

RENEGOTIATION OF CONTRACTS

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

SEVENTY-SEVENTH CONGRESS

SECOND SESSION

ON

Sec. 403 of Public Law Numbered 528

AN ACT MAKING ADDITIONAL APPROPRIATIONS FOR THE
NATIONAL DEFENSE FOR THE FISCAL YEAR ENDING
JUNE 30, 1942, AND FOR OTHER PURPOSES

REVISED

SEPTEMBER 22 AND 23, 1942

Printed for the use of the Committee on Finance



UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON : 1942

COMMITTEE ON FINANCE

WALTER F. GEORGE, Georgia, *Chairman*

DAVID I. WALSH, Massachusetts

ALBEN W. BARKLEY, Kentucky

TOM CONNALLY, Texas

JOSIAH W. BAILEY, North Carolina

BENNETT CHAMP CLARK, Missouri

HARRY FLOOD BYRD, Virginia

PETER G. GERRY, Rhode Island

JOSEPH F. GUFFEY, Pennsylvania

PRENTISS M. BROWN, Michigan

OLYDE L. HERRING, Iowa

EDWIN C. JOHNSON, Colorado

GEORGE L. RADCLIFFE, Maryland

WILLIAM H. SMATHERS, New Jersey

ROBERT M. LA FOLLETTE, JR., Wisconsin

ARTHUR CAPPER, Kansas

ARTHUR H. VANDENBERG, Michigan

JAMES J. DAVIS, Pennsylvania

HENRY CABOT LODGE, JR., Massachusetts

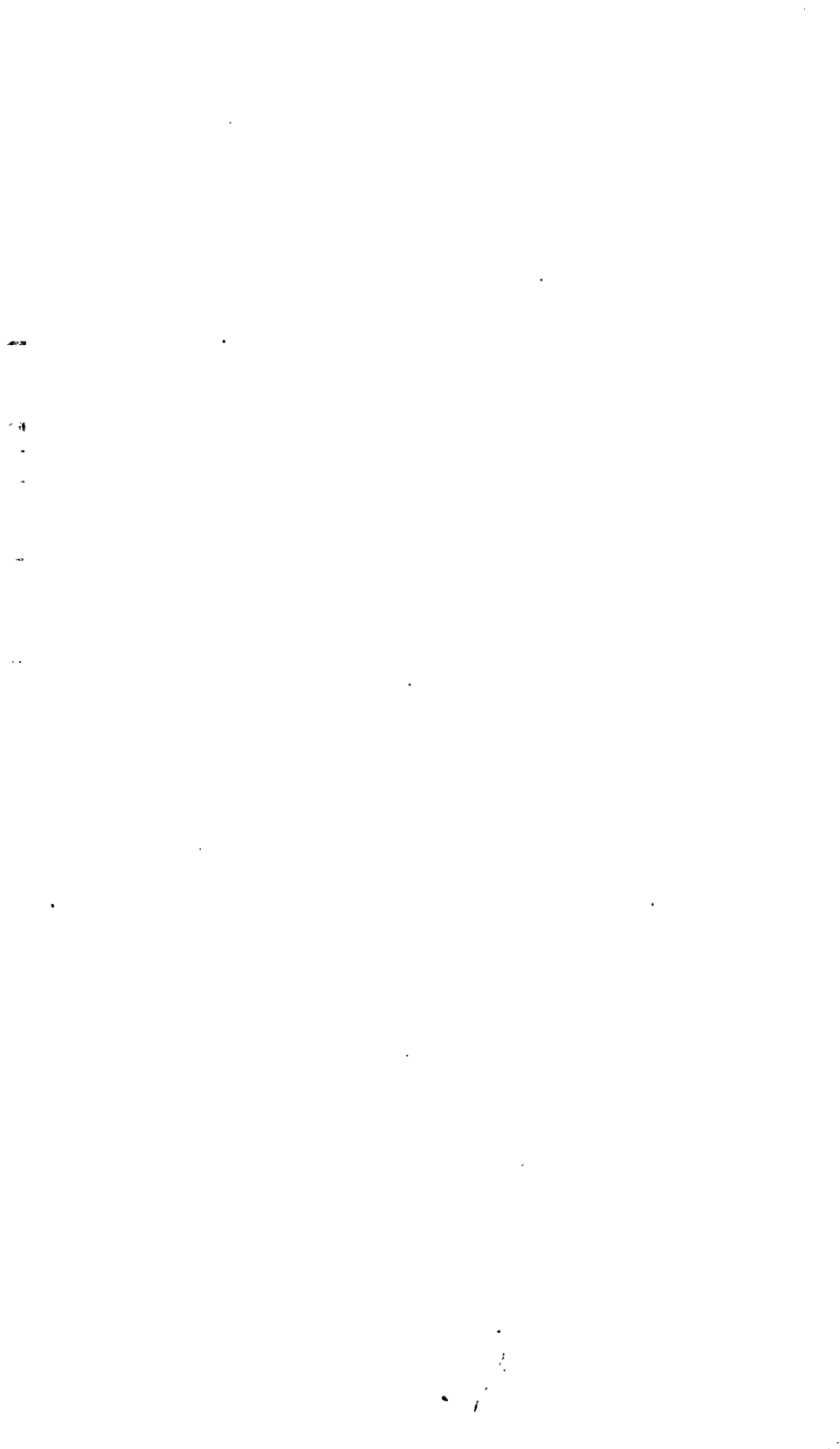
JOHN A. DANAHY, Connecticut

ROBERT A. TAFT, Ohio

CHRISTIE B. KENNEDY, *Clerk*

CONTENTS

	Page
Statement of--	
Brown, Lt. Walston, Assistant General Counsel, Maritime Commission.....	48
Kenney, John, Special Assistant to the Undersecretary, Navy Department.....	46
Marbury, William L., Purchase Division, Legal Branch, Services of Supply, War Department.....	1
Paul, Randolph E., General Counsel, Treasury Department.....	53
Letters, briefs, etc.:	
Guffey, Hon. Joseph F., United States Senator from Pennsylvania, memorandum to.....	62



RENEGOTIATION OF CONTRACTS

TUESDAY, SEPTEMBER 22, 1942

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

EXECUTIVE SESSION

The committee met at 10 a. m. pursuant to call, in room 310, Senate Office Building, Senator Walter F. George (chairman), presiding.

The CHAIRMAN. The committee will please come to order.

The committee has this morning representatives from the Navy and the War Department and the Maritime Commission, relating to the renegotiation contract law.

Mr. Paul, will you be kind enough to indicate in what order these gentlemen representing the various departments would like to appear?

Mr. PAUL. Mr. Marbury, of the War Department, might start.

The CHAIRMAN. All right. Mr. Marbury, you may come around here, if it is convenient for you, and take that chair right there. You are representing the War Department, Mr. Marbury?

Mr. MARBURY. Yes, sir.

The CHAIRMAN. The general purpose of the inquiry is to see what amendments or what treatment should be given to the Renegotiation Contract Act which did not originate in this committee, but came through, as you know very well, the House Appropriations Committee and the Senate Appropriations Committee.

The final form was written in the Senate, I believe, with some slight changes in committees. But it is a matter that does affect our problems here, and it has been, perhaps, the most definitely controversial field in this whole tax picture that has been presented to the committee from time to time by numerous, numerous representatives of the various industries, war contractors throughout the country, and we would like to have you make a statement with respect to the renegotiation work proceeding under this act, with such suggestions as you are free to make to us with reference to amendments to the act.

STATEMENT OF WILLIAM L. MARBURY, PURCHASE DIVISION, LEGAL BRANCH, SERVICES OF SUPPLY, WAR DEPARTMENT

Mr. MARBURY. Well, Mr. Chairman, the War Department is entirely conscious of the fact that this act raises very basic and fundamental questions which are having a very serious collateral effect on industry, on taxation, on price regulation, and on almost every phase of the war program. They feel that a very thorough study of the act and of its effects, should be made and they would welcome such a

study by this committee, or a subcommittee or any other properly duly authorized committee of Congress.

They feel, however, that to undertake such a study as a part of the consideration of a revenue bill would probably be impractical and they feel that an attempt to revise the act radically and basically without such a study might lead to a situation which would be considerably more serious than that in which we now find ourselves.

The War Department has been operating under section 403 of the Sixth Supplemental National Defense Appropriation Act of 1942 for a period of 4 months. While the act is, in many respects, obscure and has presented many serious administrative difficulties, we have, we think, managed to adapt our procedure to the practical requirements of administration and still stay within the bounds of reasonable construction of the act, and we are apprehensive lest, in the process of an attempt to deal with the situation radically, we find ourselves with something that we could not successfully administer, and that would impede the procurement program.

Now, for that reason the War Department has not taken the initiative in suggesting any amendments to the act at this time, nor are we in a position officially and with the sanction of the Budget Bureau to propose any amendments to the act. However, if this committee feels that the situation is one that should be dealt with at this time, notwithstanding the considerations which I have suggested, we are prepared to offer informally for your consideration certain clarifying amendments to the act which we think would assist in its administration, and with respect to which we have obtained the consent—or rather, we are authorized to say not only that the War Department would find such amendments helpful, but that the Navy Department and the Maritime Commission are in agreement on that point.

The statute is phrased in general terms and does not specifically cover some of the questions which have arisen in practice. Of necessity, these questions have been resolved in the light of the purposes of the statute and the practical requirements of administration. If Congress deems it desirable to clarify the provisions of the act to eliminate any doubts and uncertainties on these points, we have prepared certain amendments which we think would serve that purpose. The function of these amendments is to eliminate existing uncertainties and to make the statute more flexible and workable as a means of reducing excessive profits, prices, and costs.

In their work thus far the Price Adjustment Boards which have been organized in the War Department and the Navy Department and the Maritime Commission, have developed certain procedures and practices in carrying out the renegotiation contracts and subcontracts. It is believed that these are consistent with the terms and provisions of the statute, but some of them are not expressly authorized. In the interest of certainty, it may be desirable, therefore, to amend the statute to cover these procedures and practices expressly, by authorizing over-all renegotiation, by clarifying the methods of eliminating excessive profits, by directing credits for excess-profits taxes, and by authorizing final agreements.

If I may, I would like to go into those, one after the other, and state briefly what the points are.

At present when a contractor or subcontractor holds a number of war contracts or subcontracts, it has been found desirable—and I

may say almost imperative—to renegotiate with him to eliminate excessive profits on these contracts or subcontracts as a group on an over-all basis, instead of individually.

Excessive profits can be determined more quickly and accurately by an over-all study of a company's financial position and the profits, past and prospective, from its contracts taken as a whole, than by analyzing each individual contract on a unit-cost basis.

In addition, this greatly simplifies the work of the Board and of contractors by reducing the number of renegotiations and by avoiding the necessity of allocating costs among the various contracts to determine the profit on particular contracts.

Senator LA FOLLETTE. May I interrupt, Mr. Marbury?

Mr. MARBURY. Yes, sir.

Senator LA FOLLETTE. When you speak of studying all a company's contracts taken as a whole, I assume you mean to find out whether or not under all their contracts they made an excessive profit, instead of determining whether there is an excessive profit on one, when there may be a loss on another, which could not be taken into account.

Would that apply to contracts with all governmental agencies purchasing for the war effort, or are you speaking of just renegotiating them solely on the basis of contracts with one or the other of the departments or commissions?

Mr. MARBURY. On all war business.

Senator LA FOLLETTE. Thank you.

Mr. MARBURY. It is believed that this method carries out the purpose of the statute, but it might well be expressly authorized.

Senator VANDENBERG. Let me ask you this question: Do you think there is a vice in the present situation which ought to be corrected in the fashion you indicate? Do you think an injustice is being done to some war contractors as a result of the present method of operation, Mr. Marbury?

Mr. MARBURY. No. I think that the method that we are now following is a just one. I think it might be well to make it clear by amendment of the statute that what we are doing is a proper procedure.

Senator VANDENBERG. In other words, the thing that you are now recommending is what you are now doing?

Mr. MARBURY. Yes; that is correct.

Senator VANDENBERG. Thank you.

Mr. MARBURY. The statute now provides for eliminating excessive profits by withholding or recovery. With respect to prospective profits it is often practical and desirable from the point of view of the Government and the contractor to eliminate such profits by reductions in the contract price, or by revision in the contract terms instead of by recapture or refund.

In the case of subcontracts, the fear has been expressed that even though the price reduction is made as agreed, the subcontractor might still be liable for the excessive profit if, for any reason, the Government failed to receive the benefit. While this construction seems improbable, the possibility should be removed, and we have prepared an amendment which would accomplish that result.

At the present the statute makes no express provision for offsetting excess-profits taxes paid by a contractor against any amount of

excessive profits found to exist by renegotiation under the statute. In the absence of such offset, the contractor would be forced to pay twice, once in the form of taxes and the second time by refund of excessive profits. While it seems plain that Congress did not intend such double liability, it would be better if the statute directed the credit for excess-profits taxes paid.

When a contractor or subcontractor has renegotiated in good faith and agreed to eliminate any excessive profits found as a result of such renegotiation, he is clearly entitled to assurance that the matter will not be reopened at a later date. The statute does not provide expressly for any final clearance for liability for excessive profits.

The War Department, however, gives clearance for the period covered by the renegotiation, either at the time of renegotiation or after a further review of the results of actual operations after the end of the period, and it is believed that this is the proper construction of the act. That is obviously of the utmost importance to contractors and subcontractors and the power to give such clearance aids in reaching agreements with contractors. This matter is so fundamental that it should not be left to interpretation, and we have, therefore, prepared an amendment of the act which would make it perfectly clear that we have that power to give clearance which shall be final for specified periods so that the contractor may know that that will not be reopened and that the profits which he has earned and which are left after the return of excessive profits will not be taken from him at some later date.

Senator VANDENBERG. Mr. Marbury, does that mean that you will proceed on the theory of just one renegotiation and that that is final?

Mr. MARBURY. No, sir. One for a given period, which may be, for example, a fiscal year. We may take a contractor, renegotiate with him, determine what amounts of profits earned in a given fiscal period are excessive, come to an agreement with him about that, and then say, "All right, you refund so much" or, "you reduce your contractor price by such and such an amount" and that is firm, and that sticks for that fiscal period, and nobody will come back later on and say, "Well, I disagree with my predecessor; I think that the profits that you earned in 1941 or 1942 were excessive to a greater degree than he did and I am going to call on you to pay back."

That is a fear that the contractors have, of course. We can only deal with that by telling them that we believe that under the present act we have the power to make a final agreement for a given period, but it would certainly assist us in the operation of the act if the statute made that crystal clear.

That does not mean that we renegotiate once and that is forever. Some of these contracts may run 2 or 3 years and it is sometimes impractical to look that far into the future. You can't tell. And, as long as the statute imposes upon the Secretary the duty to eliminate excessive profits, it is very difficult for him—in fact, it would be impossible for him to perform that duty by one renegotiation in many cases.

Senator VANDENBERG. Well, then, as I understand you, Mr. Marbury, you are undertaking to pursue the theory of one single renegotiation for a given period?

Mr. MARBURY. Yes, sir.

Senator VANDENBERG. All right. What is that period in length of time usually?

Mr. MARBURY. Well, I would like to check that with Mr. Pengra, who has been doing the day-to-day operations with the Board, but I think it is generally a fiscal year. Is that correct, Mr. Pengora?

Mr. PENGRA. (Charles O. Pengra, counsel, Price Adjustment Board, War Department). That is correct; yes.

Mr. MARBURY. Generally it is a fiscal year, the fiscal year of the contractor.

Senator VANDENBERG. And that means then that when you are through with him in one renegotiation he does not have to worry about you for 12 months?

Mr. MARBURY. Yes, sir; that is our position.

Some people are dissatisfied with the statute as it now reads. They have the fear that some later official may undertake to rip the thing up; but we think we have the power, and we are purporting to exercise it, and the Navy Department, and I think the Maritime Commission are taking the same position.

Senator VANDENBERG. Is that a recent development in your policy?

Mr. MARBURY. No, sir; I think that has been a consistent policy ever since we have begun our negotiations.

Senator VANDENBERG. Then what is the genesis of the constant complaint from certainly well-meaning, patriotic business men that they are ridden to death by this renegotiation obligation and that in many instances, they have to keep constantly coming to Washington, as a result of which they can't even tend to their war production business. What is the justification for that attitude, where does it arise?

Mr. MARBURY. Well, I think, Senator, it arises from the fact that the business community as a whole is not yet familiar with the actual operations of the statute. I do not believe that any business man who has actually been before one of the Price Adjustment Boards would make a statement of that kind, unless he were relying on an opinion of his lawyer to the effect that while the Department purported to make a final agreement for the fiscal year, they did not believe we had that legal authority.

Senator TAFT. I certainly do not think you have that authority under the present act. Under this act I think it could be reopened every year. I think your amendment is very wise and I am for it.

Mr. MARBURY. The fact that, as excellent a lawyer as Senator Taft could say that is another reason we think it desirable.

Senator RADCLIFFE. Mr. Marbury, have you attempted to outline any specific formula or basis for this negotiation, what would be excessive profits and what would not? Is there any particular rule-of-thumb, or any specific method that you have in mind by which that could be worked out?

Mr. MARBURY. No, sir; there is none. I do not know of any conceivable way of determining an excessive profit by any fixed formula.

Senator RADCLIFFE. Wouldn't you have to have some general basis in mind—I don't know whether it would be a percentage or not—but you must have some concept in your mind which would furnish a dividing line between what is excessive and what is not.

Mr. MARBURY. Senator Radcliffe, I would not be in a position to answer that question. If the committee wanted to understand the process by which, for example, the War Department Price Adjustment Board proceeds in determining what is excessive, I think it would get a more satisfactory answer if they called on the Chairman

of the Board or Mr. Pengra, who is here, but I can say this, we have to deal with each case on an individual basis, taking into consideration any number of factors—the efficiency of the operation, whether the man has been in it for a long time, or whether he is a new marginal producer, the invested capital involved, and to what extent the Government is supplying facilities, the rapidity of turn-over—there are any number.

It is a matter of business judgment and the Price Adjustment Board has businessmen who sit down with the contractors as businessmen, and it is surprising how close they can come to an agreement, as to what part of the profit is unreasonably and excessive.

Senator RADCLIFFE. I can readily see the difficulty of trying to work out and have any one set formula because of some of the factors you have mentioned and a good many others which suggest themselves to one's mind.

On the other hand, it seems to me that a contractor would be somewhat in the dark when he starts into a proposition like this, if he has no idea whether, roughly speaking, you are going to allow him say, 3 percent or 5 percent, or 30 percent.

I see the difficulty in being specific, but, on the other hand, I can see grave objection if the matter is up in the air and it is dependent on what some board some day, some time, might decide would be a fair way of handling it.

Mr. MARBURY. There is no denying that. Here is a board given authority to call these men down and require them to return an excessive profit without anybody being able to point to a limit and say, "Beyond that you can't ask us for a nickel."

Senator TAFT. Isn't it true that it is based on cost plus something?

Mr. MARBURY. Of course, everything is based on profit, and profit is something in addition to cost.

Senator TAFT. Yes. Complaint is made fundamentally that what we are doing in this thing is getting back to a cost-plus basis and that there is no real reward for efficiency any more, that the fellow who does not reduce his costs is allowed his cost plus a reasonable profit.

On the other hand, here is a man who is efficient and who reduces his cost and his profit is negotiated down. So we get back to the cost-plus system that we had in the World War.

Mr. MARBURY. Well, I think that is undoubtedly one of the very serious considerations, one of the aspects of the statute which requires most serious consideration, but I know of no way that you can deal with that unless you were to undertake to repeal the statute out of hand.

Senator VANDENBERG. Aren't we, Mr. Marbury, pretty nearly back on the cost-plus basis, the very thing that Congress sought to avoid?

Mr. MARBURY. If you ask for my personal opinion, I would not think so. I don't think you are back on a cost-plus basis because our procurement officers are negotiating their contracts on a lump-sum basis, and negotiating them, as closely as they are able to do so.

Now, the operation of this statute usually comes in the case where the procurement officers at the time of negotiation did not have adequate data to go on or where some surprising development has taken place, some surprising improvement in efficiency, or a sudden increase in volume which has reduced cost and created a much wider spread between cost and price than the parties foresaw.

The cost-plus, percentage of cost, has as its principal vice, as I understand it, that the incentive is to increase rather than to diminish cost. That would not be the case in the administration of this statute. As a matter of fact, it is the policy of the Board, where a contractor by efficiency has decreased his cost, to allow him a larger profit as being reasonable, than in the situation where the increase in spread between cost and price is due to other factors than his own efficiency.

Senator RADCLIFFE. Of course, the Maritime Commission has followed out that plan of having a base price which is reduced by efficiency—rather, is increased by that—and I think you do, too. Of course, the dangers you pointed out are all inherent on your eliminating the competitive basis of operation, and I can readily see how the competitor plan, that is, requiring everything to go on bid, is not altogether practical now. I do not know if you are taking advantage of applying it whenever you can. It seems to me that whenever the competitive basis can be followed out, without tying up your program, that it is a very wise thing to bear in mind.

Senator TAFT. That is what I wanted to ask you about, Mr. Marbury. Isn't it possible to draw a distinction between contracts which are negotiated contracts, where you may well reserve the right to renegotiate, and contracts that are let on a competitive basis? It would seem to me there is much less reason for renegotiation where they are let on a competitive basis, and there might be some possibility of accepting such contracts and encouraging them as the costs become better known, and in some fields they are already fully known.

It may well be that a competitive basis is better, and if you are going to have a competitive basis at all, it seems to me there is not so much reason for renegotiation. On the other hand, these negotiated contracts, I see good reasons for renegotiating them.

Senator RADCLIFFE. Senator Taft, the urgency of the war program and the necessity of the contractor should be brought out. There are a good many reasons why the competitive plan, as usually followed out, is not workable.

Senator TAFT. Yes; but in many places it will work. This renegotiation applies to anyone—one who sells beans to the Government. Someone can come back 5 years from now and say they charged too much for beans. It seems to me that there might be a distinction between those two kinds of contracts.

Mr. MARBURY. That is the kind of basic question on which you may find a number of opinions that would be worth hearing, and that is why we say that any thorough-going radical revision of this statute ought, we submit, to be based on a real and thorough study, because that very kind of question is the sort of thing I might have one opinion on, and might get a different opinion from others, better qualified to express an opinion, and I am certainly not in a position to state the opinion of the War Department as to whether there should or should not be a distinction.

I will say this, that, to the best of my knowledge, at present it is the view of the Price Adjustment Board that that is a fact which they will take into consideration, but the mere fact that there has been competition does not exclude a contract from renegotiation.

Senator VANDENBERG. Is there any effort in your suggestions, Mr. Marbury, to be any more specific in a definition of the phrase "excessive profits"?

Mr. MARBURY. No, sir.

Senator VANDENBERG. I notice on the first page:

For the purposes of this section (No. 4) the term "excess profits" means any amount of a contract or subcontract price which is found, as the result of renegotiation, to represent excessive profits.

Mr. MARBURY. The only purpose of putting it in was that it avoided the necessity of repeating some words in the act. We do not undertake to add a bit of light, cast a bit of light on that question of what is "excessive profits."

Senator RADCLIFFE. Could you say that your determination of what has been excessive profits, or rather, what profits would not be excessive, has been reached in any way? In other words, have you had any standard in mind? Suppose, you had a dozen of these contracts out and you have renegotiated them. Now, when you have done that, the profits that have been allowed—let me put it that way has that approximated any particular figure? In other words, have you allowed, say, a 3 or 4 percent figure in some cases, have you allowed 7 or 8 percent in others? Have you had any kind of a basis for approximating an average?

Mr. MARBURY. No, sir; I think not. I think there has been a very wide spread as to percentages.

Senator RADCLIFFE. You might allow 20 percent in some cases?

Mr. MARBURY. I don't know whether there has ever been anything quite as high as 20 percent, but there has been a wide variation.

Senator TAFT. Percent of what?

Mr. MARBURY. I presume of cost is what Senator Radcliffe asked about.

Senator TAFT. Do you work on a percentage-of-cost, rather than a percentage-of-capital basis?

Mr. MARBURY. No, sir. We do not do it that way.

The question Senator Radcliffe asked was, Have we come to any figure, have we developed any method of rule-of-thumb, as to percentage of cost? The answer is no.

But, if you want to know how the percentages actually work out, that is something that can be determined.

Senator RADCLIFFE. My second question went further. Even if you have not worked out any method, have your operations been such that you have approximated something along that line?

Mr. MARBURY. That is what I thought your question was, and the answer is no.

In other words, there is a very wide variation. If you study the cases and try to determine the percent of cost, you will find a wide variation.

Senator RADCLIFFE. I can see room for a certain variation, but it seems to me that it ought to fit within some particular group somewhere. I mean, you said 20 percent, you didn't recall any case like that. I can hardly conceive of any situation where it might be 20 percent, except maybe in creating a plant, or something of that kind, but there must be some common ground which would be the road usually traveled.

Senator TAFT. Do you attempt to get a single percentage on a particular kind of contract? For instance, the building of merchant ships. I can see why it should be very different on merchant ships than on some others. For instance, airplanes.

Mr. MARBURY. Senator, I am not qualified to answer that question. I am certainly not as to merchant ships. The representative of the

Maritime Commission is here. I would think, and this is just nothing more than really a guess on my part, that there would be some tendency in particular categories to approximate similarity of treatment, although even there difference in the invested capital of the company, and the efficiency of its operation, and the amount of facilities which it is asking from the Government, justify differences in the allowances that are made to the specific contractors producing the same article.

Senator TAFT. How many different boards are there sitting today?

Mr. MARBURY. Well, there are three boards. In other words, the Price Adjustment Board of the War Department, one of the Navy Department's and one of the Maritime Commission's. They do not overlap, however.

Senator TAFT. You have separate panels, however?

Mr. MARBURY. We have organized in the service of supply what are called price-adjustment sections, which function.

For instance, the Army Air Force has a Price Adjustment Section; the Ordnance Department has a Price Adjustment Section; various other of the supply services have their sections, to whom the main Board assigns cases.

Senator TAFT. And they hear the case?

Mr. MARBURY. Yes, sir.

Senator TAFT. And they make a decision?

Mr. MARBURY. Yes, sir.

Senator TAFT. It is pretty hard for the main board to change that decision; is that not so?

Mr. MARBURY. I do not think so.

Senator WALSH. Are they not regional boards?

Mr. MARBURY. No, sir. I believe in the case of the Ordnance Department, their Price Adjustment Sections have been broken up into different groups. They may sit in different procurement districts.

Senator WALSH. Aren't there a large number of those?

Mr. MARBURY. Well, now, I cannot answer that. I don't know how large the Price Adjustment Section of the Ordnance Department is, or how many separate panels they have, but they all operate as one organization and they operate under the supervision and control of the War Department Price Adjustment Board.

Senator WALSH. What control have these boards over the items that establish the cost?

Mr. MARBURY. What control have they over the items?

Senator WALSH. Do they examine them to determine whether the cost is fair and just and right or not, or do they take the contractors' word for cost?

Mr. MARBURY. Well, they have the clear power to do so. I should say that to the extent that it is practicable to do it, they are doing it.

Senator WALSH. In the early days of the building of cantonments repeatedly my attention was called to collusion between the contractors and subcontractors or those furnishing supplies in piling up the costs and charging excessive amounts.

In fact, one case, which you, perhaps, have not heard of, before the Navy Department discovered it, there was an attempt to defraud the Government of \$500,000, which the Government was able to get back through the Treasury, where there was misrepresentation all along the line on costs and of the amount of labor performed.

Now, it seems to me, from my observations, that the question goes beyond what ought to be the profit, but are the costs honest and fair and just, and is there a complete absence of collusion? It seems to me that if these boards are not able to go into that, they are not getting the whole problem that is involved here.

And let me add this: I noticed a statement of Mr. Nelson made a short time ago which impressed me very much, that a contractor who made false statements about his costs ought to be found guilty of treason.

I was very much impressed with it because it seems to me to be the conception we ought to have of these fraudulent statements that have allegedly been made with reference to these costs.

The Naval Affairs Committee recommended a bill depriving the citizenship of one found guilty of making a fraudulent statement about his costs. The bill was vetoed. I wondered how far these boards are going into that phase of it.

Mr. MARBURY. Well, I think that there is a very thorough consciousness in the War Department of the vital importance of keeping as close a check on costs as it is possible to do within the limits of personnel and I know that during the last 6 months many steps have been taken to strengthen the control over those items.

Senator WALSH. I am pleased to hear that, because, as I said before, from the information that came to me, and it was apparently well-founded, it showed shocking illustrations of collusion in padding the costs.

Senator RADCLIFFE. Mr. Marbury, following Senator Walsh's inquiry, everyone knows that collusion has existed, and probably has existed from time to time in matters of contracts of this sort.

Senator WALSH. In time of war it is a serious offense and there ought to be no mercy shown anyone who does it.

Senator RADCLIFFE. What steps do you take to follow this as it goes along? In other words, do they look into it after it is all over or do they have machinery by which they can follow these contracts, or are they restricted to a consideration after it is all over?

Mr. MARBURY. The Price Adjustment Boards are, to a large extent, functioning merely as to profits. The question of cost control is one which has rested, let us say, with the procurement agencies themselves, through their auditors and through their original negotiations, their inspections, and their audit.

Senator RADCLIFFE. But in the study of special cases which have come up from time to time, have you reached the conclusion that the Procurement Division has had adequate facilities for that? You can look backward and see what they have done. Do you think the machinery which they have had has been sufficient?

Mr. MARBURY. The only answer to that is that the War Department is constantly striving to strengthen it and that they are not satisfied and complacent about what they are doing.

Senator RADCLIFFE. I am not insensible to the unprecedented difficulties in getting the work done, but I still feel that there ought to be some way of approximating, some way of having some general basis instead of leaving the thing entirely undetermined, as to what would be a reasonable profit; there ought to be some rule which, while not controlling, would be at least a large factor and be potent in determining it.

We must get something in the way of rules and regulations and formulae or bases of determination.

Mr. MARBURY. Well, that is another one of the basic questions, which, in view of the seriousness of the statute and the incalculable consequences of its impact on industry, we think ought to be given the most thorough study.

The CHAIRMAN. Do not your contracts, Mr. Marbury, fall within general categories, classifications, that could be reasonably simplified?

Mr. MARBURY. Of course, they do fall into general categories, Senator George, there cannot be any question about that, but there is an immense and bewildering variety of contracts.

The CHAIRMAN. I know that.

Mr. MARBURY. It is just almost unbelievable. The variety of contracts and all types of contracting problems that are presented to the procurement agencies are such as almost to stagger the imagination, and it is hard to reduce this thing to any simple formula. If we are to recapture profits and, as long as we have that duty, I don't know—and again, I am expressing my personal view—I don't know how it can be done except by a business trade in the light of the facts, with full knowledge of the facts.

Senator TAFT. You have a definite rule on recapturing profits in the tax bill.

Mr. MARBURY. Yes, sir; but you have given us the job of eliminating excessive profits.

Senator TAFT. I say, a definite formula can be written; it may be unjust but it can be done.

Mr. MARBURY. Quite so, but that is a tax, and that has a separate function. We don't conceive that it is our job to administer a tax bill.

Senator VANDENBERG. Let me ask you this: Suppose you did not renegotiate one of these contracts. Would the excessive profits be caught by the excess-profits tax?

Mr. MARBURY. That would depend upon what the excess profits tax turns out to be.

Senator VANDENBERG. Couldn't you write an excess-profits law which would do, eventually, directly what you are going to do and in a more definite and definitive formula?

Mr. MARBURY. I don't know, Senator. That is too large a question for me to answer. I wouldn't like to undertake the job.

Senator BARKLEY. If the contractors can inflate their costs and everything else so as to make it necessary for you to try to recapture some of that by renegotiation, couldn't they inflate it in the same way as to reduce their excessive profits when the Treasury tries to collect their taxes?

Mr. MARBURY. Yes, sir.

Senator TAFT. If you pay it out, of course, you haven't the money to pay the taxes.

Senator VANDENBERG. In fact, this thing is the guts of the whole show, and it is a thing affecting popular morale in the country; is it not?

Mr. MARBURY. Well, I would think so.

Senator VANDENBERG. A community which has large war production activities is on a tremendously accelerated scale, salaries and expenditures and everything, and the poor private citizen, who has

no function except to buy war bonds and pay the bill—is aghast at the contemplation, isn't he?

Mr. MARBURY. Some of them certainly are.

Senator VANDENBERG. You have no control, of course, over wage questions in dealing with cost items, have you?

Mr. MARBURY. I don't think that is quite the case. I think that we do have possibilities of control under our cost-plus-fee contracts.

Senator WALSH. Your inspectors are supposed to say, "This wage is too high, this fellow has had no experience in inspecting, he is just a taxidriver, he should not get \$100 a week;" they can say that, and I suppose they are expected to.

Mr. MARBURY. Yes.

Senator TAFT. And if the National Labor Relations Board decides he should have that amount, then you have to keep still, don't you?

Mr. MARBURY. Yes.

Senator RADCLIFFE. These representatives have pretty wide authority; they are not merely checkers, but men who look into questions of policy otherwise?

Mr. MARBURY. That is correct.

Senator RADCLIFFE. Let me ask you this: Of course, any businessman likes to have his basis as definite as possible; at present, it is exceedingly indefinite because no one can know what would be the motivating reasons which would lead this Board to rearrange the profits. There is no maximum and there is no minimum. It leaves the thing indefinite. Do you think that indefiniteness has any deterrent effect upon your getting contractors? Do you think they are willing to go ahead and operate as efficiently as though there were some definite standard?

Mr. MARBURY. Senator, I do not know how to answer that question. My personal opinion would be that every uncertainty would have its effect on the morale of producers.

Senator RADCLIFFE. I think so.

Mr. MARBURY. Every additional uncertainty.

Senator RADCLIFFE. And to carry that line further, any process which would tend to reduce the scope of that uncertainty would make for greater efficiency and be a greater stimulant to production.

The CHAIRMAN. Did you want to ask a question, Senator Danaher?

Senator DANAHER. Yes.

Under the War Powers Act, we give—the Second War Power Act—we give you power to go in and audit all items of cost for any contractor; do we not?

Mr. MARBURY. Yes, sir.

Senator DANAHER. Now, under the pending proposal, this section 403, we said, "The Secretary shall not make any allowance for any salaries, bonuses, or other compensation paid by a contractor to its officers or employees in excess of a reasonable amount."

Do you make any effort to determine what is a reasonable salary or a reasonable bonus or a reasonable rate of pay to an employee?

Mr. MARBURY. Well, Senator Danaher, I don't know the extent to which that is actually being done but it is my belief—I would prefer to have that question asked of those who are in charge of the actual operation—but it is my belief that, to the extent we have the personnel and it is practical to do so, that we do investigate those questions.

Senator DANAHER. And it also goes on to say:

The Secretary shall make no allowance for any excessive reserves set up by the contractor or for any costs incurred by the contractor which are excessive and unreasonable.

Mr. MARBURY. Those are questions of reserves and are carefully considered. Of course, these things are all questions of degree. When you are dealing with 20,000 contractors obviously an audit of every cost is simply inconceivable. There are not enough accountants in the country to do it. To some extent, you have to spot check and do what you can.

But, unquestionably those questions are all dealt with in renegotiation.

Senator DANAHER. At the time we adopted Public, 528, it was stated that there were approximately 3,000,000 outstanding contracts that would be brought within the purview of the act. Is that approximately correct, according to your understanding?

Mr. MARBURY. I don't know the answer to that. Is that about right, Mr. Pengra?

Mr. PENGRA. Yes.

Senator DANAHER. And what progress have you made in reducing the 3,000,000 to a less number in the course of this renegotiation?

Mr. MARBURY. Well, I don't know that but it has not been very notable. Have you any idea, Mr. Pengra, how many of the 3,000,000 contracts have been renegotiated?

Mr. PENGRA. I think we estimated that a majority of the important contracts were held by less than a hundred companies.

Senator DANAHER. A majority were held by less than 100 companies?

Mr. PENGRA. Yes, sir.

Mr. MARBURY. And we deal with the companies rather than with the individual contracts.

Mr. PENGRA. So, I cannot tell you how many contracts were covered by the contractors with whom we have dealt.

Senator DANAHER. Have you been able to renegotiate contracts with a majority?

Mr. PENGRA. We have had negotiations with about 50 companies.

Senator DANAHER. As I recall the act, the only problem, or the chief problem, which would arise, would be in cases where you fail of agreement with the contractor, where, under the definition of renegotiation, you would be permitted to go in and renegotiate on your own terms. Have you been called upon to do that in many instances?

Mr. MARBURY. Never have done it.

Senator DANAHER. So that in instances where you have completed your work successfully, it has been by agreement with the contractor?

Mr. MARBURY. Correct.

Senator DANAHER. And in those cases where agreement is thus reached you find that you are divested under the authorization of the act in that you cannot give a definitive status to the agreement thus arrived at?

Mr. MARBURY. We think we can but Senator Taft thinks we cannot, and if good lawyers are doubtful about it, we think it ought to be made clear.

Senator DANAHER. And practically how many employees do you have engaged in renegotiation work?

Mr. MARBURY. I will ask Mr. Pengra to answer that question.

Mr. PENGRA. The War Department Board has 47 employees including the clerical staff here in Washington. The sections are organized within the services. The Engineer Corps has two divisions. Those sections vary with the services, according to their set-up, but the idea is that those sections will consist of one or two officers of the Army who have had experience in this sort of work and with the addition of civilians who might be commissioned for the purpose. The total number of those civilians, some of whom have been commissioned, who have been added for this purpose is less than 300 at the present time.

Senator DANAHER. Do you have available to you the reports of the audits which are permitted under the Second War Powers Act?

Mr. MARBURY. Yes, sir.

Senator DANAHER. And those audits would be made by the General Accounting Office?

Mr. MARBURY. No, sir.

Senator DANAHER. Or by your own office?

Mr. MARBURY. I understand they are made by our War Department offices.

Mr. PENGRA. The Fiscal Division of the War Department has cost analysis sections which are segregated for the purpose of doing this particular work.

First, the companies come to the Board—or the Board sees some reason to look into a company. We now have 4,000, practically 4,000, companies which are subject to investigation, so to speak.

Those have been assigned, some to the Board, perhaps 100 or so to the Board, some to the Navy. Where the Navy has a predominant interest and the matter comes to our attention, we release the case to the Navy. Likewise with the Maritime Commission. The Navy Department does the same in cases that come to them in which the War Department has the predominant interest. In that case they release it to the War Department.

Within the War Department we have probably 3,500 companies which have been assigned to the different services. And, in answer to a previous question, the Ordnance has, as I understand it, 13 subsections of their board in their ordnance procurement districts throughout the country. The services are not all set up the same way but according to their convenience.

The air forces have a single-price adjustment section, at Wright Field. The Signal Corps has a price adjustment section in Washington. I think they have a branch in New York. All the agreements made by any of those sections are sent to Washington with a report and are reviewed by the Board before the agreement is executed and the agreement is approved by the War Department, by the Under Secretary or his representative.

Senator DANAHER. Under section F, the—

authority and discretion herein conferred upon the Secretary of each department, in accordance with regulations prescribed by the President for the protection of the interests of the Government, may be delegated—

and so forth.

Do you have a common set of regulations that apply to each secretary, or do you have different sets of regulations?

Mr. MARBURY. We have none at all.

Mr. PENGRA. We have no regulations. There has been no delegation of power in the War Department, except automatically to the Under Secretary. The Under Secretary or his representative, Colonel Browning, approves every single agreement.

Senator DANAHER. Would it not be possible for you to relieve the fears of a great many contractors were you to have some common, general regulation which would apply to each of the services affected?

Mr. PENGRA. Well, we have had no occasion so far to deal with regulations. The cooperation between the services has been such that it seemed unnecessary—between the departments that is—it seemed unnecessary to establish any regulations for that purpose.

Senator DANAHER. You remember we also said that in certain instances, the Secretary of the Navy could conduct the renegotiation if he had a larger number of contracts than the War Department.

Have you followed some such procedure as that?

Mr. MARBURY. Yes, sir.

Senator DANAHER. And do the contractors have available to them anywhere some book that they can pick up and say it says, "A, B, C, D, and here is where we come in"?

Mr. PENGRA. The War Department has a comprehensive release which is put out.

Senator TAFT. What kind of a release?

Mr. PENGRA. A comprehensive release.

Senator TAFT. You mean a press release?

Mr. PENGRA. No; there is a separate press release put out jointly. This is a statement put out by the War Department Board itself for the purpose of informing contractors and others as to the procedure.

Senator DANAHER. And does that procedure thus comprehended in the release, apply to the Navy and Maritime Commission?

Mr. PENGRA. No, sir; this is the War Department release.

The Navy does not have any subdivision of boards and neither does the Maritime Commission.

Senator DANAHER. Approximately how many men do you have in your best estimate, available to you for assistance in renegotiation outside of your own 47?

Mr. PENGRA. Well, we have, as I say, some 300 civilians who are attached to the different price adjustment sections. We have with the board, the members of the board, certain negotiators who have had experience in this work, and certain financial analysts. We also have available to us the service of the cost analyses sections of the fiscal division, which are assigned to us for this work. But I could not say how many members of those organizations there are. They furnish the reports.

Before we deal with a company, we have a report from the cost analyses section on that company and the report is reviewed and checked for the cost items which have been mentioned in the questions to Mr. Marbury.

Checked for cost, checked for excessive bonuses, salaries, and we negotiate particularly with respect to reserves.

To check with the larger companies the matter of reserves is a question of importance. They have tremendous reserves, for various purposes, and a large part of renegotiation consists of cutting down the reserves.

Senator DANAHY. A great misapprehension occurs by reason of the fact that people confuse the term "excess" with respect to excess profits for tax purposes, and the word "excessive" as used by you gentlemen. There is no place, a regulation or otherwise, in which they can ascertain standards to determine what is excessive, is there?

Mr. PENNA. In our bulletin we have laid down general principles which apply in renegotiation. I shall be happy to read them.

Senator DANAHY. If we could have them filed it would be sufficient for my purposes. They can be made a part of the record.

Mr. PENNA. Yes.

Mr. MARBURY. I will furnish a copy.

(The document referred to is as follows:)

WAR DEPARTMENT, PRICE ADJUSTMENT BOARD

PRINCIPLES, POLICY, AND PROCEDURE TO BE FOLLOWED IN RENEGOTIATION

(August 10, 1942)

PRINCIPLES, POLICY, AND PROCEDURE TO BE FOLLOWED IN RENEGOTIATION

Pursuant to a directive issued by the Under Secretary of War on June 30, 1942, designating the War Department Price Adjustment Board as the coordinating agency of the War Department to determine and eliminate by renegotiation excessive profits from War Department contracts, and subcontracts thereunder, subject to approval by the Under Secretary of War or his designated representative, the Board has established the principles, policy and procedure to be followed in renegotiation.

I. STATUTE AND DIRECTIVES

The Sixth Supplemental National Defense Appropriation Act, 1942, approved April 28, 1942, contained a specific Congressional enactment relating to excessive profits, constituting Section 403 thereof, and authorizing and directing the Secretary of War, the Secretary of the Navy, and the Chairman of the Maritime Commission to require contractors and subcontractors to renegotiate contract prices, a copy of Section 403 being attached hereto as "Exhibit A".

Subsection (b) of Section 403 provides for the insertion in contracts made after April 28, 1942, of a provision requiring renegotiation of the contract price "at a period or periods when, in the judgment of the Secretary, the profits can be determined with reasonable certainty" as well as a provision requiring the contractor to insert a similar provision in each subcontract for an amount in excess of \$100,000 made by him under such contract. For the form and discussion of these provisions reference is made to Circular No. 23 issued by Headquarters, Services of Supply, on July 7, 1942.

Subsection (c) of Section 403 provides as follows:

"The Secretary of each Department is authorized and directed, whenever in his opinion excessive profits have been realized, or are likely to be realized, from any contract with such Department or from any subcontract thereunder, (1) to require the contractor or subcontractor to renegotiate the contract price, (2) to withhold from the contractor or subcontractor any amount of the contract price which is found as a result of such renegotiation to represent excessive profits, and (3) in case any amount of the contract price found as a result of such renegotiation to represent excessive profits shall have been paid to the contractor or subcontractor, to recover such amount from such contractor or subcontractor. Such contractor or subcontractor shall be deemed to be indebted to the United States for any amount which such Secretary is authorized to recover from such contractor or subcontractor under this subsection, and such Secretary may bring actions in the appropriate courts of the United States to recover such amount on behalf of the United States. All amounts recovered under this subsection shall be covered

into the Treasury as miscellaneous receipts. This subsection shall be applicable to all contracts and subcontracts hereafter made and to all contracts and subcontracts heretofore made, whether or not such contracts or subcontracts contain a renegotiation or recapture clause, provided that final payment pursuant to such contract or subcontract has not been made prior to the date of enactment of this Act."

This subsection authorizes and directs the Secretary of War, as well as the Secretary of the Navy and the Chairman of the Maritime Commission, whenever in his opinion excessive profits *have been realized, or are likely to be realized*, from any contract with his department or from any subcontract thereunder, to require the contractor or subcontractor to renegotiate the contract price of any existing contract or subcontract, even though made prior to April 28, 1942, (provided final payment had not been made prior to that date) and of any contract or subcontract made thereafter, whether or not it contains a renegotiation or recapture clause.

On June 30, 1942, the Secretary of War delegated to the Under Secretary of War all the authority and discretion conferred upon him by subsections (a) to (e), inclusive, of section 403 and on the same day the Under Secretary of War in a memorandum directed to the Commanding General, Services of Supply, and the Commanding General, Matériel Command, Army Air Forces, designated the War Department Price Adjustment Board as "the coordinating agency of the War Department to determine and eliminate by renegotiation excessive profits from War Department contracts, and subcontracts thereunder, subject to approval by the Under Secretary of War or his designated representative," a copy of this directive being attached hereto as "Exhibit B."

This directive described the functions of the Board as follows:

(a) To establish policies, principles and procedures to be followed in renegotiation.

(b) To assist the Services of Supply and the Matériel Command, Army Air Forces, in the selection and training of personnel.

(c) To assign companies to the Services of Supply and the Matériel Command, Army Air Forces, for renegotiation and to coordinate all renegotiation functions and activities.

(d) To review renegotiations and settlements recommended by the Services of Supply and the Matériel Command, Army Air Forces.

(e) To conduct renegotiation with any company, whenever, because of the size of the company, the dollar volume of the contracts involved, the number of contracting services interested, new questions presented, or for any other reason, it appears that renegotiation by the Services of Supply or the Matériel Command is impracticable.

(f) To develop and recommend for approval such other policies and procedures as it may deem advisable in performing its functions and accomplishing its purposes.

and authorized and directed the Commanding General, Services of Supply, and the Commanding General, Matériel Command, Army Air Forces, (1) to create Price Adjustment Sections to conduct renegotiations with such companies as may be assigned to them by the Board, subject to review by the Board and approval by the Under Secretary of War or his designated representative, except in cases where by general instructions or in the particular instance the Under Secretary or his representative may authorize them to make final agreements, and (2) to establish Cost Analysis Sections to act as fact-finding units with respect to costs and profits on contracts and subcontracts for the Price Adjustment Sections. Pursuant thereto, the Commanding General, Services of Supply, on July 3, 1942, and the Commanding General, Matériel Command, Army Air Forces, on July 8, 1942, issued directives providing for the creation of such Price Adjustment Sections and Cost Analysis Sections within the Supply Services and the Matériel Command, the latter being designated a Price Adjustment Branch, copies of these directives being attached hereto as "Exhibit C" and "Exhibit D."

II. DUTIES OF PRICE ADJUSTMENT BOARD, PRICE ADJUSTMENT SECTIONS, AND CONTRACTING OFFICERS

The ultimate purpose of renegotiation under the statute is to determine excessive profits realized, or likely to be realized, from contracts with the Departments and the Commission, or from subcontracts thereunder, and to provide for the withholding or recovery thereof by the United States. In renegotiation with

companies which have contracts with the Navy Department or the Maritime Commission, as well as with the War Department, the renegotiations will be in charge of the Department or Commission which they mutually agree has the predominant interest, the other Departments or the Commission being represented if they so desire.

The directive from the Under Secretary of War provides that in conducting renegotiations the Board "shall take into consideration the financial position and over-all profits, past and prospective, of a contractor or subcontractor with a view to *determining or agreeing upon* the amount of any excessive profits realized, or likely to be realized, from its war contracts taken as a whole" and each of the directives providing for the creation of the Price Adjustment Sections provides that all renegotiation by them "shall take into consideration the financial position and over-all profits, past and prospective, of the contractor or subcontractor with a view to *determining by agreement* the amount of any excessive profits realized, or likely to be realized, from its war contracts taken as a whole." Under these directives the Sections will confine their activities to reaching agreements subject to review by the Board and approval by the Under Secretary of War, or his designated representative. When an agreement cannot be reached, the Board will be advised promptly.

The Board itself will conduct renegotiation with any company whenever because of the size of the company, the dollar volume of the contracts involved, the number of contracting services interested, new questions presented, or for any other reason it appears that renegotiation by the Supply Services or the Matériel Command is impracticable.

Companies will be assigned by the Board to the Supply Services or the Matériel Command to determine whether they have realized, or are likely to realize, excessive profits from their contracts and subcontracts, and if so to conduct renegotiations through the Price Adjustment Sections. The Service or Command to which the company is assigned will be in charge of the renegotiation, but will notify the other Services interested and, when interested, the Navy Department and the Maritime Commission, who may be represented if they so desire, it being the intention that only one agency shall negotiate with any one company on an over-all profit basis. Upon reaching an agreement, the Service or Command in charge of the renegotiation will obtain from the company a recommendation as to the allocation of any price reduction among the interested Services, the Departments, and the Commission for adjustment of prices and fees in individual contracts.

Under the directives, and as provided in Circular No. 23, Headquarters, Services of Supply, referred to above, the contracting officer is still authorized (a) to renegotiate the contract price or fixed-fee pursuant to any renegotiation article in any contract whether inserted pursuant to Section 403 or otherwise; (b) to redetermine the contract price under any article in the contract providing therefor; (c) to enter into supplemental agreements effecting voluntary reductions in the contract price or fixed-fee of any contract; and (d) to demand cost and financial statements pursuant to statutory or contract provisions to the extent necessary to carry out these functions. The contracting officer periodically will review costs and profits under contracts subject to his supervision in order to obtain reductions in the contract price whenever justified. The provisions of (d) above relate to the review of individual contracts and contracting officers should not demand financial statements for the purpose of renegotiation on the overall profit basis.

The contract price as renegotiated or redetermined by the contracting officer or as voluntarily reduced will still be subject to renegotiation under Section 403, and any contract article pursuant thereto, to eliminate excessive profits of the contractor. The supplemental agreement or other instrument affecting the adjustment in price or fixed-fee will therefore include a provision substantially as follows:

"The adjustment hereby made in the contract price is without prejudice to the determination of any excessive profits of the contractor upon subsequent renegotiation under Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, or any contract article inserted pursuant to that Act."

The contracting officer will promptly report each such adjustment to the chief of the appropriate Supply Service or the Commanding General, Matériel Command, Army Air Forces, as the case may be, for transmittal to the Director, Purchases Division, Services of Supply, as representative of the Under Secretary of War.

III. CONTRACTORS AND SUBCONTRACTORS WHO MAY BE REQUIRED TO RENEGOTIATE

The form of the renegotiation clause to be inserted in each contract for an amount in excess of \$100,000 made after April 28, 1942, in accordance with subsection (b) of the statute requires contractors to include a similar renegotiation clause in only those subcontracts which are made with prime contractors, or with manufacturers producing for the prime contractor the same completed unit covered by the prime contract (who for purposes hereof will be included in the term "prime contractor"), in other words, the so-called first tier of subcontracts, and defines the term "subcontract" as follows:

"The term 'subcontract' includes any purchase order from, or any agreement with, the contractor (i) to perform all or any part of the work to be done under this contract, or to make or furnish all or any part of any articles or structures covered by this contract, (ii) to supply any services required directly for the production of any articles or structures covered by this contract, or any component part thereof, not including services for the general operation of the contractor's plant or business, (iii) to make or furnish any articles destined to become a component part of any article covered by this contract, or (iv) to make or furnish any articles acquired by the contractor primarily for the performance of this contract, or this contract and any other contract with the United States. The term 'articles' includes any supplies, materials, machinery, equipment or other personal property."

Pending further instructions this definition of subcontracts will be adopted in determining what subcontractors may be required to renegotiate under subsection (c) of the statute. Accordingly any company which has one or more prime contracts with the War Department or which has one or more subcontracts (as so defined) with a prime contractor may be required to renegotiate. Nevertheless when it appears that a company has made excessive profits on subcontracts or orders from others than prime contractors for products or materials flowing into war production and the company refuses to renegotiate them, a statement of the circumstances will be forwarded to the Board promptly.

IV. CONTRACTS AND SUBCONTRACTS SUBJECT TO ADJUSTMENT AS A RESULT OF RENEGOTIATION

Subsection (c) of the statute, providing for renegotiation of the contract price where excessive profits have been realized or are likely to be realized, is applicable to all contracts and subcontracts (as defined above), whether made before or after April 28, 1942 (provided that final payment had not been made prior to that date), and whether or not they contain a renegotiation or recapture clause, and the terms "renegotiate" and "renegotiation" are defined in subsection (a) to include "the refixing by the Secretary of the Department of the contract price."

Subsection (c) of the statute does not impose a minimum dollar limitation on contracts or subcontracts under which the contract price may be refixed, corresponding to the \$100,000 limitation in subsection (b), and therefore the contract price in any contract or subcontract may be so refixed irrespective of the amount of the contract or subcontract.

Under subsection (c) of the statute, contractors and subcontractors may be required to renegotiate the fees in cost-plus-a-fixed-fee contracts in force on April 28, 1942, and as a result of such renegotiation the fees may be refixed. They will also be required to renegotiate the fees in cost-plus-a-fixed-fee contracts made after that date in those cases where the contract contains a provision for renegotiation of the fee. For instructions relating to the insertion of renegotiation clauses in cost-plus-a-fixed-fee contracts pursuant to subsection (b) of the statute, reference is made to Circular No. 23, Headquarters, Services of Supply, referred to above.

V. RENEGOTIATION PROCEDURE

The procedure in renegotiation will conform with that prescribed in the directives supplemented by such instructions as may be issued by the Under Secretary of War from time to time.

Renegotiation should proceed first to a determination of the total excessive profits from war production during a specified period, which ordinarily will be the current fiscal year of the company. It is necessary to distinguish between a period already past, for which definite figures are available, and a current or

future period for which only estimates are available. For a past period, such as a prior fiscal year or the expired part of the current fiscal year, a definite amount of excessive profits can be determined. For a current or future period, such as the current fiscal year or the unexpired part thereof, the estimated amount of excessive profits is related to the estimated volume of business. The full dollar amount of excessive profits determined for a past period may be withheld or recovered by the Government, but the dollar amount determined for a current or future period is only an estimate, unless otherwise agreed, and the actual dollar amount withheld or recovered may turn out to be more or less than that stated.

The total war production for the period should be segregated, when practicable, between (a) the prime contracts, (b) the subcontracts with other prime contractors and (c) the rest of the war production. When this is not practicable, for accounting or other reasons, the total excessive profits agreed upon may be allocated between (a), (b), and (c) above. This allocation need not be by individual contract or on a unit-cost basis and can readily be worked out with the company by groups of contracts. Provision must be made for withholding or recovery by the Government of excessive profits from the prime contracts and the subcontracts with prime contractors, but voluntary arrangements for additional price reductions on products or materials flowing into war production are to be encouraged and obtained wherever possible.

The primary purpose of the renegotiation is to arrive at the prices which would have been agreed upon when the contracts were made if the facts and factors now known had been known at that time. Accordingly, after an agreement has been reached with a contractor or subcontractor as to the aggregate amount of any excessive profits realized, or likely to be realized, from its prime contracts and subcontracts with other prime contractors, these excessive profits may be withheld or recovered by the Secretary of War, the Secretary of the Navy, or the Chairman of the Maritime Commission in various ways, among which are the following: (1) A direct cash refund by the prime contractor to the Government, in which event his contract prices would not be adjusted; (2) a reduction in the contract prices on future deliveries under prime contracts, which automatically would accrue to the benefit of the Government; (3) a direct cash refund by the subcontractor to the Government; and (4) a reduction in the contract prices on future deliveries under subcontracts, with a provision that the prime contractors, as a condition to its acceptance, should pass on an equivalent benefit to the Government in the form of a corresponding reduction in the contract prices of the prime contracts or a direct cash refund to the Government. These methods may also be used in combination and are not exclusive of other appropriate and effective methods applicable to particular situations. When the procedure under (4) above places an undue burden of adjustment on the prime contractor, the latter can arrange with the Government for a periodic method of accounting.

Notwithstanding the foregoing, when substantially all the war work of a company, such as those engaged in construction, is covered by a few individual contracts, renegotiation may be conducted on the individual contract basis, subject to check on the over-all profit basis, with the approval of the chief of the appropriate Supply Service or the Commanding General, Matériel Command.

Agreements reached by the Board will be transmitted directly to the Under Secretary of War, or his designated representative, for final approval. Agreements reached by the Price Adjustment Sections of the Services of Supply will be transmitted in the first instance to the chief of the appropriate Supply Service. Agreements reached by the Price Adjustment Branch of the Matériel Command, Army Air Forces, will be transmitted in the first instance to the Commanding General, Matériel Command. When approved by the chief of the Supply Service or the Commanding General, Matériel Command, they will be transmitted to the Board for review, except in cases where by general instructions or in the particular instance, the Supply Services or the Matériel Command may be authorized to make final agreements.

The Director, Purchases Division, Services of Supply (Colonel A. J. Browning), has been designated by the Under Secretary of War as his duly authorized representative for the foregoing purposes.

VI. ELIMINATION OF EXCESSIVE PROFITS

In the present emergency the existence of excessive profits is no indication that a company has taken undue advantage of the Government or that the contracting officers have failed to exercise their best judgment under all the circumstances where companies have been asked to produce war equipment with which neither they nor others have had any previous experience, and in quantities far beyond

anything ever before contemplated. Estimates of costs have necessarily been unreliable and when subjected to the test of actual production have often proved to be substantially higher than the actual costs. Companies have been left with profits which they neither anticipated nor wish to retain. The true purpose of renegotiation is to determine, preferably by agreement, the amount of these profits which exceed a fair margin under all the circumstances, and those circumstances are bound to vary in individual cases.

The purpose of renegotiation is to eliminate excessive profits at the source and in this respect it is distinguishable from taxation which can only reach excessive profits long after they have accrued. When these profits have to be eliminated or returned as they accrue instead of a year or more later costs will be substantially reduced for lower prices invariably stimulate efficiency in production and any reduction in contract prices will leave the War and Navy Departments and the Maritime Commission that much more money available to meet the expenses of the war without asking Congress for additional appropriations.

The ultimate test is what would have been a fair profit before Federal and other income and excess profits taxes. It is for Congress, through the Treasury, to determine how much of that profit should be taxed. Increases or proposed increases in tax rates, while a factor to be considered, should not affect the principles of renegotiation or change the basic consideration from what would be a fair profit before taxes to what would be a fair profit after taxes. To renegotiate on the basis of allowing a company a fair profit after taxes would be tantamount to returning to the company part of what Congress has decided should be its contribution to the war effort. The effect of the excess profits tax on companies which are financially extended and have little or no tax base is frequently so severe, however, that strict adherence to the principle of considering only profits before taxes would leave practically nothing for the company, or even result in financial embarrassment, and under these circumstances the profit after taxes is a factor which may be taken into consideration in order not to impair its incentive to production.

VII. DETERMINATION OF EXCESSIVE PROFITS

Renegotiation in most instances will be confined to the determination of excessive profits, past and prospective, for the fiscal year of the company in which the renegotiation takes place. Companies will not be required to renegotiate for any fiscal year ending on or before December 31, 1941, except with the approval of the Board on each occasion.

The Coast Analysis Sections will obtain, from other Government agencies and by use of statistical services or personal inquiry or investigation, the basic data for its fact-finding report on the profits, past and prospective, as shown by the records and estimates of the company. If questionnaires are used, they should be of a uniform type to be developed under the supervision of the Board.

The Price Adjustment Sections will analyze the costs allocable to war production of the company with a view to excluding improper or excessive charges including excessive salaries, bonuses, and commissions; unreasonable maintenance and depreciation charges; improper amortization of war facilities or write-ups of property; unreasonable charges for research, development, and experimental work; and unallowable advertising expenses. They will consider the propriety and amount of the reserves and extraordinary charges to income. They will review the estimates of prospective sales and costs in the light of information obtained from the War Department and based on experience with other companies.

The Price Adjustment Sections will be guided in general by the following principles of renegotiations established by the War Department Price Adjustment Board:

A company is entitled to no more than a reasonable wartime margin of profit. Ordinarily this is taken as the ratio of profit before taxes to sales or to costs or to net worth at the beginning of the year. Under existing war conditions more reliance should be placed on the ratio of profit to sales or to adjusted costs, and the ratio of profit to net worth should be used only as a check. In determining what percentage would be fair, consideration should be given to the corresponding profits in prewar years for the particular company and for the industry especially in cases where the war products are substantially like the prewar products, but it cannot be assumed that under war conditions a company requires as great a margin of profit as under competitive conditions in normal times; to the corresponding percentage allowed to other companies manufacturing similar war products or operating under similar conditions; and to the volume of sales, the allowable percentage being reduced on a graduated scale as the volume increases. Consideration should also be given to the ratio of labor and burden (overhead) to

materials included in the adjusted costs since a company performing its own contracts requires a greater margin of protection than one which subcontracts most of the work, and a company engaged in a complex manufacturing operation is entitled to more consideration than one engaged in a comparatively simple manufacturing operation. Consideration may also be given to the fact that a company has voluntarily made available to the Government its patent rights affecting war production.

The margin of profit so determined should be adjusted, upward or downward, to reflect consideration of so-called factors of performance in respect of which the operations of the company compare favorably or unfavorably with those of other companies engaged in war production. Among these factors of performance are the following: (1) quality of production; (2) rate of delivery and turn-over; (3) inventive contribution; (4) cooperation with other manufacturers; (5) economy in use of raw materials; and (6) efficiency in reducing costs.

The margin of profit so determined should also be adjusted upward to reflect consideration of risks attributable to war production which a company with fixed-price contracts must assume. Among these risks are the following: (1) increases in cost of materials; (2) imminent wage increases; (3) inexperience in new types of production; (4) complexity of manufacturing technique; and (5) delays from inability to obtain materials.

In the case of a company with substantial capital devoted to war production, the ratio of the profit so determined to net worth at the beginning of the year should then be used as a check to determine whether the company is making a fair return on its investment. Net worth should be analyzed to determine to what extent it includes accumulated profits from war business. Furthermore, it cannot be assumed that under war conditions a company is entitled to as great a return as under competitive conditions in normal times.

No attempt will be made to prescribe or even recommend actual percentages or ranges of percentages, for use in determining excessive profits. These percentages necessarily vary under all the circumstances and should be arrived at by the Price Adjustment Sections in discussions with representatives of companies engaged in the particular business under consideration.

VIII. AGREEMENTS

All agreements resulting from renegotiation should be in writing signed in behalf of the company by the owner, a partner, or an authorized officer and, in the case of a corporation, accompanied by an attested copy of the authorizing resolution of the board of directors. They will be executed in behalf of the Government by the Under Secretary of War, or his duly authorized representative, or by the chief of the appropriate Supply Service or the Commanding General, Matériel Command, when so authorized by general instructions or in the particular instance.

If further negotiations are contemplated before the company receives a clearance under the statute for the period under consideration, the agreement will not be final, but in that event must contain a provision substantially as follows:

"This agreement is not final and is made without prejudice to the determination of any excessive profits realized, or likely to be realized, by the undersigned {for the fiscal year under consideration to _____} upon subsequent final renegotiation under Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, or any contract article inserted pursuant to that Act, but no amount previously paid or credited to or withheld by the Government as a result of any renegotiation shall be refunded as a result of any subsequent renegotiation."

On the other hand, if the company is to have a clearance for the period under consideration, it must execute a final agreement, a skeleton form of which is attached hereto as "Exhibit E".

(1) *Prohibited provisions.*—For administrative reasons agreements should not contain any provision which would have the effect of requiring the Government to repay all or any part of any payment previously made to it thereunder.

Complicated questions of taxation arise in connection with renegotiation, particularly where the agreement provides for a cash refund. It is expected that as a result of recent conferences the Internal Revenue Bureau will presently issue a statement of its policy from which companies and their counsel will be able to satisfy themselves as to the general principles involved, but the company should take up detailed questions relating to any particular return or to any unusual situation directly with the Bureau. Conferences with representatives of the

Bureau can be arranged through the Board upon request. The Bureau will be prepared to rule promptly on questions presented and accordingly no agreement should be made conditional upon the determination of any related tax question.

(2) *Interim agreements.*—Agreements which are not final need not be in any particular form, a covering letter signed by an authorized officer of the company being sufficient. They may contain provisions of more latitude than would be appropriate from an administrative standpoint in a final agreement, but care should be taken not to impose an unusual or unnecessary burden on contracting and accounting officers. An effort should be made to see that the Government obtains directly or indirectly the benefit of any price reductions provided for, and general price reductions on products and materials which ultimately flow into war production should be encouraged and obtained when possible even though the benefit to the Government may be too indirect to be made the subject of specific provision.

(3) *Final agreements.*—Final agreements must be related to the statute and must follow the general structure of "Exhibit E." For that purpose schedules should be attached to the agreement containing either an enumeration or a general description of the prime contracts and the subcontracts with other prime contractors. In many cases an enumeration of the subcontracts will be impracticable but by arrangement with the company the known subcontracts can be generally described.

A dollar amount should be agreed upon, and inserted in the agreement, as representing the aggregate excessive profits realized, or likely to be realized, by the company from the prime contracts and subcontracts described in the schedules for the fiscal year or other period under consideration. The expression "or likely to be realized" is taken from the statute and indicates that the aggregate dollar amount is based on estimates for such fiscal year or other period. The excessive profits ultimately realized, being based on estimates, may turn out to be more or less than the dollar amount stated and, accordingly, unless otherwise agreed, the actual dollar amount stated may not be withheld or recovered.

Although such agreements are final in the sense that no further or subsequent renegotiation for the fiscal year or other period in question is contemplated, the estimates on which they are based should be set forth in an exhibit attached thereto and will be subject to review after the close of such fiscal year or other period and accordingly the provision to that effect set forth in "Exhibit E" is a uniform provision and may not be changed in any respect. The uncertainty of estimates requires that the right be reserved to review findings when final figures of the fiscal year or other period become available, but it will be the policy of the Secretary of War to allow original agreements to stand unless the actual figures with respect to such factors as costs, volume of production, or nature of products prove to be materially at variance with the estimates upon which the settlements were based. In the final review, if it is shown that increased profits have resulted from extra effort on the part of the company to reduce costs, the company will be given the benefit of this factor.

The last paragraph of "Exhibit E" must be included and may not be changed in any respect.

(4) *Illustrative provisions.*—The provisions of "Exhibit E" relating to refunds and price reductions may be varied to give effect to particular refunds and price reductions negotiated, but so far as possible the framework of these provisions as they appear should be followed. The terms and conditions upon which such refunds or price reductions may be negotiated cannot be prescribed because of the impossibility of anticipating particular situations which may have to be provided for, but simplicity is essential and so far as possible conditions which are dependent upon future circumstances involving complicated accounting, administrative difficulties, or controversial questions should be avoided. Whatever these terms and conditions may be, they should be set forth specifically in an exhibit attached to the agreement.

Without intending to restrict or encourage the use of any particular type of provision and merely as an illustration, the following description of certain types of provisions which have already been used by the Board in renegotiation is submitted:

In renegotiation for a prior fiscal year, such as 1941, the return of excessive profits will ordinarily take the form of a refund. Since the agreement and refund will be made after the close of such fiscal year the Internal Revenue Bureau will not adjust the tax liability to reflect the result of the renegotiation and therefore that part of the tax liability, settled or admitted, which represents a tax on the excessive profits agreed upon must be taken into consideration in the renegotiation.

It is expected that upon request the Internal Revenue Bureau will furnish a statement of this amount and enter into an appropriate closing agreement. The agreement should contain a provision whereby the company waives any claim for redetermination, abatement, or refund of the tax by reason of the renegotiation.

In renegotiation for a current fiscal year, such as 1942, the return of excessive profits may be accomplished by a price reduction as well as by a refund. The agreement will determine the excessive profits realized, or likely to be realized, by the company during such fiscal year from prime contracts and subcontracts with prime contractors in force at the time of the renegotiation or completed prior thereto, based on the estimates attached thereto. The withholding or recovery of these estimated excessive profits may be accomplished by various forms of price reduction or refund. Among these, for example, are the following: (a) The company will make an actual reduction effective as of a particular date in the actual price to be charged for certain products or materials; or (b) instead of making an actual price reduction, the company will make a cash refund to the Government monthly, quarterly, or semiannually in an amount equal to a specified percentage of its actual net sales of certain products or materials or perhaps of all products or materials during the period with a credit for any price reductions ordered by the Office of Price Administration or other government agencies; or (c) the company will set aside on its books a reserve in the amount agreed upon against which it may make certain charges for prescribed items such as reduction in volume of net sales below the estimated amount, uncompensated costs from shut-downs due to shortages of materials or imminent labor difficulties, price reductions ordered by the Office of Price Administration or other government agencies, increases in the price of raw materials and other anticipated situations and at the end of the year it will pay or credit to the Government the balance of the reserve; or (d) the company will make reductions in the price of various products or materials for the balance of the current fiscal year, in amounts which may vary from time to time in its discretion, and at the end of the year it will pay or credit to the Government an amount equal to the excess of its profit before taxes over a certain percentage of its actual net sales during that period, which percentage should be limited to a specified dollar amount. Provisions of the type in (c) and (d) above should be resorted to only when special circumstances make the use of the type in (a) or (b) impracticable. Tax questions arising out of these provisions, when not covered by the statement of policy to be issued by the Internal Revenue Bureau, should be taken up with the Bureau by representatives of the company, and conferences to this end can be arranged through the Board upon request.

IX. REVIEW

Four original counterparts of each agreement, interim or final, each final agreement being executed in behalf of the company in the manner prescribed above, will be transmitted by the Price Adjustment Sections of the Supply Services to the chief of the appropriate Service or by the Price Adjustment Branch of the Matériel Command, Army Air Forces, to the Special Assistant to the Chief of Staff and will be accompanied by the following documents:

A signed original and three copies of a summary analysis along the lines indicated in PAB Form No. 10-E.

A memorandum showing the allocation of the refunds and price reductions provided for in the agreement between the War Department, the Navy Department, and the Maritime Commission, and their subordinate Services, proposed by the company and recommended by the Section or Branch.

If the chief of the appropriate Supply Service or the Commanding General, Matériel Command, approves the settlement covered by the agreement, it will be transmitted to the War Department Price Adjustment Board for review unless the Under Secretary of War, by general instructions or in the particular instance, has directed that such approval shall be final.

X. AUDITS AND FINANCIAL INFORMATION

Subsections (d) and (e) of Section 403 provide as follows:

(d) In renegotiating a contract price or determining excessive profits for the purposes of this section, the Secretaries of the respective Departments shall not make any allowance for any salaries, bonuses, or other compensation paid by a contractor to its officers or employees in excess of a reasonable amount, nor shall they make allowance for any excessive reserves set up by the contractor or for any costs incurred by the contractor which are excessive and unreasonable. For

the purpose of ascertaining whether such unreasonable compensation has been or is being paid, or whether such excessive reserves have been or are being set up, or whether any excessive and unreasonable costs have been or are being incurred, each such Secretary shall have the same powers with respect to any such contractor that an agency designated by the President to exercise the powers conferred by Title XIII of the Second War Powers Act, 1942, has with respect to any contractor to whom such title is applicable. 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 each such Secretary and the approval of the Secretary of the Treasury, be made available to the extent determined by the Secretary of the Treasury for the purposes of making examinations and determinations with respect to profits under this section.

(c) In addition to the powers conferred by existing law, the Secretary of each Department shall have the right to demand of any contractor who holds contracts with respect to which the provisions of this section are applicable in an aggregate amount in excess of \$100,000, statements of actual costs of production and such other financial statements, at such times and in such form and detail, as such Secretary may require. Any person who willfully fails or refuses to furnish any statement required of him under this subsection, or who knowingly furnishes any such statement 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 two years, or both. The powers conferred by this subsection shall be exercised in the case of any contractor by the Secretary of the Department holding the largest amount of such contracts with such contractor, or by such Secretary as may be mutually agreed to by the Secretaries concerned.

Subsection (a) provides that for the purposes of subsections (d) and (e) the term "contract" includes a subcontract and the term "contractor" includes a subcontractor.

Pursuant to Executive Order 9127, issued on April 10, 1942, the President designated certain governmental agencies, including the War Department, as the governmental agencies authorized to inspect the plant and audit the books and records, as provided in Title XIII of the Second War Powers Act, 1942, and authorized the War Production Board to issue rules and regulations and establish policies to coordinate and govern these agencies in exercise of the functions vested in them by that order. Accordingly, no inspection or audit under subsection (d) should be made or authorized except through the Cost Analysis Section of the Supply Service or of the Matériel Command in charge of the renegotiation, which will first advise the Cost Analysis Section of the War Production Board in the manner prescribed by the Fiscal Division. All formal demands for inspection or audit under subsection (d) or for financial statements under subsection (e) must first be authorized by the chief of the Supply Service or the Commanding General, Matériel Command, in charge of the renegotiation who will obtain any necessary approval by the Under Secretary of War, or his designated representative.

MAURICE H. KARKER,
Chairman, War Department Price Adjustment Board.

Recommended for approval:

ALBERT J. BROWNING,
Colonel, A. U. S.

Approved:

ROBERT P. PATTERSON
Under Secretary of War.

EXHIBIT A

SEC. 403 OF TITLE IV OF THE SIXTH SUPPLEMENTAL NATIONAL DEFENSE APPROPRIATION ACT, 1942, APPROVED, APRIL 28, 1942.

SEC. 403. (a) For the purposes of this section, the term "Department" means the War Department, the Navy Department, and the Maritime Commission, respectively; in the case of the Maritime Commission, the term "Secretary" means the Chairman of such Commission; and the terms "renegotiate" and "renegotiation" include the refixing by the Secretary of the Department of the contract price. For the purposes of subsections (d) and (e) of this section, the term "contract" includes a subcontract and the term "contractor" includes a subcontractor.

(b) The Secretary of each Department is authorized and directed to insert in any contract for an amount in excess of \$100,000 hereafter made by such Department (1) a provision for the renegotiation of the contract price at a period or periods when, in the judgment of the Secretary, the profits can be determined with reasonable certainty; (2) a provision for the retention by the United States or the repayment to the United States of (A) any amount of the contract price which is found as a result of such renegotiation to represent excessive profits and (B) an amount of the contract price equal to the amount of the reduction in the contract price of any subcontract under such contract pursuant to the renegotiation of such subcontract as provided in clause (3) of this subsection; and (3) a provision requiring the contractor to insert in each subcontract for an amount in excess of \$100,000 made by him under such contract (A) a provision for the renegotiation by such Secretary and the subcontractor of the contract price of the subcontract at a period or periods when, in the judgment of the Secretary, the profits can be determined with reasonable certainty, (B) a provision for the retention by the United States or the repayment to the United States of any amount of the contract price of the subcontract which is found as a result of such renegotiation, to represent excessive profits, and (C) a provision for relieving the contract from any liability to the subcontractor on account of any amount so retained by or repaid to the United States.

(c) The Secretary of each Department is authorized and directed, whenever in his opinion excessive profits have been realized, or are likely to be realized, from any contract with such Department or from any subcontract thereunder, (1) to require the contractor or subcontractor to renegotiate the contract price, (2) to withhold from the contractor or subcontractor any amount of the contract price which is found as a result of such renegotiation to represent excessive profits, and (3) in case any amount of the contract price found as a result of such renegotiation to represent excessive profits shall have been paid to the contractor or subcontractor, to recover such amount from such contractor or subcontractor. Such contractor or subcontractor shall be deemed to be indebted to the United States for any amount which such Secretary is authorized to recover from such contractor or subcontractor under this subsection, and such Secretary may bring actions in the appropriate courts of the United States to recover such amount on behalf of the United States. All amounts recovered under this subsection shall be covered into the Treasury as miscellaneous receipts. This subsection shall be applicable to all contracts and subcontracts hereafter made and to all contracts and subcontracts heretofore made, whether or not such contracts or subcontracts contain a renegotiation or recapture clause, provided that final payment pursuant to such contract or subcontract has not been made prior to the date of enactment of this Act.

(d) In renegotiating a contract price or determining excessive profits for the purposes of this section, the Secretaries of the respective Departments shall not make any allowance for any salaries, bonuses, or other compensation paid by a contractor to its officers or employees in excess of a reasonable amount, nor shall they make allowance for any excessive reserves set up by the contractor or for any costs incurred by the contractor which are excessive and unreasonable. For the purpose of ascertaining whether such unreasonable compensation has been or is being paid, or whether such excessive reserves have been or are being set up, or whether any excessive and unreasonable costs have been or are being incurred, each such Secretary shall have the same powers with respect to any such contractor that an agency designated by the President to exercise the powers conferred by title XIII of the Second War Powers Act, 1942, has with respect to any contractor to whom such title is applicable. 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 each such Secretary and the approval of the Secretary of the Treasury, be made available to the extent determined by the Secretary of the Treasury for the purposes of making examinations and determinations with respect to profits under this section.

(e) In addition to the powers conferred by existing law, the Secretary of each Department shall have the right to demand of any contractor who holds contracts with respect to which the provisions of this section are applicable in an aggregate amount in excess of \$100,000, statements of actual costs of production and such other financial statements, at such times and in such form and detail, as such Secretary may require. Any person who willfully fails or refuses to furnish any statement required of him under this subsection, or who knowingly furnishes any such statement 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 two years, or both. The powers conferred by this subsection shall be exercised in the case of any contractor by the Secretary of the Department holding the largest amount of such contracts with such contractor, or by such Secretary as may be mutually agreed to by the Secretaries concerned.

(f) The authority and discretion herein conferred upon the Secretary of each Department, in accordance with regulations prescribed by the President for the protection of the interests of the Government, may be delegated, in whole or in part, by him to such individuals or agencies in such Department as he may designate, and he may authorize such individuals or agencies to make further delegations of such authority and discretion.

(g) If any provision of this section or the application thereof to any person or circumstance is held invalid, the remainder of the section and the application of such provision to other persons or circumstances shall not be affected thereby.

(h) This section shall remain in force during the continuance of the present war and for three years after the termination of the war, but no court proceedings brought under this section shall abate by reason of the termination of the provisions of this section.

EXHIBIT B

JUNE 30, 1942.

Memorandum for Commanding General, Services of Supply, Commanding General, Matériel Command, Army Air Forces.
Subject: War Department Price Adjustment Board.

1. The Price Adjustment Board created by memorandum of April 25, 1942, is hereby redesignated as the War Department Price Adjustment Board. It will serve as the coordinating agency of the War Department to determine and eliminate by renegotiation excessive profits from War Department contracts, and subcontracts thereunder, subject to approval by the Under Secretary of War or his designated representative.

2. The functions of the Board will be:

(a) To establish policies, principles and procedures to be followed in renegotiation.

(b) To assist the Services of Supply and the Matériel Command, Army Air Forces, in the selection and training of personnel.

(c) To assign companies to the Services of Supply and the Matériel Command, Army Air Forces, for renegotiation and to coordinate all renegotiation functions and activities.

(d) To review renegotiations and settlements recommended by the Services of Supply and the Matériel Command, Army Air Forces.

(e) To conduct renegotiation with any company, whenever, because of the size of the company, the dollar volume of the contracts involved, the number of contracting services interested, new questions presented, or for any other reason, it appears that renegotiation by the Services of Supply or the Matériel Command is impracticable.

(f) To develop and recommend for approval such other policies and procedures as it may deem advisable in performing its functions and accomplishing its purposes.

3. The members of the Board will be appointed by the Under Secretary of War on the recommendation of the Commanding General, Services of Supply, and the Commanding General, Matériel Command, Army Air Forces. One member will be selected with the approval of the Chairman of the War Production Board as his representative. The present membership of the Board shall continue during the pleasure of the Under Secretary of War.

4. The Board is instructed wherever appropriate to function jointly with representatives or agencies of the Navy Department, Maritime Commission, and other Departments or agencies of the Government.

5. The Board will receive from the Cost Analysis Section of the War Production Board, the Cost Analysis Section of the Fiscal Division of the Services of Supply, the Supply Services, the Army Air Forces, and from any other source, information with respect to contractors and subcontractors who are thought to have excessive costs, to be making excessive profits, or to be paying excessive salaries or bonuses.

6. (a) The Cost Analysis Section of the Fiscal Division of the Services of Supply shall upon request of the Board make such audits and analyses as may be designated by the Board and shall secure for the Board from the Treasury Department, the Securities and Exchange Commission, the Federal Trade Commission, and

from any other Department or agency of the Government, or from the contractor involved, such additional information as the Board may request in order to expedite and assist it in the performance of its functions.

(b) All Divisions and personnel of the Services of Supply and the Matériel Command, Army Air Forces, shall furnish such information and assistance to the Board as it may request or as may appear desirable to aid it in the performance of its functions.

7. The Board is authorized to delegate to any one or more of its members the power to initiate investigations and request information and assistance on behalf of the Board and to represent the Board in renegotiations with contractors and subcontractors.

8. In conducting renegotiations the Board shall take into consideration the financial position and over-all profits, past and prospective, of a contractor or subcontractor with a view to determining or agreeing upon the amount of any excessive profits realized, or likely to be realized, from its war contracts taken as a whole, subject to such instructions as the Under Secretary of War may issue from time to time.

9. All agreements reached as a result of such renegotiation shall be made expressly subject to approval by the Under Secretary of War, or his duly authorized representative, and shall be in such form and accompanied by such supporting reports and documents as he may prescribe from time to time.

10. The manner in which agreements shall be carried out, whether by a reduction of contract prices, refunds, or otherwise, shall be determined by the Under Secretary of War, or his designated representative. Agreement shall be reached with the Navy Department and the Maritime Commission as to any part of the agreement affecting contracts with them.

11. The Commanding General, Services of Supply, and the Commanding General, Matériel Command, Army Air Forces, are authorized and directed to create, with the advice of the War Department Price Adjustment Board, Price Adjustment Sections to conduct renegotiations with such companies as may be assigned to them by the War Department Price Adjustment Board, subject to review by the Board and approval by the Under Secretary of War or his designated representative, except in cases where by general instructions or in the particular instance, the Under Secretary or such representative may authorize them to make final agreements.

12. The Commanding General, Services of Supply, and the Commanding General, Matériel Command, Army Air Forces, are authorized and directed to establish within their command such Cost Analysis Sections as shall be necessary to act as fact-finding units with respect to cost and profits on War Department contracts, and subcontracts thereunder, for the foregoing Price Adjustment Sections.

13. The Chief, Purchases Branch, Procurement and Distribution Division, Services of Supply, is hereby designated as the duly authorized representative of the Under Secretary of War for the purposes specified herein.

14. The Board will be assigned to the Services of Supply for administrative purposes.

15. The provisions of memorandum of April 25, 1942, are modified accordingly.

(Signed) ROBERT P. PATTERSON,
Robert P. Patterson,
Under Secretary of War.

EXHIBIT C

WAR DEPARTMENT,
HEADQUARTERS, SERVICES OF SUPPLY,
Washington, D. C., July 3, 1942.

Memorandum for Directors and Chiefs of Staff Divisions, this Headquarters; Chiefs of Supply and Administrative Services, Services of Supply; and Commanding Generals, all Corps Areas.

Subject: Price Adjustment Sections.

1. The chief of each Supply Service is authorized and directed to create, with the advice of the War Department Price Adjustment Board, such Price Adjustment Sections as may be necessary, to renegotiate contracts with such contractors and subcontractors as may be assigned to his Service by the War Department Price Adjustment Board.

2. The chief of each Supply Service is authorized and directed to establish in the Fiscal Division of such Service a Cost Analysis Section, the function of which shall be to act as a fact-finding unit with respect to costs and profits on War Department contracts and subcontracts thereunder. Pursuant to Paragraph 9 g (5) of the initial directive for the organization of the Services of Supply, dated March 9, 1942, the Fiscal Division, Headquarters, Services of Supply, shall prescribe, supervise, and coordinate all cost-analysis methods and procedures within the Supply Services.

3. All renegotiation by any Price Adjustment Section shall take into consideration the financial position and over-all profits, past and prospective, of the contractor or subcontractor with a view to determining by agreement the amount of any excessive profits realized, or likely to be realized, from its war contracts taken as a whole, subject to such instructions as the Chief, Purchases Branch, Procurement and Distribution Division, Services of Supply, may issue from time to time.

4. All agreements reached as a result of such renegotiation shall be made expressly subject to approval by the Under Secretary of War, or his duly authorized representative, and shall be in such form and accompanied by such supporting reports and documents as may be prescribed.

5. Agreements reached by the Price Adjustment Sections shall be transmitted to the chief of the appropriate Supply Service and, when approved by such chief, shall be transmitted to the War Department Price Adjustment Board for review by the Board and final approval by proper authority, except in cases where, by general instructions or in the particular instance, the chiefs of the Supply Services are authorized to make final agreements.

6. The manner in which agreements shall be carried out, whether by a reduction of contract prices, refunds or otherwise, shall be determined by the Chief, Purchases Branch, Procurement and Distribution Division, Services of Supply.

7. Nothing herein contained shall preclude contracting officers from—

a. Continuing to make adjustments of prices or fees in individual contracts containing an express provision for redetermination of the price or fee on the basis of a specified formula or containing an express provision that the price or fee shall be subject to renegotiation, whether or not under Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942.

b. Continuing to reconsider individual contracts of any type with a view to adjustment of the contract prices by voluntary renegotiation or to accept voluntary reductions in such contract prices without auditing the accounts of the contractor or subcontractor if the amount is deemed reasonable.

Each adjustment shall be reported promptly to the Chief of the appropriate Supply Service for transmittal to the Chief, Purchases Branch, Procurement and Distribution Division, Services of Supply, for the information of the War Department Price Adjustment Board and shall be expressly made without prejudice to the determination of any excessive profits of the company upon subsequent renegotiation.

8. These instructions are issued in conformity with memorandum from the Under Secretary of War dated June 30, 1942, copy attached, and supplement the memorandum dated April 25, 1942, subject: Price Adjustment Board, Services of Supply.

For the Commanding General:

(Signed) H. A. MALIN,
H. A. Malin,
Colonel, General Staff Corps,
Executive, Administrative Branch.

1 Incl.

c/Memorandum dated, 6-30-42.

EXHIBIT D

JULY 8, 1942.

Contract Price Renegotiation,
Commanding General, Matériel Center,
Wright Field, Dayton, Ohio.

1. *Problem Presented.*

a. To establish within the Contract Section, Matériel Center, Wright Field, Dayton, Ohio, a Price Adjustment Branch and a Cost Analysis Branch.

2. *Factual Data.*

a. By memorandum directive from the Under Secretary of War to the Commanding General, Services of Supply, and Commanding General, Matériel Command, Army Air Forces, dated June 30, 1942, a copy of which is attached, a War Department Price Adjustment Board was established and provision was made for the establishment of Price Adjustment and Cost Analysis Sections within the Matériel Command of the Army Air Forces.

3. *Authority.*

a. The Under Secretary of War.

4. *Action Desired.*

a. The creation within the Contract Section at the Matériel Center, Wright Field, Dayton, Ohio, of a Price Adjustment Branch and a Cost Analysis Branch.

b. All renegotiation shall take into consideration the financial position and over-all profits, past and prospective, of the contractor or subcontractor with a view to determining by agreement the amount of any excessive profits realized, or likely to be realized, from its war contracts taken as a whole.

c. All agreements reached as a result of such renegotiation shall be made expressly subject to approval by the Under Secretary of War, or his duly authorized representative, and shall be in such form and accompanied by such supporting reports and documents as may be prescribed.

d. The functions and duties of the Price Adjustment Branch, Matériel Center, shall be as follows:

(1) It shall conduct reviews and renegotiate contract prices of companies in accordance with the policy and procedure established and maintained by the Commanding General, Matériel Command.

(2) It shall submit all proposed contract modifications resulting from such renegotiation to the Commanding General for review and approval by proper authority.

(3) It shall procure from the Cost Analysis Branch such additional factual information or data as may be pertinent to or useful in connection with any review or renegotiation conducted by it.

(4) It may request the Contract Audit Section, Fiscal Division, Dayton, Ohio, to conduct special audits or reviews of the records of contractors or subcontractors holding contracts or subcontracts subject to renegotiation.

e. The function of the Cost Analysis Branch of the Contract Section of the Matériel Center shall be to act as a fact finding unit with respect to costs and profits on War Department contracts.

f. Nothing herein contained shall preclude contracting officers from—

(1) Continuing to make adjustments of prices or fees in individual contracts containing an express provision for redetermination of the price or fee on the basis of a specified formula or containing an express provision that the price or fee shall be subject to renegotiation, whether or not under Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942.

(2) Continuing to reconsider individual contracts of any type with a view to adjustment of the contract prices by voluntary renegotiation or to accept voluntary reductions in such contract prices without auditing the accounts of the contractor or subcontractor if the amount is deemed reasonable.

g. Each adjustment shall be reported promptly to the Commanding General, Matériel Command, for transmittal to proper authority and shall be expressly made without prejudice to the determination of any excessive profits of the company upon subsequent renegotiation.

B. E. MEYERS,
Brigadier General, Army Air Forces.

Attach.

Cy memo fr USW 6-30-42.

EXHIBIT E

WAR DEPARTMENT

(SUPPLY SERVICE OR MATÉRIEL COMMAND)

Price Adjustment Section

AGREEMENT

DATE: -----, 194...

I. As a result of renegotiation between the undersigned.....

----- { a sole owner
a partnership.
a ----- corporation } with its principal office at
-----, in the City of -----, State of -----

and the Under Secretary of War, it has been found that ----- Dollars (\$-----) of the aggregate prices and fees of the undersigned in effect under the contracts of the undersigned with the War Department (and in contracts, if any, with the Navy Department and the Maritime Commission) enumerated or generally described in "Exhibit A" attached hereto, and in its subcontracts enumerated and generally described in "Exhibit B" attached hereto, represent the amount of excessive profits realized or likely to be realized, by the undersigned during its fiscal year ending -----, 1941... The finding herein is based upon the financial and other data including the comparative statement of projected operating results before and after this adjustment for said fiscal year, and is subject to the terms and conditions, all as set forth in "Exhibit C" attached hereto. "Exhibit D" attached hereto contains a complete list of the subsidiaries of the undersigned, all of which are consolidated with the undersigned for the purposes hereof except such, if any, as may be expressly excluded by proper notation on said exhibit.

II. The undersigned agrees that the Secretary of War (and, if applicable also the Secretary of the Navy and the Chairman of the Maritime Commission) shall have the right to withhold or recover from the undersigned, and the undersigned will pay or credit to the United States, the sum of ----- Dollars (\$-----), in accordance with the provisions of "Exhibit E" attached hereto.

III. The undersigned likewise agrees that it will make reductions in the prices and fees provided for in said contracts and subcontracts in accordance with a schedule of new prices and fees which the undersigned has submitted concurrently herewith, or will submit within ----- days hereafter, and represents that in its opinion such reductions are calculated to eliminate from said contracts and subcontracts, taking into consideration the provisions of II hereof, the excessive profits found herein to have been realized, or likely to be realized, by the undersigned during said fiscal year. If any such reductions are submitted after the date hereof, they shall be subject to approval by the Secretary of War (and if and to the extent applicable, also the Secretary of the Navy and the Chairman of the Maritime Commission) who shall have the right to require the undersigned to revise said prices and fees in such manner as he deems appropriate to effectuate the purposes of this agreement.

IV. To assure to the United States the benefit of reductions in the prices and fees under subcontracts as herein provided, the undersigned agrees to give notice of such reductions to its contractors forthwith and to insert therein a provision substantially in the following form:

"This reduction is the result of renegotiation between the undersigned and the Under Secretary of War, in behalf of the United States Government, and therefore, in respect of your prime contracts with the Government under which costs will be affected by this reduction, you agree with the Government, as a condition to the acceptance of this reduction, that the full benefit thereof shall be passed on to the Government through equivalent aggregate price reductions or refunds under these prime contracts. Contracting officers of the War Department, the Navy Department and the Maritime Commission are being advised accordingly."

V. The undersigned will not utilize this renegotiation or adjustment in any attempt to recover for its own benefit from any person, firm or corporation all of any part of any such price reduction or of any amount so withheld or recovered from, or paid or credited to the United States by, the undersigned pursuant to this agreement. It is expected, however, that the undersigned will make every effort to reduce its costs whenever possible, to enable it in turn to reduce its prices to the Government.

VI. Within three days after the end of said fiscal year the undersigned will furnish to the Under Secretary of War, properly signed by or on behalf of the undersigned, (1) a written statement, substantially in the form of "Exhibit C", showing the actual results of operations for said fiscal year, with necessary supporting data, and (2) a balance sheet, profit and loss statement and analysis of surplus for said fiscal year, in form satisfactory to the Under Secretary of War, certified by independent public accountants who may be those regularly employed by the undersigned.

VII. The finding herein shall be deemed a final determination of the excessive profits of the undersigned for said fiscal year under said contracts and subcontracts, subject to the right of the Under Secretary of War, or his duly authorized representative, (a) to reopen the renegotiation in his discretion, but not later than sixty (60) days after the undersigned shall have filed with the Under Secretary of War the statement and financial statements provided for in VI hereof, if the actual figures with respect to such factors as costs, volume of production or nature of products prove to be materially at variance with the estimates on which the finding herein was based, and (b) to reopen the renegotiation in his discretion at any time hereafter if the undersigned in the course hereof knowingly furnishes any false or misleading information or fails to disclose any material information. In deciding whether to reopen the renegotiation and for the purpose of any subsequent renegotiation for said fiscal year, if it is shown that increased profits have resulted from extra effort on the part of the undersigned to reduce costs, the undersigned will be given the benefit of this factor.

VIII. This agreement is executed by or on behalf of the undersigned pursuant to proper authority and shall be binding upon the undersigned and upon the War Department if and when approved by the Under Secretary of War or his duly authorized representative (and also upon the Navy Department if and when approved by the Under Secretary of the Navy or his duly authorized representative, and upon the Maritime Commission if and when approved by its Chairman or his duly authorized representative) and shall remain in full force and effect notwithstanding any interpretation, amendment, or disposition of Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942.

By -----
President.

(Attached hereto is an attested copy of an authorizing resolution of the Board of Directors.)

Approved:

For the Under Secretary of War.
 By -----
Authorized Representative.

Approved:

For the Under Secretary of the Navy.
 By -----
Authorized Representative.

Approved:

For the Chairman of the Maritime Commission.
 By -----
Authorized Representative.

Mr. PENGRA. May I say one thing more?

Mr. Marbury mentioned the percentage of profit to cost, and that is one item which we take into consideration, but we also take into consideration the ratio of profits—and profits in all cases being before taxes—to sales and to invested capital. The principal consideration is the ratio of manufacturing profit before taxes to sales, rather than cost or even adjusted cost, and the matter of invested capital is something but is not the basis on which we approach the problem, but something which we necessarily have to take into consideration.

Now, it is impossible to establish percentages, fixed percentages, which would be fair to all companies alike; or all companies in the

same industry, but as we develop our procedure and negotiations, we do find we gravitate under certain wheels for the industry, we will say, with perhaps exceptions in certain cases, and percentages which we have used have had a wide range, but nevertheless, for companies in the same situation. Being based on the same approach, they naturally would tend to reach more or less of a percentage, not a fixed amount, no percentage would be the same, but within a certain range for that industry, unless the situation of a particular company is different.

In so doing, and dealing with the matter before taxes, and having the right, which the tax laws do not have, to deal with the question of efficiency, and the difficulty of manufacturing technique, the ratio of material and labor in the cost, the contractor is entitled to indicate he is doing most of his own work, he is entitled to greater reward, than if he had subcontracted all those things—all those things are taken into consideration.

We can take into consideration, if I may illustrate, if a man has costs—in answer to Senator Taft's question about the reduction in costs—if a man has sales of \$100 and his costs are \$70 and another contractor has sales of \$100 and his costs are \$80, if we find the reason the first contractor's costs are only \$70 is because of his efficiency, after consideration of the factors which we do consider, we are in a position to give him a larger measure of profit than the man who has higher costs because of inefficiency.

That, as I conceive it, is something that taxation does not do.

Senator DANAHER. In your determination of the costs, at that point, do you go into the matter of determining whether a given rate of bonus is excessive?

Mr. PENGRA. Yes, sir. In negotiating with the larger companies, of course, we adjust the salaries and bonuses and in the case of the big company, it does not usually affect the result.

But with the smaller companies, we consider it in each case, and have records of it, but the smaller the company, the more consideration that is given. We do check in all cases, even with the larger companies, the status of the bonuses and salaries involved.

Senator DANAHER. We had some man in here a month ago crying all over the House because he wanted relief and it developed last week that he had a \$448,000-a-year salary, and he voluntarily wrote a letter to the President that he was reducing his yearly stipend to \$25,000 after taxes. I wondered if you took things of that kind into account. Do you try to preserve a \$25,000-after-taxes ratio as reasonable?

The CHAIRMAN. Mr. Marbury, do you take into consideration anything but the war contracts?

Mr. MARBURY. No, sir. We deal with them on the basis of their war contracts.

The CHAIRMAN. Alone.

Mr. MARBURY. That is correct.

The CHAIRMAN. Not anything they are making for civilian use?

Mr. MARBURY. No.

The CHAIRMAN. And you deal with them without regard to taxes?

Mr. MARBURY. That is correct. I think Mr. Pengra stated that exactly.

We conceive it is our problem to recover excessive profits before taxes but you cannot always ignore, in determining what is excessive, you cannot always ignore the impact of a tax bill. You have to give some consideration to it.

The CHAIRMAN. I don't think you can ignore it in any case and arrive at a just result.

Mr. MARBURY. That is right.

Senator TAFT. As a matter of fact, every hearing is opened by saying you are considering profits before taxes. Every matter sent to hearing is opened with that statement, that the Board determines this question before taxes.

Mr. MARBURY. That is usually the first subject of controversy, I think. They usually want to say, "of course, you are talking about profits after taxes," and we say, "Oh, no."

Senator TAFT. You mean you do make some allowance for taxes?

Mr. MARBURY. That matter is taken into consideration in determining what is excessive profits.

Senator TAFT. I should think that would have to be taken into consideration very substantially or not at all.

Mr. MARBURY. No; because the condition in which a company will be left with reference to working capital is a thing you cannot ignore, but at the same time the fact a man, after taxes, may have a low percentage on the cost of operation is not the controlling factor.

Senator TAFT. Let me say this, one of these contractors, one of the big ones, told me that a man on the Board, I won't swear it was the top Board, said to him, "Why do you object to renegotiating this thing and reducing it? You are going to pay 90 percent out to the Government anyway, and you would be far better off to leave the money here and not take it out and pay it back." Now, of course, if that attitude was taken generally it wouldn't leave much money for taxes. Do you think that was just an accidental statement or is that the policy of the Board?

Mr. MARBURY. I am sure it is not the policy of the Board.

Senator CLARK. What do you do with the money refunded; does it go back into the general revenue fund?

Mr. MARBURY. Yes. Actually these funds go back. The statute says so. One of the items we sought to obtain while that bill was in passage was an amendment which would permit that to be credited to our appropriation.

Senator CLARK. I had a statement from a contractor in which he said that the Board, the renegotiation Board, stated when he suggested he couldn't renegotiate the contract on the basis of a year's profit until the end of the year, because he didn't know what his losses might be, in the way of strikes, floods, cyclones, or what have you, the Board said that their object was to negotiate it before the end of the year because otherwise the Treasury would levy a tax, and they were supposed to make this renegotiation so that the War Department could use the money without further appropriation of Congress, without its having to go back to the Treasury.

Mr. MARBURY. That is a little more complicated than it sounds. As far as money that is paid back to the Government by the contractor is concerned, it is very clear that goes right into the Treasury.

The CHAIRMAN. Has there been much of that?

Mr. MARBURY. Quite a good deal, I think. Now, as far as a reduction in price is concerned, the man merely reducing his price,

that raises a different question, and it can conceivably be that the man would point out to him, Now, you reduce your price now, and the effect of that is that we have to pay out less, whereas if we pay it out to you and the Government takes a tax off, that goes back into the Treasury, and we are conserving our appropriations by reducing prices.

Senator TAFT. And you might get more orders out of this appropriation.

Mr. MARBURY. Yes.

Senator BARKLEY. This is all contracted for out of money Congress has already appropriated?

Mr. MARBURY. Yes, sir.

Senator BARKLEY. If by reduction of the contract you do not have to pay out a certain amount you otherwise would and do not pay it out, certainly that ought to remain available to the War Department for further contracts because it has not been paid out and therefore does not have to go back to the Treasury.

Mr. MARBURY. That is my legal opinion, but in order that there should be no doubt about it we think it should be cleared up.

Senator BARKLEY. But where you have paid it out and it is returned in cash, that goes into the Treasury?

Mr. MARBURY. Yes, sir.

Senator BARKLEY. Although Congress has, of course, appropriated it for that purpose?

Mr. MARBURY. That is right.

Senator RADCLIFFE. You spoke of reserves, a little while ago. That is a broad term. Would that contemplate maintenance for defects, or would it be simply things which are obviously required in order to keep the work as it is? Do you give consideration in your adjustment with the contractors to maintenance with the possibility that there may be defective work?

Mr. MARBURY. I don't know the answer to that, Senator Radcliffe. Mr. Pengra probably does. I don't have those details.

Senator RADCLIFFE. One more question. Is it your general policy to encourage subcontracting? In other words, if a contractor can make arrangements with another contractor, and that work, of course, has many branches, some of which are highly technical, is it your general policy to encourage subcontracting, or do you encourage the contractor to create his own facilities to do certain kinds of specific work?

Mr. MARBURY. Unquestionably it is the policy to encourage the subcontracting to the utmost practical limit.

Senator DANAHER. In section (d) the final clause reads:

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 each secretary and the approval of the Secretary of the Treasury, be made available to the extent determined by the Secretary of the Treasury for the purposes of making examination and determinations with respect to profits under this section.

Do you know whether or not that particular clause, the mechanism of it, has been relied upon at all by your Department?

Mr. MARBURY. I think not. I don't believe that the Bureau of Internal Revenue has been called upon to make any investigation.

Senator DANAHER. You are building up a large accounting force on this thing to check costs?

Mr. PENGRA. We are using one which already existed within the War Department.

Senator DANAHER. And expanding it rather rapidly and necessarily, I would think?

Mr. PENGRA. I don't think it has been expanded very much.

Senator TAFT. One of the complaints we get is that the method of calculating costs by the Accounting Section is entirely different from that used by the Internal Revenue, so that the accountants have to go back and figure the whole thing all over again. Is there any possibility of combining these two, which after all are ultimately for the same purpose?

Mr. MARBURY. I cannot answer that one, Senator Taft. I am not prepared to answer it. I don't know the extent to which it is a justifiable complaint. I think there is considerable doubt about that, but I would prefer that question be asked of General Carter, Director of the Fiscal Division. He would be the man who would know and would be able to give you an accurate answer.

Senator BARKLEY. Isn't there a good deal of difference between the two purposes? There is a difference between excess profits in a tax law and the excess profits in a contract.

Mr. MARBURY. There is an obvious difference, but I may say this, that the emphasis has been to try to avoid plaguing contractors with a lot of detailed auditing and accounting for the purposes of this statute.

Now, I think there may have been some instances where things are blamed on the statute and on the operation of the statute which are quite independent of that. In other words, audits and cost determinations and studies made not for the purposes of renegotiation under this statute, but for these other purposes.

Senator TAFT. It seems to me, in getting the information necessary, where the Bureau of Internal Revenue and yourself are involved, you ought to be able to work out one force to do the same work. That is all I have to suggest.

Senator DAVIS. There is no relation between the excess profit basis and the excessive profits.

Mr. MARBURY. No.

Senator BARKLEY. The excess under the tax law may not be excessive under a contract.

Senator BROWN. The word "renegotiation" in the statute implies, in the minds of men like myself who are not familiar with it, that there is some power of renegotiation. It is the power of redetermination. In other words, there is no chance at all for a contractor to say no, if the Secretary determines that his price should be lower.

Mr. MARBURY. Senator, I do not know the answer to that question. You will remember that in the debates on this bill, the conferees took diametrically opposite views on precisely that question. I think that the statute has a clear ambiguity in it as to whether or not it gives a power of unilateral determination to the Secretary. I would not undertake to say whether it did or not.

Senator BARKLEY. How clear must an ambiguity be before it is clear?

Senator BROWN. It says, in section (c):

The Secretary is authorized and directed, whenever, in his opinion excessive profits have been realized, or are likely to be realized, from any contract with

such Department or from any subcontract thereunder, to require the contractor or subcontractor to renegotiate the contract price.

Mr. MARBURY. That is correct.

Senator BROWN. And it goes on to say he cannot pay out any money at the higher rate thereafter. It seems to me the word "renegotiation" is wrong. It is a redetermination.

Senator CONNALLY. Isn't it based on the fact that the Constitution does not prohibit Congress from abrogating a contract?

Senator BROWN. It says, "All contracts heretofore made"—there may be a renegotiation, which I say is a redetermination.

In other words, I think, since a record is being made here, that it ought to be clear that someone on the committee thinks there is no negotiation in the proposition at all, there is no right such as a man has before he enters into the contract, to say he will or won't, after he knows what the terms are; he has got to take the Secretary's determination.

Senator BARKLEY. Or not take it at all.

Senator BROWN. No, he cannot refuse. He has already got it. So he has got to come under the reduced price.

Senator BARKLEY. I understood Mr. Marbury to say that in every case there had been an agreement, so that it is a renegotiation.

Senator BROWN. It has to agree.

Senator TAFT. Yes.

Senator BROWN. He has no right to say no.

Senator TAFT. It is a rededecision.

Senator LA FOLLETTE. May I say this: Mr. Marbury suggested that this matter was debated at length and the conferees took diametrically opposite positions, and I would suggest that we get the balance of Mr. Marbury's testimony. Some of the gentlemen are going away from here very soon.

The CHAIRMAN. Yes; suppose we let Mr. Marbury proceed.

Mr. MARBURY. May I proceed, then?

The CHAIRMAN. Yes.

Mr. MARBURY. Several problems have developed with respect to the contracts and subcontracts covered by the act and subject to renegotiation.

The most important of these concerns subcontracts. Since the act applies to all "subcontracts" but does not define that term, considerable uncertainty has arisen as to its correct meaning. This is particularly important to contractors who are under a duty to insert the renegotiation provisions in their subcontracts and must determine which of their contracts and purchases require these provisions. For this reason, and because disagreements between the contractor and his suppliers over the necessity of including the clause would delay procurement, the Army has included in its contracts a definition of the term. This definition was adopted after study of the administrative construction of the word "subcontract" under the Vinson-Trammell Act, and was made broad in order to give full effect to the statute in view of its uncertainty. Within the last month, however, the Board of Tax Appeals has decided in a case, under the Vinson-Trammell Act (*Aluminum Company of America v. Commissioner of Internal Revenue*), that the term "subcontract" as used in that act does not include materialmen or suppliers of raw materials or standard commercial articles. As a result some contractors have objected that the present definition

in use by the Army extends the renegotiation statute beyond its intended scope. Under the circumstances, a definition of the term by Congress would be helpful in clearing up this difficulty.

Now, on this point, let me say this, I have said that these amendments which we have suggested have the concurrence of the Navy Department and the Maritime Commission. On this one point of the definition of "subcontract", however, the Maritime Commission does not assent to the suggestion which we make on behalf of the War Department and in which the Navy Department has indicated its concurrence.

SENATOR LA FOLLETTE. Do you follow the decision of the Board of Tax Appeals or not?

MR. MARBURY. To an extent as far as we can interpret it; yes, sir.

If a statutory definition is adopted, it might properly exclude agreements for raw materials or standard commercial fabricated or semi-fabricated articles. The prices of articles of this character are subject to regulation by the Office of Price Administration and are reasonably susceptible of such generalized treatment. Any excessive profits resulting from increased volumes of such business can be satisfactorily handled by the excess-profits tax. If the contracts and purchases of these supplies and materials are excluded, renegotiation will be limited to prime contracts and to subcontracts with those doing specialized war work. In this field price control by the Office of Price Administration is not feasible without seriously dividing authority and impeding war production. Renegotiation, however, provides a method of price and profit control retaining sufficient flexibility to allow for the wide variations in conditions. 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 would probably 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.

I would like to add to this that this is really quite a serious administrative problem, and this is one thing on which we certainly do need some guidance. Now, we find ourselves in disagreement with the Maritime Commission as to the extent to which the subcontract should be included, and certainly, regardless of that, we are getting into administrative difficulties with material-men and suppliers who claim they ought never to have been included.

SENATOR TART. What do you think of excluding contracts under \$100,000? You did that in the first part of the act, but when you got to the redetermination section, it covered everything. You have 3,000,000 contracts; suppose you renegotiate half of them.

Then there are a million and a half contracts out that are not renegotiated and won't be from now until 3 years after the war, and your business about closing agreements won't apply, because you never will have gotten to them at all. Could not there be some way to exempt a large number of the small contracts and leave those to the excess-profits taxes?

Could that not be considered?

Mr. MARBURY. I certainly think it should be considered.

Senator TAFT. As I read this act, it is any contract in effect, and that means anybody from now until 3 years after the war does not know where he stands; he can't borrow money from his bank, but perhaps they figure they might come and take what he has away from him.

Senator BROWN. That is an actual condition.

The CHAIRMAN. Do you renegotiate the contracts for raw material with a price fixed on it by the O. P. A. and where it is operating under that price ceiling?

Mr. MARBURY. I am not certain. I think the answer to it under the present statute, the present definition of "subcontract," would be yes. The uncertainty, the legal uncertainty under which we have been placed by this new interpretation of the Vinson Act makes it impossible to give you a categorical answer to that question. What we are suggesting is that we be not called upon to do that, Senator.

On the price of copper or aluminum—those materials, that we be not called upon to renegotiate such contracts.

Senator CONNALLY. Would you go so far as to exclude all raw materials?

Mr. MARBURY. Yes, sir.

Senator CONNALLY. You advocate excluding all raw materials?

Mr. MARBURY. Yes, sir; we do.

A second problem relates to the omission of the renegotiation provision from certain prime contracts and subcontracts where it is inappropriate. The provision should not be required in contracts with other Federal or local governmental agencies or a foreign government. Likewise the Secretary should be permitted to exempt contracts from renegotiation when the profit can be determined with reasonable certainty when the original price is agreed on. Contracts of this type include those for personal services, for the purchase of real estate or perishable goods or for commodities at a minimum price fixed by a regulatory body, and contracts to be performed in a short period. Contracts to be performed outside the United States also often present special difficulties for renegotiation. In the opinion of the War Department, the Secretary should have authority to exempt contracts of these types from renegotiation whenever he thinks it justified.

Certain types of patent license agreements, certain types of leases, contracts to be performed in Mexico, in Africa. How are you going to, practically speaking, make an African take a subcontract with a provision in it that the Secretary shall renegotiate it? There has to be some power of exemption and it has got to be fairly flexible, otherwise you run into a hopeless administrative condition.

Certain minor changes are suggested in the provisions required to be inserted in contracts and subcontracts primarily to set at rest certain fears and doubts of contractors and subcontractors from some of the present language. These include amendments to make clear that excessive profits may be eliminated through a reduction in the contract price or otherwise, as the Secretary may direct, and need not be recovered if so eliminated; that a contract or subcontract may be required to refund excessive profits only if they have actually been paid to him; that the Secretary may fix a period or periods for renegotiation.

tiation in the contract and in this way prescribe a statute of limitations for renegotiation, that a contractor is liable for reductions in the sub-contract price only if he receives the benefit of the reduction; and that a surety under a contract is not liable for excessive profits upon renegotiation.

In addition, there are a few other changes of a purely verbal nature involving no questions of policy.

As I have said, most of these proposed amendments merely give explicit sanction to the procedure and practices being followed in negotiation under the statute. They do not change existing policy or purpose. Such clarifying amendments are desirable, however, in a statute of such wide application and importance, in order to remove any doubts as to the power and procedure of the renegotiating boards in carrying on operations, and to reassure contractors in their dealings with the boards. The more important of the proposed amendments are the amendment covering express authority for over-all renegotiation, the amendment providing for final and other agreements, and the amendment defining the term "subcontract."

In conclusion, may I say that the War Department is fully alive to its duty to control and supervise the prices and costs under contracts and related subcontracts. In the interest of conserving materials and using most effectively the available manpower and productive resources, it is vitally necessary to promote the greatest possible efficiency in production and the operation of plants. Concretely this means that contractors and subcontractors should be encouraged to keep down costs of production.

Reduction of current contract prices through renegotiation and consequent prevention of excessive profits before they accrue have the tendency to keep costs at a minimum. In this respect, renegotiation is distinguishable from taxation which reaches profits only after they accrue and affords no incentive to reduction of costs. In the administration of the statute greater emphasis is being placed on reductions in contract prices to reasonably close margins to promote such cost control.

In order to maintain incentives for contractors to reduce costs, it is essential to distinguish between contractors on the basis of efficiency in keeping costs down. It is sound policy to reward the more efficient. If a uniform flat percentage is applied, all contracts are virtually on a cost-plus basis and there is little incentive for performance above average.

Because of this danger, the War Department has not favored flat limitations on profits. It is administering the renegotiation statute with a view to the relationship between profits and the control of costs. From this point of view, comparison of the rate of profit of particular contractors is unwise and misleading unless the factors affecting costs have been considered.

In other words, we feel that profits should be a reward for performance and that they should be judged and compared in terms of relative performance and not on the basis of flat percentages. Only by constant attention to costs as well as profits will the public interest be well served. For this reason, it is the announced policy of the Price Adjustment Board to reward low-cost producers by the allowance of a greater margin of manufacturing profit. This is a second benefit which a tax statute does not accomplish.

I think that concludes what I have to say.

The CHAIRMAN. Are there any further questions?

Senator LA FOLLETTE. Were you planning to have the suggested draft in the record?

Mr. MARBURY. Yes, sir. I am perfectly satisfied to have it go in the record with the explanation, as I said, it has not been cleared with the Bureau of the Budget, and that we are not presenting this as an official request for the amendment of the statute.

I have also here, and which I will hand to the stenographer, the definition of "subcontract," which we would like to see. That is not in here [indicating] because the things which we have formally filed have all been agreed to by the Navy and the Maritime Commission, whereas the definition of "subcontract" has not been agreed to by the Maritime Commission, and they are here.

(The matter referred to is as follows:)

The term "subcontract" means any purchase order or agreement to perform all or any part of the work, or to make or furnish any article, required for the performance of another contract, except order or agreements to furnish (i) raw materials; (ii) standard commercial fabricated or semi-fabricated articles ordinarily sold for civilian use, or (iii) articles for the general operation or maintenance of the contractor's plant. The term "article" includes any material, part, assembly, machinery, equipment, or other personal property.

Senator LA FOLLETTE. You are tendering these amendments which have been cleared with the various departments and agencies involved in connection with this bill where there isn't time for studies. These are the amendments that have been agreed upon?

Mr. MARBURY. Yes, sir.

Senator LA FOLLETTE. And it does not go to the root of the matter?

Mr. MARBURY. Isn't in any sense more than clarifying, largely authorizing, what we are already doing, and found necessary to do, and which we believe we have the authority to do but want it made clear.

Senator TAFT. What concerns me is this large number of smaller contractors that, under your amendments, would be wide open; you never get to them.

Mr. MARBURY. Yes, sir.

Senator TAFT. Yet, from now until 3 years after the war, those people are in suspense and the Government may step in and take a lot of money away from them.

Mr. MARBURY. Yes, sir.

Senator TAFT. I think we should consider some exception for the smaller contractors. That is, assuming that this is a compulsory renegotiation.

Mr. MARBURY. I cannot speak about those as I can about the others, but from a personal standpoint, I can't imagine an objection to some limitation.

Senator TAFT. You won't be able to reach most of the others, that is why I would like to except them from that wide open provision.

Senator DAVIS. Aren't the larger institutions on practically 100-percent war production?

Mr. MARBURY. Yes.

Senator DAVIS. And you have men familiar with those industries to make a check-up on them? For instance, in the steel industry; men familiar with the cost of ore, and blast furnaces and finishing mills.

Mr. MARBURY. Well, I don't know that we have gone down to the blast furnaces and the ore.

Senator DAVIS. It is all part of the making of steel.

Mr. MARBURY. Yes, sir.

Senator DAVIS. I don't know how you are going to determine the cost unless you go all the way, from the beginning until it is produced. Have you men of experience doing that work?

Mr. MARBURY. You pick out the one subject, of raw materials, which is what we are asking to be relieved of. We are asking to be relieved of raw materials. If you ask about airplanes, the answer would be "Yes," we do have the men who know what those things all cost, and who keep a constant check.

Senator VANDENBERG. One further question. In the hearings of the Finance Committee, I read a letter from Mr. Paul under date of August 5 regarding this problem of excess-profits tax return where subsequent to the filing of such return, the taxpayer is required to pay a portion of its profits pursuant to renegotiations. Mr. Paul takes the position that no legislation is required to authorize and establish an over-all program for dealing with this whole thing all at once. Is that your position?

Mr. MARBURY. Well, we have asked that we be told definitely that we should give credit for excess profits paid. We think that, while the Treasury is taking that position—and we are very glad they are and think it is a sound one—we think that some of the fears of business would be relieved if we were definitely told we should give that credit, and it certainly is reasonable.

Senator VANDENBERG. Thank you. I quite agree with you.

(The matter referred to is as follows:)

SEC. 403. (a) For the purposes of this section—

(1) The term "Department" means the War Department, the Navy Department, and the Maritime Commission, respectively.

(2) In the case of the Maritime Commission, the term "Secretary" means the Chairman of such Commission.

(3) The terms "renegotiate" and "renegotiation" include the refixing by the Secretary of the Department of the contract price.

(4) The term "excessive profits" means any amount of a contract or subcontract price which is found as a result of renegotiation to represent excessive profits.

For the purposes of subsections (d) and (e) of this section, the term "contract" includes a subcontract and the term "contractor" includes a subcontractor.

(b) Subject to subsection (i), the Secretary of each Department is authorized and directed to insert in any contract for an amount in excess of \$100,000 hereafter made by such Department—

(1) a provision for the renegotiation of the contract price at a period or periods when, in the judgment of the Secretary, the profits can be determined with reasonable certainty, which provision, in the discretion of the Secretary, may fix the period or periods when or within which renegotiation will be had;

(2) a provision for the retention by the United States from amounts otherwise due the contractor, or for the repayment by him to the United States, if paid to him, of any excessive profits not eliminated through reductions in the contract price, or otherwise, as the Secretary may direct;

(3) a provision requiring the contractor to insert in each subcontract for an amount in excess of \$100,000 made by him under such contract (i) a provision for the renegotiation by such Secretary and the subcontractor of the contract price of the subcontract at a period or periods when, in the judgment of the Secretary, the profits can be determined with reasonable certainty, which provisions, in the discretion of the Secretary, may fix the period or periods when or within which renegotiation will be had, (ii) a provision for the retention by the contractor for the United States of the amount of any reduction in the contract price of any subcontract pursuant to its renegotiation hereunder, or for the repayment by the subcontractor to the United

States of any excessive profits from such subcontract paid to him and not eliminated through reductions in the contract price or otherwise, as the Secretary may direct, and (iii) a provision for relieving the contractor from any liability to the subcontractor on account of any amount so retained by the contractor or repaid by the subcontractor to the United States;

(4) a provision for the retention by the United States from amounts otherwise due the contractor, or for repayment by him to the United States, as the Secretary may direct, of the amount of any reduction in the contract price of any subcontract under such contract, which the contractor is directed pursuant to clause (3) of this subsection, to withhold from payments otherwise due the subcontractor and actually unpaid at the time the contractor receives such direction.

(c) (1) When ever, in the opinion of the Secretary of the Department, the profits realized or likely to be realized from any contract with such Department, or from any subcontract thereunder whether or not made by the contractor, may be excessive, the Secretary is authorized and directed to require the contractor to renegotiate the contract price. When the contractor or subcontractor holds two or more such contracts or subcontracts the Secretary, in his discretion, may renegotiate to eliminate excessive profits on some or all of such contracts or subcontracts as a group without separately renegotiating the contract price of each contract or subcontract.

(2) Upon renegotiation, the Secretary is authorized and directed to eliminate any excessive profits under such contract or subcontract (i) by reductions in the contract price of the contract or subcontract, or by other revision in its terms; or (ii) by withholding, from amounts otherwise due to the contractor or subcontractor, any amount of such excessive profits; or (iii) by directing a contractor to withhold for the account of the United States, from amounts otherwise due to the subcontractor, any amount of such excessive profits under the subcontract; or (iv) by recovery from the contractor or subcontractor, through repayment, credit, or suit, of any amount of such excessive profits actually paid to him; or (v) by any combination of these methods, as the Secretary deems desirable. In determining the amount of any excessive profits to be eliminated hereunder, the Secretary shall allow the contractor or subcontractor appropriate credit for any Federal taxes (including income, normal, and excess-profits taxes) paid or payable with respect to such excessive profits and not subject to adjustment, but may require such evidence thereof, including a closing agreement with the Internal Revenue Bureau, as he deems necessary. Such Secretary may bring actions on behalf of the United States in the appropriate courts of the United States to recover from such contractor or subcontractor, any amount of such excessive profits actually paid to him and not withheld or eliminated by some other method under this subsection. The surety under a contract or subcontract shall not be liable for the repayment of any excessive profits thereon. All money recovered by way of repayment or suit under this subsection shall be covered into the Treasury as miscellaneous receipts.

(3) Upon renegotiation pursuant to this section, the Secretary may make such 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 section, as the Secretary deems desirable. Such agreements may cover such period or periods, may apply to such contract or contracts of the contractor or subcontractor, and may contain such terms and conditions, as the Secretary deems advisable.

(4) This subsection (c) shall be applicable to all contracts and subcontracts hereafter made and to all contracts and subcontracts heretofore made, whether or not such contracts or subcontracts contain a renegotiation or recapture clause, unless (i) final payment pursuant to such contract or subcontract was made prior to April 28, 1942, or (ii) the contract or subcontract provides otherwise pursuant to subsection (b) or (l) of this section 403.

Subsections (d) through (h) of the present section 403 would remain unchanged. New subsections, (i) and (j), would be added after the present subsection (h) to read as follows:

(i) The provisions of this section shall not apply to any contract by a Department with any other department, bureau, agency or governmental corporation of the United States or with any territory, possession or State or any agency thereof or with any foreign government or any agency thereof. The Secretary of a Department is authorized, in his discretion, to exempt from some or all of the provisions of this section 403, (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 Secretary, the profits can be determined with reasonable certainty when the contract price is established, such as certain classes of agreements for personal services, 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, of leases and license agreements, and of agreements where the period of performance under such contract or subcontract will not be in excess of 30 days.

(j) Nothing in sections 109 and 113 of the Criminal Code (U. S. C., title 18, secs. 198 and 203) or in section 190 of the Revised Statutes (U. S. C., title 5, sec. 99), shall be deemed to prevent any person appointed by the Secretary of a Department for intermittent and temporary employment in such Department, 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) which arises from any matter directly connected with which such person is employed, or (2) during the period such person is engaged in intermittent and temporary employment in a Department.

MEMORANDUM

Subject: Suggested amendments to section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942 (Renegotiation of Contracts).

Attached hereto is a draft of certain sections of this statute incorporating changes which would (1) eliminate certain existing ambiguities and (2) make the statute more flexible and more effective as a means of reducing prices and costs. The changes embodied in the draft submitted are as follows:

1. DEFINITIONS

(a) "Excessive profits": Throughout the present statute the phrase "Any amount of a contract price which is found as a result of renegotiation to represent excessive profits," is constantly used. For convenience and brevity in revised form the term "excessive profits" has been substituted for this phrase, but subsection (a) (4) defines the term as having the same meaning as the phrase for which it is substituted.

2. CONTRACT PROVISIONS

Subsection (b) prescribes the contract provisions required to be inserted in contracts over \$100,000. The changes proposed in this subsection are designed to eliminate ambiguities or uncertainties in the present statute. The following are the most important of these changes:

(a) Subparagraphs (2) and (3) are revised to make it clear that a contractor or subcontractor can be forced to repay excessive profits only after they have actually been paid to him.

(b) The Secretary may in his discretion fix the period or periods for renegotiation and in this way prescribe a statute of limitations on renegotiations.

(c) The revision of these subparagraphs also makes it clear that excessive profits may be eliminated through reductions in the contract price or otherwise as the Secretary may direct and need not be recovered if so eliminated.

(d) While subparagraph (3) of the present law appears to require the United States to withhold excessive profits from a subcontractor, this will normally be impossible, since the Government will not owe anything directly to the subcontractor. The revision of this subparagraph makes it clear that such amounts are to be withheld by the prime contractor for the benefit of the Government.

(e) Under subparagraph (2) (B) of the present law contractors fear that they may be liable for reductions in the subcontract price even though they do not receive the benefit of it. In the new draft subparagraph (4) which replaces subparagraph (2) (B) eliminates this risk.

3. RENEGOTIATION PROCEDURE

Subsection (c) prescribes the procedure for renegotiation and the elimination of excessive profits. For clarity it has been divided into five subsections in the revised form.

(a) Over-all renegotiation: At the end of subsection (c) (1) a new sentence has been added which expressly allows renegotiation of contracts or subcontracts of a contractor or subcontractor as a group. This authorizes the procedure which

has been found to be more practical where a contractor or subcontractor holds a large number of such contracts.

(b) Methods of eliminating excessive profits: Subsection (c) (2) specifies the methods by which excessive profits may be eliminated. It expands the present methods of eliminating excessive profits. It expressly authorizes elimination through reductions in the contract price by revision in its terms and clarifies several minor uncertainties in the present statute. It also relieves the surety under a contract from liability or excessive profits thereon as was done under the Vinson Act.

(c) Excess-profits taxes: Under the present statute no provision is made to offset excess-profits taxes paid against the excessive profits under the statute. Subsection (c) (2) of the revised form provides for such offset.

(d) Payments to Treasury: The present statute makes it doubtful just what amounts are to be covered into the Treasury as miscellaneous receipts. The revised sentence in subsection (c) (2) expressly limits it, as originally intended, to money repaid to the Government or recovered by suit.

(e) Agreements: Subsection (c) (3) expressly authorizes final agreements with a contractor or subcontractor for the discharge of any liability for excessive profits under this section. This is intended to make it clear that final action by the Secretary or his representatives will preclude reopening of the question at a later date. It also permits the agreement to contain any terms of conditions which the Secretary deems advisable.

4. EXCEPTIONS

A new subsection (i) is added at the end of the present statute permitting certain exemptions from its terms.

(a) Governmental contracts: The contracts with any Federal or local agency or any foreign government are completely exempted.

(b) Permissive exemptions: The Secretary is authorized to exempt—

(1) contracts to be performed outside the United States and

(2) Contracts where the profits can be determined with reasonable certainty when the price is established such as certain classes of agreements, specified in the statute as agreements for personal services, 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, of leases and license agreements, and of agreements where the period of performance under such contract or subcontract will not be in excess of 30 days.

5. LIMITATION OF OPERATION OF SECTIONS 109 AND 113 OF THE CRIMINAL CODE AND SECTION 190 OF THE REVISED STATUTES

A new subsection (j) has been added to the statute to make clear that the above-mentioned statutes do not prevent any person employed on an intermittent or temporary basis by a Secretary, from acting as counsel, agent, or attorney for prosecuting a claim (such as a claim arising under the tax statutes) against the United States, under certain conditions. This subsection has been added in order to make it possible for the Department to retain the services of lawyers, accountants, and other professional men who might otherwise feel constrained to refuse to continue their present intermittent or temporary work for the Department because of these statutes. While this new subsection (j) has been added to section 403 primarily to clear up any doubts as to the application of these statutes to persons employed to aid the Secretary in renegotiating prices under contracts, it is not limited to such persons.

The CHAIRMAN. Mr. Barkley advises there will not be a vote for a couple of hours. The committee may have to recess and go to the floor, but we will proceed for a few minutes and hear from Mr. Kenney.

Mr. PAUL. Mr. Chairman, will this session go on tomorrow?

The CHAIRMAN. It will have to, I believe, Mr. Paul, before we can reach any decision as to what we will do. Would you want to put something in the record?

Mr. PAUL. I would rather wait until all the witnesses have been heard.

The CHAIRMAN. I thought you would.

All right, Mr. Kenney.

**STATEMENT OF JOHN KENNEY, SPECIAL ASSISTANT TO THE
UNDER SECRETARY, NAVY DEPARTMENT**

Mr. KENNEY. Senator George, I do not believe I have very much to add after Mr. Marbury's discussion, except that I would like to point out one or two things, one for the benefit of Senator Taft, and that is a renegotiation is not conducted on a basis of cost. We take into consideration a great many factors in determining whether the profits of a particular contractor under a contract for a certain period have been excessive, and we try to give effect for reduced costs and for efficiency.

I can, perhaps, best illustrate this by the case of three contractors whom we had before us, all of them were making comparable articles; namely, gun mounts. One was a very efficient organization, was manufacturing a gun mount for about \$7,500.

Another was an organization that had never manufactured that type of product before and was not as efficient, and was manufacturing for around \$11,000.

Another company, which was an old company, had very old equipment, and it was costing that company in the neighborhood of \$12,500. The company which was manufacturing for \$7,500 was allowed a larger profit than the other companies.

Senator TAFT. You mean a larger percentage?

Mr. KENNEY. A larger dollar profit.

Senator TAFT. You finally find it in dollar profits on particular contracts, or for the year or how?

Mr. KENNEY. In this particular company it happened to be the main thing they were manufacturing and so we took into consideration their profits for a specific period of time in relation to the number of gun mounts they were manufacturing.

Senator TAFT. Don't you necessarily start with an idea—particularly, it seems to me when you get down to these adjustment boards of Army officers—that is the way the contractor would feel about it—it is a cost-plus proposition?

Mr. KENNEY. Naturally.

Senator TAFT. Don't you necessarily, on the question of gun mounts, think that "Well, 6 percent is about right, but this fellow is very efficient, so we will give him 7", or 8 and some other fellow gets 5? Don't you necessarily have to have some standard?

Mr. KENNEY. Naturally.

Senator TAFT. On each thing, based on cost plus percentage?

Mr. KENNEY. You have to take cost into consideration, there is no doubt of that.

Senator TAFT. If you had to get uniformity between five or six adjustment boards throughout the country, the central board almost has to let it be known that they think 6 percent is reasonable on gun mounts, isn't that the only way you can get uniformity, everything being equal?

Mr. KENNEY. Yes, but, of course, we never have everything equal, like the three contractors we had, everything was different, one had his own facilities, another had Government facilities, and the third was mixed.

Senator TAFT. Supposing you laid down a general idea of 6 percent, cost-plus 6 percent for gun mounts, and a new contractor comes up

to the Procurement Division, wouldn't they try to let their contract on about the basis you have set for the others?

Mr. KENNEY. Well, you have some idea as to cost, and you will probably let that contract for that gun mount at approximately that price.

Senator WALSH. These three companies—was the original contract based upon a percentage of the cost or was it based upon a lump sum?

Mr. KENNEY. All three of those were fixed-price contracts.

Senator WALSH. And, of course, the company that was efficient was making very much more money than the company that was not, if they were all the same?

Mr. KENNEY. Well, the original price in each case differed.

Senator WALSH. And, of course, the company presented to you their costs and you could tell from the contract how much profit they made, and then you cut it down?

Mr. KENNEY. That is correct, sir.

The next thing I wish to point out is the matter of our supervision of costs. The Navy Department has selected a panel of auditors. They were located all through the country. There are some 300 men on that panel and they belong to the leading accounting firms in the country. As a patriotic duty, we have asked these men to serve on this panel. Any time we have a company we are investigating in that particular area, we ask this accountant to go in and make the survey of cost and profits of that company and make a report back to the Price Adjustment Board.

Senator WALSH. That must be very satisfactory.

Mr. KENNEY. It has been a very satisfactory arrangement, Senator Walsh.

Senator WALSH. Now, one of the witnesses stated that you deal only with the companies.

When you deal with a company, do you segregate their private contracts and have nothing to do with that, and have only their contract with the Government to deal with?

Mr. KENNEY. We segregate the private business from the Government business; yes, sir.

Senator WALSH. It was suggested at one time before the Committee on Naval Affairs that every company that has Government contracts should make two separate tax returns, one of its private business and one of its contracts with the Government. I was personally very much impressed with it. That is what you are doing now. You take these Government contracts and deal with them as a separate entity and apart from the rest of the business of the company to determine the excessive profits?

Mr. KENNEY. Yes. We construe the statute really as a pricing statute to get the price of the goods that the Navy Department is buying down. We are not concerned so much with the returns of money as we are with getting the prices for the future down. This, in our opinion, is in no way a revenue statute, although we do, incidentally, collect certain sums of money which we turn into the miscellaneous receipts fund of the Treasury.

Senator WALSH. So that a company, in making its tax return, makes its return on an income from its private business, plus the income from Government contracts and pays taxes upon that?

Mr. KENNEY. Yes.

The CHAIRMAN. Have you anything further, Mr. Kenney?

Mr. KENNEY. No; I have nothing further, Senator, unless members of the committee have further questions.

Senator DANAHY. Will somebody from the Maritime Commission tell us in what particular they are in disagreement with the suggested definition of a subcontract?

The CHAIRMAN. We haven't gotten to the Maritime Commission yet, Senator.

Mr. BRADLEY (F. M. Bradley, counsel, Price Adjustment Board, Maritime Commission): Mr. Chairman, Mr. Brown, assistant general counsel of the Maritime Commission is here, now, and he will be glad to make some observations on behalf of the Maritime Commission with respect to the "subcontract" definition.

The CHAIRMAN. Lieutenant Brown, you may come around then, if you will.

STATEMENT OF LT. WALSTON BROWN, ASSISTANT GENERAL COUNSEL, MARITIME COMMISSION

Mr. BROWN. The main objection arises from exclusion 2 which excludes standard commercial articles, which are a large percentage of the costs of the average ship—steel plates, steel shapes, and perhaps could be construed to include engines and motors.

Now, it very often happens that those articles are being bought by the prime contractor from its affiliate or subsidiary or parent corporation. Ingalls Iron Works is a parent shipbuilding company of the Ingalls Shipbuilding Co. and they purchase their fabricated plates from Ingalls Iron Works. That leaves the field open for excessive profits with them.

As far as exclusion 3 goes, it is all right if it is confined to expenditures made by the contractor himself for the improvement of its own plant but it can be construed to go to purchases under their facilities contracts, which should not be allowed because a subcontract under a cost facilities contract is in the same category, for the purposes of payment, as a prime contract, with the Commission.

Senator TAFT. Isn't the price of steel articles fixed by O. P. A.?

Mr. BROWN. Yes; certain steel is.

Senator TAFT. Certain steel, but not some of the special articles?

Mr. BROWN. Well, some of the fabricated work. I may be mistaken on it. The process of shipbuilding can be done in the shipyard, or it can be go back into other plants of the contractors. Now, we have contracts with Consolidated Steel in California that do their own fabricating in their own plants and the whole contract is with Consolidated.

Senator TAFT. There is no particular reason why we should not make one rule for the Maritime Commission and another for someone else. It does not have to be uniform?

Mr. BROWN. No, it would not have to be uniform but this exclusion (2) is very broad. Contractors will begin arguing that everything comes within that exclusion.

Senator LA FOLLETTE. Have you any suggestion as to language that would meet your situation?

Mr. BROWN. No, I do not, except to leave it out.

Now, in our regulations for determining profit under Section 505 (b) of the Maritime Act, we exclude purchases by the contractor made in usual course of business to replenish his stock and not assignable to a particular contract.

Now, that would take care of cases where the contractor had a great variety of business. In the case of most of our shipyards, everything they purchase is assignable to a particular contract because they are doing nothing but work for us, or 80 or 90 percent of their work is for us.

The CHAIRMAN. Do you have any further statement to make?

Mr. BROWN. No, sir.

The CHAIRMAN. Thank you, Lieutenant Brown.

Mr. PAUL. Does the committee have time, Mr. Chairman, to have this letter of Mr. Henderson read into the record?

The CHAIRMAN. Yes.

Mr. Paul has handed me this letter addressed to him from Mr. Henderson, Administrator of the O. P. A. It says:

OFFICE OF PRICE ADMINISTRATION,
Washington, D. C., September 22, 1942.

Mr. RANDOLPH E. PAUL,
General Counsel, Department of the Treasury,
Washington, D. C.

DEAR Mr. PAUL: I understand from you that Senator George is holding a meeting of the Senate Finance Committee today to discuss the question of possible changes in the statutory provisions relating to renegotiation of war contracts. I should appreciate it if you would present to Senator George and the committee my views on this matter which are briefly as follows.

I believe that any proposal to change the present profit control powers and responsibilities of the War Procurement Agencies should be carefully considered in relation to the antiinflation program now being developed by the Congress. Willing acceptance by farm groups and labor groups of stabilization of farm prices and wages cannot be assured without effective control of profits.

The renegotiation power can be an effective instrument of profit control in the munitions field where profits have been large. If this power and the correlative responsibility of the War Procurement Agencies is to be modified in any way, such change should be made only after full consideration of its relation to the antiinflation program and after other provisions for effective profit control consistent with the objectives of the antiinflation program are made. I believe that before any changes are made the matter should be studied with great care.

Any proposals to change the powers and responsibilities of the War Procurement Agencies relating to control of profits and prices are of especial concern to me at this time inasmuch as the War and Navy Departments have requested that the Office of Price Administration exempt from price control most military equipment, and have maintained that they can and will control profits and prices in that area.

Sincerely yours,

LEON HENDERSON, Administrator.

Mr. PAUL. Mr. Chairman, with respect to the words, "will control" at the end there, the Army and the Navy and the Maritime Commission have the understanding that the correct wording is "will make an effort to control".

I don't think they have undertaken an absolute job, but they will make every effort to do so.

The CHAIRMAN. I think we understand.

Mr. PAUL. May I say just one more word, for the Secretary of the Treasury, that we would like to have the Secretary awarded the same powers with respect to the Treasury Department contracts as the Secretary of the War Department and the Secretary of the Navy and the Chairman of the Maritime Commission have with respect to their

contracts, whatever is done. That applies, of course, principally to lend-lease contracts.

It would seem that any power of renegotiation or whatever it may be called should be extended to contracts made by the Secretary of the Treasury—principally lend-lease contracts.

The CHAIRMAN. Is it the pleasure of the committee to go on now or recess until tomorrow?

Is there any other gentleman here, from either one of the departments, that would like to appear this morning?

(No response.)

The CHAIRMAN. Is there anything further to be submitted by either the War or Navy Departments or the Maritime Commission?

Mr. KENNEY. The Navy has nothing further to submit, Senator.

Mr. RYDSTROM (Lt. Comdr. A. G. Rydstrom, Price Adjustment Board, Maritime Commission). The Maritime Commission has nothing further to submit.

Speaking categorically, we concur with what Mr. Marbury and Mr. Kenney have stated. We feel that this whole question of section 403 is of such vital importance to the Commission and to business in general, we would welcome a thorough investigation and a chance to state our case in chief.

The CHAIRMAN. We will recess then until tomorrow at 10 o'clock. Thank you gentlemen for coming in.

(Whereupon, at 12:15 p. m., the committee recessed until 10 a. m. Wednesday, September 23, 1942.)

(The following letter to the chairman of the Finance Committee from the chairman of the United States Maritime Commission, under the date of September 22, 1942, was ordered entered into the record:)

SEPTEMBER 22, 1942.

Senator WALTER F. GEORGE,

Chairman, Senate Finance Committee, United States Senate,

Washington, D. C.

MY DEAR SENATOR GEORGE: We shall appreciate it if the following statement could be made a part of the record of the committee's hearing Tuesday, September 22, 1942, regarding section 403 of Public Law No. 528.

The Commission wishes to call your committee's attention to certain objections which it has to the definition proposed by the War and Navy Departments of the word "subcontract" appearing in section 403 of the Sixth Supplemental Defense Appropriation Act, 1942 (P. L. No. 528).

The Commission finds the proposed definition objectionable insofar as such definition excludes standard commercial fabricated or semifabricated articles ordinarily sold for civilian use. In the case of the merchant type of ship, such articles comprise a substantial part of the material costs of the ship. The definition would, therefore, preclude renegotiation of the greater part of the subcontracts and purchase orders of shipbuilders who have contracts with the Commission. This is especially undesirable in view of the fact that in certain instances the subcontractor who is furnishing a substantial portion of this material is a parent corporation, a subsidiary or an affiliate of the prime contractor and, therefore, if excessive prices are charged under subcontracts or purchase orders for such articles, the renegotiation of the prime contract could not preclude the making of excessive profits by the corporate family of which the contractor is a member.

Although it is true that in many instances ceiling prices for these articles have been fixed by the Office of Price Administration, such fact will not of itself preclude the making of excessive profits in the manufacture and sale of such articles, since the ceiling price is usually the maximum price and will not in every instance constitute a reasonable price for the article purchased, especially where quantity orders are placed.

The Commission opposes the exclusion from the definition of the word "subcontract" of "articles for the general operation or maintenance of the contractor's plant" on the grounds that such exclusion might be construed to include purchases of shipyard equipment and other facilities under facilities contracts with the Commission. Such contracts provide that the Commission will pay the contractor the cost of these purchases and, therefore, the application of the renegotiation provisions of the Sixth Supplemental Defense Appropriation Act to such purchases is necessary for the protection of the Government's interests. It is suggested that the clause numbered III included in the proposed definition of the word "subcontract" be reworded to read "articles for the general operation or maintenance of a plant owned by the contractor in those cases where the Government is not obligated to reimburse the contractor for the cost of such articles."

Attention is called to the fact that under the provisions of section 505 (b) of Merchant Marine Act, 1930, which provides for repayment to the Commission of certain profits derived under subcontracts, the Commission has heretofore defined the term "subcontract" so as to include a portion of the purchases of contractors made under clause II of the proposed definition of the word "subcontract."

Subject to the wishes of the committee, the Commission would be pleased to explain its position by illustrations of specific cases.

Yours sincerely,

E. S. LAND, *Chairman.*



RENEGOTIATION OF CONTRACTS

WEDNESDAY, SEPTEMBER 23, 1942

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

The committee met at 11 a. m. pursuant to adjournment, in room 310, Senate Office Building, Senator Walter F. George (chairman) presiding.

The CHAIRMAN. The committee will come to order, please.

STATEMENT OF RANDOLPH PAUL, GENERAL COUNSEL, TREASURY DEPARTMENT

The CHAIRMAN. Will you proceed with the additional suggestion you submitted?

Mr. PAUL. I have been asked by the War Department, and I understand the Navy Department is agreeable also, to suggest that there be added to the statement on page 43 of this confidential record of the hearing yesterday, suggested amendments.

The first is an addition to subparagraph 4 of paragraph (c) of section 403. It is printed on page 43. It is as follows:

No renegotiation of the contract price pursuant to any provision therefor or otherwise shall be commenced more than one year after the date of completion or termination of the contract as determined by the Secretary.

Senator LA FOLLETTE. Is that really new matter?

Mr. PAUL. Yes, that is new matter.

Senator LA FOLLETTE. Or is it a new idea?

Mr. PAUL. It is a new idea, and the thought behind it is to add a sort of period of limitation beyond which there shall be no renegotiation of the contract price.

Senator VANDENBERG. Does that affect the 3-year limitation?

Mr. PAUL. Yes.

The CHAIRMAN. That is what I wanted to get. Will you read it again, Mr. Paul?

(The statement was reread.)

Senator LA FOLLETTE. Where does it go in?

Mr. PAUL. As an addition to subparagraph 4 of paragraph (c) of section 403, which is printed toward the bottom of the page, page 43.

What I read would be in addition to that subparagraph 4.

Senator BARKLEY. Does it go in after the figure "403"?

Mr. PAUL. That is right.

Senator LA FOLLETTE. The effect of that is, as I understand it, to shorten the 3-year period to 1 year.

Mr. PAUL. I think that is true.

Senator TAFT. It is not only that. The 3-year period begins at the end of the war, whereas this begins at the end of the completion of the contract.

Mr. PAUL. Or determination by the Secretary.

Senator LA FOLLETTE. The net effect of it is, as far as anything that extended into the period, would be to cut that 3-year extension after the emergency to 1 year.

Senator VANDENBERG. What is the validity of the 3-year clause now with this in? Don't you have to repeal the 3-year clause?

The CHAIRMAN. It looks as if this would be in effect, a repeal of the 3-year clause, because where a contract was completed concurrently with the termination of the war—

Mr. PAUL (interposing). I think that the 3-year position is eliminated in this rewrite.

Senator RADCLIFFE. The 3-year clause and the 1-year clause are clearly inconsistent.

Mr. PAUL. I think the one submitted yesterday contemplates an elimination of the 3 years. It does; yes.

Senator VANDENBERG. Where?

Mr. PAUL. The 3-year provision just is not in there. This is a redraft of the whole section, and the 3 years is not there.

Senator DANAHER. Mr. Chairman—

The CHAIRMAN (interposing). Will you let Mr. Paul finish his statement?

Senator DANAHER. I think what I have to say is pertinent.

Mr. PAUL. I have another amendment to the next subparagraph.

Senator DANAHER. I think you should add the words "except in cases of fraud or mutual mistake of fact." We had that all up after the last war.

There were fraud cases and recapture suits for years after the war, and plenty of cases of fraud existed, and it does seem to me that we should not give anybody the benefit of a closing agreement which would avoid the possibility of its being reopened in the event of fraud or mutual mistake of fact.

Mr. PAUL. This is really not a closing agreement. It is simply a period of limitation, and of course what you are really saying is that the statute of limitations or the period within which there may be renegotiations should not be applied where there is fraud or mutual mistake of fact.

Senator TAFT. That is true of all statutes.

Mr. PAUL. It is true of all of our income-tax statutes. No limitation applies if there is fraud.

Senator TAFT. The language you suggested seems to me a little indefinite.

Mr. PAUL. The other suggestion which I have been asked to submit is an addition to—

Senator BYRD. Who asked you to submit this?

Mr. PAUL. Mr. Marbury of the War Department, and he told me that the Navy was agreeable.

Senator BYRD. Are you in favor of it?

Mr. PAUL. Yes; I think it is all right. Of course, the Treasury has much less concern about this than the War Department. We have a very small number of contracts compared with them, but I certainly would agree with the principle of it.

The CHAIRMAN. There is no objection to the suggestion made by Senator Danaher?

Mr. PAUL. I have no objection. I have no objection to the principle of it.

Senator BYRD. You said something about facts.

Senator DANAHER. Mutual mistake of fact. In other words, if both parties have made a mistake in the light of what this situation truly should be, and which both recognize to be true, then there might be a renegotiation.

Senator LA FOLLETTE. It is apparently a two-way street.

Senator DANAHER. It has to be mutual.

Senator RADCLIFFE. Does that apply to the Maritime Commission also?

Mr. PAUL. I cannot say. I will be glad to communicate with the Maritime Commission and insert their attitude on that point.

Mr. STAM. I notice under the closing agreements relating to the Internal Revenue taxes, it provides that such agreement shall be final and conclusive except upon a showing of fraud or malfeasance or misrepresentation of a material fact.

Is that about what you had in mind?

Mr. PAUL. That is a one-way street.

Senator DANAHER. I am trying to make it in favor of both, if there be a mutual mistake of fact—if in the accounting, or excess reserves, or something of that character, were so, then both parties clearly would want to be in a position to renegotiate an agreement. If operates both up and down.

Mr. STAM. But both would have to agree on that?

Senator DANAHER. Both would have to agree on a mutual mistake of fact.

The CHAIRMAN. I would not think there would be any objection to that principle being written in in the proper language.

Senator DANAHER. I don't care how it is worded particularly.

The CHAIRMAN. What is the other suggestion?

Mr. PAUL. I would like to suggest that the possibility that Senator Danaher has in mind, should be dealt with in subparagraph 3, which deals with closing agreements.

Senator BARKLEY. That language ought to be drawn so that a mutual mistake is one that both parties make at the same time. That is different from a mutual agreement that there had been a mistake made.

Senator DANAHER. This last would be an after-fact.

Senator BARKLEY. You said where there was fraud or mutual mistake of facts. That means that both of them were mistaken at the time the contract was made. I think it ought to be a mutual agreement that there was a mistake, because both of them might not have made it at the time.

Mr. PAUL. Senator Danaher's language does not necessarily mean that. He means not that there be an agreement later, but that there would have been a mutual mistake of fact at the time originally.

Senator DANAHER. That is right, that both parties were wrong in assuming a state of facts to exist.

Senator RADCLIFFE. I understand that the Government could insist upon reopening of the case, notwithstanding the objection of the contractor provided that it was based upon a mistake or of fraud.

Mr. PAUL. I think the contractor could insist on a reopening if the contractor should show that there was such a mistake of fact.

Senator BARKLEY. I did not want to have them both agree later on that there was a mutual mistake.

Mr. PAUL. No, I do not think that would be true; certainly, I think that should be clarified if there is any doubt on the point.

Now, the other amendment suggested is to add a new subparagraph No. 5 to subsection (c).

That would go in right after No. 4, at the bottom of page 43, and I will read the suggested amendment:

Any contractor or subcontractor who holds contracts or subcontracts, to which the provisions of this subsection (c) are applicable, may file with the Secretaries of all of the Departments concerned statements of actual costs of production and such other financial statements for any prior fiscal year or years of such contractor or subcontractor, in such form or detail, as the Secretaries shall prescribe by joint regulation. Within one year after the filing of such statements, or within such shorter period as may be prescribed by such joint regulation, the Secretary of a Department may give the contractor or subcontractor written notice, in form and manner to be prescribed in such joint regulation, that upon a review of the statements filed the Secretary is of the opinion that the profits realized from some or all of such contracts or subcontracts may be excessive, and fixing a date and place for an initial conference to be held within 60 days thereafter. If such notice is not given and renegotiation commenced within such 60 days the contractor or subcontractor shall not thereafter be required to renegotiate to eliminate excessive profits realized from any such contract or subcontract during such fiscal year or years and any liabilities of the contractor or subcontractor for excessive profits realized during such period shall be thereby discharged.

That of course, is to take care of the type of situation brought forth by Senator Taft yesterday where the Department does not get around to particular cases.

Senator TAFT. Mr. Chairman, the conclusion that the 3-year period is not in the act is a mistake; it is in the act.

Mr. PAUL. It is quite true that the 3-year provision remains.

However, with these added provisions, that have been suggested by the War Department, the only effect of that 3-year provision would then be that if some particular contract were not completed until after the war, the 1-year provision will apply to all contracts completed up to—well, in practical effect, up to 2 years after the war.

Senator TAFT. You do not think they conflict? You mean this is a kind of an inside statute additionally?

Mr. PAUL. Practically.

Senator RADCLIFFE. I do not quite catch that point. I thought the amendment offered was 1 year from the completion of the contract, whether that was during the war or after the war.

Mr. PAUL. Completion or termination of the contract.

Senator RADCLIFFE. Either during the war or after the war, is not that so?

Mr. PAUL. Yes.

Senator RADCLIFFE. I did not get that point a moment ago as to what happened if it was completed after the war.

Mr. PAUL. The general authority in the Secretaries of War and Navy to renegotiate pursuant to this statute is effective up until 3 years after the end of the war, but the department suggests that, as to any particular contract, no renegotiation may be commenced more than a year after the completion of that contract.

Senator RADCLIFFE. Are they not inconsistent?

Mr. PAUL. Not necessarily. There may be contracts which will not terminate until considerably after the war.

Senator RADCLIFFE. I know, but I understood the amendment was that it was 1 year after the contract was completed, and I understood it was either during the war or after the war. What difference does it make? You are fixing a period of 1 year during which a renegotiation can be effected. Is there any particular significance in making a distinction as to whether it is during the war or after the war?

Mr. PAUL. No; there is no distinction.

Senator RADCLIFFE. Then I do not see just where the 3 years is still in the picture.

Mr. PAUL. The 3 years' vision will cut off this section entirely 3 years after the war.

What the 3-year provision says is that this section shall remain in force during the continuance of the present war and for 3 years after the termination of the war, but no court proceedings brought under this section shall abate because of the provisions of this section.

Senator TAFT. It would apply to contracts made after the war, would it not?

Mr. PAUL. Yes; by its terms it would. It merely is a period within which the section, however it may be worded, is in effect. There is no provision there for any 3-year limitation.

The provision simply says that the section shall remain in force. That would apply to the whole section.

Senator RADCLIFFE. In other words, this is an attempt to fix a period within which the 1 year will operate?

Mr. PAUL. That is right.

The CHAIRMAN. This brings up this whole question. There is another amendment that has been submitted to me. It may be covered in the recommendations made yesterday by Mr. Marbury on behalf of the War and Navy and with one exception, on behalf of the Maritime Commission, and this is the substance of the new amendment which is suggested, and the new amendment which is suggested and the new amendment itself discloses on whose behalf it is submitted:

The term "contract" and "subcontract" includes respectively all contracts and subcontracts except contracts and subcontracts for the purchase of natural-resource products or of any general commercial commodity which is produced from natural-resource products, and in which the purchase price does not exceed a specified ceiling price which has been, or may be hereinafter, established by statute or by the Office of Price Administration or other Government agency.

I would like to inquire first whether the substance of that is covered in the recommendations.

Mr. PAUL. I think it is, but I think the Maritime Commission was opposed to that.

The CHAIRMAN. I understood that; yes.

Senator CONNALLY. Is that the so-called exemption of raw materials?

Mr. PAUL. Where there is a price ceiling.

Senator CONNALLY. I understood Mr. Marbury yesterday to favor that.

The CHAIRMAN. Yes; but the Maritime Commission did not agree. My thought is that this is an impossible situation that you are in under this renegotiation.

I am still convinced that that is true.

I think that the full power and authority of negotiation, is of course, lodged in these departments and should remain there, but the power to renegotiate even under these clarifying amendments as suggested, and curative amendments suggested by Mr. Marbury, does not seem to me to reach the crux of this problem. I am very definitely of the opinion that you are going to slow down production; that you are going to have a great many contractors declining contracts or endeavoring to decline them, and declining them as far as they can with this renegotiation law standing.

With that in view, I have prepared a substitute for the whole thing, and it was based upon repeal. I am not going to read it all, because I have a further suggestion to make, but the effect of it is to say that there shall be imposed upon every war contractor, and "contractor" is of course defined in this amendment, and which it is unnecessary to read--

for such taxable year ending after the date of the enactment hereof a tax of 100 percent of the amount by which his profit limit or his income exceeds 5 percent of his volume for war contracts.

I want to make this further suggestion, that it should be further amended, in my judgment by a limitation of 100 percent on all contracts, where the Government is furnishing the plant, or operating capital.

And in the case of a relatively few contracts, long-term turn-over, the 5 percent may not be adequate, but with those two exceptions I think we ought to repeal this act altogether and make this substitution. I think it will fit in with our excess-profits tax, and our whole revenue scheme and I think that this renegotiation is wiping out your excess profits, practically, so far as war contracts are concerned. They constitute certainly 50 to 60 percent of all of the excess profits that you are going to get under the excess profits provision.

Now, may I make this further statement--

Senator WALSH. Who will administer this?

The CHAIRMAN. This will be part of the tax act.

Mr. PAUL. You base your percentage on volume. Is that really a sale. By "volume" do you mean sales?

The CHAIRMAN. Yes. And section 2 "volume" is defined. I undertake to set up a whole scheme here which has not been studied by the Treasury—I understand that there is a great deal of merit in the suggestion made by Mr. Marbury, in my judgment, in behalf of the War, Navy, and the Maritime Commission and Treasury and Mr. Henderson has added his voice to it also, and we ought to very carefully consider the whole problem before repealing the renegotiation contract act. It ought to be given very careful consideration, and whatever is substituted for it, of course, ought to be very carefully scrutinized.

My thought is, if the committee concurs in it, that this committee ought to appoint a subcommittee with the authority to report a floor amendment during the consideration of this tax bill, and that its report should have the approval of the committee as far as the committee can conscientiously support it, just as any other provision in the tax bill, of course. Nobody is absolutely bound to go along with everything in the tax bill because he is on this committee without even making any special reservations, and it might be wise to under-

take to amend as suggested by Mr. Marbury yesterday, if such modifications can be made to meet the objections, insofar as they seem meritorious by the Maritime Commission, as to the one recommendation, and with the additional recommendations made by Treasury, that it also be included in the renegotiation of contracts, which it is required to make, which, as I understand it, applies very largely to the Lend-Lease Act of the program.

Mr. PAUL. That is right.

The CHAIRMAN. And together with the amendments this morning-- in other words, it might be that the subcommittee might very properly conclude to disregard the suggestion that I am making for an outright repeal, although I do wish it studied by the subcommittee, and report only amendments on the floor when the tax bill is brought before the Senate. I make that suggestion because we are dealing with an outside law.

The Appropriations Committee of the Senate probably feel keenly that they have a responsibility and an interest in preserving it, and I am not at all sure that the departments are not right in their view of the situation.

Senator LA FOLLETTE. I move that the Chair be authorized to appoint a subcommittee, and that the amendments suggested by Mr. Marbury be referred to the subcommittee, together with any suggestion the chairman may desire to submit.

The CHAIRMAN. These are the only suggestions I desire to submit.

Senator CONNALLY. On that point Senator McKellar has approached me several times, desiring to appear before the committee. I presume, if you adopted this motion, he could appear before the subcommittee?

The CHAIRMAN. That would be the purpose of it, that he could appear before the subcommittee. And I would most anxiously wish to avoid a floor controversy over outright repeal, and as far as possible, over even amendments to the existing law, and I repeat that I think there is a great deal of force in the suggestions in which all of the department heads have concurred, that no outright repeal or drastic amendments be considered, until they have been very carefully scrutinized and the whole picture looked at and in a comprehensive fair way.

Senator VANDENBERG. I wish Senator La Follette would extend his motion to include a provision that the chairman of the committee shall be the chairman of the subcommittee.

Senator LA FOLLETTE. I would be very happy to do that if the chairman will accept that responsibility.

The CHAIRMAN. I did not want to do that because I had so many other things to do.

Of course, any amendment might be considered, but as a basis of the subcommittee's deliberation, we have certain amendments that have been submitted to us; and I wish to repeat that while I will not be on the subcommittee, I am submitting a draft which I have prepared here to the subcommittee for its scrutiny, and that can be put in the record.

But, I will turn it over to the subcommittee. My belief is that it would not, perhaps be wise to undertake the outright repeal at this time, and without very careful study, but that certain amendments can certainly be made, and that the draft which I have proposed

might have some value to the subcommittee in performing its work on this matter.

As I understand now, Senator La Follette has made a motion with respect to what I suggested—or substantially—and with the modifications that have also been suggested. If so, I am ready to put the question, unless there is some further consideration. (The motion was carried.)

The CHAIRMAN. I will appoint on this subcommittee, as I presume the members of the committee will have time to give some consideration to it, a committee of at least seven Senators, so that the matter may be given consideration.

I will name Senator Walsh, Senator Barkley, Senator Connally, Senator Clark, Senator La Follette, Senator Capper, and Senator Vandenberg. Senator Walsh, I will turn this draft over to you.

(The draft referred to is as follows:)

SEPTEMBER 7, 1942.

PROFIT LIMITATION

OUTLINE DRAFT OF PROPOSED TAX LIMITING EXCESSIVE PROFITS AFTER OTHER TAXES

It has been suggested that excess war profits may be effectively prevented, without unduly distracting war contractors from the primary job of winning the war by a 100 per centum tax upon profits after Federal income taxes which exceed 5 per centum of contract prices. This is an outline of a statutory provision to accomplish this result.

Sec. 1. *Definitions.*—(a) *War contractor.*—“War contractor” means any person having one or more war contracts as defined herein and having an annual total volume from such contract or contracts in excess of \$250,000.

(b) *War contract.*—“War contract” means a prime contract or subcontract as defined herein.

(c) *Prime contract.*—“Prime contract” means:

(1) A contract with the United States entered into on behalf of the United States by an officer or employee of the War Department, the Navy Department or the United States Maritime Commission; or

(2) A contract with a person having a contract of the type described in paragraph (1), to produce or furnish substantially the same service or completed unit as that to be furnished under such contract of the type described in paragraph (1).

(d) *Subcontract.*—“Subcontract” means:

(1) A contract in excess of \$1,000 to perform work or services for a person having a prime contract, directly upon the supplies or services to be furnished under such prime contract or upon articles to be incorporated in such supplies. At the time of making such contract, the person having a prime contract shall notify the subcontractor that the work or services to be performed are with respect to the supplies or services to be furnished under the prime contract. Any person having a prime contract who wilfully or fraudulently fails thus to notify the subcontractor shall, upon conviction thereof, be punished by a fine of not more than \$1,000 or imprisonment for not more than six months, or both.

(2) A contract to furnish articles or services with respect to which the Secretary of War, Secretary of Navy, or the Chairman of the Maritime Commission certifies as follows:

(A) That such articles or services are flowing directly into the war effort;

(B) That such contract is so directly connected with the war effort that the profits derived therefrom are war profits; and

(C) That such Secretary or Chairman believes that the profits from such contract are or will be so large that a portion thereof will be subject to payment of the profit-limit tax imposed hereby.

In every case in which such Secretary or Chairman intends to make a certificate hereunder, notice of such intention shall be served upon the person having such contract not later than the fifteenth day after the end of the taxable year of such person. After such notice is served upon such person and not later than 75 days after the end of such taxable year, such Secretary or Chairman shall grant such person an opportunity for a hearing with respect to the making of such a certificate. If after such hearing is held, a certificate hereunder is made, it shall be

made, and copies thereof served upon such person and furnished to the Commissioner of Internal Revenue, not later than 90 days after the end of such taxable year.

(c) *Volume*.—"Volume" means net sales and the gross amount received for services, including the amounts billed to the Government by the contractor under any cost-plus-a-fixed-fee contract.

SEC. 2. *Profit limit tax*.—There shall be imposed upon every war contractor for each taxable year ending after the date of enactment hereof, a tax of 100 per centum of the amount by which his profit limit net income exceeds 5 per centum of his volume from war contracts.

SEC. 3. *Definition of profit limit net income*.—(a) "Profit limit net income" means net income from war contracts reduced by the sum of—

(1) Federal income taxes for the taxable year attributable to war contracts; and

(2) The amount of the profit limit carry-over (as hereinafter defined), if any.

(b) For the purposes of this section, "net income from war contracts" means:

(1) An amount equal to the same proportion of total net income (determined in accordance with ch. 1, I. R. C. and, in the case of corporations, excluding dividends and capital gains) that gross receipts from war contracts are of total gross receipts (in the case of corporations, excluding dividends and amounts realized upon casual sales of property) for the taxable year; or

(2) If the war contractor establishes to the satisfaction of the Commissioner that in his books and records, gross income and deductions from any war contract are segregated, and that in such segregation a fair and reasonable allocation of costs is made in accordance with accepted accounting principles, then with respect to such war contract, net income from war contracts means the actual gross income from such contract reduced by the actual deductions attributable to such contract (both determined in accordance with ch. 1, I. R. C.). If this paragraph is applied with respect to any war contract, then gross receipts from such war contract shall be eliminated in computing the ratio specified in paragraph (1).

(c) For the purposes of this section, Federal income taxes for the taxable year attributable to war contracts means an amount equal to the same proportion of total Federal income taxes for the taxable year (computed without regard to the foreign tax credit), that net income from war profits is of total net income (determined in accordance with chapter 1, Internal Revenue Code and, in the case of corporations, excluding dividends and capital gains).

(d) "Profit limit carry-over" means the amount, if any, by which 5 per centum of total volume for all prior taxable years commencing after December 31, 1941, exceeds total net income from war contracts for all such years reduced by total Federal income taxes attributable to war contracts for all such years. For the purposes of this subsection, the total amounts referred to shall be computed by adding together the amounts separately determined for each such taxable year.

SEC. 4. *Returns and computation of Federal income tax*.—(a) Returns with respect to the tax imposed herein shall be filed by every war contractor within 75 days after the date on which other Federal income-tax returns are required to be filed (including the period allowed by any extensions of time) and shall be filed for the same taxable year as that used for other Federal income-tax purposes.

(b) The amount of Federal income taxes for purposes of section 3 shall be the amount of the liability therefor determined for the taxable year under the applicable provisions of the Internal Revenue Code. If the amount shown on the taxpayer's income-tax returns shall later be adjusted by the Commissioner, by the Board, or by any court, then the amount shall be adjusted accordingly for the purposes of the tax imposed herein. If as a result of such an adjustment, the tax imposed herein is determined to have been overpaid, the taxpayer shall be entitled to a credit or refund of the amount of such overpayment, and if the tax imposed herein is determined to have been underpaid, then the amount of such underpayment shall be assessed and collected in the same manner as a deficiency in income tax.

SEC. 5. *Administration, jurisdiction, and controversies*.—(a) The tax imposed herein shall be assessed and collected in the same manner as other income taxes.

(b) Liability for the tax imposed herein shall be determined with respect to each taxable year. Deficiencies may be asserted by the Commissioner in the same manner as with respect to other Federal income taxes, in which case the tax payer shall have the same rights as in the case of other Federal income taxes. Procedure with respect to refunds shall be the same as in the case of other Federal

income taxes. No refunds shall be made for any year prior to the taxable year in which occurs the cessation of hostilities because a profit limit carry-over exists in a later year.

(c) Any statute of limitations otherwise applicable to the assessment and collection of deficiencies or the allowances or making of refunds or credits of tax under this chapter shall not expire prior to two years from the date of cessation of hostilities.

(d) Interest shall not run with respect to deficiencies or overpayments until the date of cessation of hostilities.

SEC. 6. *Final settlement at end of war.*—(a) At the end of the taxable year in which occurs the cessation of hostilities, there shall be a redetermination as to the amount, if any, of liability of the war contractor for the tax imposed herein, for the entire period commencing with the first taxable year ending after December 31, 1941, and ending with the taxable year in which occurs the cessation of hostilities.

(b) For the purposes of such redetermination, the final amount of the tax imposed herein shall be 100 per centum of the amount, if any, by which the total of profit limit net income for such entire period exceeds 5 per centum of the amount of the total volume from war contracts for such entire period. For the purposes of this subsection, the total amounts referred to shall be computed by adding together the respective amounts separately determined for each taxable year in such entire period.

(c) If the final amount of tax computed as provided in subsection (b) exceeds the amount of tax theretofore payable, such excess shall be assessed and collected in the same manner as a deficiency in other Federal income taxes. If the amount of tax theretofore payable exceeds the final amount of tax computed as provided in subsection (b), the war contractor shall be entitled to a refund or credit of the amount of such excess, to be made in the same manner as a refund or credit of other Federal income taxes.

(d) Not later than five months after the end of the taxable year in which occurs the cessation of hostilities, the taxpayer shall file a final return computing the amount of final liability for the tax imposed herein. The period of the statute of limitations for collecting deficiencies or refunds with respect thereto shall be the same as in the case of other Federal income taxes, except that if a controversy is still pending for any taxable year during said entire period with respect to (1) the amount of the tax imposed herein, or (2) the amount of any other Federal income tax, the statute of limitations shall not expire prior to a date six months after a final determination is made with respect to such controversy.

SEC. 7. *Cessation of hostilities.*—For the purposes of this chapter, "cessation of hostilities" means the date on which substantial hostilities in the present war between the United States and the Governments of Germany, Japan, and Italy have ceased.

SEC. 8. *Repeal of provision for renegotiation.*—(a) Section 403 of title IV of the Sixth Annual Supplemental National Defense Appropriation Act, 1942, approved April 28, 1942, is hereby repealed, effective as of April 28, 1942.

(b) Since the provisions of this subchapter are adequate to prevent the realization of excessive war profits, the War Department, the Navy Department, and the Maritime Commission shall not conduct renegotiation of contract prices with contractors, and all provisions for renegotiation of prices heretofore or hereafter inserted in contracts made on behalf of the United States by said Departments or said Commission shall be void and of no effect; *Provided*, That nothing contained herein shall preclude the United States and any contractor from entering into a voluntary agreement to reduce the price provided in any contract.

The committee will meet tomorrow at 10 o'clock, and it will be our last meeting until the bill is printed, at least.

(The following memorandum to Hon. Joseph E. Guffey, United States Senator from Pennsylvania, was offered and ordered inserted in the record:)

MEMORANDUM OF CONFERENCE ON RENEGOTIATION OF WAR CONTRACTS

A manufacturing corporation, about two-thirds of whose production is going into war articles, was called to Washington for a conference on the renegotiation of contracts.

The matter originated by a telephone call from an official of the War Department, asking for certain information. The company asked to have a written request. This request was received in the form of a letter which stated that the

request was being made under the terms of section 403, title IV, of the Sixth Supplemental National Defense Appropriation Act of 1942, and asked for the following information:

1. Your income statement in as much detail as possible for such period of this year as is available and a comparison of the previous 5 or 6 years.
2. Your balance sheet on the same basis as your income statement.
3. A copy of your income tax report for 1941.
4. An estimate of your 1942 business showing what portion you contemplate with the Government and with civil.
5. Your estimated 1942 Government business divided into the different Government agencies with whom you have contracts.

The company officials took the information to Washington and had an interview with representatives of the War Department. The interview was conducted by —, a man named —, and another man named —. In the course of this discussion the company officials were told that it was the policy of the War Department to consider all the contracts of the company as a whole; that the broad objective was to work out an arrangement that would make it possible for the War Department to recapture any profits before taxes in 1942 that were in excess of the average profits before taxes for the years 1936 to 1940, inclusive. They would told that the year 1941 would not be included.

The company officials stated that that sounded to them like an effort to renegotiate the company's profits, and not its contracts, and that such a proceeding would result in the company paying to the War Department a portion of its income and excess-profits taxes instead of paying them into the Treasury. It was also pointed out that by such a process the profits, if any, which the company made on its normal civilian business would be paid over to the War Department. The so-called renegotiating committee replied that such was the case but that it was desirable to handle the situation this way because in the case of income and excess profits taxes, if paid into the Treasury, the funds would thus be made subject to appropriation by Congress, whereas such refunds as might be made directly to the War Department would be immediately available for the further purchase of war materials and would not be subject to another appropriation by Congress. Such a method would mean that the original appropriations would not have to be increased to take care of additional requirements. The committee of the War Department, however, pointed out that they would consider separating the profits into those arising from war business and those arising from civilian business.

The financial statements of the company were examined and the committee suggested that the company should offer several million dollars to the War Department as representing its increased profits over the so-called base years, and asked for an offer that day. The officials were astounded and said they could not make any such offer without considering the matter with their board of directors. They left and were told to make an offer within a week.

It was also suggested by the representatives of the War Department that in the event the company did not care to offer a cash refund of profits, arrangements might be made for the company to furnish an increased number of units on Government contracts already existing, to equalize the amount of cash which otherwise would be refunded. The company pointed out that the year 1942 was not concluded; that there might be losses, strikes and floods, or other occurrences, and they thought that if there was to be any adjustment for 1942 it should not take place until after the year closed. The committee suggested, however, that if that was the case the taxes would already be paid and the War Department would only get back the balance, and they were interested in getting the larger amount without deduction for taxes.

If this is the War Department's idea of the renegotiation of contracts, it is going to be a very serious matter. This is not renegotiating a contract, but amounts to voluntarily paying over to the War Department a portion of a company's profits. All kinds of questions might arise as to whether or not you were even then protected from further renegotiation, whether or not the officers of a company had a right to give up profits in this way, and various other matters.

I know the officials of the company involved. Of course they are anxious not to be disclosed until other companies have been approached in the same way, but I am passing this information on to you for your consideration.

(Whereupon, at 12 noon, the committee recessed until 10 a. m. Thursday, September 24, 1942.)