court for a redetermination thereof; that the court shall then have exclusive jurisdiction, by order, to finally determine the amount, if any, of such excessive profits received or accrued by the contractor or subcontractor; and that such determination shall not be reviewed or redetermined by any court or agency. The court may determine as the amount of excessive profits an amount either less than, equal to, or greater than that determined by the Board. The proceeding before the Tax Court is to be a proceeding de novo.

It is provided that the filing of a petition in the Tax Court shall stay the execution of an order of the Board if within 5 days the petitioner files a bond with the Tax Court in such amount as may be fixed by the court. It is also provided that, where under an order of the Board there has been collected an amount greater than the amount of the final determination made by the Tax Court, the excess is to be refunded with 6 percent interest thereon.

REMAINING PROVISIONS OF TITLE I

The remaining sections of this title make certain necessary formal provisions, including, in section 109, a provision that the Board shall have authority to make appropriate rules, regulations, and orders. Also included, in section 113, is a provision that certain specified provisions of law shall not prevent any person by reason of service prior to January 1, 1954, in performance of duties required by the bill, from acting as counsel, agent, or attorney for prosecuting any claim against the United States after such person is no longer employed in a Department or the Board, if the subject matter of the claim does not involve any subject matter directly connected with which such person was employed.

TITLE II—MISCELLANEOUS PROVISIONS

Section 201. Functions under World War II Renegotiation Act

This section abolishes the War Contracts Price Adjustment Board created by the World War II renegotiation statute. All of the functions of that Board relating to the payment of renegotiation rebates and other refunds are transferred to the Administrator of General Services. All other functions of that Board are transferred to the new Renegotiation Board created by this bill.

Section 202. Period of limitations for Renegotiation Act of 1948

This section provides a statute of limitations for proceedings under the Renegotiation Act of 1948, which does not now contain any such limitation.

Section 203. Amendment of section 3806 of the Internal Revenue Code

This section amends section 3806 of the Internal Revenue Code, which provides the tax credit allowed to a contractor in the elimination of excessive profits, in order to make the appropriate references therein to the Renegotiation Act of 1948 and the Renegotiation Act of 1951.

Section 204. Separability provision

This section provides that, if any provision of this act or the application of any provision to any person or circumstance is held invalid, the validity of the remainder of the act and of the application of its provisions to other persons and circumstances shall not be affected thereby.

That concludes my statement. I shall be happy to attempt to supply any information the committee may desire.

The CHAIRMAN. Are there any questions by any member of the committee?

Senator MARTIN. I do not have any further questions.

The CHAIRMAN. Let me draw to your attention—and I do so in order that you may have it—a suggested amendment for paragraph 3, section 106, as follows—you will note the added language:

Any contract or subcontract for the procurement of a mine, oil or gas well—

and this is new in the amendment—

plant for physically separating natural gasoline, butanes, propanes, and residue gas from natural gas, from any oil or gas well * * *.

That is the new part of it, and I will not read the balance of the section. It occurs additionally about midway in that section, where, after the words "mine, well", the word "plant" is inserted. In the same line—

or deposited from which such product is produced new or separated.

Do you see the purpose of that amendment?

I ask you to give some thought to it, because it is an amendment that will be presented to the committee.

And from various sources a suggestion with respect to raw products, particularly agricultural products, an amendment that will strike the words:

but only if such contract or subcontract is with the producer of such agricultural commodity.

I presume similar amendments may be offered with respect to other raw products; that is, minerals and timber.

I had these amendments already presented, and I know they will be pressed. That is the reason I am directing your attention to them.

Mr. ROBERTS. May I make one observation, Mr. Chairman: that if the committee does adopt the amendments, striking that limited to a producer or to one who acquires such product, that there will be necessary some other provision to go into the bill.

The CHAIRMAN. That would be true; yes, sir. I recognize that is true. Are there any further questions?

Senator HOEY. I do not have any.

Senator FREAR. I have none, Mr. Chairman.

Senator MARTIN. I do not say that I will offer an amendment, but I do feel we should give consideration to the subject of pig iron and, certainly, to timber, and then to what Senator Butler mentioned awhile ago relative to utilities—I mean, to give it some thought, so that if it is pressed we can consider it intelligently. I am not saying I am going to press it; but, if we do it, we will consider them intelligently. You have much more information than we possess, because you have had the practical side of it. Ours may be just theory.

Mr. ROBERTS. We will make freely available all our information to you, sir.

The CHAIRMAN. I would like to call attention to this. I suppose this addresses itself to your counsel. As I read this bill, it says, an order determining the excessive profits bears 6 percent interest rate. That is true even though the case may be pending in the Tax Court on appeal; is that correct?

Mr. MARCUS. Yes, sir.

Mr. ROBERTS. May I point out that that same provision was in the 1943 act, but the percentage was not provided. I would like to make this further observation: that a contractor who receives an order from the Board does not have to pay any interest, and that results from his paying the amount of the order. Then later in the bill it provides that, if after a hearing the Tax Court determines a lower amount, the Government is required to pay him back the overage.

The CHAIRMAN. The overage at 6-percent interest?

Mr. ROBERTS. At 6-percent interest.

The CHAIRMAN. I notice that among the miscellaneous provisions in title II of the bill. I was just thinking of that, wondering whether or not there might be some amendments offered about that. I am not suggesting that there will be, but that occurred to me.

Is there anything else you would like to submit now?

Mr. ROBERTS. I believe not. I thank you, sir.

The CHAIRMAN. You are the Chairman of the Military Renegotiation Board; are you not?

Mr. ROBERTS. Yes, sir.

The CHAIRMAN. How long have you been serving in that capacity?

Mr. ROBERTS. September 1948.

The CHAIRMAN. Well, sir, we are delighted to have you appear here before us this morning, and we thank you very much for your statement. Of course, the committee does not want to go into a long-protracted hearing on this bill, but we will recess over tomorrow, and then on Friday there we have scheduled some 10 or 12 witnesses to be heard. I presume you or some representative of the Defense Establishment will be on hand.

Mr. ROBERTS. I will be here, Mr. Chairman.

The CHAIRMAN. Thank you very, very much, Mr. Roberts. We appreciate your appearance.

Mr. ROBERTS. Thank you, sir.

THE CHAIRMAN. I have a report on H. R. 1724 from the Reconstruction Finance Corporation which will be inserted in the record.

(The matter referred to follows:)

RECONSTRUCTION FINANCE CORPORATION,
Washington 25, D. C.

Re H. R. 1724, the proposed Renegotiation Act of 1951.

Hon. WALTER F. GEORGE,
Chairman, Finance Committee, United States Senate,
Washington 25, D. C.

DEAR SENATOR GEORGE: At the time H. R. 1724 was introduced in the House, Reconstruction Finance Corporation had not had sufficient opportunity to study and to suggest the desirability of its inclusion as a named department. Section 103 (a) of the bill provides two means whereby Government agencies can be brought within the scope of renegotiation:

(1) By being specifically named as a "department," in which case the effective date is January 1, 1951; and

(2) By designation of the President, and in this case renegotiation is effective only "* * * on or after the first day of the first month beginning after the date of * * * designation * * *" (sec. 102 (a) relating to contracts subject to renegotiation).

Reconstruction Finance Corporation is making very extensive purchases of raw materials in connection with its synthetic-rubber program. Certain phases of its tin and abacá operations might also properly belong within the body of defense contracts to be considered in renegotiation. Since strenuous efforts were being made prior to January 1 of this year to reach maximum production (at present estimates the rubber program alone is expected to reach a total of $425,000,000 during the next fiscal year), inclusion of Reconstruction Finance Corporation's purchase contracts seems desirable, and the earliest date possible is considered preferable. The commencement of renegotiation at the uniform accounting cut-off date—i. e. January 1, 1951—will also make it easier for our contractors in segregating renegotiable from nonrenegotiable business.

Reconstruction Finance Corporation was a named "department" in the Renegotiation Act in effect during World War II and had a great deal of experience with the difficult problems that face an agency brought under renegotiation at a date date later than that of the other major procuring "departments." This experience holds fesh before us the desirability of participating in the formative period when basic regulations are written and the broad policies for subsequent operations are laid down.

It is therefore respectfully suggested that your committee give favorable consideration to the desirability of an amendment to section 103 (a) of H. R. 1724, now before your committee, along the following lines: Insert immediately after the words "Atomic Energy Commission" the following: "the Reconstruction Finance Corporation".

We have been advised by the Bureau of the Budget that this amendment is in accord with the program of the President.

Sincerely yours,

W. E. HARBER, *Chairman.*

The CHAIRMAN. There are some letters and telegrams that will be inserted in the record at this point.

(The letters and telegrams referred to follow:)

ATLANTIC COTTON ASSOCIATION,
Atlanta, Ga., January 27, 1951.

Senator WALTER F. GEORGE,
Senate Office Building,
Washington, D. C.

DEAR SENATOR GEORGE: The renegotiation bill (H. R. 1724) provides that subcontractors are subject to renegotiation. As cotton is mentioned in the bill, it probably would be construed that a merchant selling raw cotton to a cotton mill would be a subcontractor and subject to renegotiation.

A cotton merchant has no way of knowing whether the actual bales sold to a mill will be manufactured into goods for civilian use, for export, or the finished goods will be sold to some Government agency. In fact, the cotton mill would not know at the time of purchase, for the cotton mills anticipate their total requirements and buy accordingly.

It is the universal practice of cotton mills to buy against competitive offers. Cotton mills do not say to a single cotton merchant, "We want to buy 1,000 B/C Middling 1-inch-staple cotton. What do you want for this quality?"—and then accept the offer. On the contrary, they ask for numerous offers direct to many

cotton merchants and through their spot cotton brokers, and accept the lowest offer to sell.

Competition is so keen in the cotton-merchandising trade that, generally speaking, one-sixteenth of a cent per pound is difference in whether a sale is or is not made.

The cotton merchant does not know, when he sells cotton to a mill, into what construction of goods the cotton he sells the mill will go. Some cotton mills may use, as illustration, one quality in a construction of goods; another mill may use other qualities in the construction of the same goods. The manufacturing technique is not known to the cotton merchant. The cotton merchant sells to the cotton mill what they want, and does not attempt to say what grade and/or staple the mill should use.

The margin of possible profit in the merchandising of raw cotton is at a minimum due to the margin of competition (one-sixteenth of a cent per pound), and possible profit is at such a minimum that excessive profits, whether for war goods, civilian consumption, or export, is not possible.

Finally, the foregoing shows that renegotiation of raw-cotton sales to cotton mills on that portion that may be manufactured for Government agency would not effect saving to the Government.

We respectfully suggest the sale of raw cotton should be exempt from renegotiation, and respectfully call your attention to the recommendation of the National Cotton Council unanimously adopted at its convention held in Biloxi, Miss., this week: That raw cotton be exempt from renegotiation. As you know, the National Cotton Council is comprised of all cotton interests from the farmer to the consumer.

Very truly yours,

J. M. GLOER,
Vice President and Secretary.

COOK & CO., INC.,
Memphis, Tenn., January 25, 1951.

Hon. K. D. MCKELLAR,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR: Reference is made to H. R. 1724, which replaced H. R. 1270.

This has to do with the renegotiation of contracts. Although the bill exempts cotton and other agricultural commodities in their raw state, such exemption applies only provided the contract or subcontract is with the producer of such agricultural commodities.

As you know, very little cotton is bought direct from the producer by the manufacturer, and if this law is allowed to go into effect it would in my opinion practically eliminate us and those in a similar type of business from continuing on with our present business.

This situation would have many repercussions in our area and, as a matter of fact, in all cotton areas.

I believe in the long run both the producer and manufacturer would be the losers.

I hope you will use your influence when the companion bill arrives in the Senate to take such steps as to exempt cotton and other agricultural commodities in their raw state without the restricting clause referred to above.

With best wishes, I am

Sincerely,

EVERETT R. COOK.

STOW MANUFACTURING CO.,
Binghamton, N. Y., January 25, 1951.

Subject: Contract renegotiation bill as passed by Ways and Means Committee, H. R. 1724.

Hon. WALTER F. GEORGE,
Senator from Georgia,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: For your consideration in connection with the above legislation, I would like to call your attention to section 105 (e) (2), which reads as follows:

"Audit of Books and Records.—For the purpose of this title, the Board shall have the right to audit the books and records of any contractor or subcontractor

subject to this title. In the interest of economy and the avoidance of duplication of inspection and audit, the services of the Bureau of Internal Revenue shall, upon request of the Board and the approval of the Secretary of the Treasury, be made available to the extent determined by the Secretary of the Treasury for the purpose of making examinations and audits under this title."

I believe that this method of audit is an improvement over the method used in World War II renegotiation, where separate auditors were furnished by the Renegotiation Board. However, I believe that the contractor should have the right to demand and receive full and final audit at this time for the year to which the renegotiation applies, and that his entire tax liability as well as renegotiation liability should be finally settled, and that he should not be subject to any further audit by the Bureau of Internal Revenue for the year in question.

I speak with feeling on this subject because, although our company was audited by the Renegotiation Board for the years 1942, 1943, 1944, and 1945, we were again audited by the Department of Internal Revenue in the year 1947 covering all four of these years. In the year 1947 we were having a very difficult time trying to recover from the after effects of the war. We sustained a net loss in the year 1947 of over $60,000, and yet during that year we were assessed nearly $240,000 including interest for back taxes applying to these same 4 years. If the additional amount of assessment had been made at the time of renegotiation, it probably would not have been seriously questioned, because we were in a cash position to take care of it. However, in 1947 it was necessary for us to appeal the assessment; and, if we hadn't been able to get it reduced to less than $50,000, it certainly would have put us out of business.

I believe that this is a most important point and should be included in the new legislation.

Very cordially yours,

STOW MANUFACTURING CO.,
C. F. HOTCHKISS, *President.*

[Telegrams]

MEMPHIS, TENN., *January 27, 1951.*

Hon. KENNETH MCKELLAR,
Senate Office Building, Washington, D. C.:

It is our understanding that a hearing on H. R. 1724, the renegotiation bill, will take place next Tuesday before Senator George and the Finance Committee. The bill as now worded exempts raw cotton only at the farmer's and cotton cooperative's level, which means that the cotton merchant, under the bill as now written, is in the same position he found himself originally under the old renegotiation bill of 1943. The Memphis Cotton Exchange recalls with great pride the invaluable assistance rendered us by you in getting raw cotton exempted under the former bill. We again solicit your aid in seeing that raw cotton is exempted under the present bill. As you know, should renegotiation of raw cotton include shippers of this commodity to the mills, it would practically eliminate them as cotton handlers. Please advise if you think a committee from our exchange should appear before the committee at the hearing on Tuesday.

MEMPHIS COTTON EXCHANGE,
C. L. PATTON, *President.*

MEMPHIS, TENN., *January 27, 1951.*

Senator KENNETH MCKELLAR:

Understand Senate Finance Committee will start Tuesday consideration H. R. 1724, which is renegotiation bill, which does not exempt agricultural products except where handled by co-ops or farm level, which means serious disruption whole marketing system. I and your other friends here remember vividly and gratefully your effective assistance same subject during last war. Please try get same thing for us this time.

Regards.

SID Y. WEST.

The CHAIRMAN. We will adjourn until Friday morning at 10 o'clock.

(Whereupon, at 12 noon, the committee adjourned, to reconvene at 10 a. m., Friday, February 2, 1951.)

RENEGOTIATION OF CONTRACTS

FRIDAY, FEBRUARY 2, 1951

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to recess, at 10 a. m. in room 312 Senate Office Building, Senator Walter F. George (chairman), presiding.

Present: Senators George, Connally, Byrd, Johnson (Colorado), Hoey, Frear, Butler (Nebraska), Martin, and Williams.

Also present: Mrs. Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

Mr. ROBERT E. Lee Hall, counsel for the National Coal Association, who is scheduled as a witness, is submitting a telegram for the record in lieu of his appearance. The substance of the telegram is simply this:

National Coal Association endorses mandatory exemption for mine products as set forth in section 106 (a) (3) of House passed bill (H. R. 1724), but recommends addition of the words "or any authorized bona fide agent thereof" after the word "operator" appearing on line 16 of page 25. By custom and practice significant percentage of coal mined is sold exclusively through authorized bona fide agents of mine owners or operators. It is submitted that mandatory exemption for "authorized bona fide agent" is justified on the same grounds that persuaded the House to include such exemption for the "owner or operator."

That will go in the record at this point.

(The telegram referred to follows:)

WASHINGTON, D. C., *February 1, 1951.*

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.:

In lieu of scheduled appearance Friday, February 2, respectfully request permission to insert this telegram in record of proceedings as statement of position of bituminous coal mine owners and operators. National Coal Association endorses mandatory exemption for mine products as set forth in section 106 (a) (3) of House-passed bill (H. R. 1724), but recommends addition of the words "or any authorized bona fide agent thereof" after the word "operator" appearing on line 16 of page 25. By custom and practice significant percentage of coal mined is sold exclusively through authorized bona fide agents of mine owners or operators. It is submitted that mandatory exemption for "authorized bona fide agent" is justified on the same grounds that persuaded the House to include such exemption for the "owner or operator." We express the hope that the committee will carefully consider our views with respect to the recommended revision of section 106 (a) (3).

ROBERT E. LEE HALL,
Counsel, National Coal Association.

The CHAIRMAN. Mr. Herman Fakler, the vice president of the Millers' National Federation, scheduled as a witness today, is submitting a statement for the record in lieu of his appearance.

We will include that in the record at this point.

(The statement referred to follows:)

STATEMENT OF MILLERS' NATIONAL FEDERATION, HERMAN FAKLER, VICE PRESIDENT, WASHINGTON, D. C.

Mr. Chairman and members of the committee, my name is Herman Fakler. I am vice president of the Millers' National Federation, which is the national association of the wheat flour milling industry of the United States. My address is National Press Building, Washington, D. C.

I am authorized to present this statement to your committee by the executive committee of the board of directors of the association, to express the views of our members with respect to H. R. 1724, as passed by the House of Representatives, entitled "A bill to provide for the renegotiation of contracts."

By its very terms, this proposed legislation appears to be designed to recapture excessive profits derived from contracts and subcontracts with specified Government agencies exercising functions in connection with national defense. Experience with a similar statute in effect during World War II and immediately thereafter indicates that this type of legislation is designed primarily to deal with products manufactured specifically for military purposes. It permits flexible pricing when it is impossible to determine costs with exactness at the time the contracts are entered into and permits a recapture of any excessive profits which may result from such uncertainties.

While these Government agencies are purchasing products manufactured specifically for military purposes, they at the same time are purchasing standard commercial articles for the use and consumption of the personnel of the Armed Forces which are identical with those purchased for such personnel during peacetime, and which are identical with those which are produced and sold for civilian consumption.

Wheat flour is an example of such a standard commercial article. Wheat flour produced for the use of military personnel is identical with wheat flour produced for civilian consumption both in wartime and peacetime. Wheat flour produced for a specific baking purpose, such as for the baking of bread, biscuits, pies, etc., is identical with and has the same baking characteristics whether it is used by a baker in the military service or by a civilian baker.

Raw material wheat costs, manufacturing, labor and packaging costs, etc., and profits, if any, can be and are determined at the time an offer of sale is made to a Government agency in the same manner and with the same accuracy as these factors are determined at the time a contract of sale is entered into with a civilian purchaser.

Unlike the situation existing in the case of contracts for other products for which costs cannot be determined with accuracy, the Government procurement officer, as well as the flour miller, is in a position to know within a very few cents per hundredweight of flour the amount the procurement officer should pay for the product and in 99 cases out of 100, he contracts for the product within a very few cents of the price he expected to pay. If he pays too much, the answer is to get a new procurement officer rather than to renegotiate the contract.

Such procedure fully protects the Government against being charged a price for wheat flour which will reflect excessive profits to the miller. Under such a buying procedure and because of the keen competition which exists in this industry, the miller being awarded the contract will be fortunate to receive as much as what may be regarded as a normal profit.

The Government is at no disadvantage in negotiating a contract of that kind. The basis for renegotiation does not exist in flour contracts as compared with contracts for other products. To require renegotiation of flour contracts would only mean that the Government, as well as the individual contractors in the industry, would be required to go through the procedures of renegotiation with no benefit to the Government for the time and expense involved for both the Government and the contractor.

These facts were recognized by the Congress in the act of April 28, 1942, Public Law 528, Seventy-seventh Congress, as amended. Section 403 (a) (7) of that act defined the term "standard commercial article," and section 403 (i) (2) authorized the War Contracts Price Adjustment Board "by regulation to interpret and apply the definition contained in section 403 (a) (7)."

Pursuant to this authority, the Board exempted from renegotiation amounts received or accrued under contracts or subcontracts for the manufacturing or furnishing of a number of articles which were determined by the Board to be standard commercial articles. Wheat flour and related products of wheat were included among these articles.

Following careful examination by the Board of the facts in connection with the purchase of wheat flour and related products of wheat by Government agencies as compared with the purchase of identical articles by civilian buyers, the Board experienced no difficulty in determining that contracts for the purchase of these articles by the Government were entitled to the exemption from renegotiation provided for in the law and the exemption was granted.

During the testimony of Mr. Frank L. Roberts, Chairman of the Military Renegotiation Policy and Review Board, your chairman, Senator George, inquired as to the reason for the omission from H. R. 1724 of a provision relating to standard commercial articles similar to that contained in the act effective during World War II. Mr. Roberts replied that members of the Renegotiation Board recommended the omission of such a provision so that the Board would be relieved of the administrative task of considering a large number of applications for the exemption of standard commercial articles.

In our opinion it would be far less of an administrative task to consider one application for the exemption of a standard commercial article, such as wheat flour, than to review hundreds of contracts for the purchase of wheat flour, only to find that no excessive profits exist and, therefore, no renegotiation of the contracts is required. Even though in some other cases it may be found that the contracts for some articles should be renegotiated, only the examination of a single application for exemption is required. When by the consideration of a single application for exemption the Board can determine that renegotiation is not required, it is perfectly obvious that the Board can relieve itself entirely of the administrative task of reviewing hundreds of contracts for the purchase of that article only to come out with the same answer.

Therefore, in the interest of reducing the administrative work of the Renegotiation Board, and thus reducing the useless expenditure of Federal funds, we most earnestly recommend that your committee restore to the bill H. R. 1724 a provision similar to section 403 (i) (4) (D) of the Renegotiation Act of 1943, authorizing the Board, in its discretion, to exempt from renegotiation any contract or subcontract for the making or furnishing of a standard commercial article.

In behalf of the members of this industry who are in position to furnish wheat flour and related products of wheat to meet the needs of Government agencies, we respectfully request favorable consideration by your committee of the recommendation we have made.

The CHAIRMAN. Mr. Vincent P. Ahearn, executive secretary of the National Sand and Gravel Association and the National Industrial Sand Association, also scheduled as a witness, is submitting a brief in lieu of his personal appearance for the record.

We will include that in the record at this point.

(The statement referred to follows:)

STATEMENT OF THE NATIONAL SAND AND GRAVEL ASSOCIATION AND THE NATIONAL INDUSTRIAL SAND ASSOCIATION, VINCENT P. AHEARN, EXECUTIVE SECRETARY

I am Vincent P. Ahearn, of Washington, D. C., executive secretary of the National Sand and Gravel Association and the National Industrial Sand Association.

The National Sand and Gravel Association is composed of producers of sand and gravel located in all parts of the United States, representing approximately 75 percent of the total annual commercial production. The National Industrial Sand Association is composed of producers of industrial sand located in all parts of the United States representing approximately 90 percent of the total annual commercial production.

Sand and gravel, including industrial sand, were exempted from renegotiation during World War II, a joint statement issued by the War, Navy, and Treasury Departments and the Maritime Commission holding that they qualified under the exemption for minerals which are not "processed, refined, or treated beyond the first form or state suitable for industrial use".

The Military Renegotiation Policy and Review Board has ruled that sand and gravel, including industrial sand, are exempt from the peacetime Renegotiation Act of 1948.

Keen and vigorous competition in the sand and gravel industry furnishes complete assurance to Government procurement that renegotiation is not necessary to the maintenance of fair and reasonable prices. Methods of processing, refining, and treating sand and gravel have not changed since wartime. Nothing

has happened to make it necessary to alter or revise the public policy stated by the Congress in World War II.

Sand and gravel are the basic materials of construction. Our industry met the unprecedented demands of World War II for military construction without the assistance of governmental loans or subsidies. Our industry is prepared to meet the demands of the armed services for industrial mobilization and production today. We have already assured the National Security Resources Board that, given the equipment and the manpower, our industry will do its part in the present national emergency.

Sand and gravel prices have always been low because of the intensive competition which is characteristic in our business. Furthermore, there is always a substantial governmental production of sand and gravel, and contractors frequently set up their own sand and gravel plants to serve specific projects. Thus the public interest in fair and reasonable sand and gravel prices is fully protected, because of the internal competition which is traditional in our business and because of the external threat of subsidized production, or production by our customers.

There are more than 2,000 companies in the sand and gravel industry, greatly dispersed as to size, but generally small. It would be an expensive and an almost hopeless administrative task to subject the large number of small companies which make up our industry to renegotiation. The public interest does not require renegotiation and we believe that our industry should be excluded from the compulsions of the act.

Industrial sand is a raw material and used in a wide variety of manufacturing processes. It finds employment principally in the glass and foundry industries, but these two industries are cited only as examples. Like sand and gravel, industrial sand is not "processed, refined, or treated beyond the first form or state suitable for industrial use." As in the case of sand and gravel, the industrial sand industry is marked by a vigorous price and service competition which is a guaranty of fair and reasonable prices to the consumers.

I respectfully urge your committee to include in H. R. 1724 the same basic exemption for minerals which appeared in section 403 (i) (1) (B) of the Renegotiation Act of 1943 and was incorporated in the Renegotiation Act of 1948, as amended. This provision should replace the present wording of section 106 (a) (3) of H. R. 1724 to clarify the exemption for the minerals industries. As now worded, section 106 (a) (3) is intended, we understand, to exempt from renegotiation sand, gravel, and industrial sand just as they were during World War II and under the Renegotiation Act of 1948, as amended. However, the reference to "ordinary treatment processes" as defined in relation to section 114 (b) (3) or (4) of the Internal Revenue Code is confusing, especially since sand, gravel, and industrial sand have not been granted depletion allowances under the income tax statutes. The exemption would be greatly clarified if it read exactly as it did under previous renegotiation statutes.

If the wording of the minerals exemption provision of the 1943 and 1948 acts is adopted, industry and renegotiation officials will have the experience of the prior renegotiation laws to administer the exemption, and the limits of this exemption will be defined with greater certainty. In addition, the continuance of the minerals exemption in its prior form will eliminate the expenditure of time by administrative personnel in interpreting and applying a new statute. The minerals exemption of the 1943 and 1948 acts is clearly understood by industry as a result of past experience, and the continuance of the exemption in the same form will be mutually helpful to both industry and Government officials. It will result in a saving of manpower and a more efficient administration of the statute.

I therefore urge your committee to substitute for section 106 (a) (3) of H. R. 1724 the provision of section 403 (i) (1) (B) of the Renegotiation Act of 1943, which reads as follows:

"(B) Any contract or subcontract for the product of a mine, oil or gas well, or other mineral or natural deposit, or timber, which has not been processed, refined, or treated beyond the first form or state suitable for industrial use; * * *"

I also urge your committee to substitute for section 106 (b) of H. R. 1724 the provision of section 403 (i) (3) of the Renegotiation Act of 1943 which reads as follows:

"(3) In the case of a contractor or subcontractor who produces or acquires the product of a mine, oil or gas well, other mineral or natural deposit, or timber, and processes, refines, or treats such a product to and beyond the first form or state suitable for industrial use, or who produces or acquires an agricultural product and processes, refines, or treats such a product to and beyond the first form or state in which it is customarily sold or in which it has an established market,

the Board shall prescribe such regulations as may be necessary to give such contractor or subcontractor a cost allowance substantially equivalent to the amount which would have been realized by such contractor or subcontractor if he had sold such product at such first form or state. * * *"

I also represent the National Ready Mixed Concrete Association. Ready-mixed concrete was exempted from wartime renegotiation during World War II as a standard commercial article. On September 12, 1944, the War Contracts Price Adjustment Board ruled that competitive conditions affecting the sale of ready-mixed concrete were such as to give the Government the benefit of fair and reasonable prices, because the public not only gets the benefit of internal competition in the ready-mixed concrete industry, but also because our industry really competes with its own consumers, who are perfectly capable in most instances of producing their own concrete on the site of the job if ready-mixed concrete prices are regarded as too high.

This exemption for ready-mixed concrete was extended throughout the remaining renegotiation years. Peacetime armed services procurement of ready-mixed concrete has been so small that a request for exemption of the industry under the Renegotiation Act of 1948 has not been necessary.

I respectfully request your committee to include in section 106 (c) of H. R. 1724 as a new subparagraph (6), the language of section 403 (i) (4) (D) of the Renegotiation Act of 1943 which reads as follows:

"Any contract or subcontract for the making or furnishing of a standard commercial article, if, in the opinion of the Board, competitive conditions affecting the sale of such article are such as will reasonably protect the Government against excessive prices."

The CHAIRMAN. The first witness scheduled this morning is Col. Willard F. Rockwell, of the Rockwell Manufacturing Co., Pittsburgh, Pa.

Will you please identify yourself for the record?

STATEMENT OF COL. WILLARD F. ROCKWELL, ROCKWELL MANUFACTURING CO., PITTSBURGH, PA.

Colonel ROCKWELL. My name is W. F. Rockwell. I am chairman of the board of the Rockwell Manufacturing Co., Pittsburgh; chairman of the board of the Standard Steel Spring Co.; chairman of the board of the Timken-Detroit Axle Co.

The CHAIRMAN. Your home is where?

Colonel ROCKWELL. Pittsburgh, Pa.

Senator MARTIN. I regard him very highly.

Colonel ROCKWELL. Thank you, Senator.

The CHAIRMAN. We will be very glad to hear you.

Colonel ROCKWELL. I have some points to make on the Renegotiation Act. First, that the Renegotiation Act accomplishes nothing which could not be done by the excess-profits tax. I will quote the best authority I know of—Senator George.

If this is recognized, then all the extra or duplicate examinations, wasting both bureaucratic and industrial executive time, could be eliminated, together with Tax Court hearings, and also the FBI examinations which are imposed for intimidation purposes, after the unilateral determination.

I think the FBI could find something better to do, but that is up to you to find out.

The Renegotiation Act provides a profit for any undetected waste, whether due to ignorance or intent, while the excess-profits tax provides some profit for every saving.

For example, 90 percent excess-profits tax means a profit of 10 cents on every dollar saved from waste, and encourages production-

increasing machinery and methods. If the Renegotiation Act leaves only 3 percent return—we had one company in which it left only 1.5 percent return—it will still give a profit of 3 cents on every undetected wasted dollar. It discourages labor-saving practices, especially for war contractors who do not expect to operate after the war—who, like the mule, have no pride of ancestry and no hope of posterity.

The very name of the act is false, because there is no renegotiation when power to make unilateral decision is in the hands of one party and recourse to regular court action is denied the other.

Mr. Marberry, who claims to be the author of the act, has stated that he was only given a few days in which to write it, and its proper title should be, "The Discretionary Excess Profits Tax." This statement, made in 1949, was never given to the congressional committee, who were told it was a scientific and weighted method of rewarding efficient contractors.

I am sure you will not find that in the congressional hearings of 1943.

The National Industrial Conference Board made a report which stated its impartial postwar study could detect no real effort at anything but leveling of profits.

Industrialists know that the discretionary excess-profits tax could also be the prejudicial profits tax, and, as Senator George predicted on December 2, 1943, such vast discriminatory power could destroy men like Patterson and Forrestal.

The Renegotiation Act gives dictatorial power to punish any who testified against passage of the act, or any who dare to report any illegal, unethical, or questionable practice of War Department officers or employees. It acts as a deterrent to any war contractor who is imposed upon by War Department officers; it also encourages contractors to accede to any demands of War Department employees, no matter how proper or improper, under possibility of retaliation through the act.

It is not surprising that all persons, firms, and corporations who are not renegotiated should be in favor of this act, which purports to prevent producers of goods or services used by the Government in wartime from obtaining excess profits in spite of the excess-profits tax. The propaganda to the effect that the act saved five to ten billion dollars in World War II is utterly misleading, but it is comforting to thoughtless taxpayers who hope their load is lightened to the extent that it is shifted onto others. There are witnesses—I can find them for you, I think—who say that Secretary Forrestal expressed the opinion that there was no net saving from the act because most of the renegotiated profit would have been recovered by the excess-profits tax, and the balance was probably completely offset by the encouragement of waste.

It is just plain common sense that contractors who wish to take extra profits under this act are able to do so by increasing every allowable expense for advertising, interest, legal expense, experimental work, entertainment, and tools of every nature that can be charged off as expense. It is absolutely impossible to detect any waste through later examination of the records by a board of local men trying to cover hundreds of plants, and even more impossible for a board in Washington to supervise and detect such items on plant operations thousands of miles apart.

If it were possible to do these things, then again it is just plain common sense to have these boards supervise the letting of contracts and all current operations to detect waste and inefficiency. Why lock the barn door after the horse is stolen? Why hold post mortems on the taxpayers' money after it is gone?

Manufacturers whose peacetime products are purchased by the War Department are particularly embittered over the fact that if they bid low, and receive the award, they may have to give up their domestic and foreign peacetime business to competitors who refuse to take war work knowing the advantage to be gained by taking over the other contractor's business. This preying on war contractors' peacetime business is going on right now. Why, then, should the patriotic low bidder have this additional penalty of renegotiation which cuts his profits while his competitors are taking over his business without any threat of negotiation?

If the act were just and honest, it should be possible to pass it without plots or unjust accusations. It was called an un-American act by its first administrator, and that was before the true purpose of holding a club over contractors was disclosed.

I have a letter here which I want to submit, which shows the rise of a new form of percenter. This letter comes from a fellow who said he was on the Renegotiation Board. He now offers his services to any and all who are threatened with renegotiation. Would you like to have me read it, or will I just submit it?

The CHAIRMAN. Either way.

Colonel ROCKWELL. He says:

DEAR MR. ROCKWELL—

this is, apparently, a circular letter—

Under the impression that your company's defense contracts are rapidly expanding, and that improving continuity and general coordination is resulting in "satisfactory" profits accruing—I would expect the subject of renegotiations to be of growing importance to your company as well as to the Government.

You will note he has quotations around "satisfactory" for reasons that I do not know.

You may know, following my resignation as Air Force renegotiator—I had also been asked to join the Ordnance Board—I had the pleasure of serving manufacturers in the capacity indicated by this letterhead—

and the letterhead is, "Renegotiation Consultant"—

during the latter years of the recent war. Incredible as it may seem, every case in which I participated—including those that had been previously impassed—was sett'ed with a satisfactory bilateral agreement. With the approval of the Renegotiation Board and the United States Securities and Exchange Commission—with whom I am registered as an investment consultant—I have resumed my service.

I feel certain that anyone with wartime experience in renegotiations appreciates how serious those "determinations" can be. Yes, a few hundred thousand dollars or more—one way or the other—frequently results from overlooking factors that renegotiators would view favorably—or, as in many cases, subjects that appear at least debatable to the businessman and/or preparation attorney (who have not "sat in the renegotiator's chair") are argued to the point of bitter feelings and—unsatisfactory—"bilateral" (virtually "unilateral") agreement or an impasse results.

It has occurred to me that you and/or one of your associates may be in this city discussing financial affairs in the near future. In that case, perhaps you could conveniently arrange to join me for an informal luncheon conference at the Bankers Club.

Senator BYRD. Did he say what he was going to charge?

Colonel ROCKWELL. No, sir. That would depend on the great savings he could make. He seems to have connections.

Senator CONNALLY. You would not renegotiate his contract?

Colonel ROCKWELL. I hope you will.

When I appeared to testify before the House Ways and Means Committee, and later the Senate committee, in 1943, I was asked about threats which had been made against my interests; and several Congressmen told of threats that were made to their constituents. There were two threats which I thought too silly to report, although you will find that I made reference to one, as reported on page 1020 of the Senate Finance Committee hearings on H. R. 3687.

The one not reported was a telephone conversation with a man who refused to give his name. He said I might have a bad accident if I testified again. When I asked him what kind of accident, he said, "You might fall out of a Washington hotel window," and then hung up.

In the other case, I was given a friendly warning by members of the Renegotiation Committee of the Maritime Commission, before I testified, that a plan had been prepared under which any individual whose testimony adversely affected the passing of the act would be blasted by a high Government official who would appear at the last open committee hearing, of this Senate Finance Committee, thus making sure that his victim could not appear face-to-face to answer unjust or false accusations.

I did not consider it probable that a high official would resort to such unfair tactics and take such undue advantage of a private citizen. I did not think a high official would resort to slander, merely because he had immunity from slander suits; but if he did, I felt certain that Congress would give the victim an opportunity to be heard and to be examined. I had no idea then of the method used by bureaucrats, under which they give out special and sometimes secret reports to sensation-seeking newspapers or the smear reports, in exchange for which these smear artists praise the work of the cooperating bureaucrats and blast anyone who opposes the bureaucrats.

Senator CONNALLY. Did he carry out this terrible threat?

Colonel ROCKWELL. I will prove that to you. Senators of both parties know what I am talking about, as Senator George and I were both blasted in a smear column of December 21, 1943. I am sure he knows. I happened to be in his office when he was telling the people over in the Army that they had done him wrong, but they did much better on me.

When I testified before this committee on December 2, 1943, Senator George, who is acknowledged generally to be the greatest expert on taxes, said to me (p. 409):

> Well, Colonel, the truth is that on the economic front the one single congressional act which conveys absolute and arbitrary power to anybody is the Renegotiation Act. There are no standards in it. There is no remedy under it. Those who contract with the Government are simply bound hand and foot. They must do what they are told or else.

He also said:

> * * * without standards or without real restriction or restraint, they inevitably would make mistakes and create discriminatory favors on one side, and harsh discriminations on the other side.

And, later:

I agree with you fully on this Renegotiation Act. If I had it in my power, I would throw it out entirely and rely absolutely on the taxing laws.

Senator Vandenberg (p. 408) said:

It seems to me on the face of the statement as you make it, the position of the Government is totally indefensible.

With such recognition of my testimony, the high official appeared on December 6, as threatened, at the last open hearing. He made virtually no attempt to answer the objections of myself or Senator George. He proceeded to give you a series of baseless statements and then asked his aide to add more smears. He not only made the statements, but he carefully refrained from telling the truth about a conversation in which I said my company was willing to make a contract—the one he discussed—without any profit, if we were relieved from the liability for subcontractors' errors, which we might not be able to detect before delivery.

We were also subject to renegotiation; and the contract he was talking about had a redetermination clause in it, so they could redetermine the price when it was partially completed.

Where I had pointed out that the excess profits tax left some incentive for savings, while the Renegotiation Act permitted a higher profit for any undetected waste, due to ignorance or intent, the high official said (p. 1004):

* * * the higher you raise the figure on the excess profits taxes, the more wasteful contractors are going to be.

And went on to claim contractors would double everybody's salary, "because the Government is going to get it, anyway."

As I said before, under the excess profits tax, the obvious truth is that the highest rate of 85.5 percent left the contractor 14.5 cents out of every dollar he could save from salaries or any other expense; while, under the Renegotiation Act, if any allowable cost was not raised to that limit, the contractor lost 3 percent to 20 percent when the flat rate of profit was announced and before taxes were decided.

It is typical of the bureaucrats that they ignored the experienced and expert advice of Senator George and many leading industrialists, and the act was passed on the basis, in part, of unfounded charges by a high official who had demonstrated that he could not read a financial statement or work out simple financial problems, and was backing the act merely to increase his own dictatorial power and set up a situation under which no contractor could oppose his ruthless tactics without becoming a victim of his power to punish. It is not surprising that the Garsson case developed under this scheme.

The high official charged, on December 6, 1943, that terms demanded by the Timken-Detroit Axle Co. were "utterly unreasonable and that the Government should never yield to them"; but, 5 days later, on December 11, 1943, orders were issued from his office to proceed with the contract without the change of a single word. Your committee may want to ask that high official if this was admission that his testimony to you was false or that he was so cowardly as to accede to "utterly unreasonable demands."

The correct answer is that there were no unreasonable demands, and that the most competent procurement officers in the Army had completed the contract negotiations and approved them many months

before. The high official was so ruthless and vengeful as to forget that, in his attempt to smear the Timken-Detroit Axle Co., he was smearing honest Army officers. There was never a moment of delay on Timken's part because of the high official's sordid and savage attacks, but later this official proceeded to send out false reports that Timken management was on strike against the war effort and, therefore, the contract would be canceled.

These false statements, which were sent out on radio programs and War Department press releases, obviously made it difficult for us to interest subcontractors and, of course, really hurt the war effort.

He had told you that this contract had to be filled and we were the only ones to fill it, which was not exactly so. After that, he deliberately set out to sabotage our efforts.

In 1943, after 6 months' study of the Timken-Detroit Axle Co.'s figures, and numerous conferences, the false statement was issued, as to Timken's dividends and salaries.

He said we had raised our dividends—we had actually lowered them—and that we had increased the officers' and executives' salaries 500 percent. And that letter is in the record. He was only 475 percent wrong about the officers' and executives' salaries. The 25-percent increase was due to the great increase in business and a contract with the officers which had been approved by the stockholders several years before. Incidentally, the Treasury Department just asked us to drop the contract with our executives, which we did, and they received no extra compensation during the war, although they were entitled to it under the stockholders' agreement. That statement could have been merely a mistake, but it is very obvious that he was wrong one way or the other.

Senator CONNALLY. I do not see the profit of devoting this whole meeting here to this high Government official. We do not know who he was, or anything of the kind. It seems to me that the witness ought to go to the question of the law, the bill, the theory of this thing, instead of spending all of this time on this.

Colonel ROCKWELL. If you will pardon me, the theory of the thing is that you will not have many people coming in here testifying, when they are afraid of this kind of retaliation.

Senator CONNALLY. I do not know who this terrible man is, but ever since I have been in here, you have been talking about this high official all of the time.

Colonel ROCKWELL. I have given you a lot of reasons here.

Senator CONNALLY. It is just a bitter attack, and that is all there is to it. You had a row with him, and you want to vent your spleen on him. We do not want to hear it; that is, I do not.

Go to the question involved in this legislation. That is what we want to know.

Colonel ROCKWELL. I will go to the question. I say that Senator George said that the thing is absolutely unnecessary and that it would ruin the men who had it, because it gave too much power to them. I am trying to prove that is the case.

Do you want to hear any more?

The CHAIRMAN. Yes.

Senator BUTLER. Yes.

Senator MARTIN. Certainly.

Colonel ROCKWELL. I received, right after I testified, all kinds of blasts in the public press. One of them was a Washington paper which came out with a front-page article giving a completely untruthful story.

Senator MARTIN. I would like, if the witness would permit, to make this comment: I think this committee ought to appreciate the presence of a witness like this. This might deteriorate his istuation to a great extent. I think it is information we ought to have. I think the witness is very courageous to come here and testify as he is now testifying. I think it is information that this committee ought to have. This is information that the Congress ought to have. It is information that the people of the United States ought to possess.

The CHAIRMAN. Yes; all right, Senator.

Colonel ROCKWELL. As I say, one of these Washington papers published an utterly false story.

Senator CONNALLY. Is this higher official still in the Government?

Colonel ROCKWELL. No; he is not. He is doing very well outside.

Senator CONNALLY. He will not have anything to do with this bill then?

Colonel ROCKWELL. I have no hesitancy in naming him.

Senator CONNALLY. I did not ask you to name him. I say, if he is out of the Government, he will not administer this bill that is before us?

Colonel ROCKWELL. I think, Senator, that Senator George's criticism still stands. There is too much power to give any man.

Senator CONNALLY. Is this the same bill he was operating?

Colonel ROCKWELL. This, apparently, will be the same kind of a bill.

Senator CONNALLY. All right.

Colonel ROCKWELL. I say, one of the Washington papers published this false statement. I filed a suit for a million dollars against them, and in a few days they came out with a front-page heavy-type article telling the truth. Then my attorneys told me that all I could hope, in view of their retraction, was a nominal statement. But there is a paper in New York, PM of which I am sure you have heard, and they published a blast against me and called Timken Co. a company which had gone on strike against the war effort. The reporter who wrote that called me up sometime later and said that he would like to know if I had any answer. I told him one thing I would like to have him say is that when he said he could not get in touch with me before he published it, that that was a downright lie. Then I also pointed out that he had repeated this statement about Timken dividends being raised, the salaries being raised, and asked him where he got the information. He said he got it out of the Under Secretary of War's office.

The Under Secretary of War's office told me they talked to him. His name was Nathan Robertson. He wrote the article.

I got the chance to answer that. I gave them a two-page answer which was published in PM after a little pressure, but these reports kept coming out—that we were going to have this contract canceled.

So I went to Senator Ferguson, our plant being in Detroit, and I told him we were having real trouble to get subcontractors on this job because of these false reports. The Senator said, "If you can find out where they are issued, you get me one, and I will use it."

So one morning there was a radio report in Detroit that the contract was to be canceled. We sent a messenger over to the station and asked them for the report and where they got it. They told us they got it from the War Department. They gave us the copy. I brought it to Senator Ferguson's office.

Senator Ferguson called up the War Department and asked them if anybody had been issuing this kind of publicity. They sent a man over who said they had not.

Well, the Senator told me his answer to them was, "If you did not do it, just see that you do not do it again."

He never disclosed the fact that he had this record of what they did in his desk.

I say, Senator George expressed his opinion on what should be done about this. And, in spite of that fact, why, the bill went through.

I have a number of the trade paper releases, and that sort of thing, all of which said at that time that some action was going to be taken to stop the injustice, but after this report this high official made to Congress, he said he would stand or fall on the need for renegotiation because of this contract which, as I say, 5 days later he was forced to approve without the change of a word. Draw your own conclusions from that.

As far as the Timken-Detroit Axle Co. is concerned, Senator, I would like to give you these statistics.

We published a 10-year report. Our fiscal year ends June 30; therefore, the first year shown is the year ending June 30, 1941. That is 5 months before Pearl Harbor.

In that fiscal year, ending June 30, 1940, we had sales of $68,000,000 on which we showed a net profit of 8 percent after taxes.

The first full war year, ending June 30, 1943, under our fiscal set-up, shows double sales at $140,000,000, and by that time the Government was demanding everything we had, as they are right today. We only got 3 percent on net sales which was, of course, a greatly reduced income to stockholders before the personal taxes, which were raised very high.

So you can see what happened to the stockholders.

And then I say to you, how could anyone call that war profiteering?

This high official declared that we had no postwar conversion problem; that we could go right back to making our peacetime products. That only demonstrated his ignorance of what we were doing.

I can prove that by the fact in 1945—that is, the fiscal year, you know, ending in June—the first postwar year, our sales dropped $100,000,000, and profits were barely half of those in 1940.

He stood up here as an expert and said that we would not stand any reduction in business at all; therefore, should be given no credit for that.

In 1947, under the most competitive conditions in the automobile business, the sales rose to $89,000,000 and profits were $3,000,000

higher than they were in 1943. The sales were still way under the 1943 figure, but profits were still $3,000,000 higher in 1947.

These figures answer all charges of profiteering and prove that we were penalized and punished in 1943. And, I think, as an expert he is completely discredited by these figures.

I shall offer this report for the record.

The CHAIRMAN. Very well.

(The report referred to follows:)

ANNUAL REPORT OF THE TIMKEN-DETROIT AXLE CO., DETROIT, MICH., FOR THE YEAR ENDED JUNE 30, 1950

REPORT TO SHAREHOLDERS

There is submitted herewith the forty-first annual report of your company, including financial statements certified by our auditors, Ernst & Ernst, which is for the year ended June 30, 1950. This report goes to the largest number of shareholders in your company's history; the 2,172,343 outstanding shares are now held by approximately 13,540 individuals, companies, and trusts.

Net sales for the year amounted to $74,913,368 and the net profit, after audit and year-end adjustments, amounted to $3,732,873, equivalent to $1.72 per share of outstanding capital stock and 4.98 percent to net sales. This compares to net sales of $89,628,142 for the year ended June 30, 1949, on which the net profit amounted to $5,057,949, equivalent to $2.33 per share and 5.64 percent to net sales. The reduction in sales was due to a general decline in the motor-truck industry extending through the first 8 months of our fiscal year.

Your company's working capital position increased during the year from $22,678,602 at June 30, 1949, to $25,081,468 at June 30, 1950. Expenditures for plant, machinery, and equipment during the year amounted to $1,420,432, which was $123,890 in excess of the depreciation provided on such facilities.

The program of relocation of plants and manufacturing facilities begun in 1946 in accordance with the recommendation of the National Security Resources Board has proceeded satisfactorily during the year and we now have in operation eight manufacturing plants located in five States.

It will be of interest to the shareholders that we have achieved a substantial diversification in our products and that during the year 32½ percent of our total sales were nonautomotive in character. Our automotive sales are in no part to the passenger car field, but entirely to the truck, truck-trailer, and bus industries.

As a result of experimental work carried on since the end of World War II, we are now in volume production on axles and transfer cases for the M 34 2½-ton 6 x 6 army truck. We also have received orders for units of similar design for the larger army M-41 5-ton 6 x 6 truck, and for units required for military vehicles used by other branches of the armed services.

While our incoming orders in all divisions of the company since July 1 have shown a decided increase, assuring capacity operations, increased taxes, which appear to be inevitable together with possible restrictions imposed by Government regulations, could be an important and undeterminable factor in the results of future operations. However, our strong financial position, large order backlog, and constant program of product development and improvement constitute a bulwark against eventualities that may arise.

Respectfully submitted.

W. F. ROCKWELL,
Chairman of the Board.
WALTER F. ROCKWELL,
President.

OCTOBER 7, 1950

Consolidated balance sheet, June 30, 1950, the Timken-Detroit Axle Co. and subsidiaries

ASSETS

Current assets:		
Cash		$3,006,479
United States Government securities—at cost		1,617,421
Trade accounts, notes, and contracts receivable:		
Trade accounts	$7,174,428	
Trade notes and contracts receivable	602,033	
Total	7,776,461	
Less allowance	200,000	
		7,576,461
Inventories—at lower of cost (first-in, first-out basis) or market	20,962,162	
Less allowance	200,000	
		20,762,162
Total current assets		32,962,523
Other assets:		
Renegotiation rebates resulting from accelerated amortization adjustments	267,552	
Miscellaneous investments and accounts, less allowances of $6,050	15,927	
Expense advances and other accounts—officers and employees	28,826	
		312,305
Property, plant, and equipment—at cost:		
Land	749,762	
Buildings, machinery, and equipment	20,395,188	
Less allowances for depreciation	7,650,577	
Total	12,744,611	
Dies, jigs, fixtures, and patterns, less amortization	984,945	
		14,479,318
Good will, patents, and license agreements: At cost, less amortization		346,305
Prepaid expenses		220,105
Total		48,320,556

LIABILITIES

Current liabilities:		
Trade accounts payable		$4,926,976
Customers' and employees' deposits and credit balances		291,633
Payrolls and commissions		1,226,279
Taxes, including taxes withheld from payrolls		742,673
Federal, State, and Canadian taxes on income—estimated	$2,805,999	
Less United States Treasury savings notes to be applied in payment	2,551,500	
		254,499
Reserves for warranties, employer's self-insurance, and other operating purposes		438,995
Total current liabilities		7,881,055
Stockholders' equity:		
Common stock—$5 par value:		
Authorized—3,000,000 shares		
Issued and outstanding—2,172,343 shares	10,861,715	
Capital surplus	3,249,920	
Earned surplus	26,327,866	
		40,439,501
Total		48,320,556

The assets and liabilities of the Canadian subsidiary have been included herein on the basis of the official rate of exchange at June 30, 1950, except for equipment

which has been included at rates of exchange prevailing at dates of acquisition. On this basis the subsidiary's net current assets amounted to $291,601 and other assets, principally equipment, aggregated $52,277.

Consolidated profit and loss statement, year ended June 30, 1950

Net sales		$74, 913, 368
Other income:		
Interest earned	$82, 127	
Royalties received	108, 028	
Rental income	108, 010	
Miscellaneous	40, 335	
		338, 500
Total		75, 251, 868
Deductions from income:		
Cost of products sold	64, 313, 231	
Selling, administrative, and general expenses	4, 304, 984	
Expenses of rental property, and property not used in operations	91, 159	
Miscellaneous other deductions	34, 621	
Federal, State, and Canadian taxes on income—estimated	2, 775, 000	
		71, 518, 995
Net profit		3, 732, 873
Costs and expenses for the year reflect the following charges:		
Amortization of dies, jigs, fixtures, and patterns		934, 052
Depreciation of other plant and equipment		1, 296, 542
Amortization of good will, patents, and license agreements		69, 483

The operations of the Canadian subsidiary are included herein on the basis of the official rate of exchange, except as to provisions for depreciation and amortization, and resulted in a net profit of $166,866 for the year.

Consolidated statement of surplus, year ended June 30, 1950

Capital surplus: Balance at July 1, 1949, and June 30, 1950	$3, 249, 920
Earned surplus:	
Balance at July 1, 1949	25, 310, 422
Net profit for the year	3, 732, 873
	29, 043, 295
Deduct cash dividends paid—$1.25 a share	2, 715, 429
Balance at June 30, 1950	26, 327, 866

ACCOUNTANTS' REPORT

BOARD OF DIRECTORS,
The Timken-Detroit Axle Co., Detroit, Mich.:

We have examined the consolidated balance sheet of the Timken-Detroit Axle Co. and its subsidiaries as of June 30, 1950, and the related consolidated statements of profit and loss and surplus for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheet and statements of profit and loss and surplus present fairly the consolidated financial position of the Timken-Detroit Axle Co. and its subsidiaries at June 30, 1950, and the consolidated results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

ERNST & ERNST,
Certified Public Accountants.

DETROIT, MICH., *September 15, 1950.*

Comparative operating statistics, 1941–50

	Years ended June 30—									
	1950	1949	1948	1947	1946	1945	1944	1943	1942	1941
Net sales	$74,913,368	$89,628,142	$111,496,284	$99,466,972	$58,707,725	$189,382,292	$157,456,669	$139,790,887	$122,079,368	$68,886,171
Profit before taxes on income and provision for extraordinary reserves	$6,507,873	$6,121,105	$12,565,102	$10,459,774	$3,566,591	$17,910,294	$17,110,419	$16,734,023	$28,949,122	$17,134,127
Provision for taxes on income	$2,775,000	$3,053,156	$4,900,000	$4,175,000	$600,000	$12,545,866	$12,087,198	$12,256,910	$22,699,278	$11,428,247
Profit before provision for extraordinary reserves	$3,732,873	$5,057,949	$7,665,102	$6,284,774	$2,966,591	$5,364,428	$5,023,221	$4,477,113	$7,249,844	$5,705,880
Provision for extraordinary reserves	0	0	0	0	0	$250,012	$250,012	0	$765,037	0
Net profit:										
Amount	$3,732,873	$5,057,949	$7,665,102	$6,284,774	$2,966,591	$5,114,416	$4,773,209	$4,477,113	$6,484,807	$5,705,880
Amount per share (present shares)	$1.72	$2.33	$3.53	$2.89	$1.36	$2.35	$2.20	$2.06	$2.99	$2.63
Cash dividends paid:										
Amount	$2,715,429	$4,344,043	$3,798,538	[1] $1,574,276	$1,983,950	$1,983,950	$1,983,950	$2,479,937	$4,215,893	$3,964,000
Amount per share (present shares)	$1.25	$2.00	$1.75	[1] $0.72	$0.91	$0.91	$0.91	$1.14	$1.94	$1.82
Stockholders' equity (capital stock and surplus):										
Amount	$40,439,501	$39,422,057	$38,708,151	$34,562,949	$28,062,598	$25,951,667	$22,821,201	$20,031,942	$18,034,766	$15,765,852
Amount per share (present shares)	$18.62	$18.15	$17.82	$15.91	$12.92	$11.95	$10.51	$9.22	$8.30	$7.26
Average number of stockholders	12,540	13,175	12,549	11,800	10,769	11,065	11,200	11,030	10,570	9,634
Total taxes (including taxes on income)	$4,520,242	$4,727,222	$6,603,078	$5,688,959	$1,708,139	$14,065,775	$13,739,191	$13,801,477	$23,194,786	$12,728,077

[1] Not including 5 percent dividend in common stock, paid in December 1946.

TIMKEN-DETROIT AXLE PRODUCTS FOR TRANSPORTATION, FARM, AND INDUSTRY

Rear driving axles for trucks.—Everything travels all or part way to market by motortruck. America's economy is dependent on the trucks which carry approximately 60 percent of the total tonnage moved in the Nation's commerce.

Front driving axles for off-highway trucks.—Developed originally for military vehicles and later adapted for commercial trucks, front driving axles provide the additional tractive effort required for off-highway operation.

Transmissions and final drives for self-propelled combines.—Self-propelled harvesters and other types of self-powered farm equipment are coming into widespread use in agricultural areas since they can be operated by one man and release tractors for other farm duties.

Two-speed axles for trucks.—Trucks are a vital transportation service, but they are more than that. The trucking industry gives direct employment to more than 5,000,000 workers—more than all other forms of transportation combined.

Lift truck transmissions and final drives.—Work savers in every phase of manufacturing are the lift trucks and fork trucks which speed the handling of materials and assist in the flow of production throughout our modern factories.

"DP" series brakes for trucks.—Safe, efficient, profitable operation of motortrucks demands maximum braking effectiveness—smooth, safe stops under all conditions regardless of road, load, grade, or weather. Timken-Detroit brakes for motortrucks insure maximum safety on our highways.

Rear driving axles for busses and trolley coaches.—Bus and trolley coach routes are the arteries of urban transportation. Millions of riders in towns and cities depend on these vehicles for fast, safe, economical transportation to and from their jobs and their shopping centers. Intercity bus routes carry millions of riders annually too.

Forgings.—Greater density and higher tensile strength of forgings has created an increasing demand for steel forgings in all industries. By special processes, the grain structure in Timken-Detroit forgings is controlled to assure better quality in the finished product.

Tandem drive units for trucks.—Six-wheel trucks and truck-tractors with two rear driving axles in tandem are increasingly popular with motortruck operators. Greater load-carrying ability within legal limits and maximum pulling ability are big advantages of six-wheelers.

Front axles (nondriving) for trucks.—The trucking industry serves more than 25,000 American communities that have no other form of freight service. In one generation the trucking industry has grown from 250,000 trucks to more than 8,000,000 today.

Axles (tubular) for trailers.—Modern trailers are especially designed for the loads they are to haul. Special livestock trailers carry animals to market, tank trailers haul milk and petroleum products and refrigerator trailers carry perishables to distribution centers.

Clutch brakes for industrial applications.—Heavy-duty truck brakes have proved ideally suited for use as clutches in traveling cranes, hoists, and winches and other heavy-duty industrial applications because of their high braking capacity and rapid cooling ability.

Transmissions and differentials for earth-moving equipment.—Mammoth, heavy-duty vehicles and machines are at work on the Nation's big construction sites, moving tons of earth and rock at every bite. Specialized equipment handles filling, leveling, scraping, and compacting.

Front axles (nondriving) for busses and trolley coaches.—The easier steering, shorter turning radius and greater over-all ruggedness of Timken-Detroit front axles have played a major role in compiling the magnificent safety record established by transit systems and bus lines.

All-wheel-drive units for military trucks.—"They go where you point them." Rugged, brute strength, high speed and ability to go anywhere are features of modern military trucks.

Transmissions and final drives for tractors.—A team of horses is a rare sight on farms today. Powerful tractors pull the plows and do the innumerable chores that fell to horses not too many years ago. In industry, too, tractors have proved their worth in handling materials.

Duo-grip brakes for industry.—Specialized, automotive-type braking devices have replaced other control methods on many types of moving and stationary industrial machinery. Moderate original cost, positive operation, and economical maintenance are fundamental requirements of such brake designs.

Stampings.—Metal stampings are used in the manufacture of everything from automobiles to zithers. Stampings, large and small, are made from steel, copper, brass, aluminum, and other metals.

Transfer cases and torque dividers for trucks.—With the advent of 4 by 4, 6 by 4, and 6 by 6 trucks came the introduction of transfer cases and torque dividers to distribute power to the driving axles. Today they are made in several models in both single-speed and two-speed types.

"P" series brakes for trucks and busses.—Swift, efficient hauling of materials and commodities by motor truck and safe, rapid transport of passengers by motorbus is dependent, to a great degree, on the unfailing efficiency of vehicle brakes. Smooth positive stopping is all-important.

Senator MARTIN. You have competitors in your line of business?

Colonel ROCKWELL. To show you what competitors we have, every big automobile company is one of our competitors. The Ford Motor Co., for example, in 1929 let us make one of their axles. We made it for a certain length of time, and then they thought they could make it cheaper, and they made it themselves for awhile. Then they gave us another set, and we made that, and then they took that away from us. They are now asking us to make the axles again.

So when you are competing with Ford, you have real competition.

In addition to that, we have two very strong competitors in the axle business. It might interest you to know that we have offered them our patents, the same as we did in World War II.

You know there is a story around, Senator, that the Army officers like this renegotiation and that the War Department gets the money that is renegotiated. As a matter of fact, that money goes back to the Treasury Department and the Army does not get the benefit of it.

Under redetermination, the Army does get the benefit of the savings.

We have found Army officers very competent and very experienced. General Quinton, who is in charge in Detroit, was in charge then, and he will stand up with any purchasing agent of anybody up there.

Furthermore, Colonel Duffy, known around in the business as Judge Duffy, is now the chief purchasing agent of the Ford Motor Co. So when some people try to tell you that you have Army officers who are not competent to handle contracts, the evidence that you have some pretty good ones is right there.

The CHAIRMAN. Are there any questions by any member of the committee?

Senator CONNALLY. You represent the Timken Boller Rearing?

Colonel ROCKWELL. No; I do not represent Timken Roller Bearing. They frequently say I am connected with it, but I am not.

Senator CONNALLY. Who is your company?

Colonel ROCKWELL. The Timken-Detroit Axle Co.

Senator CONNALLY. It is not the same concern?

Colonel ROCKWELL. No, sir. Originally, the Timken Roller Bearing Co. made axles. In 1914 they put the axle business into Detroit, and since that time there has been no connection between the two companies, except that the Timken family ownership is in both of them. Two of the Timken brothers are directors in the Detroit company, the Timken-Detroit Axle Co., but there is no corporate connection between the two companies.

The CHAIRMAN. Are there any further questions? Thank you very much.

Colonel ROCKWELL. Thank you.

The CHAIRMAN. We will next hear from Mr. W. D. Lawson, vice president of the American Cotton Shippers Association.

Will you please step forward and be seated. Please identify yourself for the record.

STATEMENT OF W. D. LAWSON, VICE PRESIDENT, AMERICAN SHIPPERS ASSOCIATION, GASTONIA, N. C.

Mr. LAWSON. My name is W. D. Lawson. I am appearing in my capacity as vice president of the American Cotton Shippers Association, and as a representative of the National Cotton Council, to ask that the exemption for cotton be restored to the same form as in the previous Renegotiation Act.

That means elimination from section 106 (2), on page 24, lines 22 and 23, of the language:

, but only if such contract or subcontract is with the producer of such agricultural commodity.

The members of the American Cotton Shippers Association are cotton merchants handling raw cotton in bales. They have no direct governmental contracts but sell cotton to textile mills, which do.

Cotton a week ago was worth some $225 a bale.

Nobody now knows what it is worth.

The CHAIRMAN. The exchanges are closed?

Mr. LAWSON. Yes; and all of the cotton merchants are stymied. They cannot move.

Senator CONNALLY. Have they not put a governmental regulation on cotton?

Mr. LAWSON. You mean, a ceiling?

Senator CONNALLY. Yes; some sort of an order?

Mr. LAWSON. That is right. They have put an order out, but it is so confused, and from my understanding of it, there is a roll-back on cotton in price, and no one is able to operate under it. For instance, you are a cotton merchant, and I am one. If you sold cotton at 50 cents a pound, and I sold cotton at 45 cents a pound, why, I can never sell any cotton higher than 45 cents a pound, but you can sell cotton at 50 cents a pound. But if I am a cotton merchant, and you are a producer, and you want some cotton, you can ask me any price you want for it. There is no ceiling on what you can ask.

Senator CONNALLY. I agree that it is confused.

The CHAIRMAN. They have been making an effort for the last 2 or 3 days to straighten the matter out; have they?

Mr. LAWSON. Yes, sir; we have gotten nowhere.

The CHAIRMAN. And you have gotten nowhere on it?

Mr. LAWSON. Yes. We maintain that the export allocation, and with sufficient cotton in this country to run the mills, and with a ceiling on manufactured goods, that there is no reason for any ceiling on cotton that will automatically be taken care of, as I understand it. The reason for the order is to protect the public from high prices. Well, the public does not buy raw cotton. The public buys cotton in shorts or underwear, in articles after it has been processed. There is a ceiling on that. The public cannot be hurt.

The CHAIRMAN. There is a ceiling on the manufactured product?

Mr. LAWSON. Yes, sir.

The CHAIRMAN. But, under this House bill, the raw product is not exempted from the renegotiation until it leaves the hands of the producer?

Mr. LAWSON. Yes, sir; you mean, it is not under a price ceiling until it leaves the producer?

The CHAIRMAN. Yes; that is what I mean.

Mr. LAWSON. Yes, sir.

Senator BUTLER. What you have to say about raw cotton applies also to other raw agricultural products; does it not?

Mr. LAWSON. Well, being only a cotton man, I could not say, but I should think it would; yes, sir.

The CHAIRMAN. Certainly it does. What cotton months are involved in these orders, these exports, and these controls that have been put on, that are so confusing—are not about the only 2 months July and August? I mean, of this last cotton year?

Mr. LAWSON. It would be from now until the new crop begins to move.

The CHAIRMAN. That is exactly what I am talking about. They expect us to raise some 15,000,000 bales of cotton. There is nothing that has been done up to now that will more certainly interfere with the production of cotton than the present confused orders that are outstanding.

Mr. LAWSON. They have rolled back the price.

The CHAIRMAN. It is a roll-back proposition?

Mr. LAWSON. Yes. As I see it, Senator—excuse me for this, but I see no reason; if the shirts and socks and underwear, and everything that the public buys, already have a ceiling on it, if we could take cotton out from under a ceiling and let the farmer get all he can, the public will not have to pay the price. It is the mill that will have to pay the price to get the cotton. I do not think that will go too high, anyway.

The CHAIRMAN. I know it is in a very confused condition now.

Mr. LAWSON. It is very discouraging.

Senator BUTLER. It is not only confused, but it is very critical.

Mr. LAWSON. It is serious.

Senator BUTLER. And you being a cotton merchant understand the seriousness of it with respect to cotton, which ultimately becomes wearing apparel, but in a pinch we can patch our old clothes, we could get along in a pinch, but the same kind of a policy applied to food products—say, meat—is an entirely different thing and a lot more serious even than it is with reference to cotton.

Mr. LAWSON. Yes, sir. You do not have to wear clothes, but you have to eat.

The CHAIRMAN. You said that you have no direct contracts with the Government as a cotton man?

Mr. LAWSON. No.

The CHAIRMAN. You merely sell to the mills, and the mill products are all, of course, regulated, and their cotton contracts are negotiated?

Mr. LAWSON. That is right.

The CHAIRMAN. But, as a subcontractor, that is, as a supplier of the mills, you are renegotiated?

Mr. LAWSON. That is right.

The CHAIRMAN. Under the bill as it comes from the House?

Mr. LAWSON. That is true.

The CHAIRMAN. What you are asking is that we go back to the original bill's provisions?

Mr. LAWSON. That is right.

The CHAIRMAN. How do you buy your cotton—how would you be able to know?

Mr. LAWSON. It would take an army of auditors to go back. Suppose we handle 50,000 or 100,000 bales of cotton a year; you would have to go back to each individual bale, find the price and the weight. That would have to be converted into the future that you sold against at the time, and the loss you might have in them. I do not believe it would ever be operative. I think it would be a waste of time and money for the Government and for the shippers.

Senator CONNALLY. The consumer is the one they are trying to protect, and he is already protected in the finished goods, is he not?

Mr. LAWSON. That is right.

Senator CONNALLY. It would not matter to him, if he buys a shirt, and it has been regulated, what the cotton cost that went into it; is that right?

Mr. LAWSON. That is correct, sir.

Senator CONNALLY. Thank you.

Senator MARTIN. Mr. Chairman, not being in the cotton-raising section of the United States, what percentage of the cost of the shirt is the cotton in it?

Mr. LAWSON. Well, now, I am not a manufacturer.

Senator MARTIN. I thought maybe you could give us that information.

Mr. LAWSON. It is very little.

Senator MARTIN. It must be very small.

Mr. LAWSON. It is very small.

Senator MARTIN. Mr. Chairman, you know the same principle that the witness is talking about applies to many things. It applies to pig iron, and certain things in the lumber industry, and demonstrates the difficulty of carrying the law into effect.

Mr. LAWSON. Another trouble we would have would be this, that if a mill was on a 50 percent Government contract and 50 percent civilian goods, they would buy their cotton to go into that, and it is all mixed in the mill, and we would have no way of telling our cotton that went into civilian goods, or that which went into the Army goods. It would be almost impossible to work the thing out.

Senator HOEY. In the purchase of cotton, you buy from the farmers?

Mr. LAWSON. Yes.

Senator HOEY. Then you sell to the mills?

Mr. LAWSON. That is right.

Senator HOEY. Of course, I imagine you protect yourself by buying futures against it until you make sales?

Mr. LAWSON. Sometimes you have to sell them, too.

Senator HOEY. That is right; you have to sell the same way. And you run along regularly, not only during the cotton season, but all around the year, buying and selling?

Mr. LAWSON. That is right.

Senator HOEY. And as you suggest, the idea of undertaking to be renegotiated, there would be no basis upon which you could tell how much of your cotton went into Government contracts in the mills and how much was used for private orders?

Mr. LAWSON. That is right.

Senator HOEY. Yet you would undertake to renegotiate it over the whole time, all of the cotton you sold?

Mr. LAWSON. Yes; that is right.

Senator BUTLER. Everything that you say with reference to merchandising cotton would apply to the merchandising of other raw products, like wheat and corn?

Mr. LAWSON. Yes; it would.

Senator BUTLER. They are also handled through future markets?

Mr. LAWSON. It is exactly the same thing, except we have a great many more classes of cotton grade and staple than they have classes of wheat and corn.

Senator BUTLER. There is more confusion with reference to the various grades?

Mr. LAWSON. That is right.

Senator BUTLER. There are still many grades of grain, too?

Mr. LAWSON. That is true. Of course, the classing of cotton is not an exact science. It is an art, and some of the artists make mistakes sometimes.

The CHAIRMAN. All right, Mr. Lawson, you may proceed.

Mr. LAWSON. This means that a small merchant selling 500 bales of cotton to textile mills having defense contracts may be subject to renegotiation. Cotton merchants are not concerned that they will earn any excess profits which will be recovered in the renegotiation process. They are concerned with the expense and bother of having to file additional reports, keep records, and have conferences with another governmental agency going over the records of all their business, in order to obtain clearance from an indeterminate liability. In the merchandizing of cotton every cost is significant, and must ordinarily be passed back to the farmer or on to the mill.

With cotton markets closed and merchants incurring heavy losses daily as a result of the price freeze, it seems a little peculiar to be worried about this subject. If it is permitted to operate the cotton merchant business is so highly competitive and market prices in ordinary times are so well-known, that no mill will pay any price above the market for cotton. Mill buyers are experts in cotton and in negotiating for it. While we believe any board would finally reach the conclusion that it should exempt raw cotton subcontracts, yet we saw them hesitate to take that responsibility previously. To save the expense and bother of a meaningless procedure for both the shippers and the Government, we ask that this amendment be adopted.

The CHAIRMAN. Are there any questions?

Senator BUTLER. The amendment that you suggest is an adaptation of what was in the old bill?

Mr. LAWSON. Yes, sir; or the new bill with the exception or elimination of the clause, "but only if such contract or subcontract is with the producer of such agricultural commodity."

The CHAIRMAN. That would accomplish the same thing?

Mr. LAWSON. Yes, sir.

The CHAIRMAN. In other words, you do not begin renegotiation until the raw product is ready for an industrial use; that is, it is gotten ready to be processed into an industrial commodity or use?

Mr. LAWSON. Yes, sir. Under this bill, a gin company could be renegotiated.

The CHAIRMAN. You would not have to gin but 500 bales a year before you would be renegotiated. About 400 bales would be sufficient to be renegotiated, counting the seeds and all?

Mr. LAWSON. Yes, sir.

The CHAIRMAN. You would be subject to all sorts of trouble. I apprehend that the board would probably say that, "We will renegotiate the subcontractors, because they are only technically subcontractors. They simply are the suppliers from which the cotton mill, the spinner, gets its raw material," just as in the case of pig iron and as in the case of meats and in the case of various other farm products, peanuts, and any other shortening, soybeans, all of it—they are faced here with this same situation. We tried to correct that in the law as we finally wrote it. It looked like it worked very well. I never heard of any great excess profits being made by any of you cotton merchants and shippers.

Mr. LAWSON. No, sir.

Senator BUTLER. I think it is very well known that the people in the cotton business are not going to be fooled very much by price. The same is true in the price of grain or any other farm commodity.

Mr. LAWSON. That is true.

The CHAIRMAN. The price is absolutely fixed. They are quoted hourly into all of the markets, or on the quarter-hour, are they not?

Mr. LAWSON. Yes.

Senator BUTLER. Anybody buying for the Government paying too much, why, I think the fault lies there. We had better get some new procurement officers, ratner than renegotiating all of the contracts already made.

Mr. LAWSON. The Government has nothing to do with the cotton. The mills buy the cotton, themselves.

The CHAIRMAN. All right, Mr. Lawson. We thank you very much for your appearance.

Mr. LAWSON. Thank you, sir.

The CHAIRMAN. We will next hear from Mr. Charles G. Caffrey, representing the American Cotton Manufacturers Institute, Inc., Charlotte, N. C. Will you please identify yourself for the record?

STATEMENT OF CHARLES G. CAFFREY, AMERICAN COTTON MANUFACTURERS INSTITUTE, INC., WASHINGTON, D. C.

Mr. CAFFREY. My name is Charles G. Caffrey. I am appearing today as the Washington representative of the American Cotton Manufacturers Institute, Inc., Charlotte, N. C., which is the central trade association for the entire cotton manufacturing industry and serves as its spokesman in matters of general and national interest. The industry is one of the country's largest, providing direct employment to more than 500,000 people and having a production output now valued in the primary market at more than $7,000,000,000 per year. Its scope of operations extends over many States in all sections of the Union, and it is especially important throughout the area extending from Maine to Texas.

The industry units are numerous, being about 1,000 in number. The size of each unit is small, the largest owning less than 4 percent of the industry's spindleage. It is, and for a long time has been,

distinctive as the most competitive and individualistic of the country's major manufacturing industries, and for that reason represents to the maximum degree the spirit of free business enterprise. The member mills of the American Cotton Manufacturers Institute, Inc., are distributed throughout the industry's entire area and operate approximately 85 percent of the industry's total spindles.

There are three problems in reference to the Renegotiation Act of 1951 that we want to particularly point your attention to:

It would appear that there are three problems as to which definite consideration should be given before final action is taken by the Senate in passing on the new renegotiation law H. R. 1724.

These deal with the (*a*) effective date of the law, (*b*) profits from a long inventory position in agricultural commodities, and (*c*) treatment of standard commercial articles as to which ceiling prices have been fixed.

Effective date: Section 102 (a) of the act as passed by the House requires renegotiation as to all amounts received or accrued by a contractor or subcontractor on or after the first day of January 1951. Thus, if a man took a contract in 1950, or even in 1949, and for reasons entirely beyond his control payment was not received until after January 1, 1951, he would be subjected to renegotiation procedures even though that was not in contemplation when the sale was made. Retroactive legislation usually is unfair and is particularly so in the present instance. It is urged that the fair approach is to limit the application to earnings which have resulted from performance of a contract beginning immediately after the effective date of the act and ending on the day the act is terminated. The first Renegotiation Act of 1942 was applied only to results from performance after April 28, 1942, the date the law was approved. In the present House bill there is a provision which recognizes this principle, namely, section 2 (a), which states that the act should not be applicable "to receipts or accruals atrributable to performance under contracts or subcontracts after termination date."

We, therefore, suggest that section 2 (a) shall be redrafted striking out in two places the word "received" and in line 10 change the phrase "on or after the 1st day of January 1951" to "on or after the date of final approval of this act."

The next problem that we ask you to give consideration to is the treatment of profits from a long inventory position in agricultural commodities which more or less coincides with the testimony given by the gentleman that testified before me.

A processor could sell an agricultural commodity owned by him (cotton, corn, wheat, etc.) for civilian uses at current market prices and buy back that commodity and treat the cost for renegotiation purposes as the repurchase price.

The Renegotiation Act of 1943 recognized the equity of permitting the producer who had a long position in an agricultural product to be in the same position as to costing the product as if he had sold his long position and repurchased. A copy of section 403 (i) (3) of the Renegotiation Act of 1943 is attached to this memorandum.

We urge that a provision similar to that should be inserted in the current renegotiation law.

The CHAIRMAN. That simply means that the fair market price of the raw material, as of the date the contract is entered into, should be used; that is all there is to it?

Mr. CAFFREY. That is right.

The CHAIRMAN. And you are using cotton and wheat and other things, and you might very well include tobacco, because frequently tobacco is carried, generally, for 3 years?

Mr. CAFFREY. Yes, sir.

The CHAIRMAN. And sometimes for a longer period of time, sometimes for several years?

Mr. CAFFREY. Yes. We are merely asking that the costing of a Government contract be on the current-price basis.

The CHAIRMAN. We struggled with that principle in conference, and this bill was finally put in shape; that did seem just and fair, that seemed to be equitable and just and fair, and terminated sometime within the foreseeable future the vast and complicated renegotiations that could be carried on in this country.

All right, you may proceed.

Mr. CAFFREY. Treatment of standard commercial articles: The act of 1951 makes no reference to standard commercial articles which in the Renegotiation Act of 1943 were defined to be those which were identical with an article manufactured and sold and in general civilian, industrial, or commercial use prior to January 1, 1940, identical with articles sold as a competitive product by more than one manufacturer as to which a maximum price had been established by the Price Control Act of 1942 or which was sold at a price not in excess of the January 1, 1941, selling price.

It seems reasonable to exclude from renegotiation an article which meets the above definition, particularly if it is sold to the governmental agency under competitive bidding.

H. R. 1724 in section 106 (c) authorizes the Renegotiation Board in its discretion to exempt certain types of contracts including those under which the profits can be determined with reasonable certainty when the contract price is established, such as certain classes of agreements for personal services or for the purchase of real property, perishable goods, or commodities the minimum price for the sale of which has been fixed by a public regulatory body. We believe that the act should provide for mandatory exemptions with respect to standard commercial articles sold as a result of competitive bids as to which ceiling prices have been established by the Economic Stabilization Agency.

It is, therefore, suggested that section 106 (a) shall be so amended that the act will not apply to—

any contract for a standard commercial article as defined in the Renegotiation Act of 1943 sold as a result of competitive bids or sold under negotiated contracts whose prices are based upon recently submitted competitive bids and subcontracts related to such contracts, provided the contract price or prices is in conformity with a price regulation or order of the Economic Stabilization Agency fixing ceiling prices.

Senator BYRD. What you want to do is to go back to the last act?

Mr. CAFFREY. Yes, sir. That is what we have in mind, Senator Byrd. In other words, if there is a fixed price by the Government, why renegotiate that price?

Mr. BYRD. Put it on a competitive-bid basis?

Mr. CAFFREY. On a competitive-bid basis.

The CHAIRMAN. If the article is a standard one.

Mr. CAFFREY. Like sheets, pillowslips, clothing of all types, would come within that category.

We believe there is more justification for the suggested amendment than there is for including in the bill the provisions authorizing exemption of contracts for the purchase of commodities, the minimum price of which has been fixed by a public body. If the price charged to the Government for an article is at or below the legally fixed ceiling price and the contract has been let after competitive bidding, it would appear that all interests of the public have been adequately protected and that there is no need to subject the successful bidders to all of the expense, trouble and uncertainty of renegotiation procedures.

I have here an amendment which we suggest, which is section 403 (i) (3) in the Renegotiation Act of 1943, and which we hope will be given consideration and made a part of the present bill, which will exempt the raw commodities.

(The amendment referred to follows:)

SECTION 403 (i) (3) IN THE RENEGOTIATION ACT OF 1943 DEALING WITH TREATMENT OF A PROCESSORS LONG POSITION IN AN AGRICULTURAL PRODUCT

(3) In the case of a contractor or subcontractor who produces or acquires the product of a mine, oil or gas well, or other mineral or natural deposit, or timber, and processes, refines, or treats such a product to and beyond the first form or state suitable for industrial use, *or who produces or acquires an agricultural product and processes, refines, or treats such a product to and beyond the first form or state in which it is customarily sold or in which it has an established market*, the Board shall prescribe such regulations as may be necessary to give such contractor or subcontractor a cost allowance substantially equivalent to the amount which would have been realized by such contractor or subcontractor if he had sold such product at such first form or state. Notwithstanding any other provisions of this section there shall be excluded from consideration in determining whether or not a contractor or subcontractor has received or accrued excessive profits that portion of the profits, derived from contracts with the Departments and subcontracts, attributable to the increment in value of the excess inventory. For the purposes of this paragraph the term "excess inventory" means inventory of products, hereinbefore described in this paragraph, acquired by the contractor or subcontractor in the form or at the state in which contracts for such products on hand or on contract would be exempted from this section by subsection (i) (1) (B) or (C), which is in excess of the inventory reasonably necessary to fulfill existing contracts or orders. That portion of the profits, derived from contracts with the Departments and subcontracts, attributable to the increment in value of the excess inventory, and the method of excluding such portion of profits from consideration in determining whether or not the contractor or subcontractor has received or accrued excessive profits, shall be determined in accordance with regulations prescribed by the Board. In the case of a renegotiation with respect to a fiscal year ending prior to July 1, 1943, the portion of the profits, derived from contracts with the Departments and subcontracts, attributable to the increment in value of the excess inventory shall (to the extent such portion does not exceed the excessive profits determined) be credited or refunded to the contractor or subcontractor, and in case the determination of excessive profits was made prior to the date of the enactment of the Revenue Act of 1943, such credit or refund shall be made notwithstanding such determination is embodied in an agreement with the contractor or subcontractor, but in either case such credit or refund shall be made only if the contractor or subcontractor, within ninety days after the date of the enactment of the Revenue Act of 1943, files a claim therefor with the Secretary concerned.

The CHAIRMAN. Are there any questions?

Senator BUTLER. I notice that you are the second man who has appeared on the subject of cotton. I do not see anyone appearing for corn or wheat, but I presume that the same arguments that you advance for commodities made from cotton would apply to articles made from other raw crops?

Mr. CAFFREY. That is right. I think you are absolutely correct in that interpretation of it.

The CHAIRMAN. And your suggested amendment here, of course, would cover all?

Mr. CAFFREY. That is right.

The CHAIRMAN. That is, all raw products?

Mr. CAFFREY. They would.

The CHAIRMAN. Are there any further questions?

Senator CONNALLY. Are you a practical man or a lawyer?

Mr. CAFFREY. I am a lawyer.

Senator BUTLER. Are they not practical?

Senator CONNALLY. Practical enough to get employment out of those in the business.

Mr. CAFFREY. Thank you very much.

The CHAIRMAN. Thank you for your appearance.

We will next hear from Mr. Richard B. Barker, Southern Building, Washington, D. C.

STATEMENT OF RICHARD B. BARKER, SOUTHERN BUILDING, WASHINGTON, D. C.

Mr. BARKER. My name is Richard B. Barker. I am a Washington lawyer, in the Southern Building, Washington, D. C. I represent some 12 or 15 cotton textile manufacturers in the States of North Carolina, South Carolina, Georgia, and Alabama.

I want to endorse the statement just given by Mr. Caffrey very thoroughly on behalf of my clients. However, I want to speak more particularly to the second point made by him, namely, the treatment of profits from a long inventory position in agricultural commodities.

I had the pleasure, Senator, of working with you when the 1943 act was up, working on the inventory profit position that took place in that act, and thereafter I had occasion to work on some 15 or 20 cases involving the use in renegotiation proceedings of the formula.

I must say that it was the only way in which justice and equity could have been done in renegotiation proceedings.

When I used cotton, I applied it equally to corn, wheat, and I know it applies to my specialty, to tobacco.

Some cotton textile manufacturers buy their entire crop, their entire year's needs of cotton, in the fall. I have one client who has borrowed as high as $5,000,000 to buy up the entire year's supply needed for manufacturing purposes.

The CHAIRMAN. The smaller mills, particularly, do that?

Mr. BARKER. That is right, because they are afraid they cannot get the grade and staple.

The CHAIRMAN. Later on in the season—they buy as soon as the cotton gets to the market?

Mr. BARKER. Yes.

Cotton, as we know, because of the short crop year this year, has gone from 30 cents to 45 cents a pound. A Government contract comes along. The price is based upon 45-cent cotton. And this manufacturer who bought his cotton at 30 cents, when it comes to renegotiation proceedings, and until the 1943 act was passed, this is exactly what happened; I was in on the proceedings.

He was immediately renegotiated out of his 15-cent profit, whereas, if you had turned around on the day he took the Government contract, and sold that cotton to an outsider and bought new cotton to fulfill

the Government contract at 45 cents, then his cost, in determining his profits subject to renegotiation, was based upon 45-cent cotton.

That just seems an inhuman penalty, because, if he had sold it at a profit, that would not have been subject to renegotiation. If he wanted to be patriotic and use that good grade and staple of cotton, which he bought, the entire 15 cents was taken away from him.

I can see no justification whatsoever for this present act not including a provision similar to the one that Senator George put into the 1943 act relating to the inventory profits on all these agricultural commodities.

Furthermore, you will work discrimination in this situation as between a contractor who is on a last-in and first-out basis, of valuing his inventories on a contractor who is on a first-in and first-out basis. The contractor who is on the last-in and first-out basis will secure preferential treatment in renegotiation over a first-in and first-out contractor.

It is highly important, if you are going to renegotiate these standard commercial articles which are highly competitive—I hope you do not, but if you are, you put these contractors on an equality-of-treatment basis in determining costs.

I do want to make one suggestion to you as to the form of the legislation. The legislation in the 1943 act was rather complicated in its administration. It need not have been, but as the Price Adjustment Board worked it out, they made it exceedingly complicated. I know what you had in mind, Senator George, I know what Mr. Stam had in mind in drafting the committee report, but they perverted it considerably when it came to the administration of it.

And so, in addition to considering that actual legislation which was put in the 1943 act, I make this suggestion to you, as possibly simpler legislation to accomplish the same purpose.

After the first sentence in section 103 (f) of the bill, the following language could well be inserted:

> In determining costs allocable to such contracts in connection with raw materials of the type described in section 106 (a) (2) of the act, used in making goods for such contracts, the fair market price for such raw materials as of the date the contract is entered into shall be used.

You see, 106 (a) (2) deals with agricultural commodities, wheat, corn, tobacco, and this would implement that section in making the cost current, at the time the contract is taken, be the cost factor in determining the profits from that contract subject to renegotiation.

I thank you, gentlemen.

Senator BUTLER. If an individual who had a Government contract and made a long profit because of an inventory, a cheap inventory that he had on hand, if he was not renegotiated, even he would yield up most of that profit in his excess profits tax, would he not?

Mr. BARKER. That is right, sir; that is the type of normal excess profits which should be subject to an excess profits tax. We are not trying to deny that fact; but the minute you have one cent of excess profits, the Government takes 100 percent of it. By the little, simple expedient of selling that to an outsider, rather than using it in Government goods, he could have his profit, subject to excess profits tax, and buy new cotton or new grain and use the cost current at the time he takes the contract. It is simple equity, so far as I can see, and I do not see that there is any justification for not following the principles

that we used in the 1943 act, and which I know from experience in handling renegotiation proceedings was the only way to establish equality of treatment between various contractors.

The CHAIRMAN. Thank you.

Mr. BARKER. Thank you.

The CHAIRMAN. We will now hear from Mr. Wesley E. Disney, representing the Western Oil and Gas Association.

Will you please come forward and identify yourself for the record?

STATEMENT OF WESLEY E. DISNEY, INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA, WASHINGTON, D. C.

Mr. DISNEY. I am Wesley E. Disney, 501 World Center Building, Washington, D. C. I appear on behalf of the Indpependent Natural Gas Association of America, a trade association composed of producers of natural gas, royalty owners of natural gas interests, distributors of natural gas, and interstate and intrastate natural gas pipeline companies, as well as the Western Oil and Gas Association, chiefly composed of producers in the Western States.

We believe that the World War II law is equitable and workable, so far as the points I am about to make here.

Senator CONNALLY. You mean, the law in 1943?

Mr. DISNEY. Yes. I refer specifically to section 403 (i) (1) (B), which provides for the exemption of —

> any contract or subcontract for the production of a mine, oil or gas well, or other mineral or natural deposit, or timber, which has not been processed, refined or treated beyond the first form or state suitable for industrial use.

As you are aware, the section also exempts other raw materials such as agricultural commodities and domestic animals.

Acting under the subsection of the present law which I have quoted, the Renegotiation Board during the last war exempted some 70 or 80 mineral products, including natural gas, as well as such materials as asphalt, feldspar, manganese, oil, talc, and others. The expansion of this list of mining products indicates that it was done in keeping with the spirit of the statute, as well as on account of the administrative difficulties because, obviously, the determination of cost in this large list of raw materials would appear to have been an almost insuperable administrative job.

We believe that the Government, as well as the contracting parties, would be well served by retaining this raw material exemption unchanged as in the proposed law. We have heard of no claim of excessive profits on natural gas or other mineral products in World War II. There is no sound reason for the elimination of the exemption or for the restriction of the exemption, but there are sound, practical reasons for its retention.

The possible instances where renegotiation could be applied to natural gas are relatively few and unimportant. Some of these could be the so-called direct sales, that are not under the jurisdiction of the Federal Power Commission. To illustrate it graphically, a pipeline from Texas to Detroit that serves a factory, say, in Missouri, their service of that factory is not under the jurisdiction of the Federal Power Commission, but the gate rate of Detroit is under their jurisdiction.

Another instance could arise where fractions, such as butane, and so forth, are extracted from the natural gas for the manufacture of gasoline which, having passed the first stage of processing, would naturally be the subject of renegotiation.

Another instance might possibly arise where oil is produced with the gas and similarly refined for use in the war effort.

Nearly every foot of natural gas sold in the trade is now under regulation by State and Federal authorities. The Federal Power Commission is now claiming the right to regulate the price for which pipeline companies may purchase gas in the field—although this is currently disputed—and has since the passage of the Natural Gas Act, had the power to regulate and has regulated the city gas rate of the interstate pipeline. It restricts these earnings to 6 percent, so we already have price control of interstate natural gas. The distributors of natural gas in the cities are regulated by the State regulatory commissions and their rates fixed by that authority, so it is seen that for all practical purposes the price of gas is determined by regulatory authorities.

We understand the goal of any renegotiation law is to prevent excess profits accruing from the manufacture of essential war materials. As I have stated, natural gas is primarily a household commodity, although large quantities have been and can be used to supply war material manufacturing plants. Direct sales of gas of this character are generally uniformly lower than the gate rates fixed by regulatory authorities, for the reason that these sales enable the pipeline companies to maintain their load factor in the months when household demands are not so great. So, taking into consideration the practical realities, we fail to see any good purpose to be served in refusing the exemption of natural gas, regulated as it is by State and Federal authorities.

In view of the complexity of the natural gas business with its leaseholds, pipelines, and other cost facilities, the determination of cost by the Renegotiation Board would indeed be a staggering administrative task, amounting in practical effect to at least some deterrent to production. A conclusion of the then Under Secretary of War, Robert C. Patterson, before the subcommittee of the Committee on Finance, made on September 29-30, 1942, seems to be important here. He gave this subject such close attention that we know of no better authority to quote on the practical operation of the renegotiation law. He said:

> Moreover with the field thus limited, a more effective job can be done with respect to the contracts and subcontracts covered.
>
> On the other hand, if purchases of standard products and raw materials are included as subcontracts, the problem of administering the statute becomes much more difficult. The number of contracts and contractors might be so large as to make it impossible to renegotiate with all of them. For these reasons the War Department feels that it is probably wiser to define the term "subcontracts" to exclude purchases of raw materials and standard commercial products.

We do not find anything in the history of the Renegotiation Act indicating that the Secretary of War changed his opinion with reference to the exemption of raw materials, but we do find that a year later he spoke with approval of this exemption. In his testimony before this committee on September 20, 1943, he said:

> With respect to the restriction of its field of operation in the meanwhile, much has already been done, and from time to time certain additional measures may be appropriate. To summarize the present situation, there have been exempted

from renegotiation under the express terms of the statute, (1) contractors having renegotiable sales aggregating less than $100,000 within a fiscal year; (2) contracts with other departments, with the States, and with foreign governments or agencies thereof; and (3) contracts for products of mines, oil and gas wells, and other natural deposits, and timber, not processed, refined or treated beyond the first form or state suitable for industrial use.

In other words, we have exercised our discretion in a large number of cases. We are not anxious for work. We have plenty of work to do right within the main scope of the renegotiation law and we do not relish expanding the field. Wherever there are other guides, prices are taken care of, say, by public regulatory bodies like public-utility commissions and we are quite content to leave that field to them.

It is believed that these interpretations and policies coincide with the intent of Congress, but it should be noted that they operate to reduce and limit rather than to expand the limits within which renegotiation is presently operating.

And, parenthetically, it appeared to me from the testimony of Mr. Roberts the other day, that it is the express purpose to expand the scope of the Renegotiation Act rather than to leave as it is under the present law.

Continuing Mr. Patterson's discussion:

The most cursory review of the foregoing statutory and administrative exemptions clearly a basic and continuing purpose to apply the renegotiation statute only to those activities directly connected with the war effort and the elimination of excessive profits and excessive prices therefrom.

There is no practical way to segregate crude oil in a refinery so that it can be said that the product shipped under Government contract came from a particular ownership of crude oil because the purchases of crude for refinery uses usually come from a great number of sellers. How would you distinguish between integrated refineries (who produce all or a part of the crude they require) and those nonintegrated refineries who purchase all their crude-oil requirements? What provision would be made for the interests of the royalty owner? These and a myriad of other questions that could be propounded indicate that the proponents of the additional language contained in the House bill, namely, the renegotiation authorities, seem to seek to move into that phase of the oil and gas business which has puzzled that business itself for many years and take on a cost-accounting problem that would harass them for a long period of time, to say nothing of the effect produced upon these businesses themselves.

We believe that the exclusion of the language we object to would not expedite any war or defense effort, but would present such complicated administrative tasks that the end would not justify the means; that the war and defense effort would not be aided but impeded to some extent at least by adopting this new and untried language in the Renegotiation Act. We believe that since the Renegotiation Act as it now stands, so far as these exempted raw materials are concerned, operating as it did in World War II, could well be retained in the present law. We know of no inordinate profits being made by the oil and gas business in the last World War by reason of the fact that the present law does not contain any of the new suggestions made in the House bill.

We are very earnest about this, and it seems to me that a vast horde of new employees would have to be engaged in the renegotiation work unless the exemption be left about as it was in the last act.

The CHAIRMAN. Were you in the conference, Mr. Disney?

Mr. DISNEY. Yes, sir; I was.

The CHAIRMAN. My recollection is that you were.
Mr. DISNEY. Yes, sir.
The CHAIRMAN. Thank you very much.
Are there any questions of Mr. Disney?
Mr. DISNEY. Thank you.
The CHAIRMAN. We will next hear from Mr. Ellsworth C. Alvord, of the United States Chamber of Commerce. Will you please come forward and identify yourself for the record?

STATEMENT OF ELLSWORTH C. ALVORD, CHAIRMAN, COMMITTEE ON FEDERAL FINANCE, CHAMBER OF COMMERCE OF THE UNITED STATES, WASHINGTON, D. C.

Mr. ALVORD. My name is Ellsworth C. Alvord. I appear as chairman of the committee on Federal finance of the United States Chamber of Commerce.

Although I have an outline of my statement, I have not been able to prepare a written statement. I trust the outline will help you somewhat in following my oral remarks. I ask that the outline be included in the record.

The CHAIRMAN. It will be inserted in the record.

(The outline referred to follows:)

OUTLINE OF RECOMMENDATIONS

GENERAL

(1) Mr. Maurice Karker, then Chairman of the War Department Price Adjustment Board, in the hearings in 1943 before the Committee on Ways and Means, stated:

"In my judgment * * * it [the renegotiation law] is a dangerous and un-American statute * * *."

It was then and is now.

(2) The grant of power to renegotiate realized profits is the delegation of the power to tax. That power should be delegated sparingly and cautiously and surrounded with safeguards.

(3) Price controls, priorities, allocations, and existing and probable tax burdens should be considered in determining the necessity for renegotiation and defining the extent of its application.

(4) Nondefense contracts with the Government are as sacred as private contracts and should be so considered.

SPECIFIC RECOMMENDATIONS

(1) The Renegotiation Act of 1948 should be the starting point of the new legislation.

(2) Renegotiation should be restricted to defense contracts and subcontracts.

(3) Renegotiation should be after taxes.

(4) The mandatory exemptions of the 1948 act (and of the prior acts) should be reenacted.

(5) The discretionary exemptions of the 1948 act (and of the prior acts) should be reenacted.

(6) Averaging devices should be adopted, such as the carry-forward and carry-back of losses.

(7) Renegotiation on a consolidated basis should be compulsory if requested by the contractor.

(8) The efficient and low-cost producer should receive higher awards.

(9) All costs normal to usual business operations, such as advertising and selling expense, should be allocable to renegotiable sales.

(10) As in the case of asserted deficiencies in tax, the contractor should be permitted a review by the Tax Court, before payment, or to bring suit for refund after payment.

(11) Decisions of the Tax Court should be subject to review, in the same manner as its decisions in tax cases.
(12) Renegotiation should be administered by service boards.
(13) The board should be required to make specific detailed findings of fact.
(14) The Administrative Procedure Act should be applicable.
(15) Reconversion costs should be allocated to renegotiable sales.
(16) The costs to the country in manpower and money should be contrasted with the consequences of renegotiation.
(17) A procedure should be established for the settlement of existing cases now pending before the Tax Court.

Mr. ALVORD. Our views are based upon the assumption, gentlemen, that renegotiation will be continued in force, accordingly it is not necessary for me to express my views or the views of our committee as they were back in 1942 and 1943, and continued on through, with respect to the principles of renegotiation.

I point out to you that renegotiation is a very dangerous, undemocratic, and un-American procedure. In my outline I quote from Mr. Karker, who was the first chairman of the War Contract Price Adjustment Board, in his testimony before the House Committee on Ways and Means. They coincided with my views at that time and they coincide with my views at the present time.

I point this out principally so that you can take that very important factor into consideration in determining the extent of the application of renegotiation at this time. Renegotiation, as it was administered during World War II, and as it presently is administered, is nothing but the exercise of the power to tax. It is not the renegotiation of prices, of contract prices, we frequently hear about. As a matter of fact, you will find that there is dropped from this proposed bill the provisions of the World War II Act relating to the redetermination of prices. However, a price redetermination provision is inserted, I think, in most contracts and probably will be effective even though it is not repeated in the statute.

Senator BUTLER. You speak of it as the power to tax. Would it not be more exact to say that it is the power to limit profits?

Mr. ALVORD. I suppose that either statement could be made. It depends on how the act is administered. It is a power to tax; whether or not it limits profits depends upon its administration. The act is capable of highly discriminatory administration. It is capable of highly improper administration. Those of the wrong race or creed or political faith can be ruined. Those of the appropriate social strata can be favored.

The effect of the act will depend upon the personnel administering it. If personnel similar to the personnel early in World War II are assembled, I would have no fear of improper profit limitations or of improper taxation. Nevertheless it is a tremendous power to give any man or group of men, and that power should be surrounded with all possible safeguards, and should not be delegated beyond the field that must be covered to obtain the objectives which the Congress and all of us seek to attain.

We have, as you gentlemen know, now in force price controls, priorities, allocations.

We have a tax system which is unprecedented in the history of the United States. And I understand that there are to be unprecedented increases in the existing unprecedented tax system.

That brings me to one of my first recommendations. Over-all renegotiation of profits should be directed toward and limited to profits after taxes. For example, I presume that we all are perfectly willing to admit that at least 50 percent of the profits of every industrial enterprise in the country will be taken through our present tax system.

If we take 50 percent of the profits, the job of determining the excessiveness of the balance is a comparatively simple job, in my opinion.

If we renegotiate before taxes, as was done in World War II, in my opinion, I would say that the personnel involved, the personnel on the part of the Government and the personnel on the part of the contractor, would be increased 10, 15, 20, to 25 times.

If renegotiation is limited to profits after taxes—and it does not have to be any more than estimated profits after estimated taxes—most of the task of renegotiation will have been performed before the renegotiators begin their work.

In line with Senator Martin's comment the day before yesterday, when Chairman Roberts was testifying, the manpower requirements of the country, quite apart from the money costs, should be a very important consideration in determining renegotiation policies—manpower on the part of the Government and manpower on the part of industry.

Bear in mind that the renegotiation job is not a job for clerks; either clerks in Government, or clerks in industry. It is a job which requires the capabilities involved in finance, costs, and pricing. It is a job which requires engineers skilled in production. It is a tremendous job.

The result is that almost every concern, in its renegotiation proceedings, requires top executives, either to conduct or to closely supervise those proceedings.

The same type man is required in the Government.

The capabilities and the abilities of these men can be used much more advantageously in the work to which they are accustomed than in renegotiation. If you will renegotiate after the taxes, you will find that you will free, I would suppose, 75 to 80 percent of these men in industry and in Government. Their abilities can then be devoted to that to which they should be devoted.

Chairman Roberts was going to explain, the day before yesterday in his testimony, why he was opposed to renegotiation after taxes. Unfortunately, he did not have an opportunity to give that explanation. I have studied his testimony as carefully as I could. In my opinion, his testimony merely reinforces the policy which I am now suggesting to you. Renegotiation should be directed to profits after taxes.

I was a little suspicious, when I saw a copy of the House bill. It makes virtually no mention of the Renegotiation Act of 1948. It is based primarily, with some very unfortunate omissions which I will discuss later, upon the Renegotiation Act of 1943.

Most of you gentlemen were here in 1942 and 1943 and 1944 and 1945. You will remember the difficulties with which you were confronted in the enactment, I should say, perhaps, in the improvement of the first Renegotiation Act which, as you gentlemen know, was adopted as a rider to an appropriation bill in 1941. You will recall the difficulties that your own subcommittee had in working it out.

You finally came out with an act which was far from perfect, but certainly better than the one you started with.

That act was improved considerably in 1948. Now we are asked to forget the improvements of 1948, and to go back and rework the Renegotiation Act of 1943.

I come now to my second point: One of the consequences of forgetting about the Renegotiation Act of 1948 is that it is now proposed to apply to the principles of renegotiation to nondefense contracts. There is nothing in this bill which is designed to limit its application to defense contracts or to contracts entered into in our preparedness program or to contracts which might be entered into if war should be declared.

This covers the ordinary, simple, everyday contracts with the agencies that are specified in the bill. You will note that the General Services Administration is specified, the Commerce Department is specified, and all other agencies designated by the Renegotiation Board —for of course they will exercise the power to designate which is given to the President. The sale of ordinary pins and clips will be subject to renegotiation.

Gentlemen, it is a job that no board in the world can conceivably undertake. I would not impose either the duty or the opportunity upon them. Their job will be big enough, if you limit them to defense contracts. That is what the Renegotiation Act of 1948 does. That act should properly be extended somewhat to include defense contracts by other than the Defense Department and the Departments specified in the Renegotiation Act of 1948—the Atomic Energy Commission, for example. However, renegotiation should not apply to any contract other than a defense contract.

There are plenty of ways in which prices on these other, nondefense contracts can be determined and controlled, if we need further controls than we now have. There are plenty of ways in which the profits on the ordinary civilian purchases of the Government can be handled. As a matter of fact, the present tax system does not leave enough profits to make anybody particularly interested from a profit point of view, in any business—forgetting the 10 to 16 billion in additional taxes that the President is today, I understand, recommending to the Committee on Ways and Means. For my third point, I want to discuss mandatory exemptions and discretionary exemptions.

I would urge this committee to return to the Renegotiation Act of 1948, which adopts the same mandatory exemptions and the same discretionary exemptions as the Renegotiation Act of 1943, which were worked out in considerable detail.

Chairman Roberts stated that it was the testimony before the Senate Committee on Investigation of Defense contracts which required the extension of renegotiation back beyond the exemptions of the 1948 and 1943 acts.

I have gone through those hearings, and the only testimony to that effect that I can find—the hearings are rather large and I may have missed some—the only testimony which says that we should forget our raw-material exemptions, and write new ones and forget our standard-article, commercial-article exemptions, and write a new one, or forget about it entirely, is the testimony of the renegotiation board and its officials, themselves.

Why they want the power, I do not know. They should not have it and I trust they will not have it.

It is true, of course, that Senator Brewster's subcommittee in February 1948 recommended that all exemptions be removed. But the Senate in the same year wisely rejected this recommendation. So far as I know it has not been renewed. It should not be revived in the absence of extensive hearings, which have not been held.

Senator CONNALLY. How radically did the act of 1948 modify the act of 1943?

Mr. ALVORD. It did not modify it at all, sir, from this point of view. They adopted exactly the same exemptions as were in the 1943 act. And, Senator, you may recall that in 1948 they were adopted by an amendment on the floor of the Senate. The bill as reported by the Committee on Appropriations, if I recall correctly, left out the mandatory and the discretionary exemptions. And they were adopted on the floor of the Senate and agreed to in conference. They are identical, word for word, with the 1943 act.

There are two or three other provisions in the 1948 act which are omitted in the preceding bill, which I will discuss a little later.

Take the matter of raw materials, whether it be cotton, corn, wheat, minerals, oil, or gas. You will recall that that problem was an exceedingly difficult one to solve. This committee, itself, could not solve it, after battling with it for several weeks. You appointed a subcommittee.

Judge Patterson took the position that the raw-material definitions, as they are now in the bill—but which were not then in the bill, should be adopted for three reasons. I think the reasons which he gave then are all at least equally applicable now, if not more so.

His first reason was that it would be absolutely impossible administratively to attempt to renegotiate raw-material contracts of this type. He was right.

There are no prices available with respect to most of these items at the point fixed in the pending bill for the determination of a price. They just do not exist, with but very few exceptions. The bill purposes to adopt the concept of percentage depletion in the determination of gross income from the property.

You gentlemen realize full well, and I do not have to stress this point, that the provisions of the tax laws with rspect to the determination of gross income from the property are very arbitrarily and artificially fixed for the very rason that there are no prices to determine gross income from the property Percentage depletion is wisely based upon gross income from the property, as distinguished from net income The problem is to segregate income attributable to the oil well or the mine, from income attributable to processing—such as refining and selling. Gross income from the property is normally determined by first determining the income that would be realized if the oil or mineral were sold at the point at which it first takes the form of a commercial product. From this point, we then work back to the processes which are normally a part of mining. In working back we subtract the costs (and normally an allocable share of the profits) involved in the various processes, beyond the mining process, required to get the raw material into a commercially salable product.

We have always had difficulty in defining the processes which are to be considered a part of the mining process. The provision now in the

tax laws (sec. 114 (b) (4) (B), defining gross income from the property) was finally enacted, after a great deal of controversy and various other legislative attempts, in the Revenue Act of 1943. It was again amended as late as the Revenue Act of 1950.

The Congress has encountered a great deal of difficulty in reaching the point of the present laws. The present laws are not yet sound, but much headway has been made. Were there a market price for the product at the end of the mining processes, there would be no difficulty. But there is no market price for concentrates, for example—with the possible exception of lead concentrates. There just is no market price. The product isn't sold. Consequently, the revenue laws make no effort to reach a market price. The percentage-depletion provisions of the present law have nothing to do with market prices. Under the provisions of the proposed bill the renegotiation board would be confronted with the task of prescribing arbitrary and artificial rules for determining a market price—and then of applying arbitrary and artificial rules to renegotiate the profits. There is no system in the world under which those prices can be determined and there is no accounting system in force or which can be devised for determining those profits.

Judge Patterson then said, not only will it be administratively impossible to renegotiate subcontracts involving raw materials of this type, but there is no necessity for it. The prices of those articles are fixed almost invariably by market conditions.

You have your market for cotton. You have your market for corn. You have your market for wheat. You have your market for hogs. You have your market for oil. You have your market for gas, and for all of your products of the mine. Those are established world prices. There can be no gouging.

Incidentally, I would strongly recommend the adoption of the inventory proposal which is omitted from the pending bill but which was in the 1943 act. Paper profits and unrealistic profits on inventories, should not be involved. Costs are realistic. The real cost of cotton used in a Government contract is the price of cotton on the day the contract is entered into.

Judge Patterson's second point was that raw material prices are not fixed arbitrarily. Normally, when a person gets a Government contract which involves, for example, copper, he immediately enters into a contract for the purchase of the copper. He has to. He cannot gamble on the fluctuations of market prices. As a matter of fact, he will probably get a commitment before he enters into the contract, if he can. There is no chance for gouging.

Third, raw material prices are all stabilized. Our stabilization formula may have to be revised somewhat. But there is no chance for artificial prices. All raw material prices are pretty well fixed now, at least by pattern.

I might add, fourth, that in many, many of the Government contracts, the raw material cost is so insignificant that it would not be worth while bothering about it. It is normally from processing and manufacturing and selling that profits are derived.

Judge Patterson was right in 1942 and in 1943. You might recall that your service departments recommended the repeal of the so-called Case-McKellar amendment which was adopted in 1942. That was the occasion for this committee and the Committee on Ways and

Means to begin working on some sort of a sensible renegotiation act. Senator Walsh was chairman of your subcommittee. He spent days and days and days trying to work out something in cooperation with the service departments.

The result was the Renegotiation Act of 1943, which was amended from time to time and which was reenacted with three or four improvements in 1948. I would urge you to retain it. The regulations on raw materials, for example, were issued back in 1943. There was a great deal of debate, of course.

The metals and materials that are exempt are all specified in the regulations. No one has ever criticized them. No one has ever criticized the producer or the processer or the seller of those materials to the manufacturer. There just are no extortionate or windfall or unreasonable profits in the picture.

If the Renegotiation Board has the common sense which I trust it will have, it will take the position that Judge Patterson took—do not, for God's sake, ask us to go back and renegotiate undeterminable unimportant profits on raw materials. I repeat. There is no accounting system in the world, gentlemen, which will permit the determination of profits on raw materials as required under the House bill. There is no accounting group in the world that can give you an accounting system to do it. If the present officials are familiar with business and business practices, they would say, just as Judge Patterson, said, "Do not give us the power. We cannot exercise it. It is not necessary. We do not want it."

Then as to the discretionary exemption, they will say that the same thing is true of standard and commercial articles. It is impossible to trace back to find out where the standard article came from, who manufactured it, how it happened to get into this particular war contract.

Nobody criticizes the exemptions, the mandatory exemption of the Renegotiation Act of 1943 or 1948, and nobody criticizes the discretionary exemptions.

That brings me to the same type of exemption with respect to organizations. I would take the 1948 act and the 1943 act, and reenact them from the point of view of exemptions either on raw materials, discretionary exemptions on standard commercial articles, or the exemption of the contractor, because he happens to be, for example, a nontaxable institution. The same thing applies to a contract for construction let after advertising.

I come now to my next point. One of the defects of the 1943 act and the 1948 act was that they did not adequately provide for the averaging of profits. You gentlemen will remember that even the Vinson-Trammell Act, the act which attempted to specify a percentage limitation of profits of certain types, provided for averaging of profits. The pending bill proposes to carry into permanent law that defect of the prior law. It is perfectly simple to provide averaging devices. For example, we have two normal, very normal, unfortunately normal, cases.

In his first contract a contractor is as ignorant of it as perhaps the Government procurement officers. And I endorse the statement that was made here this morning. Government procurement officers are able and reliable men. The first contract, by reason, perhaps, of changes in his facilities, changes in his plant which he had not con-

templated, changes in the production line which he had not contemplated, increased costs which he had not anticipated, may very well produce a loss. Two of you gentlemen in front of me had cases exactly like that back in 1942. By the time the second contract was entered into, which would produce profits in 1943, for example, they had gotten the bugs out of the prior contract and began to make some profits. However, the 1942 losses were not considered in determining whether the 1943 profits were excessive. Gentlemen, you even do that under the tax laws. You should do it, certainly, for renegotiation purposes.

The second type occurs almost as frequently. The third contract the man enters into is another new contract, and he begins to produce under that, and deliver in 1944. An entirely new product, new materials. He suffers a 1944 loss. The 1943 act did not let that loss be carried back. That loss should be considered and allowed.

Exactly the same situation now exists. You can provide simple averaging devices. Renegotiation after taxes will do the job.

People probably will tell you that although a carry-forward is administratively possible, a carry-back is not. Well, gentlemen, if we are going to renegotiate—for example, let us take 1942, 1943, and 1944, again—if we are going to renegotiate 1944, we can do it whether there is a loss or a profit. And the Renegotiation Board can say, "We were wrong in requesting the refund from you in 1943 to the extent of 'X' dollars by reason of your 1944 loss. Therefore, we cancel that." It is perfectly simple to do it. There is no difficulty with it.

Somewhat the same is the problem of affiliated groups. Renegotiation on a consolidated basis for consolidated companies having defense contracts should be mandatory upon request of the contractor. I hope you will so provide.

Under the old law, we had some difficulty, but it finally worked out pretty well. They started with the idea that they would consolidate for the benefit of the Government, but not if it benefitted the contractor. That policy was soon abandoned. So, generally speaking, if the contractor requested consolidation, they would give it to him. The provision ought to be in the law.

The pending bill says it will be done upon agreement with the contractor. But the agreement of the Renegotiation Board is not at all necessary. It should be done at the request of the contractor.

There is a provision in the 1948 act which was new. This was one of the improvements of the 1943 act. The 1948 act said, in just so many words, that where the renegotiated price was based upon estimated costs, and an allowable profit based on those costs, then if costs are reduced by the efficiency of the contractor, the contractor will benefit. If you want to get the job efficiently done, write that specific provision into the law. Make it mandatory. That will do more to keep costs down, to encourage efficiency, than any other one provision.

Let us see if we cannot eliminate as much waste as possible. I suspect your budget can be reduced very substantially if you get real efficiency in your procurement program.

We also had a policy during World War II, under the regulations—and there is no authority in the act for them—that selling expenses, advertising costs, and so forth, would not be allocated to renegotiable sales. It should be done. There is just as much selling expense

involved in sales to the Government, relatively, as in sales to the public. Advertising must continue unless the contractor is to lose his place in the world. He should be entitled to an allocation based on gross income. Take your civilian gross income and your defense gross income, and allocate on that basis. If it is 50–50, half will be allocated to the defense contract.

Now I come to the collection of the amount determined to be excessive. I know of no reason why we cannot adopt practically the same procedure for the collection of deficiencies in income tax, to the collection of amounts determined to be excessive. If the contractor wishes not to pay, let him petition the Tax Court, exactly as you do in tax cases. There is no more involved. Let him get a decision by the Tax Court, and then pay. If he chooses to pay, let him pay, and then bring suit for the refund. That will give him a chance to bring his suit back in the district court of his home State. There is no reason in the world why it should not be done.

And one more very important point. Under the Renegotiation Act of 1948, an appeal is permitted from the decision of the Tax Court to the appropriate circuit court of appeals. That appeared for the first time in the renegotiation statute in 1948. You gentlemen who were on the conference committee back in 1943, will recall that you thought you had provided for an appeal then. Unfortunately through an error, the appeal provisions were not included. And for some strange reason we could never get the administration officials to agree upon an appeal thereafter. So that none was adopted until the 1948 act. Some provision for an appeal should be in the new law, both with respect to renegotiation under the new bill, and with respect to any existing renegotiation proceedings.

Why do I recommend that so strongly? For the very simple reason, I regret to tell you, it is almost impossible to get any kind of a review of the decisions of the administrative officials under the Renegotiation Act. It is almost impossible. When you permit that review, and you do get it, it costs a lot of money. It is a difficult job to do. Take a look at the statute and find out how much discretion there is and how many facts you do not know.

When you do get a review by the Tax Court, I regret to tell you, you get nothing but a casual review. The Tax Court has not taken the job seriously. They thought the cases would soon be out of the way, and if they affirmed the Renegotiation Board, time after time after time, the fewer petitions there would be. The statute had been repealed by the time the cases reached the Court. And they said, "Let us get rid of them."

That is not the kind of review you want. It is not the kind of review you will get if you provide for an appeal. And it is not the kind of review you will get if you permit suits for refund where the merits can really be tried.

In that connection, you will recall one very substantial improvement you thought you made in 1943—it was in 1944, I think. You required the Renegotiation Board to set forth the facts upon which its decision was based, the purpose being to give us some sort of a chance on review.

Gentlemen, this is the kind of a finding of fact you actually got from the Board: "We find that the contractor is reasonably efficient. We find that such-and-such a profit will give a normal yield on net

worth." None of the actual facts at all. Nothing but conclusions of fact.

All of us understand a little bit about how this thing worked. The general rule was that, "We will allow 10 percent." There is nothing in the regulations about that. But that was the normal guide. "We allow 10 percent on sales." If the fellow is unusually inefficient, they might cut him to 2 percent. If he is unusually good, they might increase him to 11 percent, but 10 percent was the normal standard.

They cannot determine in each case just how efficient a contractor is, how he is holding his costs down, what he is doing with his plant. It cannot be done except on the wholesale basis.

That is why renegotiation again should be restricted to those cases where the renegotiation is required. But require the Board to give, not only the facts, but the detailed facts, so that they can say precisely, "Now, Alvord was not nearly as efficient as Senator Johnson. They are both making the same stuff. Alvord's costs are twice what Senator Johnson's costs are." Let them give us the actual facts on which they decide that Alvord gets 2 percent and Senator Johnson gets 10 percent.

As to the Board I believe the law can be administered better by the Services. The chairman of course, should be independent, and perhaps an independently appointed review board, whose decisions are based upon and confined to the record. But everyone else should be appointed by the Secretary of Defense or the Secretary of War or the Secretary of the Navy, the Secretary of the Air Force, and so forth. I do not think a semipolitical board should undertake this job. You will find politics in it enought but, the service people knew pretty well what they were doing in the first instances. They are free from politics. They have a lifetime job. They know what they did with the original procurement contracts. They know how it worked, and they know what their ideas were. They can reach an agreement with the contractor when those original estimates prove wrong. They are already familiar with the job. A brand new board has a terrific undertaking, if it is going to attempt to become familiar with every contract that there is.

Senator CONNALLY. Do they not classify the different industries and arrive at somewhat of a standard allowance for them, for the different types of contracts?

Mr. ALVORD. I will answer that "Yes," first, Senator; but bear in mind that renegotiation was pretty well decentralized in the first instance. A board in Pittsburgh or Philadelphia handled all types of contracts. These so-called percentages were never published. I cannot guarantee that they existed, although I used to hear about them. There were certain types of contracts, of course, where the 10 percent rule did not apply. Turn-over was a very important factor, for example, a man engaged in building a battleship will take 3 or 4 years to build it. His rate of profit is, obviously, one that should be larger than the man engaged in the making of uniforms which he is delivering every 30 days. But they did have some guiding percentage principles which they applied generally, but also refused to apply specifically.

Next we find a strange provision in the bill. It says that the Administrative Procedure Act shall not be applicable except with respect to the publication of regulations. I know of no emergency

which presently exists which says that the Renegotiation Board shall not be subject to the Administrative Procedure Act. That act was enacted after some 15 or 18 years of consideration by the bar association and the committees of Congress for the review of administrative action in the Government. It is a pretty good act. I would keep it. I know of no reason to exempt the Renegotiation Board from it.

We have at least one more problem which, I think, should be considered at the present time. Under the old law and the old practice, the reconversion costs with which industry was confronted in the tail-end of 1945 and 1946, the costs which you heard Mr. Rockwell discuss this morning, are very apt to wipe out all war profits. Those costs should certainly be considered in determining excessive profits. They are part of the cost of the defense program. If your contracts are terminated, if the emergency is over, and you begin to reconvert to civilian production, the costs of that are just as much a cost of your defense program as the original costs of converting over to a defense facility.

I would most strongly urge that the starting point be the Renegotiation Act of 1948, and that these additional suggestions that I have made, to the extent that they seem practical to you, and if they were not practical to me I would not be advocating them, be considered and adopted. If you do that, you might have a renegotiation procedure that might work during the period of our defense program, whatever period that is.

Finally, there are still pending before the Tax Court a fairly substantial number of cases involving renegotiation during World War II. Based largely upon the doctrine, I presume, that "The King can do no wrong," an existing policy has been established that these cases will not be settled on their merits. Of course, if any mistakes were made they will be corrected. But whether the Board's decision was right on the merits will not be considered. I know of no basis for according this kind of sanctity to the decisions of the Renegotiation Board, or any other administrative agency. Government counsel should be authorized to negotiate with the contractor's counsel and every effort should be made to dispose of the pending cases without litigation. I repeat that renegotiation litigation is time-consuming and costly. It should and can be avoided by the adoption of reasonable and sensible settlement policies.

The CHAIRMAN. Are there any questions? If not, we thank you, Mr. Alvord.

Mr. ALVORD. Thank you.

The CHAIRMAN. We will insert in the record at this point a statement from Mr. Robert H. Shields, president and general counsel of the United States Beet Sugar Association.

(The statement is as follows:)

STATEMENT OF UNITED STATES BEET SUGAR ASSOCIATION, ROBERT H. SHIELDS, PRESIDENT AND GENERAL COUNSEL, WASHINGTON, D. C.

The United States Beet Sugar Association recommends that your committee amend H. R. 1724 to make specific provision for a definition of standard commercial articles and to make further provision authorizing the Renegotiation Board proposed to be set up by the bill to interpret and apply such definition as was done by the Congress in the act of April 28, 1942, Public Law 528, Seventy-seventh Congress, as amended.

Under the World War II legislation, the Board had authority to exempt from renegotiation amounts received or accrued under contracts or subcontracts for the

manufacture or furnishing of a number of articles which were determined by the Board to be standard commercial articles. Under the old act the term "standard commercial articles" was defined and the Board was authorized by regulation to interpret and apply the standard commercial articles exemption provided for in that act. Pursuant to this authority, the Board determined that contracts for the purchase of sugar by the Government were entitled to exemption from renegotiation.

It seems quite obvious that if sugar is purchased by Government agencies through competitive bidding, with each processor offering sugar in competition with all other beet and cane sugar processors, that the lowest bidder would be awarded the contract on such a standard commercial article. Since sugar is a standard commercial article and is the same whether produced for civilian or military use—whether used directly or for cooking or for other further processing, either by a housewife or the armed services—it does not appear that any basis for contract renegotiation exists in the case of such a standard commercial article. The purchase of a standard commercial article such as sugar or wheat flour is greatly to be contrasted with the purchase of products manufactured specifically for military purposes.

For the reasons above indicated, based upon the experience in the procurement of sugar and other such commercial articles during World War II, it is respectfully recommended that H. R. 1724 be amended to make specific provision for the exemption of standard commercial articles, such as sugar, in the same manner in which these exemptions for such articles were provided for in World War II legislation.

The CHAIRMAN. We will next hear from R. P. S. McDonnell. Will you please come forward and identify yourself for the record?

STATEMENT OF R. P. S. McDONNELL, WASHINGTON, D. C.

Mr. MCDONNELL. My name is R. P. S. McDonnell. I am engaged in the practice of law with offices at 1025 Connecticut Avenue NW., Washington, D. C. My interest in the proposed legislation stems from the fact that during World War II, while on active duty as an officer of the Naval Reserve, I participated in the administration of Navy Department war contracts dealing with problems of procurement, renegotiation, and termination. Since 1945, in association with other representatives of industry, I have taken part in discussions with public officials on matters pertaining to the drafting and administration of the Armed Services Procurement Act of 1947 (Public Law 413), the Armed Services Procurement Regulations, the Renegotiation Act of 1948 (Public Law 547), and the Defense Production Act of 1950 (Public Law 774).

My practice of law has been and is largely devoted to the representation of small business firms with problems raised by Federal administrative action. At present, while these firms have not engaged in defense work, they undoubtedly will participate in the procurement program and will be affected by this bill providing for the renegotiation of Government contracts.

When the President signed the Armed Services Procurement Act February 19, 1948, he wrote the Secretary of Defense, in part, as follows:

> It declares that a fair proportion of all procurement shall be placed with small business concerns.

According to a report of the Munitions Board for the fiscal year 1950, the armed services made direct purchases from small companies (fewer than 500 employees) which amounted to 24.5 percent of the annual total ($1,310,615,000 out of $5,355,296,000). In terms of the number of purchases made, 1,267,000, or 73 percent, were transacted

with small firms. Of the total purchases in fiscal 1950, some 72 percent of the dollar value represents purchases by negotiation—and of this percentage small business obtained defense business of about only 14 percent. Therefore, it is seen small firms have begun to participate in the procurement program. However, the business they have received has been predominantly awarded to these firms on a competitive-bid basis.

During the past week, I have had the occasion to discuss some of the problems raised by current defense procurement with executives of small companies as well as to receive some of their reactions to provisions of H. R. 1724. I would like to give your committee the benefit of certain observations I have made as a result of these discussions.

Small business expects to participate more fully in the defense contract programs. In the first place, executives feel that their firms can better do business with the Government on a negotiated basis than through competitive bidding. The declaration of the national emergency by the President has made possible a greater application of the negotiated contract in procurement under section 2 (c) (1) of the Armed Services Procurement Act of 1947. This belief is reinforced by their observation that a great many small businesses, which were awarded contracts under competitive bidding before the Korean conflict, are now having serious financial difficulties because of the rise in costs since last June which has undermined the basis on which they quoted prices to the Government. In the second place, these businessmen feel that their firms will be forced into a position where they will have to take defense work because of scarcity of materials for civilian production and the operation of the priority program of the National Production Authority.

I will now proceed to discuss several features of this bill which I believe deserve your particular attention.

Senator CONNALLY. You say in your statement, while on active duty as an officer of the Naval Reserve, you participated in the administration of war contracts dealing with problems of procurement and renegotiation and termination. Were you representing the Navy?

Mr. MCDONNELL. Yes, sir; I was an officer on active duty.

Senator CONNALLY. Were you representing the Navy before the renegotiation boards?

Mr. MCDONNELL. I was an officer in the administration of the contracts, and when renegotiation problems come up, they were referred to the renegotiation officers.

Senator CONNALLY. You did not go before the board?

Mr. MCDONNELL. No.

Senator CONNALLY. You just talked to some of their employees?

Mr. MCDONNELL. Yes; we did. We forwarded the material when it appeared that excessive profits were being made.

Senator CONNALLY. Would you regard your duties there as representative of the Government to try to cut these negotiations down as much as you could, or were you just there in a general capacity?

Mr. MCDONNELL. Well, we regarded our duties to see that the contract was fairly and properly administered from the point of view of the public interest and the Government, and at the same time that

it was fairly administered from the point of view of doing a fair job to the business firms that were cooperating with the Government.

Senator CONNALLY. But you were not a part of the staff of the board?

Mr. MCDONNELL. No, sir.

Senator CONNALLY. That is, the renegotiation board?

Mr. MCDONNELL. No, sir.

Senator CONNALLY. You just sort of sat on the side lines, and if you saw something going wrong, you would come in?

Mr. MCDONNELL. The duties that were imposed upon my office were those which I did not determine, and when such questions came up, they were carefully considered and then forwarded, if necessary.

Section 105 (f) (1) (p. 22 et seq.) of the bill provides that a contractor or subcontractor with a minimum of $100,000 volume business will subject the contractor or subcontractor to renegotiation. The 1944 Renegotiation Act provided for a minimum of $500,000. When the exemption was changed under that act from $100,000 under previous legislation (the 1943 act) to $500,000, a practical reason favoring the $500,000 minimum was found in a letter (March 25, 1943) from the Secretaries of the Army and Navy to the Speaker of the House of Representatives:

> It has been found that in the administration of the section—

which would subject the contractor or subcontractor to renegotiation—

> with a $100,000 floor that a difficult task is presented by the great number of contractors with whom renegotiation is required. This—

referring to the provision of the 1943 act which increased the minimum from $100,000 to $500,000—

> greatly facilitates renegotiation with larger contractors and subcontractors without seriously affecting the principal objectives of this section.

Likewise, the Truman committee, in its report on renegotiation recommended the $500,000 exemption. (See Rept. No. 10, pt. 5, of Special Senate Committee Investigating the National Defense Program.)

It should be further pointed out that part 4 of the Armed Services Procurement Regulations (sec. 3-400 to 3-409) provides a variety of types of negotiated contracts which can make provisions for the adjustment of contract prices where it is found during the administration of the contract excessive profits appear to be occurring under the contract. Conscientious administration of smaller war contracts should be able to reveal excessive profits, which can be adjusted by a redetermination of prices without resort to renegotiation.

It is my contention that the floor of $100,000 provided for in section 105 (f) (1) of H. R. 1724 should be changed to a $500,000 minimum volume of business. This would avoid the administrative task of renegotiating smaller defense contracts after their completion and would eliminate the imposition of the burden of expense, time and effort upon small business. Careful drafting of original contracts with small firms and efficient administration of the contract during its operation should be used as the lever to recoup profits in situations where profits are out of line. In this way, when the contract is completed, the small firm knows what profit it has made on the contract and can plan to use these profits in its business without the fear

of a renegotiation proceeding many months later—and the Government has protected the public interest.

From the definition of "excessive profits" under section 103 (e) it would appear that contracts derived from competitive bidding may be subject to renegotiation. The report of the Committee on Ways and Means re. H. R. 1724 does not clarify as to whether or not such contracts are to be subject to renegotiation. It is submitted that this should be clarified in the bill and not left to administrative interpretation. Further, I urge for you favorable consideration the position that defense contracts let pursuant to competitive bidding and for standard commercial items should not be subject to the drawn-out, expensive process of renegotiation. In the case of such contracts, the price quoted has been submitted in terms of the competitive market for such articles and competitive bids, which win the award of a contract, necessarily have gone to the lowest bidder. It is hard to visualize how the public interest is prejudiced when the profits on such contracts have been determined in competition with the open market. This seems especially true because the Armed Services Procurement Regulations in part 4, section 2-403, imposes the duty on the contracting officer to reject bids (i) when rejection is in the interest of the Government or (ii) when he finds the bids are not reasonable. Unreasonably high prices quoted by bids on a contract, to which an excessive profit figure might attach, would be a most proper ground to reject bids. Since, as pointed out earlier, small business participates in the defense work primarily by the award of contracts on a bid basis, it is important to these firms that such contracts are not made subject to renegotiation since there are existing safeguards to protect the public interest.

Section 107 (a) of the bill establishes an independent, five-member renegotiation board and provides that not less than three members of the board shall be appointed from civilian life. The objective of setting up an independent board, according to the report of the Committee on Ways and Means, is to keep final responsibility for the renegotiation of Government contracts separate from the procurement authorities which initially issued the contracts. This is a step in the right direction, namely, to divorce the administration of the procurement program from renegotiation.

While the President may appoint the entire board membership from civilian life, this is not mandatory under subsection (a). It is suggested that the business community would have greater confidence in the work of the board if the language of the bill provided that all members of the board shall be appointed from civilian life.

There is reoccurring criticism of the Federal Government related to its inability to secure top-caliber men for administrative positions. Under World War II statutes, $200,000,000,000 in contracts were subject to renegotiation and gross amounts of more than $11,000,000,000 were recaptured through renegotiation. Certainly, in the administration of the important renegotiation program ahead, the Government should try to attract highly competent professional and business men to serve on the renegotiation board. For this reason, favorable consideration might well be given to compensation for members of the board at an annual rate, say of $15,000, instead of the $12,500 provided for in section 107 (a) of the bill. As you gentlemen know, during World War II a number of outstanding men were

brought into Government service on per diem basis. In my opinion, the renegotiation program may be strengthened if the bill is amended to grant the board the authority to obtain the services of personnel on a per diem basis.

Under section 107 (f) of the bill, the renegotiation board is permitted to delegate authority to conduct renegotiation proceedings to agencies charged with procurement. This provision tends to defeat the basic objective of establishing an independent board. Further, by such delegation, it diffuses the responsibility of the board for the administration of renegotiation proceedings. I submit that the renegotiation board should not be permitted to redelegate its authority. It should retain complete control over all phases of renegotiation and be responsible alone for the proper administration of its work under the proposed Renegotiation Act.

Thank you for the opportunity of appearing before your committee today.

The CHAIRMAN. Thank you, sir.

The committee will recess until 2 o'clock.

(Whereupon, at 12:30 p. m., the committee recessed, to reconvene at 2 p. m., of the same day.)

AFTERNOON SESSION

The committee reconvened at 2 p. m. upon the expiration of the recess.

The CHAIRMAN. The committee will come to order.

Mr. Leslie Mills, will you come forward, please, and identify yourself for the record?

STATEMENT OF LESLIE MILLS, CHAIRMAN OF SUBCOMMITTEE ON RENEGOTIATION, COMMITTEE ON NATIONAL DEFENSE, AMERICAN INSTITUTE OF ACCOUNTANTS

Mr. MILLS. My name is Leslie Mills, and I represent the American Institute of Accountants, which is the national organization or practicing certified public accounts, and which is offering its services in the business and accounting problems in the defense effort.

The CHAIRMAN. You may proceed with your statement.

Mr. MILLS. I would like to say, Senator, that on this subject I have had some personal experience, in that I was a member of the Navy Price Adjustment Board and of the War Department Price Adjustment Board, so that with the members of the American Institute who worked with me in considering this matter, we had some practical experience.

We have prepared a statement which I gave to the clerk of the committee, and with your permission I would like to take just 5 minutes to emphasize some of the points in the statement.

The CHAIRMAN. Do you wish your statement put into the record as a whole?

Mr. MILLS. Yes, sir.

The CHAIRMAN. Your statement will go in as a whole, and you may supplement that with your oral statement.

Mr. MILLS. Thank you, Mr. Chairman.

(The statement referred to follows:)

STATEMENT OF AMERICAN INSTITUTE OF ACCOUNTANTS, LESLIE MILLS, CHAIRMAN OF SUBCOMMITTEE ON RENEGOTIATION, COMMITTEE ON NATIONAL DEFENSE

INTRODUCTION

The American Institute of Accountants is the national organization of practicing certified public accountants. It has approximately 17,000 members. It has created a committee on national defense to consider the many problems of accounting and auditing, and the utilization of accounting manpower, in connection with the national defense mobilization effort, and to offer the advice and services of the accounting profession in the solution of such problems.

The accounting profession is particularly interested in and, we believe, is particularly well qualified to speak on, renegotiation as an arm of Government procurement policy. Many of its members served in key positions in renegotiation organizations in World War II, and were vitally concerned in preparing regulations for the administration of the wartime proceedings and those under statutes now in effect. Even more members were required to assist clients in development of factual data for purposes of renegotiation, and often sat in at conferences with renegotiation boards. Accounting is basic to the renegotiation process, since the judgment of the renegotiation boards is applied to the accounting concepts of costs and profits.

PHILOSOPHY OF RENEGOTIATION

We believe that renegotiation within certain areas is a proper and essential part of Government procurement of military matériel in time of war and during a preparedness period such as the present. However, we hope that the Congress looks on renegotiation, and will continue to look on it, as purely an emergency wartime measure, and not as a normal part of the machinery for purchasing war matériel and supplies or for maintaining the vast Defense Establishment which obviously will be necessary for a long time to come. We agree that under present conditions this bill is probably necessary and desirable, but we hope that those who will administer it will feel charged with the duty and responsibility of limiting its application to the fullest extent that they find possible. Our hope is that congressional intent, to be reflected in administrative practice, is that as much procurement as possible will be secured on the basis of normal competitive and contracting standards, for the mutual protection and interest of both Government and business. The renegotiation process should be reserved for those circumstances in which normal purchasing procedures cannot adequately protect either the Government or the contractor.

H. R. 1724 contains several provisions for exemption from renegotiation, some mandatory and some at the discretion of the Renegotiation Board. We shall comment on some of these later in this memorandum. The hope we wish to express at this time is that those charged with administering the act will feel it their duty to seek every means available (*a*) to devise procedures which will encourage sound procurement, or (*b*) to recognize procedures developed by procurement offices, which will reasonably prevent excessive profits. The renegotiation process should be confined to those cases in which it is impossible to predetermine a price fair to either or to both parties.

We point out that, as a buyer, the Government is in a much stronger position both morally and in power than the ordinary customer of American business. On the other hand, as a seller, business has many fewer cards in dealing with the Government than with other customers, particularly as control of essential materials and manpower come upon us. This is as it should be, but at the same time it puts on the Government a great measure of responsibility for avoiding unnecessary burdens on business. Specifically, section 106 of H. R. 1724 grants the Renegotiation Board power to exempt from renegotiation contracts and subcontracts which by their terms are unlikely to result in excessive profits. Similar power was available to the renegotiation agencies during World War II but, by our experience and observation, we believe that the agencies were unnecessarily reluctant to use that authority; as a result the administrative burden to both parties was unnecessarily great. We believe this matter is particularly important at the present time, since so much Government procurement of war matériel at the prime contract level is by means of contracts with price redetermination clauses. It appears to the accounting profession an unnecessary burden to have the reasonableness of costs and profits reviewed and "renegotiated" twice by Government officials, with different techniques and measures of costs and profits sometimes being used.

Renegotiation is conducted on an over-all basis for an accounting period, without regard to profit results on individual contracts or orders. Accordingly, exemption from renegotiation by administrative action of the Board of contracts or subcontracts by class or type may prove inequitable, since the contractor or subcontractor involved will be deprived of the right of review of profits on renegotiable business on an over-all basis. We therefore recommend that in the case of any permissive exemption other than one applied by specific contract provision, the contractor or subcontractor shall have the right when the contract or subcontract is entered into to decline to accept such exemption.

On the specific matter of statutory factors to be taken into consideration in determining excessive profits, we note and approve the addition of "reasonableness of return on net worth." However, we recommend specific reference to the further factor of adequacy of profits on renegotiable business of a prior year covered by this bill or the present act of 1948. One of the most difficult things for a businessman to understand about the renegotiation process is how he can be held to have realized excessive profits in one fiscal year when in the prior year on similar business (or maybe on the same contracts) he suffered a loss greater than the profits of the year for which he was required to make a refund. We as accountants recognize the need for conducting proceedings on the basis of annual fiscal periods. The same problem is present and is recognized in the tax statutes although here the Congress has acknowledged the need for considering profit results for a period of several years together by means of carry-backs and carry-forwards (specifically excluded from costs by sec. 103 of H. R. 1724). We also recognize that consideration in renegotiation of losses of subsequent years would be impracticable, or at least unwise, since it would in effect defer conclusion of all renegotiation proceedings until after the termination of the renegotiation act. We therefore recommend only that the statute include (in factor (4) "extent of risk assumed") the provisions of regulation 424.403–5 under the Renegotiation Act of 1948, thus giving statutory recognition to a consideration presently provided merely by administrative interpretation.

ORGANIZATION OF THE RENEGOTIATION BOARD

We are in wholehearted agreement with the provisions of the bill creating a Board independent of procurement authorities charged with the duty of contract negotiation. We endorse the comments of the report of the House Committee on Ways and Means (p. 3) on the need for such independence at levels of policy and operations, and hope that the Board will recognize the intention there expressed that renegotiation duties and functions be not delegated under any circumstances to agency personnel directly responsible for procurement. We recognize that there must be close liaison of renegotiation activities at the working level with procurement officers, but our observation of and experience with prior renegotiation acts persuade us to recommend that the statute itself should specifically provide for such separation and independence. Specifically we recommend that the bill provide:

(1) That all Board members be appointed from civilian life, and that none have any responsibility or derive any authority from any other Government agency. (We do not feel it proper for us to comment on compensation of Board members.)

(2) That delegations or redelegations to a department or agency named or covered by section 102 of the bill be permitted only if those receiving the delegated power are directly responsible to the secretary of such department or agency, as defined in section 103 (b) of the bill, and they shall not otherwise be concerned with procurement activities.

ACCOUNTING MATTERS

We agree in general with the provisions of section 103 (f) of the bill setting forth the standards for allowance of costs and expenses for renegotiation purposes. We approve particularly the required correlation with the Internal Revenue Code, since the renegotiation process necessarily includes so many elements of judgment that any specific standard is to the good. However, we recommend that the statute provide in specific terms that, while all tax deductions are to be allowed (to the extent allocable), the fiscal period for which they are to be allowed should depend on the accounting methods employed by the contractor (if in accordance with generally accepted accounting principles) rather than on the sometimes arbitrary rules on time of deduction for Federal income-tax purposes. Income-tax practice on this matter is frequently at variance with sound accounting practice and, while the effect of such variations for tax purposes is at least partly

alleviated by Internal Revenue Code provisions for carry-backs and carry-forwards, the effect on profit determinations for renegotiation purposes may be very inequitable. (Regulations under the Renegotiation Act of 1948 provide specifically that, with one exception applicable only under limited circumstances, items of cost are to be attributed to fiscal years for which they are allowable for Federal income-tax purposes.)

We also recommend the following less important and more technical changes to section 103 (f):

(*a*) Page 6, line 12: Delete "cost."

(*b*) Page 6, line 14: Delete "cost."

Comment: We believe the word "cost" in these lines is confusing and meaningless in the accounting sense.

(*c*) Page 6, lines 13 and 14: Delete "in keeping his books."

Comment: The significant method of accounting is that employed in determining income for Federal income-tax purposes. The allocation of receipts and accruals and costs and expenses for renegotiation purposes should be made in accordance with generally accepted accounting principles applicable in the circumstances. "Books" may be records of cost allocations, etc., for various management or control purposes.

(*d*) Page 6, line 21, to page 7, line 5: Delete entire sentence beginning "Irrespective of the method" and ending "to such contracts or subcontracts."

Comment: This sentence seems redundant, and its inclusion may suggest to the Board a course of action beyond our understanding of the intent of the Congress. The section has already provided that the method of accounting to be used for determining or allocating costs must be approved by the Board or the Tax Court. It is an unsound concept that the Board in its determination of profit actually realized must eliminate items of cost which in its opinion are "unreasonable." In the case of most controllable costs of significance, the Internal Revenue Code imposes a standard of reasonableness, so that this provision must be taken to encompass costs which are determined to be proper tax deductions by nature and in amounts stated. Our concept of the schematic arrangement of the bill is that under the rules of section 103 (f) the Board must first determine sales, costs, and profits attributable to renegotiable business. Thereafter, under section 103 (c) the Board must determine the portion of such profits which are "excessive," taking into consideration as a specified factor the "reasonableness of costs" (p. 5, line 4).

RENEGOTIATION PROCEDURE

The Renegotiation Act of 1943 provided for appeal from orders of the Board to the Tax Court of the United States, and made that court's determinations conclusive and not reviewable by any court or agency. The Renegotiation Act of 1948 provided for review of Tax Court determinations by the United States Courts of Appeals. H. R. 1724 readopts the 1943 provision, allowing no judicial review beyond the Tax Court. We recommend adoption of the 1948 provision, allowing the same judicial review available to business organizations in tax controversies under the Internal Revenue Code. The code is such an integral part of the renegotiation process that we see no justification for a less complete judicial review of renegotiation determinations than is accorded to tax controversies.

We approve the provisions of section 105 (f) with respect to minimum amounts subject to renegotiation, and suggest addition of a provision for a minimum refund in renegotiation, either specified in the statute or by the Board under statutory authority. Our suggestion does not contemplate that such minimum would prevent a recovery to the "floor" provided by section 105 (f), if but for that "floor" the refund would have exceeded the specified minimum.

We recommend that a contractor aggrieved by a determination made by an agency under delegation from the Board be accorded review by the Board as a matter of right. The bill provides for such review on the motion of, or at the discretion of, the Board. We do not suggest that the Board be required to grant a hearing before it in such cases, but believe it would be more equiable, and sounder procedure, if such cases were finally settled either by agreement directly with the Board, or by order issued by the Board after review by it.

EXEMPTIONS

We repeat our comments earlier in this statement as to the desirability of confining renegotiation proceedings to circumstances under which other factors are inadequate to prevent realization of excessive profits.

Subsection (i) (1) (D) of the Renegotiation Act of 1943 provided for mandatory exemption of "any contract or subcontract with an organization exempt from taxation under section 101 (6) of the Internal Revenue Code." No doubt the subject departments and agencies have or will let contracts with educational institutions for research and other services. Aside from the public policy involved in renegotiating such organizations, it is our opinion that:

(*a*) In such cases the procurement officers should be able to avoid accrual or realization of excessive profits by specific contract provisions.

(*b*) The administrative problem of determining and allocating costs properly applicable to such contracts will in all likelihood prove impracticable or impossible. Since such organizations are not required to file with the Bureau of Internal Revenue financial data in the same form or detail as required of business organizations, preparation of the required data will be much more burdensome.

We therefore suggest exemption from renegotiation of activities of exempt organizations not subject to taxation under the Internal Revenue Code.

CONCLUSION

We attach hereto suggested restatements of:

(*a*) Section 103 (e) (4), the "risk" factor.

(*b*) Section 103 (f), accounting rules.

Section 103 (e) (4): Extent of risk assumed, including the risk incident to reasonable pricing policies, as reflected by profits or losses realized for the fiscal year under renegotiation and for prior fiscal years subject to renegotiation under this act or under the Renegotiation Act of 1948.

SEC. 103. (f) PROFITS DERIVED FROM CONTRACTS WITH THE DEPARTMENTS AND SUBCONTRACTS.—The term "profits derived from contracts with the Departments and subcontracts" means the excess of the amount received or accured under such contracts and subcontracts over the costs paid or incurred with respect respect thereto and determined to be allocable thereto. All items estimated to be allowable as deductions and exclusions under chapter 1 of the Internal Revenue Code (excluding taxes measured by income) shall, to the extent allocable to such contracts and subcontracts, be allowed as items of cost, except that no amount shall be allowed as an item of cost by reason of the application of a carry-over or carry-back. Such costs shall be determined in accordance with the method of accounting regularly employed by the contractor or subcontractor, or with the approval of the Board a different method requested by the contractor or subcontractor that is in accordance with generally accepted accounting principles, but if the method so employed or requested does not in the opinion of the Board (or, upon redetermination, in the opinion of the Tax Court of the United States) properly reflect such costs, such costs shall be determined in accordance with such method as in the opinion of the Board (or, upon redetermination, in the opinion of the Tax Court of the United States) does properly reflect such costs. The allocation to contracts and subcontracts of such costs shall be made under a method of accounting which is in accordance with generally accepted accounting principles and which in the opinion of the Board (or, upon redetermination, in the opinion of the Tax Court of the United States) does properly reflect the proper allocation of such costs.

Mr. MILLS. First I would like to say that we believe that within certain areas renegotiation is a proper and essential part of Government procurement of military matériel during wartime and during an emergency period like the present. But we hope sincerely that this committee and the Congress look on renegotiation and will continue to look on it as purely a war or emergency measure, justified only by emergency circumstances and not to be a part of the permanent formula of Government procurement.

We especially hope that, in administration, renegotiation will be used only when normal purchasing procedures cannot protect either the Government or the contract.

During the World War II period the renegotiation boards had quite broad powers for exempting contracts and subcontracts, and in our opinion those powers were not used often enough. It is our opinion that the renegotiation process tends to be used to cover up careless buying or pricing or in effect to avoid the responsibilities of a buying

officer; and, since the United States Government is the world's biggest buyer, we think it ought to be an astute negotiator as well.

So we hope that it will be the expression of the Congress that this great power of renegotiation, which we feel is essential, is to be used only when the normal procurement tools are inadequate.

Now, on the matter of the measures of excessive profits, the statutory factors, we approve those in the bill, but we suggest specific adoption of a provision in the regulations under the present act recognizing in the current renegotiation the loss on renegotiable business in a prior year. One of the witnesses this morning suggested that losses should be carried back as well as carried forward. I do not believe that would be proper, nor do I believe it would be possible, because I look on renegotiation as a part of procurement, and that would, to me, make renegotiation somewhat like a tax act. But I do believe that, if a contractor suffers a loss on renegotiation and makes an excessive profit the next year, the loss should be considered by the renegotiation boards, and this view is shared by the present Board, which has such a provision in its regulations, and I would like to see that provision in the statute because I think it is fair and reasonable.

The CHAIRMAN. Do you set that out in your statement?

Mr. MILLS. I have attached to our statement a suggested draft of a restatement of the factors which would take care of that.

The CHAIRMAN. I see.

Mr. MILLS. Now, on the accounting matter of determining costs and profits, we accountants have some difficulty in understanding the statutory provisions, and we have attached to our statement a suggested redraft which we think makes no substantive changes in what we understand to be the accounting rules, but we believe that the redraft will be better understood by the accountants, who, after all, are the ones that are going to have to interpret them for business. And I have attached that to the statement, too, Senator, for your consideration.

The CHAIRMAN. Very well.

Mr. MILLS. On the further matter of organization of the Board, we are in very complete agreement with the provisions for making the Board independent of officers directly concerned with the procurement and with the letting of contracts, and in our statement commenting on this we make specific recommendations for statutory provisions to insure such independence beyond any doubt.

On renegotiation procedure, the principal recommendation in our statement is that an aggrieved contractor be given the right to review by the Board of a unilateral determination by a lower echelon agency working under delegation. We are not suggesting that the Board be required to give any such aggrieved contractor a hearing; but we do feel that, if there is an order for a refund on a unilateral basis, it should be made by the Board itself after it has reviewed it.

We also feel, as one of the previous witnesses stated, that there should be complete appeal provision to the circuit courts of appeal, as presently provided in the act.

Finally, on one matter which is not mentioned in the statement, the 1942 act had an exemption, or a floor, of $100,000, which was raised in 1943 to $500,000. The present act and this bill go back to $100,000. I have no desire to see contractors retain excessive profits merely

because their business is small; but, unless the Board's staff feels that there is a great deal of excessive profits involved in the area above $100,000 and below another figure, I would like to see an increase in that exemption purely because of the saving in administrative burden on both the contractors and on the administration of the act.

That is all I have.

The CHAIRMAN. Are there any questions?

Senator MARTIN. No. That was a very good statement.

The CHAIRMAN. Thank you very much for your appearance.

Mr. MILLS. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Terborgh.

You may be seated. Will you please identify yourself for the record?

Mr. TERBORGH. May I stand, Mr. Chairman?

The CHAIRMAN. You may if you wish to.

STATEMENT OF GEORGE TERBORGH, RESEARCH DIRECTOR, MACHINERY AND ALLIED PRODUCTS INSTITUTE

Mr. TERBORGH. I am George Terborgh, research director of the Machinery and Allied Products Institute, of Washington and Chicago.

The CHAIRMAN. You may proceed with your statement.

Mr. TERBORGH. I have submitted a manuscript, Mr. Chairman, which I should like to have incorporated in the record if you are agreeable. It is rather long to go over in detail here, and with your permission I will just high light some of the main points.

The CHAIRMAN. You may do so. Your complete statement will be entered in the record.

(The statement referred to follows:)

STATEMENT OF MACHINERY AND ALLIED PRODUCTS INSTITUTE, GEORGE TERBORGH, RESEARCH DIRECTOR

Let me begin by expressing the appreciation of the Machinery and Allied Products Institute for the opportunity to offer its views on H. R. 1724, the proposed Renegotiation Act of 1951. The institute, as most of you know, is an organization of capital-goods manufacturers, the main purpose of which is research in the economics of capital goods and the furtherance of technological and economic progress. I may add, as pertinent in the present connection, that during the recent war and since it has had an excellent opportunity to observe the working of contract renegotiation, particularly as applied to capital-goods companies.

THE PROBLEM BEFORE US

We are dealing today with a problem of tremendous importance for both industry and government, which deserves the most earnest consideration by all concerned. This is doubly true at the present juncture, for it seems likely that the basic policies adopted now, at the beginning of the expanded military program, will be with us for a long time. We respectfully submit, therefore, that the committee's deliberations on the pending bill should embrace a thorough review of the principles and practice of renegotiation as applied to the conditions we now confront.

Such a review is not only timely; it is thoroughly practicable. For, as the committee knows, we already have a renegotiation law in effect, the Renegotiation Act of 1948, which has been incorporated (with certain limitations) in all military appropriations passed since it became operative. It can be incorporated in future appropriations for as long as necessary to give the whole problem a careful and unhurried review. There is no occasion this time for precipitate action.

I say "this time" by way of contrast for, as the committee will recall, both the wartime renegotiation law and the act of 1948 were rushed through Congress with no opportunity for industry to present its views or even to offer suggestions.

The first of these enactments (sec. 403 of the Sixth Supplemental National Defense Appropriation Act) was introduced on the floor of the House in April 1942 as an amendment to an urgently needed military appropriation. There were no hearings at the time, and none were held until a year and a half later, when the legislation was up for amendment. By then the organization and procedure of renegotiation had become firmly established and fundamental changes were excluded. The history of the 1948 law is similar. The first opportunity of industry to testify on the application of renegotiation to peacetime defense procurement was in August 1950, when the House Ways and Means Committee held hearings on H. R. 9246, a bill generally similar to the one before you. The present hearings represent the first opportunity to discuss this important subject before a committee of the Senate.

We propose, with your indulgence, to take a fresh look at the renegotiation problem. What is the appropriate role of over-all, retroactive renegotiation as a procurement device under present and prospective conditions? How does it tie in with other repricing or profit-limitation techniques? What are the criteria for its application? How does it affect the financial incentives of the contractor and the economy and efficiency of defense production? What does it do to the quality and competence of procurement? Finally, what modifications of the wartime pattern of renegotiation are indicated?

WARTIME VERSUS PROSPECTIVE PROCUREMENT CONDITIONS

It may help to put renegotiation in perspective if we consider for a moment the procurement conditions that originally gave rise to the device.

In each of the war years 1942, 1943, and 1944 the Federal Government was purchasing about 35 percent of the total output of private industry (including agriculture).[1] With this over-all take, it was, of course, absorbing the entire output of many individual industries and a major portion of the output of many others. It was buying unheard-of quantities of military equipment, in frenzied haste, with an overworked procurement organization, often from contractors unfamiliar both with the product and the necessary production techniques. Even in the purchase of ordinary commercial articles it had frequently to contend with markets made noncompetitive, or insufficiently competitive, by war conditions. Under these circumstances the situations were exceedingly numerous in which provision had to be made for a retrospective review of contract prices, with backward repricing or a recapture of profits as the remedy. Since it was impossible under the stress of the emergency to conduct this review contract by contract, periodic over-all renegotiation of the profits of the contractor emerged as the alternative. It was a hastily conceived improvisation to facilitate the rapid placement of contracts under these conditions.

No one can deny that similar conditions are reappearing to some extent under the expanded defense procurement and will continue to be present at least through the build-up phase of the program. There is no prospect, however, that they will attain anything like the intensity and generality that prevailed in the recent war. This for two reasons: (1) If we assume a total military and military-aid expenditure of $60,000,000,000 a year, the proportion of the output of private industry absorbed by the Federal Government will be less than half the proportion taken during the war (around 15 percent as against 35 percent);[2] (2) the experience of the services in the recent conflict should be conducive to more expert and scientific procurement than was possible then.

While it will still be necessary, as during the war, to set tentative prices for many military end products and components, either because they are new or because the contractor is unfamiliar with them, and to revise these prices with experience, a sizable proportion of the parts, subassemblies, and supplies that enter into final products can be firmly priced by reference to the competitive market. We must remember that for many of these component materials the military demand is, and presumably will remain, only a minor fraction of the total.

That the difference between all-out war and a peacetime defense program implies a difference in the scope of contract renegotiation appears to have been recognized, though to a limited extent, in recent legislation. Thus the Renegotiation Act of 1948, while essentially a reenactment of the wartime statute, authorized the Secretary of Defense, in promulgating regulations under the act, to have

[1] See the Survey of Current Business, July 1950 (national income number), tables 7 and 9. The figure includes Federal purchases for nonmilitary purposes.

[2] The total expenditure of $60,000,000,000 a year, of course, includes the pay and family allowances of military personnel, salaries of civilian personnel of the services, purchases in foreign countries, military aid spent abroad, and other items that do not constitute purchases from American industry.

"regard for the differences in economic conditions existing on or after the effective date of the act from those prevailing during the period 1942 to 1945." Recognition of these differences no doubt accounted also for the fact that in the next application of renegotiation to military procurement (in the Second Deficiency Act of 1948, sec. 401) Congress authorized the Secretary of Defense to designate renegotiable contracts selectively and in his discretion, all others being exempt, thus reversing the wartime arrangement by which contracts were presumptively renegotiable unless expressly exempted. Again the same recognition of altered circumstances was reflected in subsequent applications of the 1948 act, in which Congress has limited renegotiation to negotiated prime contracts and their underlying subcontracts.

Although these several modifications of wartime renegotiation procedure have been embodied in existing legislation, the pending bill ignores them all in favor of a complete and unqualified restoration of the former arrangements. Indeed, it goes even further in some respects than the war legislation itself. Here is by implication a complete denial of any difference between the procurement policy appropriate to an all-out war and the policy suitable to a defense program of the magnitude now in prospect. We believe there is a difference and that it should be given legislative recognition. It is our considered judgment that under present conditions the retroactive renegotiation of profits should be employed much more sparingly than it was during the war.

The bases for this judgment will be more evident when we have considered the advantages and disadvantages of renegotiation as a procurement device. Let me begin with its advantages.

ADVANTAGES OF RENEGOTIATION

There are certain situations for which renegotiation is clearly superior to any available alternative. Consider, for example, the case of a contractor with a large number of Government contracts and subcontracts which cannot be firmly priced at the outset, and which therefore require periodic review and repricing. Ordinarily it is far more convenient both for him and for the procurement agencies involved to renegotiate all of them in one proceeding after the close of the year than to attempt to reprice each contract separately as the year proceeds. Renegotiation in this case is a simple alternative to a multiplicity of separate price redeterminations. It has, moreover, an added advantage from the contractor's standpoint in the fact that loss or low-profit contracts can be offset against the more profitable ones in the over-all review.

From the Government's standpoint there is another advantage of considerable importance: Renegotiation affords a means of dealing with subcontracts that require repricing, or at least price review. The Government itself has, of course, no direct contractual relations with subcontractors, and it is difficult to reprice their products through the prime contractor or higher station subcontractor. It is often equally difficult to reprice individual subcontracts by direct dealings. Here retroactive, over-all renegotiation of the subcontractor is one answer, however imperfect.

DISADVANTAGES OF RENEGOTIATION

If renegotiation has a legitimate place in procurement policy, as we believe it has, we must recognize, nevertheless, that its defects are so serious that its role is properly a limited one. Let us consider four of these defects: the inducement it creates for careless procurement, the impairment of incentives to economy and efficiency, the burden it places on management, and the arbitrariness of its results.

Inducement to careless procurement.—As indicated earlier, renegotiation was developed during the recent war as a means of retroactive correction for mistakes made in pricing contracts under the pressure of emergency. As such it served a very useful purpose. The facility with which mistakes can be rectified in this way has its disadvantages, however, particularly under more normal conditions when close buying and firm pricing should be the objective of procurement policy. By inducing an easy reliance on retroactive review and adjustment, it tends to develop carelessness and lessened responsibility on both sides of the contract negotiation. It tends, in other words, toward sloppy procurement.

Effect on incentives.—Within the range of its application, renegotiation constitutes a 100 percent tax on profits, resulting in an almost total eclipse of financial incentives for economy and efficiency in the production of Government work. No government of which we have knowledge has ever imposed a 100 percent tax on any portion of corporate income, even in wartime, without abating the effect by postwar refunds and similar devices. In the recent war, the maximum applica-

ble rate, after the allowance of postwar credits, was the 81 percent rate in effect in this country. Since the impact of retroactive renegotiation is unrelieved by future credits or similar abatements, recapture being complete and final as to profits deemed excessive, it evokes where applicable, in only slightly diminished degree, the same reactions that have made total taxation inexpedient.

It is universally recognized that a government cannot afford a 100 percent rate without substantial abatements, for the simple reason that it loses more from from increased prices on the things it buys than it gains in additional tax revenue, these increased prices resulting, of course, from loose control of costs by producers whose financial incentive to economy has been completely destroyed.

The destruction of incentive inseparably associated with 100 percent taxation is said to be avoided in renegotiation by the use of special rewards for efficiency. It is claimed that efficient producers are allowed to retain a larger profit, after renegotiation, than they would have been allowed if they had been less efficient, and that this provides an inducement to well-doing. If the power of the renegotiators to reward merit is to influence the behavior of contractors, the certainty and substantiality of the reward must be widely believed in. From our observation of renegotiation in practice we doubt that that is the case. The determination of excessive profits by the renegotiation boards is so inscrutable a process, and the comparative results of various determinations are so inexplicable to the outsider, that little concrete evidence is available of the nature and extent of rewards for merit, and little reliance is placed on such rewards.

It is entirely possible that the impairment of incentives for cost reduction attributable to universal, retroactive renegotiation of profits from Government business can leave the Government a net loser on its procurement costs. Indeed, when we note how relatively small an increase in production costs is required to offset whatever the Government obtains (net) from renegotiation refunds, we may well wonder if this possibility is not rather a probability. Consider the fact, for example, that the Federal Government obtained net refunds (refunds in excess of the reduction of tax liabilities through renegotiation) of somewhere around $2,000,000,000 over the entire period 1942–45, during which it purchased goods and services from private industry in the amount of $200,000,000,000.[3] It is hard to believe that the increase in the cost of producing this enormous bill of goods, by reason of the impact of renegotiation on management incentives for economy and efficiency, did not exceed the sum harvested by the Treasury in net refunds.

Even if it could be shown that the Treasury was a net gainer by a small margin from the widespread application of renegotiation during the war, it would not necessarily follow that the Nation as a whole was likewise a gainer. For the increased costs incurred in producing renegotiable business represented a waste of scarce human and material resources, a waste which necessitated an added diversion of these resources from the civilian economy. If the average citizen gained a few dollars from renegotiation as a taxpayer, he lost them as a consumer. Lowered efficiency in the use of productive resources is a social loss for which there is no real compensation.

If the disincentive effect of general renegotiability was serious in the recent war it will certainly be no less so in the kind of defense program we now confront. Since the war was by expectation a short-lived affair, many Government contractors were acutely concerned with the effect of loose cost control on their postwar competitive position. It is not easy to tighten up after a period of letdown on war work. Under the defense program, however, this consideration will be less compelling. Many contractors will look forward to an indefinite period of work on Government orders, hence the disincentive effect of renegotiation will be more fully realized. The longer the prospective emergency, the more narrowly renegotiation should be applied.

Burden on management.—Let me turn now to the third defect mentioned above. Not the least of the wastes of renegotiation results from the absorption of management time in identifying Government contracts and subcontracts, segregating them for cost accounting purposes, assembling data and exhibits, filling out forms, and appearing before renegotiation boards. Few people realize the immense amount of preparation required before renegotiation is even started, to say nothing of the further work—often exceeding the initial effort—frequently demanded before it is completed. If the committee is in doubt on this score, I suggest that

[3] The exact amount of net refunds over this period is in dispute. The official Treasury figure for all corporations is 1.7 billion dollars. (Statement of the Secretary of the Treasury before the Ways and Means Committee, November 15, 1950, exhibit 1). However, this does not include a small volume of net refunds obtained from renegotiations prior to the filing of tax returns, or net refunds from individuals and partnerships.

it examine the forms, questionnaires, and instruction sheets for contractors issued by the Military Renegotiation Policy and Review Board under the Renegotiation Act of 1948. It is obvious that much of this work requires the attention of top executives of the company, and diverts them from their normal functions so essential to defense production.

It is worth while to point out in this connection that general renegotiability of Government contracts and subcontracts can be more troublesome during a defense program such as the one now contemplated than during full-scale war. In the latter case, Government business is identified, all the way down to the raw materials level, by allocations and priority symbols, thus facilitating its accounting segregation by suppliers at all levels. Under a defense program, however, the identification is less complete, and it will be more difficult for lower-tier subcontractors, and for suppliers of standard commercial articles, to tell what part of their business is renegotiable. Government procurement will generate literally millions of subcontracts and purchase orders for articles that will not identify themselves as destined for government use. The task of identification will be, accordingly, difficult and time-consuming.

Arbitrariness of the results.—The bill before us prescribes no standards for the determination of excessive profits, the only ultimate test being the opinion of the Renegotiation Board (or on appeal, the opinion of the Tax Court). It is true that it does enumerate a list of factors to be taken into consideration" but there is no indication of relative importance, and no suggestion of formula of any kind. The determination of excessive profits is fundamentally and incurably arbitrary. Moreover, as an exercise of personal judgment it does not lend itself to convincing explanation or rationalization. Without such an explanation, or access to the detailed facts and figures upon which the decision rests, outsiders cannot make a valid comparison of renegotiation settlements. These must simply be taken on faith.

This extraordinary procedure, comparable to the imposition of an excess-profits tax by the Secretary of the Treasury in his unfettered judgment and discretion, can be tolerable only when administered by men of probity and judgment enjoying the confidence of the contractors whose cases they review. That renegotiation has been workable at all must be credited largely to its administration by officials of this type. But while this can ameliorate the inherent defect of arbitrariness in the renegotiation procedure, it cannot wholly cure it, nor can it prevent honest differences of opinion among the local and sectional renegotiating boards, and a considerable variation in the administration of the law from one of these boards to another. There remains, unfortunately, in spite of general confidence in the integrity of the administrative officials, widespread suspicion of inequality of treatment, a suspicion which in view of the essentially secret nature of the determination it is difficult to allay.

The arbitrariness of declining in the absence of any guiding standard or formula is discounted in official quarters by the assertion that the renegotiation settlement is a voluntary agreement which must meet the judgment and acceptance not only of the renegotiating board but also of the contractor. To be sure, the agreement is in form a voluntary meeting of minds, but we must recognize that its voluntary character is a matter of relativity. The Board has the power to impose a settlement unilaterally, a power which lies always in the background and which inevitably influences the contractor's decision.

PROPER RULE OF RENEGOTIATION

In view of the defects of renegotiation, it is pertinent to inquire further into the circumstances and conditions which justify its use. It is in order only when it is impracticable for one reason or another to make firm (that is to say, nonreviewable) contract prices at the outset, and when its use is considered preferable to the review and repricing of contracts individually. It has no place if fair and reasonable prices can be satisfactorily determined in advance. Where firm-price buying is feasible, renegotiation should be out.

It is interesting to note that this view of the role of renegotiation coincides essentially with the position taken by renegotiation and procurement officials during the recent war. Industry was told repeatedly that what the Government was trying to do was to recapture overpayments to the contractor resulting from poor pricing; that such pricing was unavoidable under the pressure of the emergency and the inexperience on both sides of the bargain; that the goal of procurement policy was the development of experience and the perfection of techniques so as to widen the area of firm pricing; and that as that area widened renegotiation would wither away. Surely if this was the mature view of the responsible wartime

officials, we should think again before confirming the universal renegotiability of Government contracts and subcontracts as a permanent feature of our procurement system.

If renegotiation is appropriate only for contracts and subcontracts for which a fair and reasonable price cannot be determined at the time of placement, the question then becomes whether there is any general criterion of reasonableness by which the procurement authorities can distinguish contracts eligible for firm and nonreviewable prices from those properly subject to renegotiation. We believe there is such a criterion, and I should like, with your permission, to discuss it briefly.

BASIC CRITERION OF REASONABLE PRICES

Let me begin by saying that the proper concern of procurement policy is the reasonableness of the price the Government pays, not the profit of the individual contractor. The latter enters the picture only in cases when it must be used, for want of anything better, as a criterion of the reasonableness of the price. These cases are exceptional in peacetime procurement, most contracts being placed in normally competitive markets where it can be assumed, in the absence of collusion or other special circumstances, that the price of the best supplier is reasonable regardless of the amount of profit he makes. In such cases we may presume, rightly, that since the business is obtained in fair competition a high profit reflects superior efficiency, and that the contractor is therefore entitled to it. The market, not the profit of the successful bidder, is the determinant of a fair price. Where a satisfactory degree of competition is present, the question of profit is therefore irrelevant.

Although normally competitive conditions are the rule in peacetime, there remain, of course, some situations in which, for one reason or another, there is not a satisfactory degree of competition on Government work, and in which, therefore, the reasonableness of the market price cannot be taken for granted. In other situations there is no market price, because the article is new, or because the contract price is fixed by a single negotiation, without competition. In these cases it becomes necessary to rely on some criterion of fair prices other than the market, and the profit of the contractor inevitably comes into the picture.

But even here judgment cannot properly turn simply on the amount of this profit. The aim of the procurement authorities should be, so far as possible, to approximate the result that would have been arrived at in a normal competitive market. If the contractor is superior in skill, energy, and efficiency, he should be allowed a profit that reflects this superiority, and the price that permits him to make such a profit should be considered a reasonable price, even though the profit is large. If he is incompetent and inefficient, but if his services are nevertheless indispensable, he should be given the lowest price that will permit him to accomplish the necessary Government work, even though the profit is small.

PROCUREMENT POLICY FOR A DEFENSE PROGRAM

With a heavy defense program, we have, of course, a situation intermediate between war and peace, in which the area of normal competition is considerably narrowed, but certainly with the program now in prospect this area will remain large, permitting firm, or nonreviewable, prices over a tremendous range of articles and commodities entering into Government procurement. The test of normal market competition will still be widely available. Certainly there is no justification for making all contract prices unfirm by the universal, retroactive renegotiability proposed in the pending bill.

It is to be expected, of course, that many prime contracts will need some form of price review, particularly in the build-up stage of the defense program when the products are often unfamiliar to the contractor, when production techniques are unseasoned, and when costs under full-volume output are unknown. This will be true also of many subcontracts, especially those for subassemblies and components of military end products that present production problems similar to those just mentioned for prime contracts. Even when the defense program is in full swing, there will inevitably remain a considerable scope either for price redetermination or for renegotiation, because of changes in designs and specifications, the introduction of new products, the breaking in of new contractors, etc. It is to be hoped however, that this scope will narrow progressively as time goes on.

While firm pricing can probably never be made universal for specialized military articles it can certainly be the rule rather than the exception for standard commercial articles or their equivalents. Whatever the military end product, subcontract and purchase orders soon fan out into ordinary articles of commerce. In terms of

numbers, though not necessarily in dollar volume, such subcontracts and orders make up the bulk of the total. In this area the presumption is overwhelmingly in favor of firm pricing, though even here renegotiation should be available in cases where for one reason or another the market does not offer a normally competitive price.

To sum up, profit control can never be made a satisfactory substitute for cost control. It should therefore be the constant purpose of the procurement agencies to widen the range of firm pricing with increased experience and improved techniques. For, as we said earlier, it is firm pricing that gives contractors and suppliers the maximum incentive to reduce costs and increase efficiency. It is for this reason the policy that by and large will give the Government the lowest prices.

DETERMINING THE AREA FOR RENEGOTIATION

Granted that under present conditions firm and final pricing of Government contracts and subcontracts should be the rule and renegotiable prices the exception, the practical problem remains of defining the area for renegotiation.

In his testimony before the Armed Services Subcommittee of the Senate Committee on Appropriations with reference to the Military Establishment Appropriation Act of 1950, the then Chairman of the Munitions Board recommended that there be exempted from renegotiation all contracts entered into as a result of formal advertising and competitive bidding, and all subcontracts thereunder. This exemption was incorporated in the appropriation then pending, and has been extended to various military appropriations passed since then.

Whether such an exemption is wise may be debatable, but it can hardly be debatable that many contracts arrived at by negotiation are equally eligible for exemption, as well as innumerable subcontracts arising under negotiated prime contracts. The fact is that as now conducted the negotiation of a contract can be a highly competitive process. Frequently several producers are asked privately and independently to submit bids or estimates and when these are in they are played against each other until the best proposition is developed. Though nominally negotiated, the resulting contract prices may be as competitive as those obtained by advertising for bids, if not more so, and quite as suitable for exemption from renegotiation. As for the underlying subcontracts, they are no different, in general, from those arising under competitively bid prime contracts.

If the exemption only of competitively bid contracts and subcontracts thereunder is for these reasons inadequate and arbitrary, the question arises how renegotiation can be made available for use by the procurement agencies in appropriate cases without being required in other cases for which it is not appropriate. Here, it seems to us, Congress can well revert to the method employed in section 401 of the Second Deficiency Act of 1948. There, as indicated earlier, it simply authorized the responsible administrative authority (the Secretary of Defense) to designate for renegotiation any contracts or class of contracts that in his judgment merited the designation. Unlike the pending bill, which makes all contracts renegotiable unless exempted by administrated action, it exempted all contracts unless expressly made subject by administrative action. This seems to us the logical approach under present conditions, when the general presumption is in favor of firm pricing, rather than renegotiability.

It may seem at first glance that it should make little difference to the final result whether Congress decrees universal renegotiability with authority for discretionary administrative exemptions, or universal exemption, with authority for discretionary administrative application of the device. The truth is, however, that the results will be as far apart as the poles. Given universal coverage save for administrative exemptions, the officials in charge will consider that Congress has indicated a general presumption in favor of renegotiability. Accordingly, they will grant exceptions with the greatest reluctance, and only in the most compelling cases. The whole history of administrative exemptions from renegotiation confirms this. If, on the other hand, Congress indicates, by the requirement of specific administrative designation, that the presumption is in favor of firm pricing and nonrenegotiability, the responsible officials will be encouraged to limit the use of the device accordingly. It is of the utmost importance, therefore, that the application of administrative discretion be reversed.

STATEMENT OF CONGRESSIONAL INTENT

While this reversal will put renegotiation in its proper place, as an instrument of procurement policy, to be used, like any other device, selectively and in appropriate cases at the discretion of the authorities, it will not suffice, in our judgment,

without an explicit statement of congressional intent, spelled out in the governing statute.

This statement should make it unmistakably clear that the purpose of renegotiation is to correct retroactively for mistakes in the pricing of Government contracts and subcontracts, and that it is to be used only when for some reason firm and final pricing is impracticable at the time the contracts are let. It should emphasize that nonrenegotiable pricing is the normal goal of procurement policy and should be employed as widely as conditions permit. It should indicate that in normally competitive markets the price of the best supplier is presumptively a reasonable price requiring no retroactive review.

IS AFFIRMATIVE DESIGNATION PRACTICABLE?

We have already noted that in the past renegotiation administrators have shrunk from the exercise of the liberal exemption authority conferred by Congress. There has been in fact a deplorable flight from responsibility in this regard. The mere possibility that some future congressional investigation might unearth cases in which exemption was unwisely granted has had a paralyzing effect, engendering a safety-first attitude that has at times reduced the exemption provision almost to a nullity.

It is obvious that Congress is in no position to prescribe exemptions in detail in the fluid and changeable situation we now confront. It is inescapably a job for the administrative authorities, and some way must be found to induce them to accept the responsibility. While there is probably no way to exercise entirely their fear of future legislative investigations, we believe the best way to get the real benefit of administrative judgment is the method suggested above: a clear statement of congressional intent and a requirement for affirmative designation for renegotiability.

It will undoubtedly be urged by those who wish to avoid this responsibility that affirmative designation is impracticable. We do not think so. It does, of course, require a close integration of renegotiation with procurement, but since renegotiation is properly a procurement device, this is as it should be. We see no reason why the renegotiation authority cannot promulgate a list of military end products and components for which prime contracts or subcontracts are renegotiable, as well as a list of ordinary commercial articles which are also subject. This list can be changed from time to time with changes in markets and supply conditions. Needless to say, where the authorities desire, designation can be by individual contracts, though the usual method will, of course, be by class or type.

This selective approach should afford adequate protection to the Government, while avoiding the absurdities that result from blanketing in everything regardless of need or justification. It should vastly simplify the process of renegotiation for both sides. Even more important, it should save money for the Treasury by broadening the incentives for economy and efficiency in production that can come only with firm pricing.

THE QUESTION OF STATUTORY EXEMPTIONS

Assuming that the administrative application of renegotiation is reversed as suggested, with all contracts and subcontracts exempt save those specifically designated, either individually or by class or type, by the Renegotiation Board, the question arises whether it is necessary or desirable to exclude from designation any categories of contracts other than those given mandatory exemption under section 16 (a) of the present bill. This is a question to which only experience under the proposed arrangement can give a satisfactory answer, but provisionally at least it may be well to give the Board a wide discretion and trust that it will designate for renegotiation only such contracts as clearly justify it.

While it may be desirable to resort sparingly to statutory exemptions under the arrangement suggested, such exemptions should be employed more liberally under the reverse arrangement proposed in the pending bill. For, as indicated earlier, with universal renegotiability, subject to administrative exemption, there is little chance that the Board will grant more than the barest minimum of relief. Congress in this case should block out the major areas of exemption by statute.

We have no map or blueprint of these areas, and will not presume to offer a list. The committee doubtless has heard and will hear from others on this subject. We should like, however, to bring to its attention an area with which we are intimately familiar, and for which the case for exemption is not only extraordinarily cogent, but unique. I refer to capital equipment sold to contractors and subcontractors for use in processing Government work. Renegotiation of the suppliers of such

equipment is highly discriminatory, for a reason that will appear obvious on a moment's reflection.

THE CASE OF PRODUCTIVE EQUIPMENT

When contractors and subcontractors in the chain of production of military end products purchase materials, parts, and components for incorporation in such products, they are buying goods destined to become the property of the Government. In effect, they are simply making advance payments on Government account. It is perfectly logical, therefore, to regard these purchases as indirect Government procurement and to treat the suppliers' profits therefrom, for the purpose of renegotiation, just as if the procurement had been direct. Such profits, unless exempt, are properly renegotiable in full.

The case is quite different, however, when contractors and subcontractors purchase long-lived equipment for the production of military end products. Ordinarily such equipment is not destined to become the property of the Government. It remains permanently in the title and possession of the contractor. Moreover, its cost, unlike the cost of military components or end products, is not directly chargeable to the Government. Instead it is reimbursed to the contractor only over a period of years, in the form of the depreciation charge for the use of the equipment on Government work. Reimbursement is complete, therefore, only when the entire service life of the equipment is exhausted in this work. Such cases are rare. Ordinarily only a fraction of the life is so consumed, the remainder being run out in production for private account. It follows that reimbursement through depreciation charges on Government work is also fractional.

Despite the partial character of this reimbursement, the entire profit of the machinery manufacturer who supplied the equipment is held, under the pending bill, to be renegotiable. But even this is not all. If this manufacturer in turn buys a machine which is used, even momentarily, in the production of the equipment he furnishes the Government contractor, the profit of his supplier becomes likewise renegotiable in full.

Even if the profit from the sale of productive equipment to a Government contractor is properly renegotiable, the renegotiation should apply only to that portion of the profit which corresponds to the portion of the service life of the equipment that is exhausted in the execution of Government contracts. If, for example, the equipment is to have only one-tenth of its potential serviceability so exhausted, the profit of the equipment manufacturer from the transaction should itself be renegotiable, at most, to the extent of only one-tenth. Similarly, only a small fraction of one-tenth of the profit from the sale of machinery to the equipment manufacturer himself should be renegotiable against his supplier. To renegotiate the entire profit in both cases, as the bill proposes, is not only unjustifiable in principle; it is a gross discrimination against the manufacturers of capital goods and their suppliers.

Obviously, there are two ways to remove this discrimination. One is to exempt from renegotiation productive equipment purchased by defense contractors and subcontractors for their own account, even though it is used on Government work. The second is to devise a procedure for renegotiating some fraction of the profit of equipment manufacturers from sales to defense contractors, rather than the entire profit. Let me consider these in order.

The straight exemption is, of course, the simplest solution, and if the only alternative is full renegotiability, as contemplated in the bill, it is certainly to be recommended. It is interesting to note that the Senate came to this conclusion during the recent war and voted the following mandatory exemption from renegotiation (eliminated in conference):

"Any contract or subcontract for durable machinery, tools, or equipment used in processing an article made or furnished under a contract with a Department or a subcontract, but which is not incorporated in or as a part of such article. For purposes of this subparagraph, the term 'durable machinery, tools, or equipment' means machinery, tools, or equipment ordinarily having a useful life of more than 10 years." [4]

If the Senate took this step at the height of an all-out war (January 1944) after nearly 2 years of experience with renegotiation, it certainly behooves this committee to consider similar action.

The second alternative to which I referred a moment ago, fractional renegotiation of profits from the sale of productive equipment to defense contractors and subcontractors, is of necessity far less simple than straight exemption. Obviously,

[4] Excerpt from H. R. 3687 (78th Cong.) as it passed the Senate.

it is possible only in rare instances to foresee what fraction of the service life of such equipment will be run out in Government work. Prediction being excluded in most cases, it is necessary to fall back on some arbitrary assumption calculated to work rough justice over all and at the same time provide an administrable rule. We propose the assumption that the first 5 years of the service of equipment originally acquired for defense production will be devoted entirely to Government work and that the remainder of the service life will be devoted to ordinary commercial work. We propose, in line with this assumption, that the renegotiable portion of the sales of such equipment by suppliers be the proportion which 5 years is of the normal service life. Thus, for 10-year equipment, one-half of the sales would be renegotiable; for 15-year equipment, one third; for 20-year, one quarter; and so on. This arrangement would not apply, of course, to sales direct to the Government or for Government account, which would be fully renegotiable like other sales of this kind.

To apply the proposed rule, it is necessary to have some readily available measure of normal service lives. For this purpose we suggest the use of Bulletin F, issued by the Bureau of Internal Revenue. An alternative would be to use the life assumed by the purchaser of the equipment for income-tax purposes. The second test is, of course, less easy to apply, since the supplier would have to ascertain his customer's tax depreciation rate in each case, but it is nevertheless thoroughly workable if the Congress prefers it.

Under present conditions, the assumption that defense contractors will use new equipment exclusively on Government work for 5 years appears to be liberal. It seems likely that on the average more private work will be done on the facilities during the first 5 years than Government work after that period. In any event, it is a reasonably satisfactory basis for fractional renegotiation in this field, and the Machinery Institute strongly recommends it if the Congress does not see fit to exempt private purchases of equipment entirely.

I can clarify our position further by saying that we do not ask a categorical exemption for productive equipment if renegotiability is determined through affirmative designation by the Renegotiation Board, as proposed earlier, but we do ask even in that case that the statute enjoin the fractional renegotiation just described whenever equipment is made subject by designation. If affirmative designation is rejected, however, we ask for either a categorical exemption or a requirement for fractional renegotiation, whichever the committee desires.

RENEGOTIATION AND PRICE REDETERMINATION

As indicated earlier, one of the virtues of over-all retroactive renegotiation is the avoidance of contract-by-contract repricing, a virtue particularly important for the contractor with a multiplicity of repriceable contracts. The avoidance is by no means complete, however. There is a legitimate place for specific repricing, especially in large prime contracts, and there is no reason to believe that over-all renegotiation over will or ever should eliminate it entirely. It is possible in many cases to tailor repricing arrangements to the circumstances of the particular contract, with benefits not derivable from a retroactive recapture of profits.

It is possible, for example, by periodic forward repricing to give the contractor an assurance of firm prices for limited periods of time, or for limited numbers of deliveries. In this way can he be given some incentive for economy and efficiency—provided, of course, that the reward for his efforts is not take away by renegotiation later on. This proviso brings me to our recommendation. There is no sense in pyramiding retroactive renegotiation on specific repricing. The law should therefore prohibit the Renegotiation Board from including in renegotiation any contracts or subcontracts that have been individually repriced under their own repricing clauses. It should be assumed that such repricing is sufficient; hence that the contracts are not to be reviewed again in an over-all renegotiation proceeding.

There is another point to bring out in this connection. The decision whether to recapture excessive profits by over-all renegotiation or by invoking price redetermination clauses in individual contracts should turn on the real merits of the alternatives, not on extraneous and irrelevant considerations. Yet, such considerations are inevitably introduced by the fact that funds recaptured by renegotiation go to the Treasury while those recaptured by price redetermination go back to the procurement agency concerned, where they are available for re-expenditure. This places an artificial premium on specific price redetermination as against renegotiation and tends to encourage excessive use of the favored device. We suggest that both procedures be put on a parity by an amendment

to the pending bill providing that recaptured profits go in both cases to the Treasury.

RETROACTIVE APPLICATION

The bill subjects to renegotiation receipts and accruals after January 1, 1951, on contracts and subcontracts entered into prior to that date, even though they were exempted by the Renegotiation Act of 1948 or by regulations issued thereunder. Such retroactive application we consider both unnecessary and unwise. We urge that the new law be applied only to contracts entered into after December 31, 1950, and to such earlier contracts as were renegotiable on that date under the 1948 act.

SUMMARY OF RECOMMENDATIONS

1. Instead of making all Government contracts and subcontracts renegotiable, save as exempted by administrative action, make them exempt except when made subject by administrative action.
2. Direct the Renegotiation Board to make renegotiable only contracts and subcontracts for which a fair and reasonable price cannot be determined at the time of placement by reference to the competitive market.
3. If universal renegotiability is continued, contrary to recommendation 1, either give statutory exemption to contracts and subcontracts for productive equipment and components thereof or provide for fractional renegotiation of such contracts. Provide for fractional renegotiation even if recommendation 1 is adopted.
4. Exclude from renegotiation contracts and subcontracts that have been individually repriced under their own repricing clauses, and cover into the Treasury any profits recaptured through such repricing.
5. Apply the law only to contracts and subcontracts entered into after December 31, 1950, and to earlier contracts that were renegotiable on that date under the act of 1948.

Mr. TERBORGH. We feel first of all that this is an opportune time to give a careful and thoroughgoing review to the whole question of the role of contract renegotiation in a defense program of the sort we now contemplate.

I should like to remind you that historically the Wartime Renegotiation Act and the act of 1948, which restored renegotiation during peacetime, were both rushed through Congress as riders on appropriation bills, and industry had no opportunity to express its views. There were extensive hearings before the Ways and Means Committee in August; and this, I believe, is the first opportunity that we have had to discuss with this committee the question of what form renegotiation should take in conditions of less than all-out war.

The decisions that are made now will last a long time, and we are in the fortunate position of not having to decide anything hastily, because, as you gentlemen know, we have a Renegotiation Act in full effect now, the act of 1948, which is adequate provisionally, and there is certainly no justification for precipitous action at this time.

Our principal objection to the bill is that it is almost a complete reenactment of the World War II statute, ignoring what we consider very substantial differences between procurement conditions obtaining now or in prospect as compared with the World War II conditions. During the height of the war, the Federal Government was purchasing about 35 percent of the entire output of private industry, including agriculture; and, with the defense program now envisaged, that percentage will probably not go over 15 percent.

Senator MARTIN. How much has our productivity increased since World War II?

Mr. TERBORGH. Our productive capacity is estimated at 30 percent higher, or somewhat more.

Senator MARTIN. Good.

Mr. TERBORGH. At any rate, by this test, we are not dealing with conditions comparable to war, and we believe that the differences in conditions justify a very radical difference in the approach to contract renegotiation.

You know how renegotiation started. The services were simply smothered with procurement commitments. They were shorthanded. They did not have the trained staff. The contractors were green. They were making products that they had never made before by productive methods that they had never used before, and it was impossible to make firm prices on any substantial part of that procurement, particularly in view of the hast. We will have a lot of that this time, of course. The same thing is going on in diminished degree. It is very much less, and, as we now confront the long-drawn-out procurement program, we can hope that with the seasoning of the procurement officials and of the contractors, and with the completion of the strains of economic conversion to war production, we can get procurement on a more or less normal basis; and we can taper down the role and function of contract renegotiation to what we consider its legitimate role is.

I want to make it perfectly clear that we are not opposed to renegotiation. We have certainly come to the view, after a great deal of experience with it in the war, that it has a perfectly legitimate role to play in procurement policy, and we do not see that role entirely extinguished in the visible future.

As I said a moment ago, we look for a tapering down of the area that is appropriate for the use of this device. It has very distinct advantages; and, if you will permit, I will mention just three:

The first is the convenience, both to the contractor and to the Government, in situations where the contractor has a great many contracts in his plant which are subject to repricing. To reprice those contract by contract is an extremely onerous job, and it is very time-consuming on both sides; and, in circumstances of this sort, retroactive over-all renegotiation after the close of the year is a marvelous time-saver, and indeed indispensable with the multiplicity of repriceable contracts.

From the standpoint of the contractor, it has the advantage of permitting the offsetting in this retroactive review of loss and low-profit contracts against high-profit contracts; whereas, if they are repriced separately and without reference to each other, the contractor gets nicked on high-profit contracts with no compensation on the loss business. That is a very important feature.

Now, from the standpoint of the Government, renegotiation has the advantage that it permits the Government to reach subcontractors as far down as it wants to go in the several tiers of subcontracting and supply. Having no direct contract with these producers, it is in a very poor position to police repricing arrangements in retroactive contracts, but at the end of the year renegotiation permits everything to be mopped up.

So, we believe that it is a perfectly legitimate operation and has a proper place. It does have, however, very grave disadvantages which we ought to take cognizance of, and which in our judgment limit its proper role of application pretty narrowly. Let me run over those.

In the first place, the assurance that everything will come out in the wash, so to speak, and that everything will be mopped up at the

end of the year in this retroactive review, is just an inducement to lazy and sloppy contracting and to lazy contract negotiating on the side of the contractor as well. It is an invitation to sloppy procurement practices, and it generates them. Anybody who has observed this in practice will keenly realize that.

Secondly, this recapture is, in effect, akin to a 100-percent tax on the profits that the renegotiators deem to be excessive. It is the only area that I am aware of where any Government has imposed 100-percent taxation on any segment of profits. You remember, it was done in some countries like Britain and Canada, but they sweetened it with a postwar refund of 20 percent, so that the net impact of the tax was only 80 percent. But, as to renegotiation, it is a 100-percent tax on the allegedly excessive portion of income. It constitutes, therefore, a very serious deterrent to the incentives of the contractor to economize to save costs and to augment his profits by doing so.

There is no point in augmenting them if they are taken away 100 percent at the end of the year.

We exaggerate, I think, the net saving to the Government of the application of contract renegotiation during the war. By pointing this out, I do not mean to oppose its application; but, as nearly as we can see, after you allow for the taxes that were lost through renegotiation and recapture, because the income would otherwise have been taxable, the Government made a net gain in the 4 years 1942 to 1945 of perhaps $2,000,000,000—maybe a little over that, but not much.

During that same period, it bought $200,000,000,000 worth of the products of private industry. The net recapture was about 1 percent of the total procurement. And, when you realize those ratios, you can see that the effect of impairing the incentives of contractors to efficient production and the inducement of loose control could easily have more than offset the net gain to the taxpayer by recapture. And, even if the taxpayer was a net gainer, it does not follow necessarily that the Nation as a whole was a net gainer, because, if it led to the wasteful use of manpower and physical productive capacity and materials, those wasted materials were diverted from civilian production, and the citizen may have gained a few cents as a taxpayer while he lost as a consumer.

So, we should not regard this in the light of a tremendously important source of net savings to the Government.

My third disadvantage of renegotiation is not so important, but a lot of people think it is very important when it hits them, and that is the burden on management in making the necessary classifications of its contracts, filling out the requisite forms, preparing renegotiation reports, meeting with the renegotiation authorities, and following up with the further researches and further statements.

Anybody who has gone through one of these proceedings has the greatest respect for the amount of time it takes, and it takes the time of top management as well as intermediate management.

My fourth objection is the complete arbitrariness of the results. Without impugning in any way the integrity of the renegotiation boards, I think it is fair to say that the results of renegotiation determinations in World War II did not convince contractors or the public of their equity and comparability. They are essentially star-chamber proceedings. The rationalization is unknown to the contractor. They are pure conclusions on the part of five men, and five different

men from this district and another district. There were 50 or more of these boards renegotiating, as you know.

Notwithstanding the integrity of the officials, I say the results remained actually and in the opinion of the business community considerably arbitrary. It was impossible to persuade the community that equity was dealt our even-handedly.

Now, those are grave objections.

Let me go on to say what I think should be the proper role of contract renegotiation. I think it is in order when firm price buying is not feasible at the time contracts are let and when the specific repricing, the individual repricing of the separate contracts is impractical because of convenience or the time required or the preference of the contractor, and so on. That is the area where it properly applies, where repricing is necessary or price determination in some form is necessary, and where it is not desirable to accomplish those redeterminations contract by contract. I think this is the view that the wartime officials took. I was in the thick of this myself, and I remember a number of addresses on the part of high procurement officials, Pulsam, Browning, and others, and the Secretaries of War and Navy, to the effect that they regarded contract renegotiation as a necessary expedient in view of the pressures that were on them and the circumstances I described earlier, but that they hoped it would wither away with the perfecting of contract techniques and the seasoning of the contractors and the stabilization of procurement.

They honestly expected and hoped that it would wither away, and they sold business on contract renegotiation partly by the promise that it was a temporary emergency expedient that would be tapered down.

Now, in less exigent circumstances we are confronting proposals to make it permanent, not only permanent but universal, covering all Government procurement. That I think is a step backward, and as I said earlier, it behooves the committee to give a fundamental review of the whole situation.

Firm pricing ought to be the goal of procurement policy, and they ought to work toward that with every effort, because wherever firm pricing is possible we are persuaded that in the long run and in general it brings the lowest possible prices to the Government, by giving the contractor the maximum incentive to control his costs. If you cannot set up procurement devices which give the contractor an incentive to control his costs, you can never hope to take up for that deficiency by any type of profit control of the contractor. The whole drift is toward contracting to turn into a cost-plus operation.

Now, where do we come out with this? It follows from the reasoning I have just offered that renegotiation is a procurement device of merit where justified, but that it ought not to be applied universally, and that it should be applied selectively at the full discretion of the procurement authorities and the renegotiation authorities, and I would not limit their discretion, but it ought to be applied selectively and by the affirmative designation of products, commodities, and classes of contracts as the need arises, with undesignated contracts nonrenegotiable.

This is a reversal of the wartime set-up, where all contracts were automatically renegotiable unless exempted, and it is a reversal of the order proposed in the pending bill. You may think that it makes very

little difference in the end whether contracts are made subject initially and whether the administrators are given power to exempt, or whether contracts are made exempt save where the administrators designate them for renegotiation. That, however, is not the case.

Anyone who has observed the administration of renegotiation will be perfectly convinced, as the preceding speaker pointed out, that if you make them all renegotiable de novo, the administrators will interpret that as a congressional statement that the presumption is in favor of renegotiation and that exemption should be narrowly construed and restricted to the most patent cases.

Under that kind of mandate, I am positive that the exemption provisions will turn out to be substantially a nullity again, as they did the last time. You cannot get the administrative boards to accept the responsibility of making large-scale exemptions.

Now, maybe you cannot get them to accept the responsibility for limiting the designations to the appropriate area. I think, however, that the chances are much better, because the reversal of the set-up would constitute an indication that Congress regards renegotiation not as the rule but as the exception, and that the presumption is in favor of firm pricing and nonrenegotiable procurement.

Notwithstanding that, I would give them full and plenary authority to designate as they see fit.

That brings me to my final point, gentlemen, and that has to do with the peculiarities of the type of product that my organization represents, namely, industrial equipment.

Now, if the contracts and subcontracts call for matériel that will eventually wind up in the hands of the Government and be paid for by the Government, where other conditions justify, it is perfectly appropriate to make the profits from those contracts renegotiable in full, that is, 100 percent. We do not think it is appropriate in the case of productive equipment that is not sold to the Government but that is sold to the private contractors and subcontractors for use in part on Government work.

The definition of a subcontract that is in this bill makes it mandatory that all sales of equipment even to private contractors be fully renegotiable. It goes even further. A manufacturer of equipment who sells a piece of equipment to another manufacturer who makes equipment to deliver to defense contractors or subcontractors has his sales of that type likewise renegotiable in full. Now, this equipment never winds up in the hands of the Government. It remains in the possession and title of the contractor, and in general it serves only part of its useful life in Government production, or defense production.

The presumption is that most if this equipment, which lasts 20 years, let us say, will not serve out its full life or anything like it in the production of Government work.

We propose, since nobody can foresee in advance what portion of the service life of equipment delivered to contractors and subcontractors will be exhausted in Government production, to solve this problem by a flat and arbitrary presumption which we consider generous to the Government, and at any rate, a satisfactory working rule. We propose to assume that the first 5 years of service of all equipment delivered to Government contractors and subcontractors will be exhausted exclusively on Government work, and that the

remainder of the service life will be used in commercial production. That I think is a postulate that is generous to the Government, because if I had to guess, I would say that there will be more commercial production on this stuff during the first 5 years than there will be Government production after the first 5 years.

But you have to have a working rule here of an arbitrary character. We propose that rule, and we propose that it be applied in this fashion: That that fraction of the profits of the equipment supplier be renegotiatable which 5 years constitutes of the normal service life of the facilities delivered.

In other words, if it is a 10-year asset, renegotiate half of his profits; if it is a 20-year asset, renegotiate a quarter of his profits. The Government pays for those facilities only through the charge for depreciation on the use of them in Government production, and that seems to us an appropriate, if rough and ready, solution of a deep question of principle here, whether it is fair to the suppliers of equipment to renegotiate all of the profit from the sale of such equipment when the Government does not buy it and does not buy more than a fraction of it through the charges it bears for the contractor's depreciation.

It is easy to solve that on either one of two bases. You can use Bulletin F promulgated by the Treasury Department in 1932 as the standard of expected service lives, or you can require the supplier to interrogate his customer and find out what rate the Treasury allows him for tax-depreciation purposes, and take that. That is a little more complicated, but it is still thoroughly workable. There is nothing that I can see that is nonadministrable in this proposal for fractional renegotiation of the profits on the sale of equipment to Government contractors. Only it has to be a matter of statutory prescription, because we cannot expect the renegotiation board on its own initiative and with no statutory mandate to inaugurate a scheme of this kind.

The alternative, it seems to us, is an outright exemption of productive equipment not sold to the Government. We are not exactly asking that. We are offering this as what we think is a reasonable compromise, but we believe that exemption is better than making such profits 100 percent subject.

You may recall that the Senate voted in January of 1944 to grant an exemption to productive equipment not sold to the Government. It was lost in conference, but this body is on record as having reached that conclusion at the height of the war, and it would seem even more appropriate today if our scheme does not commend itself to you.

I apologize. I have one more point, that will take only a minute. That has to do with the interrelation between over-all contract renegotiation and the price determination on specific contracts.

As I said earlier, renegotiation is a saving grace whenever the contractor has a multiplicity of repriceable contracts, but that does not mean that renegotiation ought to supersede this specific repricing. On the contrary, we think that repricing has a very important role, and it should not be excluded or supplanted by renegotiation where its own merits are paramount.

There are a lot of major contracts that offer excellent scope for repricing arrangements, preferably forward repricing by periods of time or by amounts of delivery on the contract. The forward repricing

gives the contractor a limited incentive to maximize the prices and keep his costs down during the period of the freeze. We would like to see a lot of experimentation with various incentive devices for the forward repricing of deliveries on long-term contracts.

We do ask, however, that we avoid the pyramiding of the two devices on top of each other. That is, where you have a contract that has been repriced in accordance with its own repricing provisions, that should be enough. That contract should not be thrown into the pot for renegotiation at the end of the year. If you do that, you emasculate the whole operation of incentive repricing arrangements on the particular contracts.

So we recommend, as I say, that where contracts have been repriced in accordance with their own provisions, they be excluded from the renegotiable business for purposes of review.

Lastly, as you see on the statement, we do not think that the act of 1951 ought to have been made retroactive in its application to contracts that were exempt before the beginning of this year under the Renegotiation Act of 1948.

Thank you.

The CHAIRMAN. Thank you very much.

Are there any questions?

Senator MARTIN. No questions.

Mr. TERBORGH. Thank you.

The CHAIRMAN. Mr. Foreman.

Will you please identify yourself for the record?

STATEMENT OF H. E. FOREMAN, MANAGING DIRECTOR, ASSOCIATED GENERAL CONTRACTORS OF AMERICA

Mr. FOREMAN. I am H. E. Foreman, managing director of the Associated General Contractors of America, a national trade association representing some 6,000 firms throughout the Nation that do a substantial majority of the construction work executed by contract.

The CHAIRMAN. You may proceed.

Mr. FOREMAN. The points which I wish to make have been summarized on the one-page sheet which has been passed out. I would like to have the opportunity to amplify these particular points a little bit.

The CHAIRMAN. Very well.

Mr. FOREMAN. Point No. 1. The presently proposed legislation makes all contracts with certain designated departments subject to renegotiation, and gives the President complete power to extend the application of the measure beyond these departments specifically named. Furthermore, it applies not only to contracts to be undertaken, but also automatically applies to contracts already in existence, to the extent of moneys to be paid or payments accrued after January 1, 1951, whether or not they are defense connected and whether or not obtained as a result of advertised competitive bidding.

I would like to point out that perhaps $2,000,000,000 worth of construction contracts are normally carried over at the beginning of any year. Construction work for various Government departments is part of the normal business of the construction industry, quite a substantial part of it.

The way we read the legislation as passed by the House, a contractor who has built a post office and has it all completed but still has some retained percentage still to be paid, finds that that retained percentage and the retained percentage of his subcontractors down the line are subject to renegotiation. Similarly, dams such as the Clark-Hill down there in Georgia and South Carolina, certainly were not influenced by the defense effort at the time of their bidding. This particular dam is still in process and probably will be in process for quite a number of years. Yet the way we read the law, it would be subject to renegotiation.

In all instances, the contracts were obtained after complete plans and specifications, after open bidding by all the bidders, on all the facts known. And while because of the inflation I doubt if very much would be recovered in any event, it certainly would make for a lot of additional expense to the contractor and to the Government as well to look into those contracts. We think it is thoroughly unjustifiable and thoroughly indefensible.

So much for that work is being carried over.

Looking to the next proposition, of work to be undertaken, we think that that divides itself necessarily into two branches, that which is defense connected and that which is not. And we think that to the extent that the nondefense work is carried on as a result of competitive bidding, again, with all plans and specifications available and advertised, and the public at large invited to bid thereon, the Government is sufficiently and completely protected.

Certainly it would not be in any worse position than the States, counties, and municipalities. If someone wants to bid on some small projects, just to make this point stand out as prominently as possible, a little remodeling, repairing, and one thing and another, that adds up to $100,000 on Government buildings, it would be subject to renegotiation; on other types of structures, it would not be.

Construction that will be undertaken by the Government will be by no means a major percentage of the total construction volume of the construction industry, in any event. Regardless of how strongly this war may develop, we are still going to have to maintain this civilian economy; we are still going to have fires and depreciation and all that sort of thing that are going to have to be taken care of, and there will be a substantial amount of new construction, highways, sewers, hospitals, schools, and all that sort of thing.

It seems to me that the Government should take a careful look. I am talking about non-defense-connected work. Why should a contractor expose himself to Government renegotiated contracts when there are other types of work available in that particular field?

Now, getting over into the defense side, again, if the work is advertised competitively, there can be no argument that all the facts were not known, and it seems to us that the committee should carefully consider whether any contracts obtained as a result of open competition in the construction field should be handled under renegotiation.

The 1948 act exempts it. It exempts all work under competitive contract, whether construction or otherwise. But I am speaking solely and alone from the construction standpoint, because that is the only thing that I pretend to know anything about.

Senator BUTLER. Mr. Foreman, do you make any specific suggestions as to omissions which should be made in H. R. 1724, or any additions or amendments that should be added to it?

Mr. FOREMAN. We had presented an amendment to the original legislation which was under consideration last summer which was reproduced, we understood, in the House, but the finally enacted piece of legislation was substantially different. I am referring to H. R. 9246, of the Eighty-first Congress, which was a duplicate of 1270, the original bill in the House.

At that time, we proposed that there be an exemption of any contract with a department awarded as a result of competitive bidding, but not including negotiated price contracts for the construction of any building, structure, improvement or facility, or any subcontract directly or indirectly under the contract or subcontract to which this subsection does not apply by reason of this paragraph.

We believe that that same recommendation is appropriate for consideration in connection with the present legislation.

Senator BUTLER of Nebraska. Do you have others besides that?

Mr. FOREMAN. Not in such specific form.

Senator BUTLER of Nebraska. In the measure, you favor the provisions in the act of 1943 - - -

Mr. FOREMAN. And 1948.

Senator BUTLER of Nebraska. And 1948?

Mr. FOREMAN. Yes, sir. I was privileged to appear before this committee on both occasions with respect to that same point.

Senator BUTLER of Nebraska. If those provisions were reenacted in this present act, do you think it would be agreeable?

Mr. FOREMAN. Yes, sir.

With regard to our point No. 3, within that area where renegotiation is bound to apply, particularly in view of a negotiated lump sum, defense connected, there are all sorts of situations in our industry, which is not like a manufacturing operation at all. One contractor may be associated with one partner as a joint venture on one project; he may be associated with an entirely different contractor or contractors in another venture. We feel that the contractor should be renegotiated according to his interest in all contracts subject to renegotiation so that the good and bad can be weighed together, and not the individual joint ventures renegotiated as such, as was the case following the last war.

Going to point No. 4, we think that the procedure that was followed in the war preceding, namely, that the renegotiation be handled within the agency that had charge of the contract from the beginning, is the correct procedure because only they, particularly in our type of business, the ones that have been present in connection with the building or the structure, or whatever it is, and know the problems that were involved, can appropriately examine and weigh the various propositions that the Congress intends shall be weighed in arriving at the final answer.

We feel, as is indicated in point No. 5, that the words "excess profits" having been used in this particular bill and those used in the internal-revenue structure should be interpreted the same, and that the rules of the Bureau of Internal Revenue, plus the statute, should be followed and applied in determining what the cost items are.

It certainly would be a very unjustifiable proposition where two different answers were arrived at for the same particular words.

Finally, in our point No. 6, we have noted that the appeal lies finally with the Tax Court under the present law. We feel that the contractor should have the way open for appeal to the courts of appeal of the United States. We feel that that is part of our Government, and it should follow, and we believe that it will demonstrate the good faith of the Government and will result in a much better attitude on the part of the contractors.

That is the extent of my statement.

The CHAIRMAN. Are there any questions?

Senator MARTIN. No questions.

The CHAIRMAN. Thank you very much for your appearance, sir.

Mr. FOREMAN. Thank you, sir.

The CHAIRMAN. Mr. Schaffner, will you come forward?

You may be seated, if you wish.

Will you identify yourself for the record, please?

STATEMENT OF GEORGE SCHAFFNER, ELECTRIC EQUIPMENT REPRESENTATIVES ASSOCIATION

Mr. SCHAFFNER. My name is George Schaffner. I am a member of the Electric Equipment Representatives Association.

With your permission, I would like to read this short statement.

The CHAIRMAN. Very well.

Mr. SCHAFFNER. Our association is not opposed to the principle of renegotiation. We believe that, if we are to be renegotiated at all, it should be on an over-all valuation of our efforts by renegotiation boards. Payments made to us by our manufacturers should be allowed 100 percent to them as costs in their own renegotiation. We understand that section 2 (d) (2) of the bill before your committee so provides.

This means that we will be free from nongovernmental renegotiation or, in other words, from the hazard of being asked by individual manufacturers that we represent to return some part of the payments made to us. Such a demand might be made—it has been in the past—upon the ground that the manufacturer was not allowed to take that payment as an item of renegotiation cost in his own renegotiation proceedings.

This type of demand results in our members being in effect renegotiated without the value of their own services ever being determined directly by the renegotiation board. Consequently, our efforts should be reviewed in our own direct renegotiation proceedings, not through those of the different manufacturers we represent.

The bill before your committee follows, in the main, World War II renegotiation standards. It particularly reestablishes the $25,000 gross income test for manufacturers' representatives. Your committee probably knows that this type of renegotiation at that dollar level was first adopted by the Congress in 1943, because of the earlier disclosures of easy and large procurement fees which were earned by so-called brokers, or 5-percenters. This background was a handicap in all World War II renegotiation proceedings affecting our members. For a long time the renegotiation agencies would lump our type of representative with such sales brokers. It took us much time and

cost us hard-earned profits before we were able to educate the agencies to recognize the difference.

We ask that your committee now recognize that difference so that we will not have to reeducate the new renegotiating personnel.

Almost all of our members are graduate or registered electrical engineers. They employ in their own organizations the same class of professional personnel. Their principal service is to engineer the electrical requirements of the customers of their manufacturer. These relate to complex, specialized electrical installations and equipment which are not standard electrical items. Sales procurement by itself is not their major effort. A broker or 5-percenter is concerned almost exclusively with procurement. He generally is not equipped to do more than that.

The Congress has said again and again that the interests of small business must be protected in the expansion of defense production. All of our members represent a segment of such small business in two ways: First, their own organizations, being professional in nature, are small; second, the manufacturers that they represent are small or medium size businesses. The large corporations of this country generally do not use independent representatives. Instead, they open expensive branch offices.

Government procurement pays for a good share of that expense. Our members save the small manufacturers they represent the cost of such outlays. This saving is also reflected in Government purchases. By representing a number of smaller electrical manufacturers at the same time, we make it possible for such manufacturers to reach defense production areas with their products when that otherwise would be an economic impossibility. This benefits Government procurement because it broadens the amount of possible competitive bidding for Government work, and brings to the Government the added engineering skills of organizations of our type and the type of manufacturer we represent.

Our association believes that the renegotiation agencies should give effect to the professional nature of the services performed by our members. Such agencies should do this by allowing a higher profit percentage than that permitted other classes of representatives whose work consists solely of procurement and similar effort. The agencies should be required to recognize the assistance given to small businesses by our efforts.

In conclusion, may I ask the committee if any Senate Member disagrees with any of my statements? My purpose in asking this question is to take advantage of my appearance here on behalf of the association to answer any committee inquiries as to the position of our association.

The CHAIRMAN. Is there anything else you wish to add?

Mr. SCHAFFNER. That is all I wish to say. Thank you very much.

The CHAIRMAN. Are there any questions?

Senator MARTIN. No. I have it very clearly.

The CHAIRMAN. Thank you very much for your appearance, Mr. Schaffner.

Mr. SCHAFFNER. Thank you.

The CHAIRMAN. Mr. Riggle.

Mr. RIGGLE. Mr. Chairman.

The CHAIRMAN. You may be seated, if you wish to.

Mr. RIGGLE. I will stand, if you please, sir.
The CHAIRMAN. Very well.
Will you identify yourself for the record?

STATEMENT OF JOHN J. RIGGLE, ASSISTANT SECRETARY, NATIONAL COUNCIL OF FARMER COOPERATIVES

Mr. RIGGLE. I am John J. Riggle, assistant secretary of the National Council of Farmer Cooperatives, 744 Jackson Place NW.

The CHAIRMAN. You may proceed.

Mr. RIGGLE. Our council is made up of farmer cooperatives in all the States of the United States handling most of the commodities produced by farmers as marketing agencies and also buying supplies for farmers. It has perhaps in its representation some 4,500 local farmer organizations.

Our organization has not asked for a renegotiation bill, but assuming that perhaps there is going to be some legislation on that subject, they did last January at the annual meeting pass a statement of policy, which is as follows:

> In any new legislation considered by the Congress, agricultural products in their first marketable or natural state, which are traded in the public markets, where prices are widely reported and become common knowledge, should continue to be exempt from renegotiation of contracts for their purchase by the Government.

The factor of cost only enters indirectly into the pricing of agricultural products. The pricing of agricultural products on the exchanges of the country is public and the prices arrived at are open and widely known.

It has been a tradition, of course, in the public exchanges trading in commodities that those prices are firm prices, and any contract based thereon would of necessity have to be a firm contract. Anything that would be done to upset that, to renegotiate it, would be to destroy the authority and the authenticity of that pricing system.

The pricing on the public exchanges of these products is a most democratic procedure, where perhaps more minds meet as between buyers and sellers to set the price range for any particular period of time, an hour or day or week, than in pricing any other goods or services; so that anything that disturbs the functioning of the public exchanges and the pricing thereon would, in our opinion, be a considerable step toward control of prices ultimately by governmental edict and authority.

As a matter of fact, the pricing of the raw materials and commodities on the public exchanges enters into the pricing of a lot of the processed and manufactured products because the prices of those products are based upon the raw material prices which are set in these public exchanges.

So we have a feeling that this would permeate the whole field of pricing if this firm pricing on the exchanges were subject to renegotiation, and therefore we think that we should be considerably concerned about that inclusion in this law, for if the Government is going to procure some 18 percent of the production of the country for purposes of defense, and they could upset pricing on the commodity exchanges, they would in effect control the pricing throughout the whole economic system. And that pricing, as I say, is derived principally from the pricing of these commodities on the public exchanges.

Now, that is recognized, as you gentlemen no doubt have observed, in section 11 (c) of the new pricing regulation, wherein they refer to those commodities which are traded regularly upon commodity exchanges operating under the jurisdiction of the Commodity Exchange Authority and the Sugar Exchange Act.

But in addition to those exchanges, there are other Government-supervised exchanges where livestock is traded, as under the Packers and Stockyards Act, and the Perishable Agricultural Commodities Act of 1930, where fresh fruits and vegetables, and so forth, are exchanged. That is in addition to these others. And, of course, a good many of our livestock products, like eggs and poultry and cheese and butter and so forth are traded on exchanges where the prices are publicly and openly arrived at.

For that reason, we would agree to the amendments which have been proposed, that on line 22, page 24 of the bill passed by the House, the amendment is proposed to delete the words, "but only if such contract or subcontract is with the producer of such agricultural commodity," because as long as these prices are arrived at openly and publicly, it does not make any difference who trades in them at that level; and secondly, the producer very rarely sells directly to the Government any considerable amount of his product. In very rare instances is he a large enough producer to participate in a Government contract.

He does, however, as has been suggested, participate as a subcontractor.

Now, another statement of policy passed by our organization in January is to this effect:

> Any Government contracts with farmers' cooperatives for purchase of processed or manufactured products should provide for exemption from renegotiation after a specified time from date of delivery under the contract, in order that final settlement with producer-members for their products involved will not be delayed—

because in these processing cooperatives, for instance, packing corn and beans, they make an advance settlement with the producer for a portion of the price expected to be received from the product at the time of delivery. And then as the product is marketed, they may make an additional settlement and finally a final settlement after the costs of the processing and handling are deducted.

Now, usually that settlement is within the first quarter after the end of the fiscal year, and if they are not in a position to make a final settlement, because they are going to be renegotiated, it makes considerable delay in their final settlement with the producer, and secondly, it ties up funds which the producer may have allowed to be allocated for operating expenses for the next year subject to this contingent liability which the Government may impose.

So we are suggesting that in your consideration of these time limitations, they be made for the initiation particularly of the renegotiation procedure as short as possible after the time of delivery under the contract.

I think, Mr. Chairman, those are perhaps the main points that we wish to make in connection with this bill.

Senator BUTLER of Nebraska. Mr. Riggle, in connection with the packers' dividend—do you call it that?

Mr. RIGGLE. The packers' refund, yes.

Senator BUTLER. Where you speak of the necessity of avoiding renegotiation to prevent that payment's being made according to custom, would not the same argument apply to independent dealers who have, say, 6, 8, 10 or more members of a company handling agricultural products?

Mr. RIGGLE. I think, perhaps, Senator, that that would apply to most small businesses, particularly.

Senator BUTLER. Most small businesses of that kind are handled, in the first place, as partnerships in my country, and a partnership in a way is no different from a cooperative.

Mr. RIGGLE. That is correct, sir. I refer to cooperatives because that happens to be our particular concern. But I think the same principle applies to particularly small businesses generally where the necessity of handling operating capital and reserves on a limited basis is a real concern.

Senator BUTLER. I appreciate that your comments apply to business generally rather than just the one group.

Mr. RIGGLE. Yes, sir.

The CHAIRMAN. Are there any further questions?

Senator MARTIN. No questions.

The CHAIRMAN. Thank you very much, Mr. Riggle.

Mr. RIGGLE. Thank you.

The CHAIRMAN. Mr. Rushlight, will you come forward, please? You may be seated if you wish to.

Mr. RUSHLIGHT. Thank you.

The CHAIRMAN. Will you please identify yourself for the record?

STATEMENT OF W. A. RUSHLIGHT, W. A. RUSHLIGHT & CO., PORTLAND, OREG.

Mr. RUSHLIGHT. My name is W. A. Rushlight, and I am appearing here on behalf of W. A. Rushlight & Co., a copartnership.

The CHAIRMAN. You may proceed.

Mr. RUSHLIGHT. Senator George, members of the Finance Committee, first let me say that I am very much in accord with the testimony given by Mr. Alvord this morning, of the United States Chamber of Commerce. There is only one particular matter which he testified on, in connection with which I would like to offer my views and thoughts, and that is in connection with the matter of providing in the renegotiation laws a provision for carry-back and carry-forward of profits.

Our little company of W. A. Rushlight & Co. has a very particular problem just in point, which I felt would show this committee how the law as it now stands, or as it is now proposed and as it previously stood actually operated in the case of small contractors, such as ourselves.

The CHAIRMAN. What is your line of business, Mr. Rushlight?

Mr. RUSHLIGHT. We are building contractors, Senator.

We established the W. A. Rushlight Co., a copartnership, in the year 1942 for the purpose of assisting in the war effort. At that particular time the Government was having difficulty getting sufficient numbers of contractors to undertake the program that had to be undertaken on the coast.

We operated from 1942 through 1948—that is 7 years. Of course, they were not all war years. The war ended in 1945. The other 3 years were clean-up years because the partnership was liquidated at the end of the year. During that entire period, on all war work, this partnership did $3,753,000-plus worth of war construction work. After paying taxes, its book net balance, without any salaries to any partners save one for their services, was $36,330. That does not represent cash. That represents physical assets, without any salaries being taken out for the partners, save $250 a month to Raymond Rushlight prior to his being taken into the service.

In 1942, prior to the passage of the Renegotiation Act, March, to be exact, this company entered into a contract to perform the mechanical work on the Walla Walla Air Base which was badly needed by the United States Government. It was a rush job, and had to be done in 90 days. And it was done in 90 days.

That was prior to the Renegotiation Act, the Renegotiation Act having passed, I believe, in April 1942, a month later. There was no renegotiation provision in this contract, the result being that we had no renegotiation proceedings.

In 1943, after this company had filed the reports required by that renegotiation law, a unilateral determination was made that this company owed the Government eighty thousand-and-some-odd dollars for excess profits in the year 1942, which comprised mainly this Walla Walla Air Base job, which made a net recovery to the renegotiation agency of $42,013. That is after the tax adjustment, you understand.

Senator BUTLER. That was taking 1943 and 1942 together?

Mr. RUSHLIGHT. No. That was just for the year 1942. All the other years were settled without any difficulty.

The renegotiation law was attacked as to the constitutionality of the retroactive provision, with the result that the administration made no effort to collect this unilateral determination made in 1943 on the 1942 excess profits, with the result that we proceeded to use that money that otherwise they might have been able to collect at that time in furtherance of the war effort, in other words, investing it in other contracts.

In the year 1944, this company on this same war work lost $25,730, and in 1945, for reasons which I could explain to the committee, which were beyond our control, this company lost $193,319.

Mind you, nobody associated with this company has ever taken one dime of salary or any moneys out of this company save $250 per month to Raymond Rushlight except to pay their taxes. And this company, I might say in passing, paid during this period $190,274 in income taxes, during that period of 4 years of war work.

Senator BUTLER. Were you incorporated then?

Mr. RUSHLIGHT. No, sir. This is a partnership.

Senator BUTLER. The partnership does not pay any taxes. The individuals do.

Mr. RUSHLIGHT. The individuals, I mean. That is the amount they paid, Senator. Thank you for correcting me.

The individuals comprising the partnership paid that amount of taxes from the proceeds of the operations of this partnership.

As a result, we find ourselves now, and have been for several years, in the hands of the Claims Department of the Justice Department.

They have had us in the Federal court in Portland on three different occasions to attempt to collect this amount which we are unable to pay, and the court, understanding the situation, has refused to try the case, instead recommending that I come back to Washington and attempt to settle it with the Justice Department.

I might say that the local attorney general out there in Portland, Oreg., has always concurred with our attorneys in that method of procedure, recognizing the unfairness of what the Government is trying to do under the law.

I also want to say in passing that in the strict interpretation of the law, we have not, as I understand it from our attorneys, a legal leg to stand on. So we find ourselves, as a contractor, in the position of actually having to pay the Government, if they can find where they can collect the money, $43,000 as a premium for the privilege of helping win World War II.

Now, the Justice Department advises me that they have no legal authority to settle such a matter with the taxpayer. We talked to Mr. Clapp, and finally to Mr. Wilhelm, and Mr. Wilhelm told me that the only basis the Justice Department could settle an inequitable matter of this kind with the taxpayer was by determining what the Government could realize if they put you through bankruptcy, and then after they determined that figure, they would agree to take that instead of going to the trouble of putting you through bankruptcy.

I think that is a good example, our little case here, of how this Renegotiation Act can result in serious damage to little companies that try to help win a war.

I am frank to say to you gentlemen on this committee that if this situation exists as it is, I and many other small contractors would not dare to take a war contract, because when you take a building contract, it is just like playing poker. You are gambling. You do not know what your costs are going to be.

One of the reasons for this large loss that we had was that it was occasioned by a large project that we had for the Navy on Camp Farragut, Farragut, Idaho. At that time, the other agencies of the Government introduced this portal-to-portal pay business which we had not figured on in our contract at all. That meant that we lost approximately 3 hours a day on every man who worked on that project, which resulted in a tremendous loss to us, because we had not figured on that at all, and we had no opportunity to get any relief. But after entering into that contract, other agencies of the Government held that the man's pay started on the outside of the project, and then you had to pay him while you hauled him in to work and while he changed into his overalls and got ready for work, and then at night the same procedure over again, and you multiply several hundred men by a loss of 3 hours a day, and you can understand readily, with the wage rates they were getting, how quickly you can run into tremendous loss.

So I would like to recommend to this committee, if it is possible, that this Renegotiation Act be so amended as to prevent such injustices as this.

I am one of those that believe that if you can take a man over and put him in Korea or someplace else and shoot him for $50 or $60 a month, I have no right to stay home here and become wealthy over any war effort. On the other hand, I do not think that I should be

required to pay for the privilege of helping one's country win a war. And that is just the way this law operates under existing law, when you have a case of this kind. And I know of many of them.

You have 600 of them, Senator, on file down there in the Justice Department now. And I believe that a committee such as this could gain a great deal of information as to necessary corrections of pending legislation if they would take the time to see how the previous laws worked in actual administration.

I have no quarrel with the principle of the Renegotiation Act. I do not know of any good American citizen that has. When the country is in need of the services of business and industry, I do not believe —and many believe with me—that anyone has the right to get rich when the lives of our boys are being jeopardized as common privates in the service.

But I do believe that little companies should have the right to live, just as well as big ones. I believe that this is a good example of one of the inequalities of the law, and that is the reason I have asked permission to appear before your committee to present this problem. I have it all worked out here by our accountants in figures which have been furnished to the Justice Department. They have had the FBI check them, so that so far as we know, it is authentic, and they have concurred in it.

Senator BUTLER. Are you going to present that for the record?

Mr. RUSHLIGHT. I will, sir. I had not planned on it. I intended to make a prepared statement, but I found out that I was going to have to testify here very shortly, and I could not get it typed. So I hope that I have been able to give you my views satisfactorily, orally.

The CHAIRMAN. Yes. You may also file your statement as a part of this record if you wish to.

Senator BUTLER. I think, Mr. Chairman, if he wishes to summarize it and file a written statement tomorrow, that would be time enough.

The CHAIRMAN. That would be quite all right.

Mr. RUSHLIGHT. Thank you. I think I could get it out by that time, Senator Butler.

The CHAIRMAN. That will be all right. You may furnish it to the secretary of the committee tomorrow, and it will go in as part of your statement.

(The statement referred to follows:)

STATEMENT OF W. A. RUSHLIGHT, W. A. RUSHLIGHT & CO., PORTLAND, OREG.

Gentlemen, my name is W. A. Rushlight. I am a partner of the W. A. Rushlight Co., a copartnership of 407 Southeast Morrison Street, Portland, Oreg.

First, let me say that I am hardly in accord with the testimony given by Mr. Alvord of the United States Chamber of Commerce with respect to the renegotiation laws. I have asked to appear before your committee to give you a concrete example of the difficulty it is easily possible for any small-business concern to have in connection with the renegotiation of contracts.

W. A. Rushlight Co. was formed in 1942 for the purpose of engaging in war work. At that particular time the Government was having difficulty getting sufficient numbers of contractors to undertake the program that had to be undertaken on the coast. During the period 1942 to 1948, inclusive, W. A. Rushlight Co. performed construction work for the war effort in the gross amount of $3,753,479.01 which resulted in a net profit before taxes for the years 1942 to 1948 of $226,605.10. Personal-income taxes were withdrawn and paid by the partners amounting to $190,274.56, leaving a balance for the period after the withdrawal for taxes of $36,330.54. All renegotiation problems for the 7-year period have been terminated with the administrative agency of the Government having to do with such problems with the exception of the year 1942.

In the year 1942, W. A. Rushlight Co. undertook a contract prior to the passage of the Renegotiation Act for the mechanical work on the Walla Walla Air Base at Walla Walla, Wash. Subsequently the Renegotiation Act was passed which contained a retroactive provision which under its terms would bring this contract under the provisions of the Renegotiation Act.

However, the best legal minds of the country stated the retroactive features of the law were unconstitutional, resulting in considerable confusion in administration of this provision of the act. No renegotiation was had between our company and the renegotiation authorities for the year 1942 but reports were filed by us as required by law with the renegotiation authorities. In 1943 a unilateral determination was made that an excessive profit had been realized by W. A. Rushlight Co. of more than $80,000 for the year 1942, which after income-tax adjustments, resulted in an amount claimed of $42,013. No attempt was made for the collection of this amount inasmuch as the question of constitutionality was taken to court by others and finally carried to the Supreme Court of the United States. The Supreme Court decided that the Congress had the constitutional right to change the terms of a contract without the parties' consent and upheld the retroactive feature of the 1942 act. However, W. A. Rushlight Co. proceeded with their operations doing war work and suffered losses of many thousands of dollars in the years 1944 and 1945 which, after payment of income taxes for the years 1942 and 1943, makes it impossible to pay the amount of $43,013 now demanded by the Government for excessive profits in the year 1912.

In other words, the effect of the operation of the Renegotiation Act has been to take profits away from business in fair years without any consideration at all for losses suffered in prior or subsequent years. This brings about a condition such as experienced by W. A. Rushlight Co., the effect of which would be to cause W. A. Rushlight Co. to actually pay the Government out of the pockets of the individuals comprising the partnership after these individuals have spent many years of hard work in executing more than $3,753,000 of war construction contracts. The claim against W. A. Rushlight Co. has been in the hands of the Justice Department for a number of years and we have made numerous attempts to get the Justice Department to consider the question of equity and fair play in settling this matter with the W. A. Rushlight Co.

The Justice Department has had us in the Federal court in Portland on three different occasions to attempt to collect this amount which we are unable to pay. The court, understanding the situation, has refused to try the case, postponing the case each time, recommending that I come back to Washington and attempt to settle it with the Justice Department.

The United States attorney, representing the Justice Department in Portland, Oreg., has, I have been told, concurred with our attorneys in continuing the case in order that I might come to Washington to make a further attempt to settle with the Justice Department.

However, we have been advised by Mr. Clapp and Mr. Wilhelm of the Claims Division of the Justice Department that Congress has tied their hands so that they have no authorization and are unable to consider the question of equity or the question of fairness in settling a claim of this kind against the taxpayer. Mr. Wilhelm, handling such matters as these renegotiation claims, advises that at the present time he has still pending over 600 cases in his department and that the only basis upon which they can consider dealing with a situation of this nature under the law, is to make a determination of the amount the Government might realize in placing the taxpayer company through bankruptcy and then settling with the company for the amount that could be realized from bankruptcy proceedings if carried to final conclusion.

Assuming that the Justice Department is right in their contention the existing renegotiation laws give them no authority under past and present legislation to consider the question of equity in the settlement of renegotiation claims, we do not believe that any company or individual would dare to again engage in war work for fear of financial bankruptcy resulting from the fact that profits were taken from them without any regard for losses in prior or subsequent years. This is the situation the W. A. Rushlight Co. finds itself confronted with today.

Mr. Wilhelm of the Claims Division of the Justice Department advised former Senator Holman, of Oregon, and myself that he belived that were he given the opportunity he could make many beneficial suggestions to Congress pertaining to the administration of the law, based on his many years of experience in the Claims Section. I would like to suggest that your committee avail itself of his testimony as I think it would be very helpful.

I would like to recommend to this committee that the Renegotiation Act be so amended as to prevent such injustices as we have suffered, and that the provisions should be made retroactive to the year 1942.

I am one of those that believe that if you can take a man over and put him in Korea or someplace else and shoot him for $50 or $60 a month, I have no right to stay home here and become wealthy over any war effort. On the other hand, I do not think that I should be required to pay for the privilege of helping one's country win a war. That is just the way this renegotiation law operates when you have a case of this kind. I know of many other companies in similar circumstances.

In conclusion, I wish to urge upon this committee that the Renegotiation Act provide for the carry-forward and carry-back of losses suffered from war contracts similar to provisions in the Internal Revenue Act, and that such provisions be retroactive to the year 1942. The carry-back carry-forward provision would permit the Justice Department to make a fair and equitable settlement of my case and other similar cases now pending before the Justice Department. Such provisions will alleviate the fears of many small businesses now entering into new war contracts, and assure them that they will not be subjected to the inequities with which the W. A. Rushlight Co. is now faced.

The CHAIRMAN. We have been very glad, Mr. Rushlight, to have your statement in the record, as an illustration of how this renegotiation process can work.

Mr. RUSHLIGHT. Thank you, sir.

The CHAIRMAN. Are there any questions?

Senator MARTIN. No, sir.

The CHAIRMAN. Thank you very much for your appearance.

Mr. RUSHLIGHT. Thank you, gentlemen.

The CHAIRMAN. That is the last scheduled witness. I have several letters and statements that will be inserted in the record.

(The material referred to follows:)

STATEMENT OF AMERICAN MINING CONGRESS, JULIAN D. CONOVER, SECRETARY, WASHINGTON, D. C.

On behalf of the mining industry and in the interest of the national defense effort, the American Mining Congress urges that the mineral raw materials exemption which has stood for many years in the Renegotiation Acts remain unchanged, and that no action be taken to amend it as proposed in section 106 of H. R. 1724, now pending before your committee.

The existing law gives a definite, workable, well-established and satisfactorily administrable test as to the cut-off point which determines whether contracts or subcontracts relating to mineral raw materials are subject to renegotiation.

The pending bill would substitute a test as to the cut-off point which is not an appropriate standard for renegotiation, which is much more difficult of interpretation and administration with respect to the production of metals,[1] and which is impractical in that it does not conform with any standard in industry and trade.

Because the proposed test is uncertain it will bring confusion to the mineral industry, and because it will involve greater administrative problems and difficulties—including a substantially augmented staff—it will be an unjustifiable burden both to metal producers and to the Government.

For these and other reasons, the new test may deter production of basic materials urgently needed in the emergency for defense purposes and essential civilian needs.

I. PERTINENT EXEMPTION PROVISIONS OF THE EXISTING LAW AND PENDING BILL

A. The provisions with respect to the minerals exemption in the statute now in effect (U. S. C. A. 50, 517–17), which continues similar provisions of the acts of 1942, 1943, and 1944, read, insofar as material, as follows:

"(i) Contracts exempted; Board's interpretations and application of exemptions

"(1) The provisions of this section shall not apply to—

* * * * * * *

[1] Some minerals, such as coal and various nonmetallics, may not be much affected by the proposed change in the exemption test, but the metals generally—such, for example, as copper, lead, zinc, iron, etc., will be seriously affected.

"(B) any contract or subcontract for the product of a mine, oil or gas well, or other mineral or natural deposit, or timber, which has not been processed, refined, or treated beyond the first form or state suitable for industrial use—

* * * * * * *

"(3) In the case of a contractor or subcontractor who produces or acquires the product of a mine, oil or gas well, or other mineral or natural deposit, or timber, and processes, refines, or treats such a product to and beyond the first form or state suitable for industrial use * * *, the Board shall prescribe such regulations as may be necessary to give such contractor or subcontractor a cost allowance substantially equivalent to the amount which would have been realized by such contractor or subcontractor if he had sold such product at such first form or state. * * *"

B. The changed provisions in section 106 (H. R. 1724), subdivisions (a) (3) and (b), insofar as material, read as follows:

"(a) *Mandatory exemptions.*—The provisions of this title shall not apply to * * *

(3) Any contract or subcontract for the product of a mine, oil or gas well, or other mineral or natural deposit, which has not been processed, refined, or treated beyond the ordinary treatment processes normally applied by producers in order to obtain the first commercially marketable product, but only if such contract or subcontract is with the owner or operator of the mine, well, or deposit from which such product is produced. The term "ordinary treatment processes" means, in the case of the product of a mine, well, or deposit with respect to which an allowance for percentage depletion is provided by section 114 (b) (3) or (4) of the Internal Revenue Code, those processes which are taken into account under such section in computing gross income from the property, and in the case of any other product such term means such similar processes as may be prescribed under regulations promulgated by the Board—

* * * * * * *

(b) *Cost Allowance.*—In the case of a contractor or subcontractor who produces * * * the product of a mine, oil or gas well, or other mineral or natural deposit, or timber, and processes, refines, or treates such a product beyond the first commercially marketable state provided in paragraph (3) of subsection (a) * * * the Board shall prescribe such regulations as may be necessary to give the contractor or subcontractor a cost allowance substantially equivalent to the amount which would have been realized by such contractor or subcontractor if he had sold the product in the form or state provided in paragraph * * * (3) of subsection (a) * * *."

II. EXEMPTIONS SPECIFIED IN THE EXISTING LAW AND THE REASONS THEREFOR

The exemption standard of "first form or state suitable for industrial use" was adopted in 1942 after Congress had devoted much time to the development of some readily administerable principle, the application of which would enable it to authorize the adjustment of those contracts and subcontracts which had been entered into by the United States or its instrumentalities with contractors during the early part of World War II for the supply of war materials. In many of such cases new materials and facilities were involved and there was no way to determine a fair price for the products. The original contract prices were, of necessity, fixed (by bid or negotiation) at a sufficiently high rate to encourage unusual effort, with the result that in many cases the profits, on mass production or with improved practices and techniques, became excessive and entirely beyond expectations of the contracting parties.

Following extended discussions between all concerned, the theory of renegotiation was proposed, developed and eventually enacted into law.

As a result of its consideration of the problem, Congress recognized from the beginning that mining and other wasting-asset industries did not fall within the class to which renegotiation was intended to apply. Accordingly, the Revenue Act of 1942 (section 801) provided an exemption from renegotiation of any contract or subcontract for the product of a mine or other mineral or natural deposit which had not been "processed, refined or treated beyond the first form or state suitable for industrial use." Such limitation was intended not only to protect the special position of the mining industry (which uses up or exhausts its assets through its operations), but also to prescribe a cut-off from such exemption when the mining industry had completed its treatment of the raw material and had thus made it suitable for industrial use.

Congress affirmed and reaffirmed its declaration in this respect by reenacting such identical exemption for the mineral industry in the Military Appropriations Act of 1943, the Revenue Act of 1943 (approved February 25, 1944) and in the so-called Renegotiation Act of 1948, which was a part of the Supplemental National Defense Appropriation Act, 1948 (Public Law 547, 80th Cong.) and is now the controlling law on this subject. Such reiteration of a sound, administrable principle should not be disturbed when, as in this case, there is no justifiable reason therefor.

In this exemption for the mineral industry the cut-off point, as repeatedly reenacted in the law, was definitely and specifically fixed for the two-fold purpose of (a) permitting the mineral industry to mine, treat and refine its raw products to the point where such products were suitable for the first time for industrial use for war and defense purposes—to which point it was recognized there was no occasion for renegotiation; and (b) making renegotiation applicable to any manufacturing or industrial operation beyond the cut-off point, whether performed by the producer or by a subsequent fabricator to whom the product was sold.

Among the reasons for adopting this cut-off point were the following: (*a*) The standard metals in their first form suitable for industrial use are the same regardless of their source. Such products from one mine are in competition with those from others. Whatever may have been the differences in the ores or the processing, the refined product available for industrial use is necessarily the same. There is no distinction whatsoever between the refined metals to be used on civilian contracts and those to be used on defense contracts. There is no particular process or other operation specially required to turn out refined metals for defense purposes as distinguished from those for other purposes. The reasons for requiring renegotiation of manufacturing and other contracts which yield special articles or products for defense purposes do not warrant attempting renegotiation of mineral products before they reach the stage of being suitable for industrial use.

(*b*) The form in which the mineral product (from a metal mine) becomes suitable for industrial use is the point at which the metal consuming industries purchase the product from the mining industry, and thus, in the commercial world, fix a market or standard price for the product which permits a clear demarcation between the processing or refining of the product, and its industrial or manufacturing use. This pricing basis is a suitable, natural, and appropriate standard for use in renegotiation.

The point to which exemption from renegotiation was to be allowed and the point beyond which it could not be applied were thus coordinated with great care and precision so as to encourage the greatest production of raw materials possible, for the benefit of the United States, and at the same time to make any profits—whether by the mining industry or otherwise—resulting from manfuacturing or industrial efforts beyong that point, with respect to defense contracts, subject to renegotiation. The line of demarcation was carefully and thoughtfully planned, with a thorough understanding of its effect and its practical administration.

III. THE PROPOSED CHANGE AND THE REASONS WHY IT SHOULD NOT BE ADOPTED

The difference in effect between the proposed provisions of H. R. 1724 relating to mineral raw materials and those which have represented the law to date are—

(*a*) As the law was enacted in 1942, 1943, 1944, and 1948, the cut-off with regard to the product of a mine or other mineral or natural deposit was that, in order to be exempted, the treatment of such product shall not have been carried beyond the first form or state suitable for industrial use, whereas

(*b*) Under the present proposal the cut-off point is to be established according to certain indicated processes which in many cases will not have yielded a product which is suitable for industrial use.

The existing law uses the standard of "the first form or state suitable for industrial use." This point of cut-off represents, generally, the termination of the treatment processes by the mining industry which are necessary to make the mining product suitable for industrial use. The cut-off thus has significance and conforms with the practice of the mining industry in disposing of its products. It also conforms with the practice of the brass, wire, and other metal consuming industries which acquire the mineral products in the first form in which industrial processes can be applied thereto to yield a manufactured product. It is a standard which is simple and can be readily interpreted and applied by those charged with renegotiating defense contracts—as evidenced by the satisfactory experience under the existing law.

The standard of the proposed bill with regard to metals, etc., would not look to any finished product of the mining industry. It would adopt, for purposes of renegotiation, the cut-off point now fixed by the revenue act for determining percentage depletion. However, the treatment processes specified in the depletion provisions (section 114 (b) (3) or (4), I. R. C.) are only certain of the steps which are necessary in order to obtain an industrial product; i. e., the product of the mine, under the new proposal, would be only in an intermediate form of processing by the mining industry. As to metal mines generally, the specified processes result only in a crude product such as ore or concentrates, for which there is no industrial market or use.

To cover this point more specifically it should be noted that the contained metals will, at this intermediate stage, exist in a conglomerate mass, requiring further processing or refining before they can be brought to any form appropriate for industrial use, and before they can be identified as metals which will be the subject of any renegotiable contract or subcontract. It will generally be impossible at that stage to determine to what, if any, extent such products or the metals to be derived from them will ever find an end-use in defense contracts. Only a part of the total metal production of the country is expected to be used in the contracts or subcontracts which will be subject to renegotiation. It is only when the metals have reached a form suitable for industrial use that their use is determined, and consequently it is impossible prior thereto (particularly when the metals are in crude or partly processed form) to make any serious endeavor to determine or trace them through to a possible end use in defense contracts. Any attempt to go behind that stage (in the treatment process) where the mining product is ready for industrial use will lack any factual basis or reasonable standard for determination.[1]

As we have stated, the pending bill would adopt as a standard the cut-off point fixed by the revenue act for determining percentage depletion. This is not an appropriate standard for renegotiation. The percentage depletion cut-off point—for historic reasons which are not here material—is determined by defining certain processes which will be considered as falling within the mining operations (extending generally to the "concentrate" stage), as distinguished from the further and often more costly processes which are necessary to produce a product of the mining industry suitable for industrial use. The standard for any sale of the metal-bearing products at this intermediate or "concentrate" stage is not based on any fixed value which they have for use in that form, but rather it is based on the value of the metals which can be obtained therefrom by processing them to the first form or stage at which they are ready for industrial use. It is the recoverable metals therein which are paid for, less an appropriate charge or deduction for their further processing and handling. The product in the form of concentrates, etc., may be considered marketable in the sense that, assuming treatment capacity is available, it could be sold to others who have the plants for its further processing and this is the basis adopted under the percentage depletion formula. However, the product in such form is not one suitable for industrial use and is not one for which there is a general market for purchase and sale or for which there is a recognized or quoted price.

It is the product in form for industrial use which has a competitive market or standard price. The determination of profits thereafter earned is a reasonable possibility for the authorities charged with the duty of renegotiation and affords a basis under which the metal mining industry can intelligently operate.

A further objection to the bill (H. R. 1824) is that it introduces a new limitation by providing for exemption "only if such contract or subcontract is with the owner or operator of the mine * * *." This is unduly restrictive and serves no useful purpose. There may be technical differences in the ownership and operation of the mines and the ownership and operation of certain mixing or blending facilities or of the further processing plants which will turn out the metal in its

[1] Example: In the case of copper, the first form or state suitable for industrial use under the existing law is "refined copper"—ingots, wirebars, billets, cakes, etc. This is the form in which brass mills, wire mills and other manufacturing plants require copper. Under the new proposal, the cut-off would be "concentrates"—a mud-like product of a concentrator—which has no industrial utility until smelted in a smelter, resulting in blister copper (an impure form of copper), which in turn is refined in a refinery to produce refined copper. At the several stages between the concentrates and the refined copper, much additional copper-bearing material, originating from various sources—domestic and foreign, primary and secondary (scrap)—is mixed together in the treatment; the copper from these various sources losing its identity and becoming merged in the final product. It is clearly impossible, at the concentrate stage, to make any realistic determination as to what, if any, of the products in that form will ever find their way into defense contracts.

"first form or state suitable for industrial use." These differences of ownership are not pertinent so far as renegotiation is concerned, since they do not affect the form or price of the metal as it goes to industry. The product will meet the same tests as to nature and price as a product which is carried through from the initial mining to production of the usable metal by a single owner or operator. In short, this proposed provision is not necessary in the interests of renegotiation, would be quite unfair in many cases, and would create severe administrative difficulties.

IV. SUMMARY

In conclusion we may then note —

1. Congress, in 1942, recognized that the mineral industry is not the type of business to which renegotiation should apply in principle. It therefore provided an exemption in the 1942 law on this subject, which was reenacted in 1943, 1944, and 1948. H. R. 1824 again recognizes that the mining industry should be exempted from renegotiation but proposes a different cut-off point at which renegotiation should become effective. Such change is objectionable and inequitable to the mining industry.

2. The existing law provides a well-founded, reasonable, appropriate cut-off point to which exemption shall extend and where renegotiation shall begin. Appropriate regulations thereunder exist, which have been applied in recognized procedures. They have proven satisfactory in practice. No justification exists and no ground has been established for throwing aside those carefully considered conclusions of Congress, as repeated, reasserted, and reenacted. For that reason, such exemptions in the existing law should remain undisturbed in the enactment of any new renegotiation law.

3. The cut-off point proposed in the pending bill is neither appropriate nor practicable as to the metal mining industry because it attempts to utilize as a standard a tax formula which has no application to renegotiation. The existing law uses as the cut-off point that at which the mining product moves into industry, thus providing as a cut-off basis not only a finished product of the mining industry but also one for which a standard recognized market price exists—which is a necessary basis for proper renegotiation. In contrast, the proposed cut-off point in H. R. 1724 is fixed with respect to products which are not in a form suitable for industrial use, and are not at that point the subject of general open-market purchase and sale. It thus fails to provide a clear-cut, practical basis for the exemption.

4. Under the existing law, with its clear, basic standards, the industry can understand its problems with regard to renegotiation, and the records habitually maintained by the industry accord with the requirements of the law. The new proposal—because its standards do not conform with those on which the industry conducts its business—would not permit of this simple, workable application in the industry's renegotiation problems. This is further emphasized by the fact that the producer cannot, at the proposed cut-off point, have any basis for determining whether his product will or will not go to Government use. His whole effort and concern at this point should be its conversion into products for which there will be industrial use, but if the issue is confused by the problem of renegotiation his operational difficulties will be increased.

The Government administration under the proposal would also be more difficult because its standards would not be those used by the industry in conducting its ordinary business. To cope with these unnecessary complications would undoubtedly necessitate larger Government staffs than under present procedure.

5. The bill improperly proposes to limit the renegotiation exemption only to owners or operators of a mine. In excluding those other members of the mining industry, whose differences in position are not material from the viewpoint of renegotiation, a serious injustice would be done, for no logical reason.

6. There is neither occasion nor reason to substitute the proposed new rules for exemptions under renegotiation for those which now exist. The proposed new rules would be unfair, more difficult to administer by the mining industry and by Government agencies, and less in accord with the nature, purpose and objectives of renegotiation as determined by Congress in 1942.

7. The now-existing rules relative to exemption applicable to the mining industry should be retained. Specifically, the appropriate provisions of the existing law, as set out on page 2, above, should be substituted in place of section 106 (a) (3) and (b) of H. R. 1724, set out on that same page.

BRIDGEPORT BRASS CO.,
Bridgeport, Conn., February 5, 1951.

In re H. R. 1724.

Hon. WALTER F. GEORGE,
Chairman, Finance Committee, the Senate, Washington, D. C.

DEAR SENATOR GEORGE: Your committee is in the process of writing a renegotiation law, and knowing of your desire to have the fullest information possible we wish to bring to your attention certain points affecting the copper and brass industry, which is of such great significance in any defense program.

We are sure your committee does not wish to do anything which weakens the smaller independent companies in an industry and strengthens the larger corporations as a result of the operation of any law. Yet this is exactly what happened in World War II.

We are the largest independent company in the brass industry, but there are about 35 other small independent companies besides ourselves who have to buy their copper and zinc from the large producers such as Anaconda Copper Mining Co., Kennecott Copper Corp., and Phelps Dodge Corp.

At the same time these large producers have important subsidiaries in the brass industry which control approximately 70 percent of the industry. During World War II the copper and zinc producers were exempt from renegotiation. This umbrella protected the capital sources of their subsidiaries, while the smaller independents were subject to renegotiation.

This meant that the large mining companies came out of the war very much stronger financially, while some of the smaller brass mills, including ourselves, were forced to become heavy borrowers.

During World War II the consolidated earnings of the three copper companies totaled $315,000,000, and their cash position (including marketable securities) improved by $132,222,702. (For details see exhibit I.)

By contrast, here are the figures of the Bridgeport Brass Co. for those same years:

Bridgeport Brass Co.

[000 omitted]

	1942	1943	1944	1945
(1) Net sales	$61,011	$67,839	$63,039	$53,162
(2) Renegotiation payment	4,700	1,574		
(3) Provision for Federal income taxes	5,406	5,837	5,004	2,300
(4) Total payment to Government (2 and 3)	10,106	7,411	5,004	2,300
(5) Company net profit after taxes	1,611	1,722	1,591	810

This company's cash position declined from $4,556,000 at December 31, 1941, to $3,362,000 at December 31, 1945. During the war the company was forced to incur a substantial amount of debt, which at December 31, 1945, amounted to $2,000,000. Since that time, to maintain its position in the industry the company increased its facilities and its working capital. Thus, it was forced to make total long-term borrowings of $13,000,000 as well as to secure short-term loans from time to time.

Of course, the consolidated earnings of the producers were mainly from mining operations. For that reason they did not have to be unduly concerned about renegotiation of their brass-mill subsidiaries. However, we and the other independents who bought our metal requirements from these same producers had to exist exclusively on profits we had left after renegotiation and taxes.

That is why we believe that World War II renegotiation tended in our industry to strengthen the big and weaken the small. This was certainly not what the committee and the Congress wished to do.

In view of the foregoing and to keep us and other independents in the brass-mill industry strong, we recommend that the brass-mill industry be exempt from the provisions of the renegotiation law.

While we are convinced these reasons are sufficient for your committee to exempt the brass-mill industry from renegotiation, we believe that renegotiation was never meant to apply to cases like the brass-mill industry.

Your committee is properly concerned with taking the profits out of war. Congress has devised two instruments to do this in the form of, first, excess-profits

taxes and, second, renegotiation. The excess-profits tax in itself accomplishes this purpose in many cases. The further objective of renegotiation is covered by the statement of the Honorable Carl Vinson in his recent testimony before the House Ways and Means Committee (August 2, 1950, p. 13) where he pointed out that renegotiation has three applications:

1. "First, because *haste* in procurement made close pricing impossible in the first instance * * *.

2. "Second, because of the *peculiar nature* of the article bought, accurate costs were unknown * * *.

3. "Third, because of the *vast increases* in the procurement of items already in production * * *." [Emphasis added.]

However, none of these three applies to the brass mill industry, and for the following five reasons:

1. The available supply of copper and zinc, which are the raw materials of our industry, is now, and will be, definitely limited. Transition from civilian to military end use will not increase the supply of copper and zinc, nor the number of pounds which our industry can produce. For that reason, there will not be any vast increase in volume to the point where accurate costs cannot be known.

2. Use of copper, zinc, and the brass made from them is already controlled. Use of copper by brass mills is governed by NPA Orders M-11 and M-12 dated November 20, 1950, and their use of zinc by NPA Order M-9 dated November 16, 1950, and M-15 dated December 1, 1950, as amended on January 15, 1951.

3. Brass-mill prices have been frozen by general price regulation dated January 26, 1951.

4. Brass-mill wages and salaries are controlled by general wage stabilization regulation No. 1 issued January 26, 1951.

5. Brass-mill products are standard items with well-established costs and published list prices which always seek the lowest level.

All of the above show that the brass-mill industry is regulated almost as effectively as a public utility, for example, without the public utility's guaranteed profits.

The committee may have heard of the bitter experience of many small companies including the brass-mill independents during the World War II renegotiation. Our renegotiation experience was particularly harsh when it was contrasted with the effective efforts made by our company to alert the Government to the need of expanding the brass-mill industry in 1940 and 1941 to be ready for World War II. It also came as a sharp contrast to the six Army and Navy E's which we received as the result of outstanding production during the war.

It is a fact that some members of our industry manufacture out of brass such products as cartridge cases, fuzes, and other items. To cover such cases we recommend that there be added to the mandatory exemptions provided in section 106 (a) of H. R. 1724 a specific exemption of contracts which contain a price-redetermination article or a target-price-incentive type of article.

You may recall that when renegotiation was originally adopted in World War II, redetermination articles, which, in effect, renegotiate price from time to time during the life of a contract, were not widely used. Hence, the 1942 and 1943 Renegotiation Acts made no specific reference to this advance in procurement procedures. The experience of many contractors was that redetermination during the latter years of World War II made further renegotiation unnecessary, and we believe that many Government officials charged with procurement and renegotiation arrived at the same conclusion.

The target-price incentive type of contract was not adopted until nearly the end of World War II. It was used only by the Navy, and was not used extensively by that Department. However, the experience which was gained will be most helpful to all procurement agencies during the present emergency.

As the committee knows, the target-price type of contract provides for the working equivalent of renegotiation on a timely basis. Provision is made for sharing the savings beyond closely estimated costs between the Government and the contractor on a specified basis. This type of contract is now available for use in appropriate instances throughout the Department of Defense. We recommend that the use of either the redetermination or the target-price articles be made subject to mandatory exemption from renegotiation for the following reasons:

1. Effective and tight pricing in the interest of the Government will be insured.

2. Greater efficiency and productivity on the part of the contractor will be encouraged.

Since price redetermination accomplishes the same objective and safeguards sought by renegotiation, further redetermination of price through renegotiation will unnecessarily duplicate the effective pricing already assured. Duplication which wastes valuable manpower under present circumstances is extravagant and unmindful of our national security.

Where tight pricing has been insured, there is no reason for allowing the uncertainty involved in ordinary renegotiation procedures contemplated by H. R. 1724 to undermine a contractor's best productive efforts. At best, the ordinary renegotiation procedure will make it impossible for a contractor to determine his financial position from time to time or to plan his production, engineering, and research with that degree of effectiveness which is to the Government's best interests in a long-term program. During World War II this uncertainty was made particularly disadvantageous where renegotiation was long delayed. At worst, the ordinary renegotiation procedure may cripple important Government suppliers financially.

Exemption from renegotiation for producers of copper, zinc, and other natural resources during World War II was justified and kept these important parts of our national economy strong for the present emergency. Since our defense program is being geared for the long run, you will undoubtedly agree that the strength of our productive organizations must be maintained. If industry is kept strong and fair rules govern, we can outproduce the world.

Very sincerely yours,

BRIDGEPORT BRASS CO.,
HERMAN W. STEINKRAUS,
President and Chairman of the Board.

EXHIBIT 1

Bridgeport Brass Co. is a long-established Connecticut corporation with its main offices located at Bridgeport, Conn. It is the largest independent company in the brass-mill industry and manufactures a complete line of brass-mill products in the form of sheet, rod, wire, and tube, as well as certain fabricating products. Since World War II it incurred long-term debt of $13,000,000 to maintain its competitive position in the industry by increasing its facilities and its working capital. (This debt has now been reduced to approximately $9,500,000.)

Some of the other independent brass companies incurred substantial debt during and after the war, and some have been acquired by copper companies. The complete list of the other independent companies in the brass industry is as follows:

Bohn Aluminum & Brass Corp.
The Bridgeport Rolling Mills Co.
The Bristol Brass Corp.
Chicago Extruded Metals Co.
The Drawn Metal Tube Co.
Wilbur B. Driver Co.
Driver-Harris Co.
The Electric Materials Co.
The Electric Materials Co.
Harvey Machine Co., Inc.
Hudson Wire Co.
C. G. Hussey & Co.
Lewin-Mathes Co.
The Lindermo Tube Co.
The Mackenzie Walton Co., Inc.
The Miller Co.
Mueller Brass Co.
The National Copper & Smelting Co.
New England Brass Co.
The New Haven Copper Co.
Penn Brass & Copper Co.
The Phosphor Bronze Corp.
The Plume & Atwood Manufacturing Co.
Reading Tube Corp.
The Riverside Metal Co.
Roberts Tube Corp.
Scovill Manufacturing Co.
The Seymour Manufacturing Co.
Small Tube Products, Inc.
Stamford Rolling Mills Co.
The Thinsheet Metals Co.
United Wire & Supply Corp.
Viking Copper Tube Co.
Volco Brass & Copper Co.
Waterbury Rolling Mills, Inc.
A. H. Wells & Co., Inc.
Wolverine Tube Division
Western Brass Mills, Division of Olin Industries, Inc.

The three largest domestic copper companies exert a dominating influence on the brass-mill industry. Up to 70 percent of the brass-mill industry is controlled by or closely affiliated with copper companies. The three dominant domestic copper companies are Anaconda Copper Mining Co., Kennecott Copper Corp., and Phelps Dodge Corp. Anaconda Copper Mining Co.'s brass-mill subsidiary is the American Brass Co.; Kennecott Copper Corp.'s is Chase Brass & Copper

Co., Inc.; and Phelps Dodge Corp.'s is Phelps Dodge Copper Products Corp. In addition, American Smelting & Refining Co., with large mining interests, exercises a strong influence in the brass-mill industry through the ownership of a substantial share in Revere Copper & Brass, Inc.

During World War II, the consolidated earnings of the three copper companies totaled $315,000,000, and the improvement in their cash position (including marketable securities) was as follows:

Company	Dec. 31, 1941	Dec. 31, 1945	Increase
Anaconda Copper Mining Co.	$78,842,659	$128,286,015	$49,443,956
Kennecott Copper Corp.	126,469,511	187,502,419	61,032,908
Phelps Dodge Corp	22,879,759	44,025,597	21,745,838
Total			132,222,702

WASHINGTON, D. C., *January 30, 1951.*

HON. WALTER F. GEORGE,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR: The House renegotiation bill (H. R. 1724) which has passed the House and is now before the Senate contains a provision (subsecs. (a) and (b) of sec. 106) which would result in a terrific and unnecessary hardship on the steel industry in its defense efforts.

Under this provision, as we see it, there is no exemption from renegotiation for pig iron but limits the exemption to ore and coal. Moreover, the exemption is available, except under unusual conditions, only to the actual producer of the ore and coal, as distinguished from the person who manufactures coke and pig iron.

During the last wartime renegotiation, we were permitted to take pig iron into renegotiation costs at the market value which had the effect of eliminating from renegotiation any profit on the ore, coal, coke, and pig iron.

There is every reason why this exemption should be carried forward into the new renegotiation act especially in view of the fact that the steel companies in World War II and in this emergency have been using up their low-cost, high-grade ore at a rapid rate and should receive additional consideration on that account. The sole object of the mining exemption is to give extra consideration to the matter of depletion and, in the case of iron ore, you do not give the owners any consideration unless you extend the exemption to the manufacturer of pig iron.

I enclose herein a brief memorandum explanatory of the problem and also a proposed amendment to H. R. 1724 to restore the pig-iron exemption.

The enclosed proposed amendment follows the exact language of the Renegotiation Act of 1942 except that we have followed the order H. R. 1724 which inserts the agricultural exemption before the mining exemption.

I respectfully request that you sponsor this amendment with the Senate Finance Committee and do everything possible to secure its adoption in the interest of national defense. I am certain that if the House Ways and Means Committee had had time to weigh the consequence of this last-minute amendment, they would not have added it at the last moment.

I would appreciate an opportunity to discuss this with you in person.

Sincerely yours,

RAOUL E. DESVERNINE.

P. S.—So that you may be advised, I am Washington counsel for National Steel Corp. and its subsidiaries.

R. E. D.

MEMORANDUM CONCERNING "PIG IRON EXEMPTION" IN RENEGOTIATION

The Renegotiation Act of 1942, under which World War II renegotiation was conducted, provided that the renegotiation provisions did not apply to "any contract or subcontract for the product of a mine * * * or other minerals * * * deposit, * * * which has not been processed, refined, or treated beyond the first form or state suitable for industrial use."

In the case of iron ore, it was held that pig iron was the first form "suitable for industrial use." As a consequence, the production and treatment of ore and coal were not subject to renegotiation; the same exemption extended to the production of pig iron.

In order to protect producers of pig iron who used the iron in subsequent processing operations, a subsequent section provided that in the case of a contractor "who produces or acquires the product of a mine * * * or other mineral * * * depo-it, * * * and processes, refines, or treats such a product to and beyond the first form or state suitable for industrial use, * * * the Board shall prescribe such regulations as may be necessary to give such contractor or subcontractor a cost allowance substantially equivalent to the amount which would have been realized * * * if he had sold such product at such first form or state."

Under this section, it was held that steel producers could take in their pig iron at market price, in figuring their excessive profits, thereby eliminating from renegotiation any profits which might have been realized in the production of the ore or coal or in the production of pig iron.

The 1948 Renegotiation Act, under which we have been thus far operating, provided in subsection (d) that it should not apply to any of the contracts or subcontracts exempted in the prior renegotiation law. As a consequence, "pig iron exemption" was continued.

The present House bill, H. R. 1724, which has been reported to the House by the Ways and Means Committee, is a "clean bill" substituted for H. R. 1270 introduced by Mr. Doughton. Mr. Doughton's original bill contained an exemption of agricultural commodities, as did the World War II renegotiation law, but had no exemption of the products of mines, etc.

The House committee did insert a limited exemption, found in section 106 of H. R. 1724, but this exemption does not cover a producer of pig iron, in the opinion of the writer.

The exemption, in H. R. 1724, declares that the act will not apply to "any contract or subcontract for the product of a mine * * * or other mineral * * * deposit, which has not been processed, refined, or treated beyond the ordinary treatment processes normally applied by producers in order to obtain the first commercially marketable product, but only if such contract or subcontract is with the owner or operator of the mine * * *." The term "ordinary treatment processes" is then defined with respect to the provisions of the Revenue Act of 1950 dealing with percentage depletion. Such provision of the Revenue Act of 1950 in effect defines ordinary treatment processes as cleaning and beneficiating processes at the mine or at a point within 50 miles of the mine, including transportation to such point. However, for present purposes, it is not necessary to discuss the technical details of this definition, in view of the conclusions reached below.

As the writer interprets this exemption, it does not cover steel producers for two reasons: (1) The exemption is limited to the producer of the mineral and (2) the exemption continues only to the point where the first commercially marketable product is obtained, as distinguished from the exemption of the wartime act which carried it through to the point of "first industrial use." It would be the writer's opinion therefore that in the case of ore and coal the exemption would be available only to the mining company and would extend only to the prepared ore or coal because it is then in a state of a commercially marketable product.

It may be suggested that where the mining company is an affiliate of the steel producer, the exemption is available because there is another provision of the bill which provides that "by agreement with any contractor or subcontractor, and pursuant to regulations promulgated by it, the Board may in its discretion conduct renegotiation on a consolidated basis." This provision, however, does not improve the situation to any substantial extent for the following reasons:

1. It applies only where the contractor agrees to consolidate renegotiation which it might not want to do for other reasons.

2. Even if such an agreement is made, the Board has the discretion to determine if and on what basis renegotiation will be consolidated: and

3. In any event, in the case of ore and coal, if consolidated renegotiation were used, only profits prior to the production of a salable ore or coal would be eliminated.

H. R. 1724 goes on to provide that "in the case of a contractor or subcontractor * * * who produces the product of a mine * * * or other mineral * * * deposit, * * * and processes, refines or treats such a product beyond the first commercially marketable state * * *, the Board shall prescribe such regulations as may be necessary to give the contractor or subcontractor a cost allowance substantially equivalent to the amount which would

have been realized * * * if he had sold the product" in the first commercially marketable state. In the writer's opinion, this does not improve the situation for the reasons indicated above with respect to the "consolidation" privilege. In the first place, unless consolidated renegotiation were applied, the exemption is limited to the producer of the ore or coal, and not the subsequent pig iron manufacturer. In the second place, the exemption, as already emphasized, carries only to the first commercially marketable product which, of course, would be the treated ore or coal.

JOHN E. LAUCHLIN, Jr.

PROPOSED AMENDMENTS TO H. R. 1724 TO RESTORE THE "PIG IRON EXEMPTION"

Amend subsections (a) and (b) of section 106 to read as follows (the new matter is italicized; omitted matter is in brackets):

(a) MANDATORY EXEMPTIONS.—The provisions of this title shall not apply to—

(1) any contract by a Department with any Territory, possession, or State, or any agency or political subdivision thereof, or with any foreign government or any agency thereof, or

(2) any contract or subcontract for an agricultural commodity in its raw or natural state, or if the commodity is not customarily sold or has not an established market in its raw or natural state, in the first form or state, beyond the raw or natural state, in which it is customarily sold or in which it has an established market [but only if such contract or subcontract is with the producer of such agricultural commodity]. The term "agricultural commodity" as used herein shall include but shall not be limited to—

(A) commodities resulting from the cultivation of the soil such as grains of all kinds, fruits, nuts, vegetables, hay, straw, cotton, tobacco, sugarcane, and sugar beets;

(B) natural resins, saps, and gums of trees;

(C) animals, such as cattle, hogs, poultry, and sheep, fish and other marine life, and the produce of live animals, such as wool, eggs, milk, and cream; or

(3) any contract or subcontract for the product of a mine, oil or gas well, or other mineral or natural deposit, which has not been processed, refined, or treated beyond *the first form or state suitable for industrial use;* [the ordinary treatment processes normally applied by producers in order to obtain the first commercially marketable product, but only if such contract or subcontract is with the owner or operator of the mine, well, or deposit from which such product is produced. The term "ordinary treatment processes" means, in the case of the product of a mine, well, or deposit with respect to which an allowance for percentage depletion is provided by section 114 (b) (3) or (4) of the Internal Revenue Code, those processes which are taken into account under such section in computing gross income from the property, and in the case of any other product such term means such similar processes as may be prescribed under regulations promulgated by the Board;] or

(4) any contract or subcontract for timber which has not been processed beyond the form of logs; [, but only if such contract or subcontract is with the owner of the timber property or with the producer of the logs;] or

(5) any subcontract directly or indirectly under a contract or subcontract to which this title does not apply by reason of this subsection.

(b) COST ALLOWANCE.—In the case of a contractor or subcontractor who produces *or acquires* an agricultural product and processes, refines, or treats such a product *to and* beyond the first form or state provided in paragraph (2) of subsection (a), or who produces *or acquires* the product of a mine, oil or gas well, or other mineral or natural deposit, or timber, and processes, refines, or treats such a product *to and* beyond the first *form or state suitable for industrial use* [commercially marketable state provided in paragraph (3) of subsection (a)] or, in the case of timber, beyond the form of logs, the Board shall prescribe such regulations as may be necessary to give the contractor or subcontractor a cost allowance substantially equivalent to the amount which would have been realized by such contractor or subcontractor if he had sold the product in the form or state provided in paragraph (2) or (3) of subsection (a), or, in the case of timber, in the form of logs.

STATEMENT OF LAKE SUPERIOR IRON ORE ASSOCIATION, M. D. HARBAUGH, VICE PRESIDENT, CLEVELAND, OHIO

Gentlemen, on behalf of the producers and shippers of iron ore in the Lake Superior district, which supplies most of the ore for the iron and steel industry of the United States, I wish to direct your attention to the language of section 106 (a) (3) of the Renegotiation Act (H. R. 1724) now before you, covering the exemption applicable to contracts or subcontracts for the product of a mine, such as an iron-ore mine.

Under the provisions of this subsection, the simple and reasonable exemption heretofore applicable under the law since 1942 to mineral raw materials is greatly restricted. Instead of exempting iron ore as under the existing law and regulations through the pig-iron stage, which is the first form or state suitable for industrial use, the proposed exemption would be limited to contracts or subcontracts for ore, concentrate, or sinter as shipped from the mining property, and then only if the "contract or subcontract is with the owner or operator of the mine * * * from which such product is produced."

Any reasons for now proposing that, under a national preparedness program, renegotiation, with all its inherent complexities, should be made applicable to a vast number of contracts and subcontracts that were exempt from renegotiation during all-out war are not apparent.

The Ways and Means Committee, in its report of January 20, 1951, states, with respect to the need for new legislation on renegotiation, "that substantially the same conditions affecting the procurement of supplies for defense that necessitated the enactment of the renegotiation statutes during World War II are again present"; that "industry will be called upon again—indeed, is already being called upon—to manufacture and deliver essential supplies and equipment hastily and against accelerated delivery schedules with sufficient opportunity to make accurate cost estimates for the production of such items"; that "contractors will be asked again to produce items not included in the customary output of their plants, as well as many items that are wholly new and unfamiliar to them or which have been invented or developed since the close of World War II"; and that "the magnitude of the defense program will entail the procurement of supplies in enormous quantities far in excess of ordinary commercial levels, with consequent inevitable effect upon production costs. The full extent of this will not be easily determinable in advance with any degree of accuracy"; that "for these reasons, it is evident that contractors and contracting officers will be unable in countless instances to make accurate forecasts of costs on which to base prices and, therefore, that close initial pricing will be almost impossible to achieve"; that "nevertheless, the procurement of needed military supplies and equipment cannot be delayed for the complemention of cost and pricing analyses that might otherwise be made as an incident to careful purchasing"; and "that specifications, quantities, and delivery rates will be revised from time to time in the light of experience and to keep pace with the fluctuations of actual or threatened military situations."

The report then states: "These are the major difficulties and uncertainties that prompted the adoption and continuance of statutory renegotiation of contracts throughout World War II. The same conditions make it necessary today."

The iron-ore producers are not disposed to question the general contention of the Ways and Means Committee that the existing Renegotiation Act of 1948, as modified to date, is inadequate in some respects and for certain reasons "to protect to a sufficient extent the enormous expenditures contemplated by recent appropriations." But the reasons stated by the committee indicate no problems related to the production and use of a mineral product, such as iron ore, which is utilized only in the ordinary, normal processes of a large, established, and basic industry to produce metal—in this case, pig iron—for industrial use.

Why, then, this proposal now to extend the renegotiation procedure back to include the blast-furnace operation and every other operation in the handling of iron ore after it leaves the actual owner or operator of the mine which produces it? It should be manifest to anyone who is familiar with this industry that the difficulties and uncertainties above cited from the committee report simply do not apply to the production of iron ore and pig iron.

Neither iron ore nor pig iron is ever sold directly to Government agencies. Much iron ore produced by individual mining companies in the Lake Superior district is transferred or sold to other ore companies. Some of these are themselves producers of ore, but others are simply intermediary companies between producers and consumers, which assemble and mix ores of differing analyses from different mines into specified grades for shipment to the blast furnaces, as required

for producing iron of the particular specifications necessary for making different steels and for a great variety of foundry products. About 175 different grades of ore are shipped down the Lakes to the furnaces each season, and many of these grades are in themselves blends of many ores from different mines. Thus, it is obvious that the iron-ore industry, as such, nivolves far more than simply the mining and concentrating operations.

Under the language of section 106 (a) (3), a substantial part of the activities of this industry would be subject to renegotiation. The additional administrative problems, both for the Government and the industry, in extending renegotiation back from the present pig-iron cut-off point to the mine that produces the ore, would constitute a burden upon both that does not appear justified by whatever so-called protection might thus be afforded to the Government in its vast expenditures for military supplies and equipment which utilize iron and steel in manufactured form. There is already an excess-profits tax that applies to this industry as to others; and, if World War II sets the pattern for the present Governmental program, then price controls will be in the picture ere long. These should be "protection" enough in the case of an industry which is continuing to produce the same things it has always produced and by essentially the same methods.

The iron-ore industry, and the iron and steel industry of which it is an integral part, are now engaged in a colossal undertaking of developing vast new sources of ore, both at home and abroad, adequate to supply for the long future our rapidly expanding furnace capacity. Profits from existing operations, whatever they are, will be largely utilized for this great expansion program which is vital to our national welfare and security. There are hazards and uncertainties enough in these new ventures, without now adding the complications and uncertainties of renegotiation by extending it into new territory far down into the activities of this industry. This is no time to create deterrents to the functioning of an industry which should be given every possible encouragement to hasten to completion the challenging task before it.

Therefore, in the absence of any apparent reasons for now changing legislation that has been reasonably satisfactory as applied to mineral raw materials, and with the assurance that the proposed change in the exemption will but create needless burdens and expense at a time when all possible manpower is needed for production and when every deterrent to production should be eliminated, it seems clear that the sensible course for Congress is to "leave well enough alone." In other words, the exemption of the product of mines from renegotiation should be retained as it has been in the law since 1942, which exempts "any contract or subcontract for the product of a mine, * * * which has not been processed or refined or treated beyond the first form or state suitable for industrial use." As applied to iron ore, this would retain the exemption through pig iron, the first form suitable for industrial use.

The Lake Superior Iron Ore Association, on behalf of the entire industry, urges favorable action by your committee on this proposal.

STATEMENT OF NATIONAL ASSOCIATION OF MANUFACTURERS LAW DEPARTMENT

This statement, directed to H. R. 1724, the proposed Renegotiation Act of 1951, is filed on behalf of the National Association of Manufacturers, a voluntary organization composed of more than 15,000 members, the greater bulk of whom fall within the category of "small business."

Over 80 percent of all articles manufactured for the Armed Forces during World War II were manufactured by members of the NAM. Consequently, the association has a genuine interest in proposals looking toward renegotiation of Government contracts. In a statement adopted on May 28, 1948, the NAM went publicly on record as "desiring to cooperate with the Congress and the executive branch of the Government in the mutual objective of preventing excessive profits in defense production."

That this spirit of cooperation existed in wartime is demonstrated by the statement made last week to this committee by Frank L. Roberts, Chairman, Military Renegotiation Policy and Review Board in the Office of the Secretary of Defense, who stated:

"I want to say that the record on the part of industry in cooperating with the renegotiation boards to date is outstanding and in the opinion of those administrating the acts deserves high praise."

At the same time, however, industry is vitally interested in achieving efficiently a maximum production of defense materials with a minimum of procedural diffi-

culties and the needless negotiation and renegotiation which is so wasteful of time and manpower.

At best, renegotiation of Government contracts is a cumbersome and administratively expensive procedure. It is contrary to well-established principles of contract law and can be justified only as an expediment to eliminate truly excessive profits during a period of national emergency. It is suggested that even under such circumstances chief reliance should be placed in sound procurement policies, with renegotiation, if any, limited strictly to the unusual situation wherein past experience in large-scale procurement and production can afford no reliable guide for accurate pricing.

Uniform procurement policies have already been fixed through legislation. With the procurement experience gained during World War II by contracting officers as well as industrial concerns expected to furnish the matériel, it should be possible adequately to protect the interests of the Government and at the same time limit renegotiation procedures to those contracts for the armed services which in light of past experience could yield excessive profits.

In the belief that the foregoing is an accurate reflection of the basic purpose underlying any renegotiation act, the following suggestions are presented with respect to the proposed Renegotiation Act of 1951 (H. R. 1724).

First, under the wartime Renegotiation Act (act of February 25, 1944, and earlier statutes), renegotiation authority was limited to the armed services and agencies executing procurement contracts for articles and materials to be used directly in the war effort. H. R. 1724, however, proposes to extend the renegotiation power not only to the General Services Administration but also to "such other agencies of the Government exercising functions in connection with the national defense as the President shall designate." In light of this broad language it is entirely possible that practically all Government contracts might ultimately be subject to renegotiation.

It is our belief that the renegotiation power should not be extended beyond the limits established in wartime without a definite showing that such extension is necessary to protect the public interest. If, however, the committee believes the President should be granted the broad power to designate agencies contemplated by H. R. 1724, we suggest that such power be limited to agencies exercising functions having a direct and immediate connection with national defense.

Second, the Renegotiation Act of 1948 required inclusion of a renegotiation clause only in contracts in excess of $1,000. H. R. 1724, however, does not contain such a provision.

It is our view that the $1,000 minimum figure should be included in any new renegotiation law for the convenience of both the Government and of business and industry. Otherwise, if contracts with all the agencies contemplated by H. R. 1724 are to be subject to renegotiation, contracts involving amounts as small as $5, for example, must contain the clause and would thus place an excessive record-keeping burden on small business enterprises, with only conjectural benefit to the Government.

These record-keeping burdens would be especially onerous on small subcontractors and suppliers who at best often have difficulty in determining what portion of their business is subject to renegotiation. Without the $1,000 exemption they would be required to keep the required records on all small orders since they could not be sure that such orders might never aggregate the renegotiable amount.

Third, the profit limitation provisions of the Vinson-Trammell Act would not apply to any contract or subcontract subject to renegotiation under the provisions of H. R. 1724. We believe the same should be true with respect to contracts under the Merchant Marine Act and recommend, therefore, that those sections also be suspended as to contracts subject to renegotiation.

Fourth, H. R. 1724 would subject to renegotiation contracts or subcontracts aggregating in excess of $100,000 in any fiscal year. Wartime experience demonstrated, however, that a $500,000 minimum aggregate exemption was sufficient to protect the public interest. Thus, for example, the Truman committee, after its investigation of renegotiation, recommended that "the $100,000 exemption in the present renegotiation law should be increased to $500,000." (See Rept. No. 10, pt. 5, of Special Senate Committee Investigating the National Defense Program.)

It is also pertinent to point out that the Renegotiation Act of 1943 (act of February 25, 1944) increased the exemption to $500,000, as recommended by the Truman committee and justified by its belief that the small amounts which might be recovered in renegotiating such contracts was not worth the administrative

burden required. Accordingly we recommend that the $100,000 exemption proposed in H. R. 1724 be increased to at least $500,000.

Actually it is our belief that the public interest would be sufficiently protected by raising the exemption substantially above $500,000 and thus save the time, effort, and manpower involved in renegotiating contracts aggregating a lesser amount. The situation today with regard to pricing is entirely different than that which confronted the procurement agencies and contractors during World War II when it was necessary to obtain rapidly many new articles as to which no previous cost experience was available. Today, however, both industry and Government procurement officers have the benefit of experience flowing not only from wartime production on a mass scale but also the experience of sound and fair pricing policies under such circumstances. Moreover, the wartime experience showed that many war contractors voluntarily redetermined contract prices and refunded amounts considered to be excessive profits. As stated by the Truman committee:

"Many patriotic war contractors have already recognized and conscientiously assumed the responsibility for tailoring their own profits on war business to rates which can be clearly defended as fair in the 'court of public opinion,' and offering voluntary refunds of any excess."

It is our belief that this same desire to be fair, plus the wartime procurement and pricing experience, can be relied upon to avoid accumulation of excessive profits on the part of contractors and subcontractors holding contracts in relatively lesser amounts. Accordingly we recommend that the exemption be increased substantially over $500,000 to avoid the confusion, expense, time and labor involved in the renegotiation of contracts aggregating lesser amounts. For, as also pointed out by the Truman committee, nearly 80 percent of the refunds from renegotiation would probably have been recovered by taxation.

Fifth, it will be recalled, the wartime renegotiation statute provided several specific exemptions for contracts for certain unprocessed agricultural or mineral products. Thus contracts for products such as grain, fruit, vegetables, cotton, tobacco, cattle, sheep, or for the product of mines, oil or gas wells, or timber were exempt from renegotiation. Contracts with tax-exempt institutions and contracts with a department for construction let after competitive bidding were also exempt.

In addition, under the wartime statute, the Secretaries had discretionary authority, which is not presently proposed in H. R. 1724, to exempt contracts and subcontracts for "standard commercial articles," if, in the opinion of the Board, competitive conditions affecting the sale of such articles are such "as will reasonably protect the Government against excessive prices."

Industry generally has long been of the opinion that contracts let pursuant to competitive bidding and for standard commercial articles should be exempt from the complicated procedures necessary under renegotiation laws. This has been recognized to some extent in former statutes and regulations. It is our belief, however, that such exemptions should be specifically provided by Congress and not left to administrative discretion. The specific exemptions contained in the wartime statute should also be included in any new renegotiation law.

The basic theory of renegotiation of war contracts was not to capture revenue but rather to adjust downward prices for future procurement on the basis of experience accumulated as new articles were manufactured. In the case of standard commercial articles, therefore, there is no basis nor need for renegotiation since the necessary cost and pricing experience has already been acquired and prices made in a competitive market. The same is largely true of contracts let pursuant to competitive bidding because the contractor must necessarily have determined his costs in order to submit a bid on a contract which must go to the low bidder. In any event it is difficult to see how the profits on such contracts could be so excessive as to endanger the public interest and warrant the administrative burden and expense of renegotiation.

Sixth, the Renegotiation Act of 1948 (sec. 3, Supplemental National Defense Appropriation Act, 1948, Public Law No. 547, 80th Cong.) permits review of unilateral orders by the Tax Court of the United States with ultimate judicial scrutiny by the Supreme Court. H. R. 1724, however, proposes to limit review of such unilateral determinations to the Tax Court. We urge that the broader judicial review provisions of the 1948 act as to questions of law be added to any renegotiation bill which this committee might report. Such broader review would not only promote better administration and public confidence in Board proceedings but also would be conducive to the reaching of voluntary agreements.

Seventh, the definition of "excessive profits" contained in H. R. 1724 directs the Board to take certain factors into consideration in determining excessive profits. One such factor for consideration is "efficiency of contractor." It is

our view that language should be inserted in the bill to make clear that the Board must so conduct its proceedings as affirmatively to encourage efficiency of operations. As stated by Congressman Reed when the bill was before the House:

"Another defect in the bill is that nowhere in legislation does the Congress express its intent that efficiency should be rewarded. If you will examine the seven factors in section 103 on pages 4 and 5 of the bill under which the determination of excessive profits is to be made by the Board, you will see that the Board does not have to reward efficiency of operation and economy in the use of materials, facilities, and manpower. I think such an expression of congressional intent should be contained in the bill, and that the contractors and subcontractors subject to renegotiation would know that the more efficiently they perform the work the greater would be the amount of profit they would be entitled to retain. I should imagine that this will be the policy of the Board, but there should be no doubt that it is the policy of the Congress." (Congressional Record, January 23, 1951, p. 612.)

We urge, therefore, that appropriate direction be given to the Board proposed in H. R. 1724.

Eighth, H. R. 1724 proposes that interest, at the rate of 6 percent, shall accrue and be paid upon amounts determined to be excessive profits.

In our judgment the United States should not be entitled to recover so-called excessive profits and at the same time be entitled to interest on sums recovered through renegotiation of contracts.

The Truman committee, in its report on renegotiation, supra, pointed out that it was universally agreed that "renegotiation can be more effectively used in bringing about downward revisions of future prices than in recovering any considerable sums of profits already earned." In other words, the Truman committee was saying that renegotiation should be a device for bringing about adjustments on pricing—not the mere recovery of money.

In renegotiation proceedings there is not present the usual debtor-creditor relationship. These normally are firm contracts and, except for an extraordinary exercise of governmental power, would be performed and paid upon the same basis as comparable contracts between private parties. In effect, therefore, the imposition of interest constitutes an additional penalty for having in good faith negotiated and executed a contract with the United States.

In addition, the bill as presently drawn proposes to have interests accrue as of the date fixed by the Board. This provision, in our judgment, would inevitably have the practical effect of foreclosing many contractors, especially smaller ones, from seeking redetermination of excessive profits by the Tax Court. The interest provision, therefore, would operate indirectly to deny persons aggrieved by an order of the Board any judicial review whatsoever since, under H. R. 1724, such review is limited to the Tax Court.

Accordingly, since we strongly feel imposing interest is wrong in principle, we urge that the interest provisions be stricken from the bill. If, however, the committee feels it is necessary for interest to accrue on excessive profits determinations, we recommend that it should not start running until (1) the 90-day period, provided in section 108, for filing in the Tax Court has elapsed, or (2) until the Tax Court has issued its final order determining the amount of any excessive profits to be due the Government. Otherwise, judicial review is completely discouraged for the smaller enterprises who may not be able to finance themselves over the possibly long period of time which might be necessary to secure a determination from the Tax Court.

Ninth, an earlier bill (H. R. 9246, 81st Cong.) did not contain a termination date for the authority proposed to be conferred by H. R. 1724.

Since it is our sincere belief that renegotiation should not be permitted to become a permanent fixture in Government procurement and in our free economy, we are gratified to see that H. R. 1724 proposes a termination date of December 31, 1953. It is our judgment that this provision constitutes a congressional recognition that renegotiation is purely an emergency device, inconsistent with all principles of contract law. It will also give the Congress an opportunity, at that time in event extension is contemplated, to reexamine the law in light of its operation and thus promote its fair and efficient administration. Since such periodic appraisal and reappraisal by the Congress is eminently desirable, we recommend that the termination date be made December 31, 1952, rather than 1953.

PICKANDS MATHER & CO.,
Cleveland, Ohio, February 2, 1951.

In re H. R. 1724, the Renegotiation Act of 1951

SENATE FINANCE COMMITTEE,
Senate Office Building, Washington, D. C.

GENTLEMEN: The proposed contract Renegotiation Act of 1951 (H. R. 1724), which is now before the Senate Finance Committee, exempts products of mines which have not been "* * * processed, refined, or treated beyond the ordinary treatment processes normally applied by producers in order to obtain the first commercially marketable product, but only if such contract or subcontract is with the owner or operator of the mine * * * from which such product is produced." As presently worded, this exemption will not apply to a large segment of the Lake Superior iron-ore industry, which is so vital in the present emergency, and will lead to very serious and unnecessary administrative problems both for the Government and the producers of iron ore and pig iron. We urge that the Renegotiation Act of 1951 contain the same exemption for products of mines as that set forth in the previous renegotiation act, namely, an exemption for the products of mines through "the first form or state suitable for industrial use." It would seem that if the exemption in previous renegotiation acts was justified in an actual war period, then certainly a similar exemption would be justified under present conditions, especially in view of the satisfactory operation of this exemption during the war period.

In the case of pig iron (the smelted product of an iron ore mine) which is never sold directly to the Government and which will be subject to price control, the proposed exemption provision will lead to many troublesome administrative problems which will unnecessarily burden the producers of this raw material. Merchant pig iron is sold to thousands of small factories and foundries which may or may not be engaged in defense work and each producer will have to attempt to trace his product so as to determine whether it will be used in connection with a Government contract. If it is used in a Government contract, in all probability it will be used in conjunction with pig iron obtained from other sources, which complicates the problem of tracing the pig iron. This aspect alone will be an interminable administrative problem and, in conjunction with many other similar types of problems, will require increased numbers of both Government and civilian employees for purposes of administration. The problems incident to administration will encourage the sale of pig iron to consumers not involved in Government contracts so as to minimize administrative difficulties and uncertainties.

In the case of iron ore, the proposed exemption does not recognize that iron ore is only valuable for industrial use when it has been smelted to pig iron. The restriction of "ordinary treatment processes" will lead to additional problems as the technology of mining and beneficiating low-grade ores is developed and expanded. Most important of all, the present exemption is so worded so as not to apply to a large segment of the Lake Superior iron-ore industry because it only exempts "contracts or subcontracts * * * with the owner or operator of the mine from which such product is produced." Each pig-iron or steel producer requires several grades of iron ore for its furnace burden and each grade is generally produced by a separate mine. Due to the tremendous cost of developing an iron-ore mine in the Lake Superior district, the consumers of iron ore have developed a method of minimizing their investments by owning fractional interests in several mines. These mines are each operated by a separate mining company which either sells the iron ore it produces at cost to the consuming companies or to an intermediate company which acts as an assembler and mixer of the various grades of iron ore to suit the furnace requirement. After assembly and mixing, the intermediate company sells the iron ore to the pig-iron and steel consumers, and the prices of such sales will be subject to price control. The proposed exemption does not cover this type of transaction because the producer of the iron ore, although exempt from renegotiation, sells at cost, thus making the exemption meaningless, and the market price of the product which is intended to be exempt, is left subject to renegotiation in the hands of the consumer or the intermediate assembling company.

In addition to this feature, the mixing and blending of grades of iron ore, which results in a conservation of ore reserves, involves many sales and transfers of ore between mining companies and intermediate companies which would be subject to renegotiation under the exemption as presently worded. Administratively, it would be impossible to trace iron ore from a particular mine into an ultimate product destined for a defense contract, not only because of the mixing

and blending done prior to shipment to the ultimate pig iron and steel consumers, but also because the consumers charge their furnaces with ores coming from many different mines, located both within this country and in foreign countries. To these complications must be added the problems which would arise in renegotiation of iron-ore contracts because an iron-ore mine involves a wasting asset and a substantial portion of the returns realized on the sale of iron ore constitute a return of capital which must be used in the exploration for new reserves and the development of existing reserves.

We feel very strongly that the exemption for products of mines in the Renegotiation Act of 1951 should be identical with the exemption contained in previous renegotiation acts, namely, the act should exempt "any contract or subcontract for the product of a mine * * * which has not been processed, refined or treated beyond the first form or state suitable for industrial use." The exemption as presently written in the proposed act is entirely inadequate and will not encourage necessary production of iron ore and pig iron which go into the manufacture of steel and other war products.

Respectfully submitted.

PICKANDS MATHER & CO.,
By H. C. JACKSON, *Partner.*

SNYDER, CHADWELL & FAGERBURG,
Chicago, January 27, 1951.

Hon. WALTER F. GEORGE,
United States Senate Office Building, Washington, D. C.

MY DEAR SENATOR GEORGE: I understand that the House of Representatives has passed H. R. 1724, a bill to provide for the renegotiation of contracts and that this bill will shortly receive the attention of the Finance Committee of the United States Senate.

Having had some experience with the operation of the Renegotiation Acts of 1942 and 1943, I would like to call your attention to some features in the House bill that I consider improper and unworkable.

H. R. 1724 is patterned in large part from the Renegotiation Act of 1943. With somewhat different language it provides for certain mandatory exemptions and other permissive exemptions. Its administration is left to a renegotiation board which presumably will have at least three top flight individuals from the business world. In actual practice, however, the extreme breadth of the operations provided for under the act will require, as it did in the earlier acts, the delegation of authority from one group down to another group and to a third or fourth group until the actual decisions regarding whether business is renegotiable or nonrenegotiable and what are "excessive profits" are being made by men with little or no experience in business or by men who have gone into the Government service because they have failed to achieve success in business. This latter group is more difficult to deal with than the former because in many instances they are antagonistic to the private enterprise system.

This act is as far-reaching as the excess profits tax law. It is something that is superimposed upon our entire tax structure and it will be applied, just as the 1942 and 1943 acts were applied, as an additional tax-levying statute. You provide for segregation of renegotiable and nonrenegotiable business but experience under the previous acts showed that the men administering the act looked to the entire picture of the company's operations to see whether in their opinion it has earned too much money on its entire business. They then allowed a percentage of profit on the renegotiable business which when fitted into the pattern would produce what they considered to be an appropriate return to a company on its entire business.

Your Finance Committee, the House Ways and Means Committee, and the entire Congress spend a great deal of time in considering the form of the tax laws in an effort to make their application upon the economy of our country equitable and to make its provisions definite and specific. Yet, under this renegotiation act you will (as you did in the Renegotiation Act of 1943) give to an inexperienced or biased group of administrators, to whom the powers of the board will have been delegated, what is essentially a power of taxation without any adequate safeguards against arbitrary action. Congress may argue for days as to whether a corporate tax rate shall be raised a couple of percentage points. The effect upon our economy of each such tax increase is carefully considered. But these delegatees of delegatees of the Renegotiation Board can in effect increase

the tax burden of a little subcontractor from the present maximum of 62 percent to any figure short of 100 percent by declaring the difference to be excessive profits without any further mandate from Congress.

In an instance with which I am personally familiar the War Contracts Price Adjustment Board, following the findings of its delegatees of delegatees without challenge or change of a single dollar, found that every cent earned by a company (which sells long-established commercial articles essential to the war effort and with which technical service is given as a part of the sales price) above a 2.704-percent margin of profit was excessive profit. In other words, after paying operating expenses and Federal taxes a company is held to have "excessive profits" even when its margin is less than 3 percent. You will get the same kind of findings under this new bill unless Congress writes into it some standard for excessive profits other than the uncharted course set by section 103 (e).

If you have read any of the reports furnished to petitioners pursuant to section 403 (c) (1) of the Renegotiation Act of 1943, when the Board has been requested to furnish a statement of the facts used as a basis for its determination of excessive profits and of its reasons for such determination, you will know that these statements are merely a pro forma restatement of the factors which the Board is required to take into consideration as recited in the statute with little or no specific information to show the basis of their conclusions.

Thus the small-business man is presented with the necessity of accepting a negotiated profit which he knows to be inadequate, or face the alternative of a proceeding in the Tax Court where he must carry the burden of proving erroneous a determination, the facts and basis of which have not been disclosed to him.

Under section 103 (e) you can have a subcontractor who will show by its operations a minimum use of manpower, a tremendous increase in production, and a cooperation in the economical use of critical materials sufficient to bring to it the plaudits of those governmental officials who can best appraise the value of such economy in critical materials. This contractor can produce products that during this emergency, as during the last war, will have been of prime importance in breaking the bottlenecks in the production lines of many of our major war industries and be acclaimed for its outstanding performance in the defense program by every department of the Government with which it comes in contact and yet, because it operated around the clock instead of an 8 hour shift and thereby made a profit of approximately twice the percentage ratio that it had made during the prewar period, be said to have excessive profits. With that finding, under the language of section 103 (e) (2) the Renegotiation Board, if it acts the same as the War Contracts Price Adjustment Board, will find that all these profits above 2.704 percent are excessive, notwithstanding the fact that its unit sales prices on a volume basis were no higher during the war period than they were for several years prior thereto when these prices were established under competitive conditions in a most competitive industry.

I do not believe that an operation of that type should be said to have made excessive profits and the first thing that should be done by the Senate is to amend section 103 to make clear that Congress did not intend that a mere increase in volume of production with attendant increase in profits constitutes excessive profits. The excess-profits-tax law adequately taxes such expanded operations.

Secondly I believe that profits derived from the sale of standard commercial articles should be mandatorily exempt. There are a lot of standard commercial articles made in this country which will be sold to Government contractors pursuant to subcontracts, as defined in the proposed bill, which have been made in quantity production for years and sold under competitive conditions of the keenest sort which, under this bill, just as in the case of the previous acts, will be subject to renegotiation. Because the manufacturer will produce a larger quantity of these articles during the war emergency and by reason thereof will earn a higher percentage of return on his entire business than prior to the rearmament program he will be subjected to renegotiation. What that manufacturer is doing in most instances is working his plant and equipment around the clock instead of for the customary 8-hour shift. You may say that he will be allowed higher depreciation or amortization on his structure and plant but that does not compensate him for the risk of destruction of his business when he subsequently has to reduce his operations down to normal and has the problem of cutting down his operating personnel and trying to earn a return on his enlarged facilities.

The 1943 act authorized the War Contracts Price Adjustment Board to exempt standard commercial articles if in the opinion of the Board competitive conditions affecting the sale of the articles where such as to reasonably protect the Government as to excessive prices. That provision was inadequate because in its ap-

plication, unless a petitioner for exemption could show that the articles were not being sold at excessive prices and producing excessive profits for the industry generally, the exemption was denied. Obviously a single petitioner could not show this for the entire industry so that he was helpless in the situation. This is not theoretical; this actually happened in the instance to which I referred.

Under the proposed bill even this standard commercial article provision of the 1943 act has been dropped from the list of permissive exemptions. As stated above it should be a part of the mandatory exemptions and the act should provide that where a standard commercial article has been sold for 1 year or more and the price thereof under the subcontract does not exceed the unit price at which said product was sold during the preceding year or as of the date of any price freeze, the profits therefrom shall be exempt from renegotiation. The excess profits tax law will take all of the profits that should be taken from this operation.

When the Renegotiation Act was first considered in 1942 its justification was that we were entering into a war preparation period where manufacturers would be called upon to produce products that were new to them, that to protect them it was necessary that they have a fair price. It was also recognized that it was impossible for them to judge in advance what would be a fair contract price because of their lack of previous manufacturing experience on such products. It was therefore suggested that in the urgency of the matter, the price be almost what you will, there would be a subsequent renegotiation of the contract. The Ways and Means Committee of the House has asserted that this present act is required for essentially the same reasons. (See Rept. No. 7.)

No one will seriously question the desirability of a renegotiation act in such special instances but there is no real justification for a renegotiation act for the standard commercial articles being produced by the thousands in this country. Unless you exempt such standard commercial articles, you will again be building up an organization to cover such a myriad of products and problems that it will fail in performing its proper function just as it did during the last war.

I should think that Congress would want to establish an organization that would fulfill its necessary function and not spread its tenacles through every little subcontracting unit in the country. It does not take very much business to reach the $25,000 subcontract exemption figure set forth in section 105 (f) (2) of the proposed bill. Thus your renegotiation act will be reaching practically every manufacturing operation in the country in which any of the end product gravitates into the defense program. It would seem that our tax laws adequately cover these operations and that a renegotiation act should be brought back to its original and alleged present purpose—that of renegotiating prices where there is no present standard upon which to base a fair and reasonable contract price to the buyer.

If the men who administered the former act are honest with you, they will tell you that on many occasions it was a mere matter of guess work and speculation when they tried to segregate the renegotiable from the nonrenegotiable business. You would not permit a tax law to be enforced by such guess work. Yet the Renegotiation Act is siphoning off income just as much as the taxing laws and should have an equally standardized method of application.

A third feature of this bill which requires amendment is the interest section. The interest provisions in section 105 (2) are typical of the coercive approach that has been constantly followed by the Government in the administration of the previous renegotiation acts.

As you know, the courts held under the earlier acts that 6 percent was not a fair interest rate. The 1942 and 1943 acts did not contain provisions for interest. The renegotiation authorities nevertheless claimed, and in many cases collected by hold-backs and other methods, 6 percent interest and continued to do so despite the fact that the great majority of the courts passing upon the question held that a 6-percent return is far in excess of the fair return for the withholding of money under these circumstances. This provision for interest is also entirely unfair since it would begin running from the time that the Board determines the amount of alleged excessive profits even though this determination is not conclusive until the contractor's right to appeal to the Tax Court has expired. There is no excuse for starting interest running prior to the expiration of the time for such appeal and the bill should be revised to so provide.

I have referred above to the delegations of power made by the War Contracts Price Adjustment Board. Paragraph (d) of section 107 authorizes the same type of delegation under H. R. 1724. If you are going to include every type of commercial article that is sold in the United Sattes and which finally gets into a war facility, then you will have to have a very broad delegation of power, and you

can expect that the act will be administered by a group of low-salaried inexperienced men without any proper perspective on what return is necessary to keep a company in business over the long pull. On the other hand, if you limit the renegotiation act to the type of contract in the defense effort where there is some reasonable requirement for renegotiation in addition to the excess-profits tax law, you can considerably cut down this delegation of power and the size of the organization needed to administer it. You may then be able to get men to administer it who have had sufficient business experience to understand some of the problems involved in keeping a business going over the long haul. It is no saving grace that the Board might delegate its functions and powers "to any agency of the Government" that might exist at the present time. There are not very many agencies in the Government who have the personnel to perform this function.

I have read several of your statements indicating that you fully appreciate the necessity of a corporation being permitted to retain a surplus adequate to enable it to survive periods of recession or depression. The other day Mr. Charles E. Wilson was reported to have said that if we built up our production during the next 2 or 3 years to the point that seemed necessary and there was a sudden slackening off due to definite assurances of peace, this country would be in a sad situation. Yet we all hope that there will be such assurances of peace. Is Congress going to adopt a taxing policy which will wreck us if the thing happens which we all hope will happen? By passing this renegotiation bill in the House form you will put it within the power of a group of unknown men to do just that thing.

The taxes paid by a company are as important a cost factor as any factor in its operations. In the determination of excessive profits, therefore, there should be an additional factor designated in section 103 (e), i. e. (8), Federal income and excess-profits taxes. These should be considered before the contractor or subcontractor can be said to earn "excessive profits." From the point of view of the stockholder it is what the company has left after paying all of its taxes as well as its other operating obligations that determines its profits. Taxes should therefore be above the line when you come to figuring excessive profits.

I saw Mr. Robert Snodgrass of Atlanta, one of your loyal constituents, in Ann Arbor last week end, where we are serving on the executive committee of the university's atomic research program. He informed me that you were in good health and I sincerely trust that you will conserve your strength so that you will keep in that condition, because at a time like this we need men of your perspective and statesmanship to maintain the strength of our economy in the face of the terrific stresses that are being placed upon it.

I am taking the liberty of sending a copy of this letter to three of your associates on the Finance Committee.

Respectfully yours,

D. F. FAGERBURG.

The CHAIRMAN. Is there any other witness who wishes either to file a brief or make a personal appearance?

If there is no other witness, then the hearing will be closed, and the clerk will notify us next week when we will go into executive session on this and the veterans' insurance bill, on which hearings have previously been held.

I may say that I think we ought to be able to proceed on Thursday of next week.

The hearing is adjourned.

(Thereupon at 3:45 p. m., the hearing was adjourned.)

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