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THE ACQUISITION OF WEAPONS SYSTEMS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON PRIORITIES AND ECONOMY IN GOVERNMENT

OF THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

NINETY-SECOND CONGRESS

FIRST SESSION

AND

SECOND SESSION

PART 5

SEPTEMBER 28 AND 29, 1971, AND MARCH 27, 28, AND 29, 1972

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TUESDAY, SEPTEMBER 28, 1971

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON PRIORITIES AND
ECONOMY IN GOVERNMENT OF THE
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:15 a.m., in room S-407, the Capitol, Hon. William Proxmire (chairman of the subcommittee) presiding.

Also present: Richard F. Kaufman, economist; Lucy A. Falcone, research economist; Walter B. Laessig, minority counsel; and Leslie J. Bander, economist for the minority.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The subcommittee will come to order.

Since December 1969, this subcommittee has been studying, among other things, the problems of shipbuilding claims against the Navy. What we have learned so far is no cause for joy to Congress, to the taxpayers, or to anyone in the Navy or the shipbuilding industry sincerely interested in creating an effective, first-classed Navy.

I would like to reiterate in opening these hearings that our basic purpose is to examine the procedures by which claims are settled and attempt to determine if the settlements are made in such a way that there is strong legal support for them, on the one hand, and that the contractors have adequate protection against Government mistakes, bureaucratic stonewalling, and delay, on the other.

If in the course of these proceedings the names of specific companies come up, I hope very much that the press and the public will keep in mind that they are illustrative of the problems which are faced and that the purpose of these hearings is not to pillory any company or person.

If in the course of the proceedings any one feels that they have been unfairly dealt with, I offer them the opportunity to state their case and to answer any issues or questions, either immediately if possible or at a date which we can mutually set up in hearings in a public forum. I know these are delicate matters and enormous sums are involved and contractors and others may feel that they have not been given fair opportunity and if they would want to testify I will be delighted to have them come up and do so.

For the past 3 years, approximately $800 million to $1 billion in shipbuilding claims have been pending or have been in the process of being filed against the Government. In this period, about $160 mil-

lion has been paid out for claims settlements, not including amounts that have been paid provisionally for claims that have been filed but not yet settled, and not including claims under $5 million each. None of the newer programs, those for which contracts have been awarded in the past 2 years or so, are represented in these figures.

One of the most unhappy facts about the shipbuilding industry in the past several years is the reduction in the number of major shipyards and the concentration of the Navy's contracts in the few remaining yards. In effect, the Navy is putting all of its shipbuilding eggs in very few baskets. An example is the Litton Shipyard which, since 1969, has been awarded contracts for the LHA—landing helicopter assault ship program, and the DD–963 destroyer program. In addition, Litton is a major supplier of submarines and ammunition ships.

Some of us in Congress have raised questions about the propriety and the wisdom of placing so many shipbuilding programs in a single yard. If Litton follows the recent trend, we can expect to see huge new shipbuilding claims filed against the Navy in the near future.

These are significant sums of money, and when the Navy wonders why Congress does not appropriate all the funds that it would like for new shipbuilding programs, it ought to reflect on how much of what Congress has appropriated goes not for new ships but for claims against old ships.

In addition to the sums of money involved, the claims problem is a disturbing one for other reasons. The quality of at least one of the programs that has been a major source of claims has been questioned by experts in and out of the Navy. In a recent article published in the U.S. Naval Institute Proceedings, Navy Capt. Robert H. Smith called the DE–1052 "the greatest mistake in ship procurement the U.S. Navy has known."

Our witnesses this morning will perhaps want to comment on that conclusion. We are pleased to welcome Rear Adm. Nathan Sonenshein, commander, Naval Ship Systems Command and Gordon W. Rule, chairman of the Contract Claims Control and Surveillance Group. Both of these gentlemen have served the United States with great distinction for many years. They are intimately familiar with both the procurement of ships constructed for the Navy and with the claims problem. Both have testified before this committee before, and I appreciate their willingness to appear before us again.

Admiral Sonenshein, we have your prepared statement. You may proceed in any way that you wish. The entire prepared statement will be printed in full in the record and any tables or statistics that you would like to have included, we will be happy to put that in the record too.

STATEMENT OF REAR ADM. NATHAN SONENSHEIN, COMMANDER, NAVAL SHIP SYSTEMS COMMAND

Admiral SONENSHEIN. Thank you, Mr. Chairman.

I appreciate your invitation to appear before your committee to discuss the settlement of shipbuilding claims, particularly those concerning Lockheed Shipbuilding & Construction Co. and Avondale Shipyards, Inc.

Background of Shipbuilding Claims

I feel that to facilitate your understanding of the problems involved, some background should be provided regarding shipbuilding claims. When I assumed command of the Naval Ship Systems Command in August 1969, the shipbuilding claims on hand, plus those which were expected to be submitted, totaled between $800 million and $1 billion. Of these, Lockheed and Avondale had submitted claims amounting to $159 million and $143 million, respectively, which I will address specifically later in my statement. In the aggregate, the shipbuilding claims were based on allegations that Government specifications were inconsistent, ambiguous, deficient, or impossible to perform; that additional Government requirements had been placed on the contractors; that Government-furnished material was defective or delivered late; and that excessive quality assurance requirements had been imposed. Several of the claims were over 1 year old and some were over 2 years old. There was concern in the Navy and Department of Defense, as well as in Congress, over the size of claims, the method of handling claims, and the need to minimize future claims.

One of my first acts was to initiate a method for the systematic resolution of claims. Another early action taken by me upon assuming command of the Naval Ship Systems Command was to establish a positive program to strengthen the management of the Navy's shipbuilding effort and thereby minimize the generation of future claims. Since the main topic today is claim settlement, I shall not go into detail on claim prevention actions unless you wish to discuss it further. For the record, however, that program is referred to as the shipbuilding and conversion improvement program. It consists of a large number of interrelated and specific actions that should eliminate or minimize the effect of the causes of ship claims. I will cite one example.

A recurrent cause of cost growth and claims in ship construction contracts has been the failure of anticipated developmental items to occur as planned. That failure would often result in a costly delay in essential Government-furnished material. To combat the problem, we now require the program managers to take three specific actions on shipboard equipments which are to be supplied to the contractor by the Government for installation in the ship:

(1) Each item of equipment must be categorized as to the degree of developmental risk if it is not an already developed and available piece of equipment.

(2) For high-risk development items, the project plan must identify the substitute equipment to be furnished or other alternative to be followed in the event that the planned equipment is not available on schedule.

(3) The project plan must be more realistic than in the past with respect to the availability of Government equipment. Also, the project manager is required to monitor the deliveries of Government equipment closely to expedite and substitute where necessary.

I believe the shipbuilding management improvement efforts I initiated were constructive and that they will go a long way toward holding down the volume and size of possible future shipbuilding claims.

Incidentally, the General Accounting Office has recently reviewed

the shipbuilding and conversion improvement program, which is now nearly 2 years old, to determine how effectively it has been implemented. I understand that a draft report of that study has been issued.

Lockheed and Avondale Claims

Now, let me return to the main item of discussion today, namely the methods followed in arriving at tentative, proposed settlements of the claims submitted by Lockheed and Avondale.

Normally, the negotiator or contracting officer will determine the Government's negotiation position and conduct negotiations on behalf of the Government on the basis of information developed by the engineers, lawyers, and auditors. Large and complex negotiations such as these which are under discussion here usually require decisions at the highest corporate level to commit the contractor to a settlement which may result in dollar losses in the millions. It is not inappropriate for the commander of the Naval Ship Systems Command to become involved with his counterparts. In view of the 15-minute time you indicated should be limited to the oral presentation, I will omit reading certain portions of Secretary Chafee's letter of May 28, 1971, to you which in response to your questions following the committee's hearings on the 28th and 29th of April furnished information on the procedures followed by the Navy in the handling and settlement of shipbuilding claims.

As I stated earlier, the high dollar amount of the claims already received plus those in immediate prospect dictated that special action be taken to permit prompt command decisions necessary to resolve problems as they arose during the investigation and disposition of the claims. Accordingly, a staff position, titled "Special Assistant for Claims" and reporting directly to me, was established in September 1969. In December 1969 a claim settlement program was issued.

Target dates were established for resolution of each of the onhand claims based on the settlement procedures I have just discussed. But, by March of 1970 it was apparent that the established schedules could not be met unless action was taken to accelerate the procedures. It was not intended, however, to let adherence to schedules result in premature or improvident settlements.

In March 1970 we modified our procedures by specifying that as soon as the lengthy investigative phase was essentially completed, a command position would be established on the basis of the written or oral advice of the claim team members, the special assistant for claims, NAVSHIPS counsel and the project manager. The command position was to be the basis on which negotiations toward settlement could commence. Documentation of the findings and recommendations of team members was to be prepared after the command position was established but prior to submission of postnegotiation clearance request.

Prenegotiation positions on the Lockheed and Avondale claims were determined in this way, and negotiations thus were commenced with the knowledge of the Chief of Naval Material and Assistant Secretary of the Navy (Installations and Logistics).

You will appreciate that we are still negotiating the subject claims with both shipbuilders and that in case we should fail to reach final

agreement, these claims could all end up in quasi-judicial proceedings before the Armed Services Board of Contract Appeals and even before the courts. To divulge any of the Government's evaluation or position with respect to any specific items of the claims could prejudice our negotiating position. The tentative settlements have not been approved at any of the higher Navy echelons, and the resolution of these claims may yet be thrown into the disputes procedure, which is essentially a judicial process. In such event, the attorneys for the claimants could utilize that portion of the Navy's public disclosure which might be of benefit to their clients. It is for this reason that we are reluctant to disclose our internal technical, legal, and audit analyses of the subject claims. Furthermore, it could benefit other contractors in their claim submissions.

Both the Avondale and Lockheed claims involve contracts for DE–1052 class ocean escorts which were awarded in July 1964, on the same day that Todd received its contracts for seven ships each at Seattle and San Pedro. Avondale claims also cover the contract for 20 similar ships of the DE–1078 class which was awarded 2 years later. Lockheed's other claims concern three contracts for LPD-class ships (landing ships, dock) which were awarded in 1963, 1964, and 1965. Lockheed has delivered all its LPD-class vessels and one of the five DE–1052 class ships. Avondale has delivered all seven DE–1052's and three of the DE–1078 class ships.

The first of the consolidated type of claims was received from Todd in 1967. This claim was based on estimates, as was its evaluation by the Naval Ship Systems Command. The settlement of the claim in March 1969 was approved by the contract clearance group in the Naval Material Command. It was not until a General Accounting Office report was released in April 1971, to which I will refer later in more detail, that questions were raised as to the adequacy of settlements based on estimates and engineering judgments.

Both Avondale and Lockheed presented their claims in a similar form, using estimates in arriving at their claimed amounts. The Avondale DE–1052 claim was submitted at the end of January 1969 and the DE–1078 claim in September 1969. Lockheed submitted its LPD claims in January–February 1969 and the DE–1052 claim in May 1969. All three firms, by the way, used the services of the same Washington law firm in putting together their claims.

The Naval Ship Systems Command formed special teams to evaluate the Lockheed and Avondale claims and the estimates on which they were based. The same negotiator and chief engineer who were responsible for the evaluation of the Todd claim headed the effort on Avondale and Lockheed claims. The Navy claim evaluation teams have devoted over 2 years to reviewing the contractors' estimates and their underlying rationale. Much of this time has been spent onsite at Avondale and Lockheed and has included extensive discussions with responsible contractor personnel.

On the basis of the analysis of the contractors' estimates engineering and technical judgments were formed as to their validity and supportability, and a Government position was established with respect to each. These positions were presented as supportable by the team engineer and negotiator as well as my special assistant for claims, who had the overall responsibility for claim settlements.

At this point it was vital to ascertain whether (*a*) agreement could be reached with the contractors and the issues resolved under the terms of the contracts or (*b*) agreement could not be reached, leaving the parties to pursue the disputes procedure.

Discussions were then carried out with each contractor over a period of some 4 to 6 months, and it was determined that agreement could be reached. Tentative agreements were successfully achieved in December 1970 with Avondale and January 1971 with Lockheed for full settlement of the claims within the ranges of the previously established Government positions. No final commitments have been made.

It was my understanding that full documentation for the proposed settlements would be available shortly. Normally, we would expect to have all documentation in support of the proposed settlements completed and the business clearance submitted for approval within 60 days, even when the technical documentation is in draft form, as it was in these cases. However, in reviewing the technical analysis reports to prepare the legal memorandum of entitlement, Navships Counsel found instances where the technical documentation which had been made available to him did not support the conclusions and recommendations on which the tentative settlement was based. Consequently, detailed reevaluation of portions of the technical analysis reports and their backup documentation was undertaken. Although this effort resulted in a more detailed identification of the supporting documentation, it was still primarily concerned with validating the estimates and engineering judgments on which both the claims and their evaluation had been based. After this was completed, a legal memorandum of entitlement was prepared.

GAO Report on Todd Claim

The General Accounting Office, in the meantime, had reviewed in depth the settlement of the DE–1052 claim with Todd. The final GAO report was received at the end of April 1971. This report was somewhat ambivalent. On the one hand, it stated that the Navy had obtained as good a settlement as possible; on the other hand, the report indicated that the claims evaluation should not be based on estimates and engineering judgments alone, but should be supported by more tangible evidence, particularly in the area of delay and disruption costs. Although we agree with the GAO that contractors should adequately support their claims, there are areas, such as delay and disruption, which do not lend themselves to a precise and mathematically exact solution. Delay and disruption is normally caused by a number of independent actions each of which has an impact of a different magnitude. It is often impossible to segregate the disruptive effect of the individual actions and we have to resort to estimates and engineering judgments in allocating the responsibility for the impact to different actions. Corroborative cost and other factual data can provide the necessary tangible evidence.

In June 1971, postnegotiation business clearance requests with documentation and legal memorandums of entitlement supporting both of the proposed settlements, were submitted for approval of the Navy's Contract Claims Control and Surveillance Group for both claims. The Avondale business clearance was disapproved and re-

turned by the Navy's Contract Claims Control and Surveillance Group because it believed the proposed settlement to be less than completely supported by the documentation and backup data. Its criticism was directed primarily to the negotiation of the tentative settlement without adequate written documentation and, as in the Todd case, use of engineering judgments and rationale without complete, corroborative, tangible backup data.

After disapproval by the Contract Claims Control and Surveillance Group, I appointed a special team to review the documentation of all Avondale and Lockheed claims. This review concluded that the documentation in support of the claims was inadequate in that engineering judgments were not fully supported by tangible backup data. Since cost data is now also available to a greater extent than before, the review team considered that this should be used to corroborate the estimates and engineering judgments. In view of these findings, I requested the return of and have received the Lockheed claim business clearance requests from the Contract Claims Control and Surveillance Group.

We have requested, in writing, that Avondale provide additional corroborative information and data of the nature indicated by the GAO report on the Todd claim to verify the engineering estimates the team engineers had determined earlier to be acceptable. Based on our review of the Lockheed claim, we anticipate that similar requests for additional data will be required of Lockheed.

Should the shipbuilders be unable to provide adequate corroboration for their estimates and substantiation for the proposed settlements, it may be necessary to reopen negotiations with the contractors for the purpose of obtaining agreements on settlement amounts that can be substantiated or let the matter be resolved pursuant to contracts disputes procedures.

That concludes my statement, Mr. Chairman. I will be glad to answer any questions that I can on these matters.

(The biographical sketch and prepared statement of Admiral Sonenshein follow:)

BIOGRAPHICAL SKETCH OF REAR ADM. NATHAN SONENSHEIN

Nathan Sonenshein was born in Lodi, New Jersey, on August 2, 1915, son of the late Mr. and Mrs. H. W. Sonenshein. He attended Passaic High School in Passaic, New Jersey, to which city his parents moved when he was a young grade school student, prior to entering the U.S. Naval Academy on appointment from his native state in 1934. Graduated and commissioned Ensign on June 2, 1938, he advanced progressively in rank to that of Rear Admiral, to date from May 1, 1965.

Following graduation from the Naval Academy in 1938, he had two months' duty in connection with fitting out the USS BOISE and, in August of that year, transferred to similar duty in the USS PHOENIX. He joined the latter upon her commissioning October 3, 1938—and in June 1941 was detached for post-graduate instruction in naval construction and marine engineering at the Massachusetts Institute of Technology, Cambridge. He received the degree of Master of Science from that institute in 1944, and in March of that year was assigned to the Mare Island Naval Shipyard, where he served initially as Ship Superintendent, and later as Assistant Planning and Estimating Superintendent.

In August 1945, his duties at Mare Island were interrupted by an assignment in technical intelligence with the Naval Technical Mission to Japan, in which he played a key role in investigating all technical aspects of the ex-Imperial Japanese Navy. He returned to the Mare Island Naval Shipyard in November 1946, where he was successively Assistant Repair Superintendent, Docking

Officer and Industrial Engineer until February 1949. He was Director of the Navy Facilities Division of the Bureau of Ships until August 1951.

He reported as Engineer Officer of the USS PHILIPPINE SEA (CV 47) in October 1951. "For meritorious service . . . (in diagnosing and effecting unusually difficult engineering repairs) during sustained periods of combat operations against enemy North Korean and Chinese Communist forces in the Korean Theater from January 31 to July 30, 1953," he received a Letter of Commendation, with authorization to wear the Commendation Ribbon with Combat "V", from the Commander SEVENTH Fleet. He is also entitled to the Ribbon for the Navy Unit Commendation awarded the PHILIPPINE SEA.

During the period September 1953 to June 1956 he was Planning and Estimating Superintendent at the New York Naval Shipyard, and was active in the planning for construction of USS SARATOGA (CVA 60) and USS INDEPENDENCE (CVA 62). In July 1956 he became Head of the Hull Design Branch in the Bureau of Ships. In February 1960 he was ordered to duty as Fleet and Force Maintenance Officer on the staffs of Commander in Chief, and Commander Service Force, US. Pacific Fleet.

In August 1962, he reported as Director of the Ship Design Division, Bureau of Ships, where he was responsible for the conduct of feasibility studies and the preparation of preliminary and contract designs for all ships, craft and boats constructed for the U.S. Navy. During the fall of 1964 he attended the Advanced Management Program at the Harvard Graduate School of Business. In June 1965 he became Assistant Chief of the Bureau of Ships for Design, Shipbuilding and Fleet Maintenance and in November of that year was designated by the Secretary of the Navy, Project Officer, Fast Deployment Logistics Ship Project. On August 1, 1967 he reported as Deputy Chief of Naval Material (Logistic Support).

In July 1969 he ordered to duty as Commander Naval Ship Systems Command, Washington, D.C.

In September 1967, Rear Admiral Sonenshein was awarded the Legion of Merit by the President of the United States for exceptionally meritorious service as Project Coordinator and Project Manager, Fast Deployment Logistic Ship Project from August 18, 1965 to August 1, 1967. In addition to the Commendation Ribbon with Combat "V" and the Navy Unit Commendation Ribbon, Rear Admiral Sonenshein has the American Defense Service Medal, Fleet Clasp; American Campaign Medal; Asiatic-Pacific Campaign Medal; World War II Victory Medal; Navy Occupation Service Medal, Asia Clasp; China Service Medal; National Defense Service Medal with bronze star; Korean Service Medal; and the United Nations Service Medal. He also has the Korean Presidential Unit Citation Badge.

His official home address is Passaic, New Jersey. He is married to the former Ila Nina Baker, the daughter of the late Mr. and Mrs C. P. Baker, of Huntsville, Alabama; and they have two children—Carol Dale and William Baker Sonenshein. They now reside at 9224 Santayana Drive, Fairfax, Virginia.

PREPARED STATEMENT OF REAR ADMIRAL SONENSHEIN

Mr. Chairman and members of the subcommittee: I appreciate your invitation to appear before your Committee to discuss the settlement of shipbuilding claims, particularly those concerning Lockheed Shipbuilding and Construction Company and Avondale Shipyards, Incorporated.

I feel that to facilitate your understanding of the problems involved, some background should be provided regarding shipbuilding claims. When I assumed command of the Naval Ship Systems Command in August 1969, the shipbuilding claims on hand, plus those which were expected to be submitted, totaled between $800 million and $1 billion. Of these, Lockheed and Avondale had submitted claims amounting to $159 million and $148 million, respectively, which I will address specifically later in my statement. In the aggregate, the shipbuilding claims were based on allegations that Government specifications were inconsistent, ambiguous, deficient, or impossible to perform: that additional Government requirements had been placed on the contractors; that Government-furnished material was defective or delivered late; and that excessive quality assurance requirements had been imposed. Several of the claims were over one year old and some were over two years old. There was concern in the Navy and Department of Defense, as well as in Congress, over the size of claims, the method of handling claims, and the need to minimize future claims.

One of my first acts was to initiate a method for the systematic resolution of claims. Another early action taken by me upon assuming command of the Naval Ship Systems Command was to establish a positive program to strengthen the management of the Navy's shipbuilding effort and thereby minimize the generation of future claims. Since the main topic today is claim settlement, I shall not go into detail on claim prevention actions unless you wish to discuss it further. For the record, however, that program is referred to as the Shipbuilding and Conversion Improvement Program. It consists of a large number of inter-related and specific actions that should eliminate or minimize the effect of the causes of ship claims. I will cite one example.

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Incidentally, the General Accounting Office has recently reviewed the Shipbuilding and Conversion Improvement Program, which is now nearly two years old, to determine how effectively it has been implemented. I understand that a draft report of that study has been issued.

Now, let me return to the main item of discussion today, namely the methods followed in arriving at tentative, proposed settlements of the claims submitted by Lockheed and Avondale.

Normally, the negotiator or contracting officer will determine the Government's negotiation position and conduct negotiations on behalf of the Government on the basis of information developed by the engineers, lawyers, and auditors. Large and complex negotiations such as these which are under discussion here usually require decisions at the highest corporate level to commit the contractor to a settlement which may result in dollar losses in the millions. It is not inappropriate for the Commander of the Naval Ship Systems Command to become involved with his counterparts.

I will explain my reasons for this in more detail later. It is noted for the record that the Commander, Naval Ship Systems Command, is a contracting officer as the Head of a Procuring Activity. I exercised the contracting officer authority of my office in negotiating tentative settlement agreements with top-level management personnel of Lockheed and Avondale.

Following the Hearings of your Committee on 24 May 1971, you asked the Navy by letter for information in connection with those matters. Mr. Chafee's letter of 28 May 1971 furnished the requested information. I shall repeat portions of his letter here for the record.

Subsequent to the Todd settlement of March 1969, which was the subject of GAO Report of April 28, 1971 (B–171096), the Navy took various additional steps to ensure that settlements of the claims would be made within the terms of the written contracts involved and based on the facts and legal merits. These steps included the establishment of a requirement that all proposed claim settlements in excess of $5,000,000 be approved by the Contract Claims Control and Surveillance Group of the Naval Materiel Command and the Assistant Secretary of the Navy (Installations and Logistics) and that no modification may be made to the contract prior to such approvals. In connection with the request for such approvals, all pertinent technical, legal, and cost information is required to be presented; and no settlement will be consummated without exhaustive evaluation and documentation of the facts and an in-depth legal review. Accordingly, there have been no settlements consummated within the last two years without this required documentation.

There have been instances when tentative agreements on amounts of proposed settlements have been made in advance of completing the written documentation of legal analysis, technical analysis, and audit. In such cases the formal documentation was completed after the tentative agreements were made on the basis of information developed by the claims team. This was done to facilitate and expedite the reaching of agreements and to avoid the expenditure of additional technical, audit, and legal resources unless agreement could be reached.

An explanation of the normal claim-processing procedures of the Naval Ship Systems Command is necessary to an understanding of how the Lockheed and Avondale claims were handled.

The first action taken by Navy on receipt of a claim is to establish a claim-review team to investigate and take the actions necessary to resolve the claim, either by settlement or by a formal denial which the contractor may appeal to the Armed Services Board of Contract Appeals.

Each claim team is headed by a contracting officer, who establishes a recommended Government position on the claim, based on the advisory reports from each team member. The other members include a negotiator, engineer, legal counsel, and auditor. Assistants are provided to each of the team members as dictated by the size and complexity of the claim.

The claim team first conducts a preliminary analysis of the claim in order to identify any unusual engineering or legal aspects and to establish a time schedule for accomplishing the following required actions:

(*1*) *Conduct preliminary investigation and legal review.*—During this phase the claim team develops the facts to establish a prenegotiation position or to serve as the basis of denial of the claim if it is evident that settlement is not possible. The team legal counsel works closely with the other personnel of the team during their investigations to assure that all relevant facts are developed which have an impact on the existence and extent of Government responsibility and that documentary evidence exists to support the findings of fact. The investigative phase includes a review of records of the contractor, the local Navy Supervisor of Shipbuilding, and the Project Manager and discussions with personnel in each of these offices.

(*2*) *Prepare preliminary technical analysis report (TAR).*—The claim team engineer prepares a written preliminary report of his findings of fact and his recommendations. The engineer's recommendations are based on his judgment for certain parts of claims (such as the effect of delay, disruption, or loss of learning) which cannot be precisely and definitively quantified. He must, however, identify those recommendations which are based on his engineering judgment and it must be established that a factual basis exists to support determinations of amount due to the contractor based on engineering judgment. Legal counsel reviews the factual basis to determine its adequacy to support the engineer's judgment determinations. The team auditor provides information to the team engineer for use in preparing the preliminary technical analysis report.

(*3*) *Prepare preliminary legal memorandum.*—The team counsel prepares a preliminary memorandum of legal entitlement on the basis of information in the preliminary technical analysis report, advice of the auditor, and his own evaluation of the claim in relation to the terms of the contract.

(*4*) *Headquarters review of preliminary technical analysis report.*—Concurrently with the preparation of the preliminary legal memorandum, the team engineer's technical analysis report is reviewed by the Project Manager and other concerned personnel in the Naval Ship Systems Command Headquarters.

(*5*) *Establish Government position.*—The Commander, Naval Ship Systems Command, determines the Government position on the basis of preliminary technical analysis report, audit advice, preliminary legal memorandum, and comments of the Project Manager. When approved by higher authority, this position becomes the basis of negotiations toward settlement of the claim if the situation so warrants. If no negotiated settlement appears to be possible, a contracting officer's final decision denying the claim may be issued at this time.

(*6*) *Prepare final technical analysis report.*—The preliminary technical analysis report will be revised as appropriate to reflect the comments resulting from the Headquarters review, the meetings to establish the Government's position, and any further information developed after the preliminary technical analysis report was written. Before preparation of the final technical analysis report, further discussions with the contractor may be held to afford the contractor an opportunity to rebut tentative findings and to clarify matters which may not have been fully developed. Such discussions with the contractor are encouraged

in order to ensure that tentative conclusions reached by the claim team are supportable in the light of information presented by the contractor.

(7) *Obtain Advisory Audit Report.*—A written advisory audit report (AAR) is furnished by the team auditor. The auditor is furnished a copy of the technical analysis report for use in preparing his audit report. Frequently, a preliminary audit report will have been obtained to provide a negotiator and legal counsel with information on labor rates, overhead rates, material cost validation, labor and overhead rate projections, and any other information which the auditor considers pertinent.

(8) *Prepare final legal memorandum.*—The final legal memorandum is normally prepared by the team counsel to reflect the information in the final technical analysis report, the audit report, counsel's independent research, and all other information developed at that time. Counsel for the Naval Ship Systems Command approves the legal memorandum; he may elect to prepare it himself. The legal memorandum is submitted to the negotiator and contracting officer.

(9) *Obtain pre-negotiation approval.*—Before beginning negotiations on any claim over $5 million, approval is obtained from the Navy's Contract Claims Control and Surveillance Group, and the Assistant Secretary of the Navy (I&L). These approvals involve the submission of a fully-documented business clearance memorandum, including the technical analysis report, audit report, and legal memorandum, to explain and substantiate the negotiation objectives.

(10) *Conduct negotiations.*—Following the foregoing approvals, negotiations may commence and proceed to either a settlement or an obvious stalemate. Any settlement negotiated is tentative until it has been approved by the same persons who approved the pre-negotiation clearance. If negotiations have not been successfully concluded after a reasonable time, the contracting officer must make a final determination, which the contractor may appeal to the Armed Services Board of Contract Appeals if he is unwilling to accept. On occasion, as in the case of Lockheed and Avondale, negotiations are conducted on a "package" basis to encompass more than one claim. In the case of complex claims, such as are involved here, it is often possible to reach agreement on the total amount of the package, although such agreement might not be possible on each individual item comprising the claim package.

(11) *Obtain post-negotiation approval.*—The post-negotiation business clearance request must explain any increases in the tentative settlement agreement over the amounts approved in the pre-negotiation clearance. In cases where the settlement exceeds $5 million, the post-negotiation business clearance must be approved by the Contract Claims Control and Surveillance Group for the Chief of Naval Material as well as by the Assistant Secretary of the Navy (Installations and Logistics).

(12) *Issue contract modification.*—The contract modification is issued after funds are made available for obligation. Normally the fund citation will be obtained concurrently with the preparation and processing of the post-negotiation clearance. It is the policy of the Navy to include in the contract modification a statement releasing the Navy from any further liability for the events covered by the claim as well as for any unknown events occurring prior to the date of the settlement.

As I stated earlier, the high dollar amount of the claims already received plus those in immediate prospect dictated that special action be taken to permit prompt Command decisions necessary to resolve problems as they arose during the investigation and disposition of the claims. Accordingly, a staff position, titled Special Assistant for Claims and reporting directly to me, was established in September 1969. In December 1969 a Claim Settlement Program was issued. Target dates were established for resolution of each of the on-hand claims based on the settlement procedures I have just discussed. But, by March of 1970 it was apparent that the established schedules could not be met unless action was taken to accelerate the procedures. It was not intended, however, to let adherence to schedules result in premature or improvident settlements.

In March 1970 we modified our procedures by specifying that as soon as the lengthy investigative phase was essentially completed, a Command Position would be established on the basis of the written or oral advice of the claim team members, the Special Assistant for Claims, NAVSHIPS Counsel, and the Project Manager. The Command Position was to be the basis on which negotiations toward settlement could commence. Documentation of the findings and recommendations of team members was to be prepared after the Command Position was established but prior to submission of post-negotiation clearance request.

Pre-negotiation positions on the Lockheed and Avondale claims were determined in this way, and negotiations thus were commenced with the knowledge of the Chief of Naval Material and Assistant Secretary of the Navy (Installations and Logistics).

You will appreciate that we are still negotiating the subject claims with both shipbuilders and that in case we should fail to reach final agreement, these claims could all end up in quasi-judicial proceedings before the Armed Services Board of Contract Appeals and even before the courts. To divulge any of the Government's evaluation or position with respect to any specific items of the claims could prejudice our negotiating position. The tentative settlements have not been approved at any of the higher Navy echelons, and the resolution of these claims may yet be thrown into the disputes procedure, which is essentially a judicial process. In such event, the attorneys for the claimants could utilize that portion of the Navy's public disclosure which might be of benefit to their clients. It is for this reason that we are reluctant to disclose our internal technical, legal, and audit analyses of the subject claims. Furthermore, it could benefit other contractors in their claim submissions.

Both the Avondale and Lockheed claims involve contracts for DE 1052 Class ocean escorts which were awarded in July 1964, on the same day that Todd received its contracts for seven ships each at Seattle and San Pedro. Avondale claims also cover the contract for 20 similar ships of the DE 1078 Class which was awarded two years later. Lockheed's other claims concern three contracts for LPD Class ships (landing ships, dock) which were awarded in 1963, 1964, and 1965. Lockheed has delivered all its LPD Class vessels and one of the five DS 1052 Class ships. Avondale has delivered all seven DE 1052's and three of the DE 1078 Class ships.

The first of the consolidated type of claims was received from Todd in 1967. This claim was based on estimates, as was its evaluation by the Naval Ship System Command. The settlement of the claim in March 1969 was approved by the Contract Clearance Group in the Naval Material Command. It was not until a General Accounting Office report was released in April 1971, to which I will refer later in more detail, that questions were raised as to the adequacy of settlements based on estimates and engineering judgments.

Both Avondale and Lockheed presented their claims in a similar form, using estimates in arriving at their claimed amounts. The Avondale DE 1052 claim was submitted at the end of January 1969 and the DE 1078 claim in September 1969. Lockheed submitted its LPD claims in January–February 1969 and the DE 1052 claim in May 1969. All three firms, by the way, used the services of the same Washington law firm in putting together their claims.

The Naval Ship Systems Command formed special teams to evaluate the Lockheed and Avondale claims and the estimates on which they were based. The same negotiator and chief engineer who were responsible for the evaluation of the Todd claim headed the effort on Avondale and Lockheed claims. The Navy Claim Evaluation Teams have devoted over two years to reviewing the contractors' estimates and their underlying rationale. Much of this time has been spent on site at Avondale and Lockheed and has included extensive discussions with responsible contractor personnel.

On the basis of the analysis of the contractors' estimates, engineering and technical judgments were formed as to their validity and supportability, and a Government position was established with respect to each. These positions were presented as supportable by the team engineer and negotiator as well as my Special Assistant for Claims, who had the overall responsibility for claim settlements.

At this point it was vital to ascertain whether (a) agreement could be reached with the contractors and the issues resolved under the terms of the contracts or (b) agreement could not be reached, leaving the parties to pursue the disputes procedure.

Discussions were then carried out with each contractor over a period of some four to six months, and it was determined that agreement could be reached. Tentative agreements were successfully achieved in December 1970 with Avondale and January 1971 with Lockheed for full settlement of the claims within the ranges of the previously-established Government positions. No final commitments have been made.

It was my understanding that full documentation for the proposed settlements would be available shortly. Normally, we would expect to have all documenta-

tion in support of the proposed settlements completed and the business clearance submitted for approval within 60 days, even when the technical documentation is in draft form, as it was in these cases. However, in reviewing the technical analysis reports to prepare the legal memorandum of entitlement, NAVSHIPS Counsel found instances where the technical documentation which had been made available to him did not support the conclusions and recommendations on which the tentative settlement was based. Consequently, detailed reevaluation of portions of the technical analysis reports and their back-up documentation was undertaken. Although this effort resulted in a more detailed identification of the supporting documentation, it was still primarily concerned with validating the estimates and engineering judgments on which both the claims and their evaluation had been based. After this was completed, a legal memorandum of entitlement was prepared.

The General Accounting Office, in the meantime, had reviewed in depth the settlement of the DE-1052 claim with Todd. The final GAO report was received at the end of April 1971. This report was somewhat ambivalent. On the one hand, it stated that the Navy had obtained as good a settlement as possible; on the other hand, the report indicated that the claims evaluation should not be based on esimates and engineering judgments alone, but should be supported by more tangible evidence, particularly in the area of delay and disruption costs. Although we agree with the GAO that contractors should adequately support their claims, there are areas, such as delay and disruption, which do not lend themselves to a precise and mathematically exact solution. Delay and disruption is normally caused by a number of independent actions each of which has an impact of a different magnitude. It is often impossible to segregate the disruptive effect of the individual actions and we have to resort to estimates and engineering judgments in allocating the responsibility for the impact to different actions. Corroborative cost and other factual data can provide the necessary tangible evidence.

In June 1971, post-negotiation business clearance requests, with documentation and legal memoranda of entitlement supporting both of the proposed settlements, were submitted for approval of the Navy's Contract Claims Control and Surveillance Group for both claims. The Avondale business clearance was disapproved and returned by the Navy's Contract Claims Control and Surveillance Group because it believed the proposed settlement to be less than completely supported by the documentation and back-up data. Its criticism was directed primarily to the negotiation of the tentative settlement without adequate written documentation and, as in the Todd case, use of engineering judgments and rationale without complete, corroborative, tangible back-up data.

After disapproval by the Contract Claims Control and Surveillance Group, I appointed a special team to review the documentation of all Avondale and Lockheed claims. This review concluded that the documentation in support of the claims was inadequate in that engineering judgments were not fully supported by tangible back-up data. Since cost data is now also available to a greater extent than before, the review team considered that this should be used to corroborate the estimates and engineering judgments. In view of these findings, I requested the return of and have received the Lockheed claim business clearance requests from the Contract Claims Control and Surveillance Group.

We have requested, in writing, that Avondale provide additional corroborative information and data of the nature indicated by the GAO report on the Todd claim to verify the engineering estimates the team engineers had determined earlier to be acceptable. Based on our review of the Lockheed claim, we anticipate that similar requests for additional data will be required of Lockheed.

Should the shipbuilders be unable to provide adequate corroboration for their estimates and substantiation for the proposed settlements, it may be necessary to reopen negotiations with the contractors for the purpose of obtaining agreements on settlement amounts that can be substantiated or let the matter be resolved pursuant to contracts disputes procedures.

That concludes my prepared statement, Mr. Chairman. I will be glad to answer any questions that I can on these matters.

Chairman PROXMIRE. Admiral, I think we would be better served if we could ask Mr. Rule to come forward now and to deliver his statement; then we can question both you gentlemen together.

Mr. Rule, will you come forward.

STATEMENT OF GORDON W. RULE, CHAIRMAN, CONTRACT CLAIMS CONTROL AND SURVEILLANCE GROUP, DEPARTMENT OF THE NAVY

Mr. RULE. Good morning Senator.

Chairman PROXMIRE. Good morning, Mr. Rule.

Mr. RULE. It will be recalled that I had the privilege of testifying before this subcommittee on the subject of shipbuilding claims on the 30th of December 1969, and again on the 24th of May 1971. Reference is made to those hearings for my position, qualifications, background, and so on.

At the May 24, 1971, hearings, the then status of our Navy shipbuilding claim backlog was furnished for the record and I gave you, Mr. Chairman, my assurances that all claims—shipbuilding and otherwise—over $5 million which under Navy procedures must be reviewed and approved or rejected by the contract claims control and surveillance group (CCCSG), which I Chair, would be thoroughly scrutinized by that group before any approval would be given.

SUMMARY OF CCCSG CLAIM ACTIONS

Although it is fundamental in the Navy that legitimate, properly documented claims against the Navy for actions or inaction by the Navy resulting in increased costs to a contractor—shipbuilding or otherwise—must be investigated, reviewed, settled and paid as promptly as possible, I can report to you that the CCCSG has not given their approval to any claim to this date.

We have had before us for review seven claims, three of which were rejected, as a result of which two others were withdrawn, leaving two claims presently pending before the CCCSG. Additionally, one request for provisional payment on a shipbuilding claim was rejected. You may be interested in the statistics of the Navy claims to date. Shipbuilding claims, there are 22 claims pending from eight contractors over $5 million, which aggregate $868.4 million. There are some approximately 10 under $5 million.

It will be recalled that at the May 24, 1971, hearings, we had claims in hand and anticipated of $790 million and the comparable figure when I testified in December 1966, was $795 million. In addition to those shipbuilding claims, there is a total of $130.5 million in claims pending from other systems commands over $5 million, for a grand total of $989.9 million in pending claims over $5 million. I should strike the word "grand." There is not much grand in that.

DESCRIPTION OF CCCSG

As the CCCSG has gained experience in reviewing claims since my last appearance before you, we have found ourselves, of necessity I suppose, developing things to look for and making decisions as a result of our reviews which might be analogized to case made law by the courts. I think you may be interested in some of the questions the CCCSG asks with respect to claims under review as well as some of the pronouncements we have made in our decisions.

First of all, I should like to quote for you the object of the CCCSG review which is stated as follows:

The object of the CCCSG review is not to determine what a claim settlement amount should be—ours is a review function, not a negotiating function—but to determine if the proposed * * * settlement figure of * * * has (I) complete substantive merit and (II) is adequately supported by evidential demonstration. These tests of substantive merit and adequate evidential demonstration are by design, rugged tests to meet, but when a contractor is asserting a unilateral claim against the Government for alleged Government actions or inaction, the undersigned Chairman of the CCCSG is of the opinion that the burden of proof which attaches to and remains with every claimant has not been fulfilled until or unless these two tests are satisfied. Doubts concerning these tests having been met will be resolved by the CCCSG in favor of the Government, from which resolution a claimant may appeal to the ASBCA and/or the courts.

In a particular case this objective was followed up by the statement:

The CCCSG does not believe that the dollar position embodied in subject clearance adequately recognizes, discusses and evaluates the Government's best position in this claim. Moreover it is patent in the clearance that the claimant has not carried his burden of proof, in the absence of which a claim cannot and will not be approved by the CCCSG. As stated above, the CCCSG will decide doubtful judgmental issues in favor of the Government and leave the claimant to carry his burden of proof to a Board or Court.

An example of a CCCSG decision relating to the sample concept for determining dollars allegedly due a claimant is as follows:

The sample concept employed in the dollar claim, whereby "X" of the "Y" claim items were evaluated in-depth, with the resulting percentages of allowance applied to the non-sampled items is not sound claim settlement procedure. Obviously, the sample technique serves to expedite analysis and TAR preparation, but claims against the Government and the taxpayer had best suffer prolongation of resolution than fall victims of undue haste and questionable evaluation. The message must be transmitted to all claim minded contractors and individuals that there is no short cut to their burden to prove every dollar claimed.

A further example of action taken by the CCCSG relating to buy-in situations is as follows:

With respect to buy-in, as it relates to a contractor's claim against the Navy, let two things be made crystal clear:

(I) When an obvious buy-in situation exists, every single element of a claim is doubly suspect. The Reason is obvious.

(II) When a claimant admits buying-in to obtain a contract, the CCCSG will not accept the claimant's word regarding the extent of the Buy-in.

In this claim by . . . we find both an obvious buy-in and an admitted buy-in. To fail to recognize and fully explore and discuss this buy-in and its effect on this claim is considered to be a fatal defect.

CCCSG Decisionmaking Process

The following are types of questions which the CCCSG asks to assist in our decisionmaking process:

A. What is the objective sought by the claimant? Answer: In our particular case it was: "Contractor personnel candidly admit that the concept for determining the hours and amounts claimed was based on the premise of repricing the total contract labor by estimating the total hours and costs at completion of the contract less the value of the basic contract plus adjudicated change orders." The object of a claim should be the identification and payment of those additional costs incurred, or to be incurred, by the contractor which are

demonstrably caused by Government action or inaction. Thus, the theory of this contractor's claim is contra to what it should be with consequent difficulty to the ascertainment of reasonable governmental responsibility and liability.

Some other questions we asked were.

B. Is there any evidence of original buy-in on the contracts involved?

C. Has the claim been prepared in such a manner that merit and specifics are reasonably evident or is it dominated by generalities and vagueness?

D. Have the several areas—not necessarily the amounts—in the original claim stayed relatively constant or have these areas changed with subsequent proposals?

E. Has the claimant been fully cooperative with the Government representatives in their investigation of the claim or claims?

F. Has the claimant fully carried his burden of proof for every item or area in his claim or claims?

G. Is there any tangible evidence that claimant has attempted to mitigate additional costs to the Government?

H. Has claimant threatened to stop work?

I. Is there any evidence that Government personnel have assisted claimant—in whole or in part—in preparing elements of the claim or claims?

J. Has the claim been prepared and documented by the claimant's regularly retained legal and accounting personnel or has claimant hired legal and accounting personnel who specialize in claim preparation against the Navy?

Procedural Versus Substantive Irregularities in Claims

The factual answers to the above questions recreate the climate in which the claim was prepared, investigated, processed and negotiated. These factual answers also impacted the credibility of the claim which was considered by the CCCSG in reaching a final decision. I would like to read one or two excerpts from our decisions bearing on the point of procedural irregularities or deficiencies as distinguished from substantive:

It should be noted that the determinations contained in enclosure (1), in this particular case, are entirely substantive in nature, as distinguished from procedural. Because of the abundance of substantive deficiency in this case, it was unnecessary to base the negative decision on procedural deficiencies or irregularities.

Obviously, review action should be bottomed—if at all possible—on substantive grounds. This is not to say however that the required procedural aspects of analyzing, negotiating and reviewing claims are not important. Indeed, the failure to follow required procedures can be grounds for disapproval of a claim clearance.

Any claim clearance submitted to the CCCSG in the future, where it appears that a negotiation was conducted in advance of and without written complete legal, technical and audit comments, will be returned to the Syscom involved without review. The reason for this position should be clear to anyone with an appreciation of the best interests of the Navy. An unsupported and improperly negotiated claim settlement can only result in GAO and other criticism of the Navy as a whole, not the individual responsible.

A further procedural irregularity noted by the CCCSG is that of the Contracting Officer or others circumscribing the DCAA Audit Review. This practice will not be tolerated by the CCCSG. Every bit of advice and assistance—

without reservation—is required to properly analyze and evaluate a claim and to tell the auditor to confine his review to labor rates and overhead is unacceptable and may lead to delay while the auditor is permitted to perform his normal review of the claim and the technical report.

The General Accounting Office recently issued guidelines for the settlement of delay claims and these guidelines which follow have been provided by the CCCSG to all of the systems commands for their guidance in the preparation and processing of claims:

1. Claims should be analyzed in light of the type of contract involved, which should aid in defining allowable cost elements.

2. Documentation in support of subcontractor original estimates should be requested and *received prior to negotiation meetings.*

3. Analysis of these data should be performed *in advance of any negotiation meetings.* Such an analysis should include a cost per week figure to enable negotiators to perform rapid, supportable computations during negotiation meetings. Any such cost per week figure should recognize the relationship between man-days and time if this is pertinent.

4. Change orders, strikes, and other non-government causes of delay should be identified and analyzed *prior to any negotiation meetings.*

5. Provisions for adjustment should be included in any proposed settlement amount based on wage settlements which are not firm at time of negotiations.

6. Estimators' mathematical short-cuts should be fully supported by descriptive data.

7. If production efficiency losses are expected to be a claim element some preliminary analysis should be used to establish a reasonable rate.

8. A detailed legal analysis concerning the acts, or failures to act, which render the government liable for breach of contract should be performed and made a part of the record with respect to each claim prior to any negotiation meetings.

Proper Role of Negotiator and Contracting Officer

Finally, you may be interested in the guidance provided by the CCCSG to the systems commands concerning the function of the lawyer in claims investigations, negotiations, and settlements as distinguished from his role in procurement generally and also as distinguished from the proper role of the negotiator and contracting officer in the negotiation and settlement of claims. This guidance is as follows:

A careful or casual reading of reference (D) indicates that the well recognized role of the negotiator and contracting officer in the procurement process is not being properly differentiated from their role in the claim settlement process. Paragraph 1.D. of reference (D) states in part as follows:

"The TAR, AAR and even the legal memorandum are a product of long and exhaustive team effort, which has been under active and influential direction of the negotiator and contracting officer. The proposed settlements were possible only through the efforts of the negotiator and contracting officer in their proper decisionmaking role in the procurement process."

To state that the legal member of a claim settlement team, whose primary function is to determine legal entitlement by the claimant contractor to any or all elements of the claim is "under [the] active and influential direction of the negotiator and the contracting officer" is just plain erroneous and ridiculous. It is the legal member of a claim settlement team who will inform the negotiator and the contracting officer what elements of a claim legally can or cannot be negotiated and become part of any settlement.

Lawyers normally do not get involved in pricing matters in the procurement process, but when claims are involved, the lawyer is the key person on the team up to the time he decides what is or is not legally compensable. Thereafter, the lawyer must stay in the claim settlement exercise to make sure that the team does not go overboard on the quantum of dollar relief that can be justified and substantiated.

for those elements of the claim which he has determined legal entitlement.

I have attempted, Mr. Chairman, to (I) bring you up to date on where the Navy stands with respect to shipbuilding and other claims having a value of over $5 million, (II) advise you of the record of the CCCSG to date in our review of proposed settlements submitted to us, and (III) provide you with excerpts from CCCSG decisions which indicate some of the CCCSG basic claim philosophy and guidance the CCCSG is providing all Navy commands.

I will be happy to attempt to answer any questions which you may have.

LPD Program's Purpose and Costs

Chairman Proxmire. I thank both of you gentlemen for very fine helpful statements. I would like to start off with Admiral Sonenshein, by asking you about one of the ship programs that is a source of a claim by Lockheed. That is the LPD. You mentioned that in your statement.

Admiral Sonenshein. Yes.

Chairman Proxmire. You described it as a landing ship dock. Can you tell us how many of these ships Lockheed has built or is building, how they are used, how much they cost on a program basis and unit basis?

Admiral Sonenshein. Yes; the LPD, as we call it, is a unit of the Amphibious Warfare Forces of the Navy used to deliver marines over the beach in amphibious assault, with their land-based equipment and supplies for initial occupation operations when they carry out an amphibious assault.

It is a ship which has the ability to submerge partially and take into a well at the stern landing craft that are used in the assault operations. It also has on its topside a flight deck from which helicopters can carry men and equipment ashore in a vertical envelopment, as it is called, again in an amphibious assault. That is the nature of the ship.

Lockheed's contracts were for the construction of seven of which all but one, I believe, at the moment are delivered. One is still under contract for construction to Lockheed.

I am sorry, they are all delivered.

Chairman Proxmire. What was the cost?

Admiral Sonenshein. There were seven LPD's and the cost of the first two in the basic contract, LPD 9 and 10, was $53.5 million. That would be about $26.5 million each. And in the second group, there were LPD 11, 12 and 13 at $74.3 million, and finally LPD 14 and 15 at $51.4 million.

Chairman Proxmire. Will you supply the background for the record. What is the total amount of the program?

Admiral Sonenshein. $179.2 million.

Chairman Proxmire. Has there been an overrun on that?

Admiral Sonenshein. There were claims on that contract, on those contracts.

Chairman Proxmire. How much was the overrun? I ask about the overrun, not simply the claims but the total overrun claims maybe part of the overrun and maybe the entire overrun.

Admiral SONENSHEIN. I do not have that immediately available.

Chairman PROXMIRE. You do not have the overrun figures with you?

Admiral SONENSHEIN. Not in that form, sir. I have mainly this claim data, sir. On the LPD's 9, 10, 11, 12, 13, 14, and 15, the claim amount was $102.6 million.

Chairman PROXMIRE. The total amount of claims was $102 million?

Admiral SONENSHEIN. Yes.

Chairman PROXMIRE. The cost of the program you initially gave was $179 million. $102 million is part of that or in addition to that?

Admiral SONENSHEIN. I am afraid I am giving incorrect information in the form you have asked for it because I do not have it that way. The contract prices without claims added up to $179.2 million, and the claims that I have just enumerated add up to $102.6 million. Those would be the comparable numbers, $102.6 million versus $179.2 million on the basic construction contracts.

Chairman PROXMIRE. I am a little confused; $179 million is the total amount and there is an additional amount of $102 million, or $102 million is part of the $179 million?

Admiral SONENSHEIN. The contract price without claims was $179 million.

Chairman PROXMIRE. There is an additional $102 million. So it is a total of $281 million. Have they been delivered on time or has there been a slippage in the schedule?

Admiral SONENSHEIN. There were delays in the deliveries too.

Chairman PROXMIRE. By how much?

Admiral SONENSHEIN. I do not have that information immediately available. I can provide it for the record.

(The following was subsequently supplied for the record:)

CONTRACT AND ACTUAL DELIVERY DATES FOR LPD 9-15

	Contract delivery	Actual delivery
Contract NObs 4660:		
LPD 9	Sept. 30, 1966	Oct. 18, 1968
LPD 10	Dec. 31, 1966	July 7, 1969
Contract NObs 4765:		
LPD 11	Apr. 15, 1967	May 15, 1970
LPD 12	July 15, 1967	Dec. 4, 1970
LPD 13	Oct. 15, 1967	Dec. 26, 1969
Contract NObs 4902:		
LPD 14	June 17, 1968	Feb. 12, 1971
LPD 15	Sept. 17, 1968	June 25, 1971

Note: These delays were occasioned by strikes, labor shortages, and workload.

PRODUCTION QUALITY

Chairman PROXMIRE. Is the Navy satisfied with the quality of the ships that have been delivered so far?

Admiral SONENSHEIN. The LPD's that were delivered from Lockheed I would say were generally of average quality; yes, sir.

Chairman PROXMIRE. Does that satisfy you?

Admiral SONENSHEIN. Well——

Chairman PROXMIRE. Average quality?

Admiral SONENSHEIN. We are never satisfied with the kind of ships we get because our objective obviously is to have a perfect ship.

This is not achievable in this kind of very complex construction operation but I would say that the performance there was generally average.

Chairman PROXMIRE. Do you believe that Lockheed is performing its contract well?

Admiral SONENSHEIN. With regard to the LPD?

Chairman PROXMIRE. Yes.

Admiral SONENSHEIN. I would say again the performance would be average.

Chairman PROXMIRE. In my opening statement I mentioned my concern with the quality of the ships that have been produced in the past several years. It seems to me a double irony the Navy may be paying unreasonable amounts for claims on ships which perform well below the standards set for them.

Let me read from a report on the LPD made by Adm. John D. Bulkeley after the final contract on the LPD-12 in May of this year.

As you know, Admiral Bulkeley is president of the Board of Inspection and Survey. As you also know, the report was made to you on June 4 of this year. Because of the length of the report I will only read brief excerpts. I think it is a devastating report and the entire report will be placed in the record.

This is what the admiral reported in June:

This ship from the significant deficiencies left over from the Acceptance Trial and further from lack of preservative painting, let alone finishing painting on the hull and mast, would lead me to the impression that the ship should not have been accepted in the first place until properly preserved and painted.

Already rust is breaking out on the hull and catwalks and I understand that the crew has painted a good deal of it. There is evidence throughout the ship that painting was done over rust and there are areas where I could find no preservative or surface preparation for painting such as zinc chromate or red lead.

And he goes on to say:

I stress the lack of proper painting and preservation simply because of the amount of workload imposed on the ship already in repainting and represerving, plus the cost in terms of time, manpower, and money to the ship. Sailors should not have to do contractor work.

Then he goes on to say:

This ship had the largest number of safety deficiencies that I have seen in a very long time, and most of them if not all must be corrected forthwith before men are hurt.

One of the worst but not most dangerous, that I have seen, is the Fiberglass handrails in the mast structure. Already, two are broken and there are repairs to other parts that I would not trust and no sailor should either. These rails should be made strong, rigid, and rugged and inspire confidence to the men who work aloft on electronics, from time to time, that it is safe to depend on them. I would not. Further, the ladder to the topmast was loose, and I wouldn't go any further aloft—it is also insufficiently braced.

In the engineering spaces, I was struck by the inaccessibility of a goodly part of the auxiliaries and other pieces of machinery that will be most difficult to maintain let alone open and inspect. This is very wrong, and a little effort could have prevented much of this at the beginning. I have mentioned this before.

The safety deficiencies are listed later in this letter but are of such magnitude that men could be hurt, such as inoperative overspeed trips on generators, as well as ammo hoists ripping open shell containers (powder cans).

Then there were a whole series of other detailed indictments. He concludes by saying:

I regret again very much indeed to have to paint such a grim picture in some areas. However, it points out to me certainly that if we had a completed ship

ready for unrestricted service, it would be cheaper in the long run for the life of the ship, comfort of the crew, and readiness for war, as well as a safe, reliable, and a maintainable ship. It appears now that without effort, time, and money we cannot obtain these attributes in this ship, especially when deployment of the ship for a midshipmen's cruise is almost here.

Now, as I understand it, Admiral, this describes a ship that is unsanitary, unsafe, unable to perform its mission. The LPD is loaded with safety and health hazards, corrosion, defective parts, and instant obsolescence, requiring the Navy to make repairs and do things to the ship which should have been done by the contractor before it was turned over to the Navy, and the LPD 12 is not a first of the line ship; an earlier one, the *Juneau*, was given its trial 2 years ago.

How do you explain the Navy's policy of paying claims on ships of such poor quality and workmanship? Why would it ever accept such a ship?

Admiral SONENSHEIN. Admiral Bulkeley and I maintain a continuous exchange of correspondence on the ships that are delivered to the Navy and for which he has the responsibility to conduct inspections at two points in their lives before they become fleet units. One inspection is conducted prior to delivery by the contractor. This is called the preliminary acceptance trial.

The second inspection is conducted by him and his board or subboard, where appropriate, at a period before a postshakedown availability, as it is called, and these are the final contract trials. That was the kind he was alluding to there. This whole period from predelivery inspection to postshakedown availability and final entry into the fleet in the average ship, and I think in this case it probably applies, takes about a year. This reflects the Navy's basic approach to grooming a ship for delivery into a fleet operational status. It recognizes that a ship such as we are considering here today and even more complex ships that we also construct are indeed extremely complicated projects. They are without question, and I think I could say this without contradiction, the most complex construction projects undertaken by man. There is no weapons system in my view that compares in complexity to the production of a ship, particularly a warship.

Now, the kind of report you have just quoted is most distressing to us when we receive it because Admiral Bulkeley is a very intelligent and well-informed and capable officer who knows the business of inspection of ships and has made many, many such inspections. A prior letter he had given to us on that particular ship at the first trial had also brought forth many deficiencies, and many of those were corrected prior to the delivery.

Remember, I pointed out there was the preliminary acceptance trial which occurs about 6 weeks before delivery. The emphasis that he put in his letter on the word "completed" ship, represents the importance we place on getting, in fact, a completed ship. This represents a mutual campaign by him and by me to deliver completed ships.

During the past 2 years, he and I have made major efforts to assure the correction of deficiencies prior to fleet introduction, and in this case we did not do as well as we have in many, many other cases. However, my reaction is that the large majority, if not a vast majority, of the deficiencies that he reported in the final contract trials were in fact corrected during the postshakedown availability which followed that inspection.

Chairman PROXMIRE. I am distressed at several things. First, you call this an average ship. If this is average, I am distressed to think what kind of ships we are getting.

Admiral SONENSHEIN. I said the shipyard is average.

Chairman PROXMIRE. I understood you to say the LPD was average.

Admiral SONENSHEIN. I believe if one were to view the condition of that ship as it finally joined the fleet after the 1 year of grooming and inspection and post-shakedown availabilities, we might well make that judgment.

Chairman PROXMIRE. This is a $179 million program for six ships, and the overrun, I should say the claims, additional claim, is $102 million. That is almost a 60-percent increase. It is just appalling that under these circumstances that ships should be in such a shape as described by Admiral Bulkeley. Are the other LPD's in a similar condition as the U.S.S. *Shreveport?*

SHIP DEFICIENCIES AND NAVAL ACCEPTANCE

Admiral SONENSHEIN. We mounted a special attempt to achieve completed ships, as I alluded to before, at that shipyard, and other ships were substantially in better condition than this one was at the final contract trial.

Chairman PROXMIRE. What steps have been taken to correct the deficiencies cited by Admiral Bulkeley?

Admiral SONENSHEIN. As I indicated in my general comment earlier, after that final contract trial is completed, the ship would normally go into a post-shakedown availability of a couple of months' duration at a navy yard. It probably went into the Puget Sound Naval Shipyard, I would presume in this instance, since the ship was built up in that part of the country, and the normal experience is that the large majority if not all of these deficiencies are corrected before the ship finally joins the fleet as an operating unit.

Chariman PROXMIRE. They are accepted, are they not? Was this an accepted ship? It had been accepted when Admiral Bulkeley made this inspection. As a matter of fact, these were accepted?

Admiral SONENSHEIN. Yes, sir.

Chairman PROXMIRE. Why does the Navy accept ships like this?

Admiral SONENSHEIN. There are a series of considerations that operate. One is that the crew had been assembled. That has to start months ahead of time, as you can imagine. In fact, the pipeline may be getting filled a year ahead of time and the crew arrives and is readied to take the ship out and it is not economical to tie them up. That is one consideration.

Another consideration is that many of the deficiencies or some deficiencies frequently require additional design, correction, and perhaps for which the time——

Chairman PROXMIRE. Let me interrupt. I can understand a lot of this where you have safety involved, and I agree it may not be economical to tie the ship up, but you certainly do not want to have lives at stake in the way that Admiral Bulkeley describes this. This could result in not only injury of personnel but conceivably in their death.

Admiral SONENSHEIN. And these, of course, get first attention, and normally, they are corrected as soon as they are uncovered. Frequently such things cannot be seen on delivery or before delivery because the ship is cluttered up with yard installation facilities, such as welding

leads and other construction facilities. It is not until the ship gets out and starts to operate with its own ship's company that many of these features come to light, and that is what comes out in the final contract trial.

Chairman PROXMIRE. The kinds of difficulties that I have just read which were described by Admiral Bulkeley, it seems to me only a fairly casual limited inspection of a few hours would disclose this kind of difficulty, would it not?

Admiral SONENSHEIN. In many cases, yes. But frequently they are not discernible during the construction period. Of course, our people are not perfect; I do not mean to say the inspectors we have and the supervisors of shipbuilding are perfect. They are under pressure to get this ship out. The crew is awaiting its acceptance. There are maybe other considerations that make it important to get the ship into an operational status.

Another factor that may mitigate against the correction of an item is availability of material that has to be ordered.

Chairman PROXMIRE. Will Lockheed be charged with the cost of correcting these?

Admiral SONENSHEIN. Normally there is provision for so-called holdback.

Chairman PROXMIRE. Was there in this case with respect to the *Shreveport?*

Admiral SONENSHEIN. Normally if the deficiency is shown to be contractor responsible there is a guarantee period in the contract for 6 months after delivery.

Chairman PROXMIRE. Was that true in this particular case?

Admiral SONENSHEIN. Every contract has that and if a deficiency is found to be his responsibility then that would be the subject of reduced cost change.

Chairman PROXMIRE. In the case of this particular ship it was inspected by Admiral Bulkeley, was Lockheed held responsible and were they required to pay for it?

Admiral SONENSHEIN. I would have to provide that for the record.

Chairman PROXMIRE. Will you also provide for the record whether or not that was part of their additional claim?

Admiral SONENSHEIN. I will do that too, sir.

Chairman PROXMIRE. It seems to me as a matter of commonsense that where you have a contract that a deficiency of this kind should have no part in the claim.

Admiral SONENSHEIN. That is right.

(The following was subsequently supplied for the record:)

Lockheed has been held responsible for the deficiencies of the LPD's including the USS SHREVEPORT (LPD-12) for which six Field Change Orders have been issued for reduced costs. These reduced cost change orders are presently under negotiation by the Supervisor of Shipbuilding Thirteen with Lockheed.

To the extent evaluated to date, the adjusted claims against contracts (LPD's) are not directly related to these deficiencies.

Chairman PROXMIRE. But I would like to have that documented whether it is or not.

Admiral SONENSHEIN. When Admiral Bulkeley makes an inspection he is not acting as a contracting officer or does not have contracting authority. He lists the deficiencies as he or his team observes them. Thereafter a determination has to be made by the program manager in the Naval Ships Systems Command as to who the responsible party

is—is it Government responsibility or is the contractor responsible. The contractor responsibility items are normally corrected to the extent of some 90 percent before delivery. Some Government responsibility items will be held back for various considerations such as the kinds I described for accomplishment even after delivery of the ship to the fleet.

Chairman PROXMIRE. In this particular case what action was taken against the inspector who certified this ship before it was accepted?

Admiral SONENSHEIN. There was no single inspector. There were probably dozens and dozens of inspectors.

Chairman PROXMIRE. Is there any supervisor?

Admiral SONENSHEIN. The supervisor of shipbuilding.

Chairman PROXMIRE. Is not someone responsible? It seems to me if you do not have some kind of action taken there is little incentive for preventing this kind of disgraceful situation in the future.

Admiral SONENSHEIN. Well, Mr. Chairman, I would like to take issue with your phrase "disgraceful situation." I do not want to read between Admiral Bulkeley's words or other than what he has said on paper but——

Chairman PROXMIRE. Maybe I should use the word "outrageous" instead of disgraceful.

Admiral SONENSHEIN. I think this ship is probably—if you and I were to go visit this ship now or shortly after it joined the fleet we would find it to be a fine ship. I think he was making a very strong point to us there and I did in fact, as I recall, communicate with the supervisor of shipbuilding at Seattle on this ship subsequent to receiving this report, and I urged him and directed him that on the next ships that were coming out to insure a higher state of completion upon delivery.

Chairman PROXMIRE. Let me read one part of this report and I will be with Mr. Rule in a minute and get back on the main issue we were discussing. This is such a striking example, however, it seemed to me I did want to see what I could do to get to the bottom of it.

What I did not read was this observation by Admiral Bulkeley.

This ship could not attain the full power RPM's of PAT without exceeding the boiler fuel oil pressure limitations. Review of the PAT data indicates a specially instrumented burner was used which is not normally available. The lagging of the steam systems of this ship is incomplete and inadequate. In this area, it is the worst new construction ship I have seen in the last 2 years. There are many, many steam lines, flanges, valves, regulators, strainers, et cetera missing lagging and this is on 600 p.s.i., 150 p.s.i., and HP drain lines. My inspectors measured the surface temperature on the SSTG and HP turbine casings, and it's hot enough to burn the unwary. I feel correcting some of this lagging should be urgently undertaken before the midshipmen cruise to keep them from getting burned.

(The entire report was subsequently supplied for the record:)

BULKELEY REPORT

JUNE 4, 1971.

Rear Adm. NATHAN SONENSHEIN, USN,
Commander, Naval Ship Systems Command,
Navy Department,
Washington, D.C.

DEAR SONNY: The Board conducted the Final Contract Trials of the USS *Shreveport* (LPD–12) during the week of 24 May this year.

You will recall that the Washington Board conducted trials on the first of this class *Juneau* (LPD–10) out of Lockheed's yard in Seattle on 20 June 1969.

Much of what was said at that time still applies and I cannot see much improvement.

This ship from the significant deficiencies left over from the Acceptance Trial and further from lack of preservative painting, let alone finish painting on the hull and mast, would lead me to the impression that the ship should not have been accepted in the first place until properly preserved and painted.

Already rust is breaking out on the hull and catwalks and I understand that the crew has painted a good deal of it. There is evidence throughout the ship that painting was done over rust and there are areas where I could find no preservative or surface preparation for painting such as zinc chromate or red lead.

In the mast structure many of the fastenings to the mast are simply not painted and are rusting. Structural sheet metal work was not finished. Further, there are bi-metallic fittings that could and do lead to rapid deterioration of the fittings and fastenings. Even on the air search radar foundations the wrong kind of metal washers were used and the rigid coaxial cable was rubbing metal-to-metal against an incomplete supporting hanger.

I stress the lack of proper painting and preservation simply because of the amount of workload imposed on the ship already in repainting and represerving, plus the cost in terms of time, manpower and money to the ship. Sailors should not have to do contractor work.

One of the first things that hits the eye is the large amount of crude welding efforts on decks and vertical bulkheads. None of which have been ground down and still scar the appearance of this ship. However, I do not believe that any of them effect the structural strength of the ship. You will recall (and I am enclosing it for you), my letter on the first ship out of this yard of this class, that I mentioned that the welding was poor. I also mentioned this to the Quality Control Officer of the yard who told me at that time that he could do nothing about it although he had tried and agreed with me. I again pointed it out to him at the critique, but this time his attitude was quite different since he apparently was on the management team's side.

This ship had the largest number of safety deficiencies that I have seen in a very long time and most of them if not all must be corrected forthwith before men are hurt.

One of the worst but not most dangerous, that I have seen is the fibre glass hand rails in the mast structure. Already, two are broken and there are repairs to other parts that I would not trust and no sailor should either. These rails should be made strong, rigid, and rugged and inspire confidence to the men who work aloft on electronics, from time to time, that it is safe to depend on them. I would not. Further, the ladder to the top mast was loose and I wouldn't go any further aloft—it is also insufficiently braced. Several of the small platforms within the mast structure that provide maintenance access to radio transmitter antennas do not have hand rails installed at all. The catwalk to certain ECN antennas stops about 5 to 7 feet short of the antennas with no provision for gaining access to these antennas (photos enclosed).

This entire mast structure needs a thorough preservation even to taking down to bare metal and then preserved and painted. It was poorly done if at all.

The ship has made the recommendation also that the same be done to the hull at the post shakedown availability and I concur for the preservation of the ship to start her life with the fleet correctly without being a burden and expense to the ship's force.

In the engineering spaces I was struck by the inaccessibility of a goodly part of the auxiliaries and other pieces of machinery that will be most difficult to maintain let alone open and inspect. This is very wrong and a little effort could have prevented much of this at the beginning. I have mentioned this before.

The safety deficiencies are listed later in this letter but are of such magnitude that men could be hurt, such as inoperative overspeed trips on generators, as well as ammo hoists ripping open shell containers (powder cans).

The engine rooms are hot. The lagging of the steam system is incomplete and some are inadequate. As a result there is a significant amount of radiated heat from missing laggings pads on flanges, valves, and other fittings as well as the poor lagging on the turbines. At this time there were not many steam leaks that would add to the already high ambient temperatures. The engine room temperatures approach the personnel heat tolerance limits prescribed by BUMED. It is not right to ask sailors to do work in spaces when much can be done to make it more comfortable for them by properly finishing the ship as it should have been done.

Further, there are several areas in this engine room that men stand watch where the noise level is of such magnitude that damage to their ears may result.

In the steering engine room the noise where men must stand watch was about 102 decibels and of such order that by BUMED standards if men wore "ear muffs" the maximum they could stand watch there would be about 1½ hours without impairing their hearing. I consider that this deficiency must be corrected forthwith before we damage our sailors' hearing.

There was no effective sanitation of the food preparation utensils or for that matter of the dishes and silverware. All dishwashers had their gauges out of calibration and the sinks for washing the food preparation utensils had no remote working gauges plus the heating of the sanitizing water by steam. This ship could have an epidemic. It does not now meet minimum health standards and must be fixed.

Also in this area of health and livability I ran across a new one for the first time. It appears that a number of the scuttlebutt drains are tied into either the urinal vent lines or sanitary drains. Of course the drains have the standard plumber's trap and work fine so long as the ship is stationary and not rolling. But in a seaway and at night when the scuttlebutts are not used much the water rolls out of the traps. The result when one takes a drink on getting up in the morning is simply electrifying. I might add that where the scuttlebutt is in a living compartment such as the chiefs' quarters the odors are appalling during the night and early morning at sea. This should be corrected forthwith. I would even recommend that it be corrected before the Midshipmen cruise. They might well get a wrong impression of habitability.

I think that it is about time that we get some decent gripes on the Lifeboat (LWE). I understand that three have been lost already. Whether they were swung in and properly secured at the time of the loss I do not know—but right now if the boat is swung in, the present gripes will work loose in a seaway and the boat could be lost. This is something that we can save some money on for the fleet.

There is a very large number of Acceptance Trial items that are carried over, have not been done, or couldn't be done for one reason or another.

This is all fine and dandy but if we had a complete ship and ready for unrestricted services at the time of the Acceptance Trials and one in which we had proper accessibility to machinery units for maintenance we would have not had the large number of items from starred to Part I deficiencies to be corrected later in the life of the ship to say nothing of safety, maintainability and operating efficiency.

I am well aware that many will never be corrected, also many will be deferred to some point later in the life of the ship. This only makes more work and cost for the Navy in the post shakedown availability and in many cases we cannot finance it and the ship is never a completed ship, one that is livable, comfortable and capable of fully carrying out her mission with safety.

If such work is given to ship's force, or at the card conference is set aside or 'not authorized' we are again short-changing the Navy. If ship's force is required to complete the ship then the training and operations of the ship and crew to say nothing of the maintenance of the ship will surely suffer. There is a significant lot to be accomplished yet in this ship and I have barely outlined some of the significant problems.

One other item that struck me and will serve as an example. The Commanding Officer of the Troops embarked has a rank of colonel. His stateroom is austere and according to specifications and has standard 'navy furniture', much like the furniture that was put in the LCC, MT WHITNEY.

The decor of the Commanding Officer's cabin and flag officer's cabin (and which are equal in appearance and well done) are in marked contrast to the Marine Colonel's stateroom. It would appear that someone forgot the Marines, or that there is 'discrimination' which of course it isn't. But if we talk about a Navy-Marine Corps team we ought to do a lot for the accommodations for the Marine officers and especially for the Colonel and at least as much as we do for our naval officers.

As I have said previously the decor of the USS BLUE RIDGE was in sharp contrast to the MT WHITNEY and we might profit from the comparison. Already one type commander has commented on this subject which you are aware of.

One problem that has been plaguing the fleet for years and which I have not been able to accomplish much on is a proper and designated sodium hypochlorite

stowage area or space. It is a very dangerous chemical and as long as we have to have it aboard our ships a proper stowage should be designated. I urge this.

Perhaps I have saved the worst for last—the ship did not make full power even though steamed in overload condition with standard sprayer plates, and the boilers were "flat cut".

There were many deficiencies in the electronics of mission degrading type. Further, my old 'friend' the 40 Alpha radar despite a tuning for performance by the Sperry technical representative left much to be desired. Further, he did not check the wave guide and see the deficiency there that is not only a poor installation but will surely fail in the near future and cause another 'Casrept'.

Most of the transceivers were below performance standard and are mission degrading. Full details of the electronic suite are covered later in this letter. I was very disappointed in the electronic area, and this is a simple installation.

In the weapons area which after all is not the 'main battery' of this class of ship, I was appalled at the number of significant safety deficiencies, as well as lack of rudimentary maintenance. This could cause most serious damage to the ship (explosion), as well as casualties to the crew if not corrected. They must be corrected forthwith.

Most of magazine sprinkling systems for 3''/50 ammo could not be sprinkled. This must be fixed. Details later in this letter.

I did not see anything significant in the personnel manning the ship. In one case a man who was qualified for the SPS–40 air search radar was working on the 40 Alpha radar which has significant differences in some areas and which he did not know about. It is not fair to have men not trained on their equipment and then expect them to give a piece of equipment the care and maintenance let alone be responsible for the performance when they do not know their equipment.

In the area of effective preventive maintenance the ship was clean, the overall painting condition was poor as has already been mentioned. There were no cockroaches.

In the gunnery department the material condition was poor and effective maintenance was almost zero. The same applied to the magazines including the cargo magazines.

I would attribute this condition to the fact that effective maintenance was not started promptly at the acceptance of this ship by the Navy and the routine maintenance as required by the PMS program was not immediately put into effect. The documentation appeared to be good.

The forward 3''/50 dredger hoist manufactured by Sunstrand Corporation, is unreliable and represents an extreme safety hazard to both ship and personnel. Because of internal misalignment, this hoist jams the projectile cams between the rotating hoist and the fixed edge of the hoist in the upper ready service room. When the cams are jammed in this position, they are bent almost double, ruptured and the enclosed projectile and powder case is severely damaged. This damage might well result in spilling powder down the hoist and/or the explosion of the round in the ready service room. To date. six rounds have been damage might well result in spilling powder down the hoist and/or the exattributed to the stability of our ordnance. The condition of the 3'' guns in SHREVEPORT is very poor and is attributable to an almost total lack of preventive maintenance by ship's force personnel. All unpainted metal surfaces are rusty, illumination is out in many dials, small parts such as sight covers are missing, train limit steps are rusted solid and evidence of lubrication is minimal. In several places, masking tape was found covering weak fittings. Presumably, this tape has been in place since commissioning. The condition of the fire control system is marginal. The GFCS MK56 does not correctly compute gun orders and gun elevation order transmission results in oscillation of the mounts. The system was unable to acquire and track targets as close as 12.000 yards. The magazine sprinkling system was totally unsatisfactory. The ship did not possess the basic equipment to test the PRP valves and the lack of familiarity with the systems displayed by ships' personnel indicated that the required monthly tests were seldom. if ever. conducted. The 3'' magazines, though loaded with ordnance, had no automatic sprinkling protection because numerous control valves that should have been locked open were closed. The forward loading room could not even be sprinkled manually because the make-shift operating handle provided by the contractor was frozen. Numerous PRP valves in the cargo magazines failed to function under tests as did several control valves. The state of preservation in the magazines was totally unsatisfactory. Approximately 30% of the lights were burned out and one magazine was completely dark. About 70% of the portable battle lanterns were miss-

ing from the ordnance spaces. There was excessive rust. dirt, loose gear and corrosion in all magazines. In the small arms magazine there was three inches of water standing in the web of one frame. In spaces other than magazines the extraneous gear present ranged from a set of weights in the power amplidyne room to a pinup picture of obvious charm blocking the ventilation in the MK63 control room.

Mission degrading items are:

(*a*) UHF communications are unsatisfactory due to inoperative or below standard equipments.

(*b*) Test equipment calibration and stowage are inadequate.

(*c*) Active ECM does not meet standards.

(*d*) Passive ECM omnidirectional antennas are inaccessible and Band 9 of the WLM–I is inoperative.

(*e*) SPS–40A output is substandard and Coax is in danger of mechanical failure.

(*f*) IFF was not operationally demonstrated.

Further details by department:

NAVIGATION

The ship's whistle required an excessive amount of force applied to the mechanical operating lever for operation. There was no electrical method provided to operate the whistle. The boat compasses were not adjusted, nor were they provided with illumination for night piloting. The visual communications center crew shelter is heated by two electric heaters that look somewhat like bulkhead mounted waffle irons. There are no protective devices to shield the surfaces of the heaters from personnel. Temperatures in excess of 165° F were recorded with the heaters in use. As such this heating arrangement is a definite burn hazard to personnel.

OPERATIONS

The UHF communications equipment was found to be in unsatisfactory condition. Of 14 transceivers, AN/SRC–20's and 21's, 3 were inoperative and the remainder were all operating below standard. The ship was not in possession of the latest alignment techniques which I understand are considered a major improvement. I mention the latter because thorough distribution of this technique apparently has not occurred since this problem has arisen several times in recent inspections and trials.

Active ECM has not yet passed its tests in accordance with system performance standards in one mode. This mode had to be operated at reduced output power in order that the equipment not overload. In this reduced output condition, it was considered to have passed the test. Needless to say, this performance below specified levels, is not acceptable.

Once again in Passive ECM, band 9 of the AN/WLR–1 was inoperative. This critical band, which is the hardest to keep operable and within specifications, has been a problem on trials and inspections rather consistently.

The Air Search Radar, AN/SPS–40A, equipment was in excellent condition except for the transmitter. This is a direct reflection of the fact the ship's technician is school trained for SPS–40 rather than SPS–40A. The transmitter, despite recent Sperry assistance, was up to standards on only one channel.

AVIATION

Deficiencies exist in such areas as communications, clearance obstructions and visual landing aids which preclude certification of the aviation facility in accordance with current directives.

One of the JP–5 storage tanks needs cleaning, surface preparation and repainting where rust has broken through on the bottom plates. The JP–5 storage tanks have been used for salt water ballast. The coating in the JP–5 service tank that was inspected is in excellent condition.

DECK

Low level red illumination is inadequate for night UNREPs. Illumination of the boat deck. B & A areas, main deck working area. and the 26′ MWB is inadequate for night boat operations and night cargo handling operations.

Boat handling is a dangerous time/man-hour consuming operation, personnel must handle boat steadying lines while transiting from 01 level to main deck to keep the boat headed forward between the crane and hole hanger. The boat bow must pass under the completely topped up boom. Consider operations above sea state 2 will be extremely hazardous.

There are no extended mono-rails or outriggers for handling cargo over the side from the side-ports.

MAIN PROPULSION

This ship could not attain the full power RPM's of PAT without exceeding the boiler fuel oil pressure limitations. Review of the PAT data indicates a specially instrumented burner was used which is not normally available. The lagging of the steam systems of this ship is incomplete and inadequate. In this area, it is the worst new construction ship I have seen in the last two years. There are many, many steam lines, flanges, valves, regulators, strainers, et cetera missing lagging and this is on 600 psi, 150 psi and HP drain lines. My inspectors measured the surface temperature on the SSTG and HP turbine casings, and its hot enough to burn the unwary. I feel correcting some of this lagging should be urgently undertaken before the midshipmen cruise to keep them from getting burned.

In addition to the lagging deficiencies being personnel hazards, the radiated heat is contributing to the high temperatures in these spaces. Also, the ventilation is deficient and the net result is the ambient temperatures approach the personnel heat tolerance limits prescribed by BUMED. When some steam leaks develop, these places will be really hot.

The L.O. flange shields throughout the engine rooms are mostly missing or of the homemade variety, which do not conform with NAVSHIPS requirements. The L.O. strainer enclosure is not adequate—a large metal box encloses the strainers but is not effective since they must be dismantled partially to shift strainers. The requirements for adequate strainer shielding is not available to the operating force personnel.

The main L.O. system is not reliable. Both electric pump controls malfunction and steam pump Leslie regulators and governors do not control automatically. The IB SSTG L.O. system is very dirty with a very fine grit contamination throughout. It is reported that the contractor sand blasted with the vent set running which may be the source of the contaminant.

There were more than the usual number of safety deficiencies including two starred PAT items.

In an era of "dry bilge" ships and with the current emphasis on preventing oil pollution, the installed waste collecting system is inadequate. It is a combined salty water and oily waste collection system, yet not all the continual contributors to oil in the bilges are connected; for example, the L.O. strainer drip pans, and L.O. pump gland leakoff. The salt water drains which are connected, overtax the capacity of the waste tank provided.

BOILERS

Steam requirements during the attempted 100% full power trial caused the boilers to operate at loads in excess of 119%. Full power and overload sprayer plates are improperly aimed to restrict the flow of oil to within proper limits. At the same time superheat on #1 boiler was excessively low (810° F vs required 840° F minimum).

Numerous examples of incomplete drain system piping exist and several constitute serious burn hazards.

AUXILIARIES

It has come to the Board's attention that most installed pressure gauge and thermometer original calibration dates are long before the ship's delivery date. In many cases, these guages are due for a re-calibration practically as soon as the crew moves on board.

DAMAGE CONTROL

There are several serious deficiencies with the damage control installation that should be corrected forthwith. The remote control docks for the installed foam system for HMR #2 fail to operate the proportioner thereby providing no foam coverage to the upper and lower levels. The No. 3 HCFF station is un-

reliable in operation and the proportioner is extremely noisy. A serious problem which could develop is related to the inaccessibility of the installed equipment at all four HCFF stations. This could seriously hinder the performance of preventive maintenance.

SUPPLY

One safety item carried over from the Acceptance Trial should have been completed by this time. It is simple to correct the problem of exposed electrical wiring under galley ranges and the alternative to not correcting this deficiency could very well be an electrical shock death.

MEDICAL

The noise levels measured throughout engineering spaces is significantly in excess of the tolerable limits for working environments as prescribed by both Specifications for Construction of Naval Vessels and the standards imposed by the Navy's hearing conservation program. For example, readings taken in the after steering space revealed 102 Db on the A scale which limits a watchs danger to 1½ hours in this space even with ear protection plugs. Such working conditions are not only injurious to personnel by permanently damaging their hearing but materially reduce their efficiency as well.

HABITABILITY

The armory is inadequate for the secure stowage of small arms and ammunition. Advanced storage racks and cabinets are required for staff M–1 rifles and Marine pistols. Under present configuration any weapon could be easily obtained within a five-minute period.

All of the brig doors can be opened on the exterior side by an ordinary screwdriver while the electrical door locks are in a locked position.

Stowage space for troop sea bags, packs and locker boxes is considered inadequate. Sea bags and locker box stowage should be provided at one end of the lower vehicle area, and a full pack should be brought on board and checked against the provided stowage space in the berthing area.

PMS COMMENTS

The PMS software installation is essentially complete with the exceptions noted in the Commanding Officer's ltr ser 161–71 of 14 March 1971. However, the lack of coverage for the crash and salvage crane, fresh water pumps, seal ballast hydraulic control stations, HF receivers, the facsimile transceiver and the IFF equipment is significant and coverage should be provided immediately.

The most significant problem noted, which will seriously degrade the ability of the ship's personnel in the performance of preventive maintenance, is the inaccessibility of numerous equipments. This is especially true for main machinery requirements, electronic equipment for the four high capacity fog foam stations.

ENVIRONMENTAL POLLUTION CONTROL

The SHREVEPORT has no equipments or integrated systems to prevent the discharge of raw untreated sewage, garbage, refuse or petroleum products into rivers, harbors, bays, or coastal waters.

SHIP'S VEHICLES

The ship's vehicles are not covered under the Planned Maintenance System. There is no comprehensive maintenance program to ensure that the vehicles will be properly maintained for operating economy or more importantly for safe use on the highway.

I regret again very much indeed to have to paint such a grim picture in some areas. However, it points out to me certainly that if we had a completed ship ready for unrestricted service it would be cheaper in the long run for the life of the ship, comfort of the crew, and readiness for war, as well as a safe, reliable, and a maintainable ship. It appears now that without effort, time

and money we cannot obtain these attributes in this ship especially when deployment of the ship for a Midshipmen's Cruise is almost here.

Warmest regards.

Sincerely,

JOHN D. BULKELEY,
Rear Admiral, U.S. Navy.

Admiral SONENSHEIN. I think it would be important to provide to you for the record the actions that were taken on each of those items. They were carefully analyzed and I would like to make that report to you.

Chairman PROXMIRE. I would appreciate it.

(The following was subsequently supplied for the record:)

This ship did satisfactorily make full power during Acceptance and Final Contract Trials and met the specification requirements. Investigation of the indicated problem of excessive fuel oil pressure developed the fact that the fuel oil pressure used during full power trials was correct and that the pressure specified in the technical manual was incorrect (low). The technical manual is being corrected.

The special instrumentation installed during Acceptance Trials consisted only of pressure gages that were used to monitor fuel oil pressures. This was done to determine the pressure drop in the system between the pumps and the burners and validate the system design. These gages are normally not used but when used could in no way alter the characteristics of the burners. Other than the gages, the burners and sprayer plates used during Acceptance Trials were the same as those to be used during normal ship operations.

In regard to lagging (insulation); the Philadelphia Naval Shipyard has been instructed to survey the machinery spaces, during the Post Shakedown Availability and to correct insulation deficiencies where found. The cost to correct conditions that are not in accordance with the contract specification requirements will be presented to the contractor as a reduced cost contract change.

Admiral SONENSHEIN. I would like to make another point on this general subject which had been a major concern of ours and on which we have expended considerable effort throughout the Ship Systems Command and the supervisors' offices. I think I can tell you that there has been an improvement in the quality of the ships delivered upon completion.

Chairman PROXMIRE. This was only 3 months ago.

Admiral SONENSHEIN. I know. But we have letters from Admiral Bulkeley that praised the ships, not necessarily the LPD's but we have ones that extolled the conditions of the ships that have been delivered and this had been brought about in part by his prodding us as he has here, and it is his duty to do so. We have extended more efforts than I would want to undertake to describe here. Many actions have been initiated to get better products upon delivery. For example, a recent survey I made indicates that upon delivery over 90 percent of contract deficient items that were uncovered in the inspection before delivery are in fact corrected. That is a pretty darn good score, I think, when you consider the complexity of the project and the extent of the work done on the many systems and subsystems contained in a ship.

Chairman PROXMIRE. Mr. Rule, in your May testimony you said that it was wrong for the commander of the Naval Ship Systems Com-

mand—that is, Admiral Sonenshein, and I quote, "To personally inject himself into and negotiate these settlements himself."

Could you expand on why you believe it is improper and what the proper behavior should be?

Contractor Limited Liability

Mr. Rule. Yes, sir. May I first say something about what you were just talking with the Admiral?

Chairman Proxmire. Yes.

Mr. Rule. One of the questions that I did not read but a question we ask when we get these claims is: Does the Navy have any counterclaim against the contractor? You rarely see that.

Sometimes, when you do—correct me, Admiral, I think I am right—in the 1052 at Avondale, we had a $1.6 million limitation of liability by the contractor.

Admiral Sonenshein. Yes.

Mr. Rule. I think I am also correct that they had about $7 or $8 million worth of things we had to correct and pay for; is that not right?

Admiral Sonenshein. Those numbers are about right, I think.

Chairman Proxmire. Let me see if I understand what you are saying, Mr. Rule.

You say there was a $1.6 million limitation on the liability of the contractor to the Government?

Mr. Rule. That is right.

Chairman Proxmire. No matter what is wrong with the ship, there is the $1.6 million, or how big the program is, there was $1.6 million limitation?

Mr. Rule. In that particular contract.

Admiral Sonenshein. I think that number is essentially correct.

What Mr. Rule is alluding to is that in almost every one of our contracts there is a warranty, extending 6 months after delivery. There is generally also a dollar limitation of liability that he would be subject to.

Chairman Proxmire. That doesn't make any sense, it seems to me, to have this kind of situation where the liability should be much bigger than that.

Mr. Rule. That is the point I want to bring out. These contractors are sitting there with a claims-minded group, looking at every drawing to make a claim against us, and why don't we do the same thing on the items of deficiency?

Admiral Sonenshein. I wanted to say, the reason or logic for not having a higher limit of liability is that if we did have such, the contractors at the beginning of the contract would probably seek insurance to cover that liability. That would be an increased cost to the Government.

Chairman Proxmire. Regardless of how they do it, the prospect of Government claims is an incentive for doing an adequate job, it is an incentive for making sure when they deliver a ship the ship meets the specifications required.

If they have a $1.6 million limitation here, a relatively small proportion of what they should be liable for under the circumstances I have described in this instance, it seems to me their incentive for cracking down and making sure that that ship meets specifications are greatly reduced.

Admiral SONENSHEIN. I would agree with that; yes, sir.

Chairman PROXMIRE. Of course, if they have to seek insurance, it is up to the insurance company to make sure that they are covered. They won't sell them more than one policy, if their performance isn't good; it that right?

Admiral SONENSHEIN. Yes. I would say this, that our general practice—I am not talking of a particular shipbuilder—our general experience has been that the 2 percent we use for the shipbuilding contracts is generally adequate to cover such deficiencies.

Now, in some instances, as has been described here, that limit has been exceeded, but as a general historical experience that has proven adequate.

Chairman PROXMIRE. Well, maybe as a general historical experience. But if it is usually adequate, then I don't see any reason why you have to have the limitation.

By eliminating that restriction, it seems to me you provide a clear-cut understandable incentive for the contractor to be aware and sure when he delivers on a contract, that he meets the specifications required.

Mr. RULE. One other point the Admiral mentioned as one of the reasons we couldn't take a certain action was because, for example, the crew would be there and we couldn't tie the crew up waiting to correct something.

Well, why not keep a record of how much it costs to keep the crew there and charge the contractor. That is what he would do if the shoe was on the other foot. He would charge us every nickel that we held him up.

Chairman PROXMIRE. I am glad you raised that point, it hadn't occurred to me.

Why isn't that logical?

Admiral SONENSHEIN. Again, in the original contract price the contractor would protect himself against such a contingency and we would be subject to higher prices in the initial negotiations of contracts.

Chairman PROXMIRE. You are subject to a very difficult choice. You have the choice of either spending the money on a crew that is idle or having the crew go on an unsafe, inadequate ship. And, again, you have an incentive, a discipline on the contractor to make sure the ship is delivered on time.

Admiral SONENSHEIN. If we were willing to accept the increased initial cost with which he would want to protect himself.

I want to emphasize again that these ships are not a pile of junk, as implied here. These are really fine ships.

I had an occasion once to go aboard a ship that had an inspection report of page after page of deficiencies. What comes out of reading

these is a feeling that it must be a terrible ship. You go aboard the ship and you are pleasantly surprised at the fine vessel it is.

Chairman PROXMIRE. It doesn't sink.

Admiral SONENSHEIN. It is a fact there is no way to weigh deficiencies. If you want to describe the fact that a thermometer is missing, it takes four or five lines. If you want to say the main engines are missing, it takes four or five lines. The enumeration of items can go on and on.

Admiral Bulkeley will tell you, he didn't in this case, but generally speaking he will: "This is a fine ship but it has the following list of deficiencies." Some of them may be safety features, some may be in preservation, some may be in operations, but the general product delivered is a good product and it has, just like any automobile or any product you get, some deficiencies.

These are the most complicated projects that man undertakes and they don't come out exactly perfect.

NAVAL INVOLVEMENT IN CLAIM SETTLEMENTS

Chairman PROXMIRE. Let me get to the question. Shall I repeat the question I asked you?

Mr. RULE. No, sir. I did make that statement that I thought it was wrong for Admiral Sonenshein to inject himself into the negotiations and settlement of these claims, and I feel just as strongly and keenly about that now as I did then.

Admiral Sonenshein is a very wonderful gentleman but I don't know what his credentials are as a negotiator.

I think his basic philosophy is wrong here. He tells you in his prepared statement that normally the contracting officer and the negotiator would get in and handle a claim, but then he goes on: "Large and complex negotiations such as these bring in the highest corporate level people."

Well, so what.

Then he says, "Is it not inappropriate for the Systems Commander himself to become involved with his counterpart."

Well, that is just about as wrong a philosophy, when you are spending dollars, as you can have.

You have trained people to negotiate, trained contracting officers, and Admiral Sonenshein does not have the time to get into the details of the negotiations.

I wrote a book once on the art of negotiation. Let me read you under the chapter of who should negotiate. I didn't write this since this hassle came up; I wrote this about 10 years ago.

> My own observation and experience convince me that the most prevalent mistake made by both Government and industry is the assumption that position and authority are synonymous with knowledge and ability to negotiate properly and effectively. Thus, corporate officers, Cabinet officials, ambassadors, high-ranking military men, agency heads, etc., who possess both title and authority, are presumed to be perfectly capable of conducting involved and important negotiations. This can be a very violent presumption.

That is basically the way I feel. And this is, I certainly hope, one of the lessons we should learn from this case, that a gentleman in Admiral Sonenshein's position should hold himself in reserve. He

should be the court of appeals, and just because corporate presidents or vice presidents have to get involved, that is their business, but the one thing that has always bugged me in the Navy is when these corporate officials—and you can't blame them for trying to get to the topside as fast as they can—they don't want to be down negotiating with the negotiator and the contract officer, they don't like that. So they try every conceivable possible way to get as high as they can, to an admiral, to a secretary and, as I say, you can't blame them for trying.

I blame the people that let them get away with it. They ought not to be up there. They ought to be told when they go up to their friends, "Go back now and negotiate with Joe Smault, that is where you belong. If you have any irresolvable problem, I am here, but don't come up and try to negotiate with me," it is just a plain mistake.

Chairman PROXMIRE. Before I ask Admiral Sonenshein to respond, you have in mind, Mr. Rule, something beyond the fact that it is a mistake for the top officers to get into something in which they haven't been involved or are not experts, bearing in mind also there is the fact of financial pressure, political clout perhaps involved here?

Mr. RULE. Very definitely.

Chairman PROXMIRE. Admiral Sonenshein.

Mr. RULE. May I?

Chairman PROXMIRE. I beg your pardon.

Mr. RULE. Senator, if you asked me what was wrong, and one of the things that I like to think I am trying to do, I hope I am not spinning my wheels down here in this job I have—I have two objectives, and I suppose I will go to my grave without achieving one of them. One is accountability by people on the producer's side of the Navy as distinguished from the user's side, who make mistakes involving millions and millions of dollars.

There is no accountability, nothing happens. As you know, if we run a rowboat aground on the user's side, there will be a board of inquiry the next morning to assess responsibility. That doesn't happen in the Navy on the producer side, and I don't suppose it ever will. But the other point is lessons learned.

I am sorry that we don't learn more lessons after we make mistakes.

Now, in this particular case, you have to ask yourself, what in the world happened, what basically happened in the Avondale and Lockheed cases, because other cases haven't run into these problems. We have settled other claims, but the Avondale, the Lockheed, as the Admiral said, has been withdrawn from the review group, and they are going to do some more work on that, but the Avondale cases, the first claim was filed in January 1969. They took several years. Here it is the end of September 1971. It came up to the review group, it was rejected, disapproved, because it couldn't be substantiated.

And I would also like to say it isn't entirely accurate to say we rejected that claim from the basis of more documentation for engineering judgments, as the GAO indicated we should have gotten in the Todd case.

There are some very fundamental issues in the Avondale case, fundamental claims theory that we rejected, and it is not enough to say that you just need more documentation. There are some very, very important Navy-claimed theories involved in that case. Nevertheless, let's look at the damned thing.

To me, it is a real debacle what happened in Avondale, and you have to ask yourself why.

Now, I say two things are the basic cause, and, Admiral, I don't mean to rub it in. One, I think you should not have gotten involved as you did.

Second, I think, and this is much more important, because I think it is very, very basic.

This whole claim, in my opinion, has fallen on its face up to the present time. The Admiral says it is still in negotiation. Let me say for the record to my friends in Avondale, I don't give a damn if they can justify $173.5 million. If they can justify and document it. They are making statements around Washington that I wouldn't approve an Avondale claim no matter how much documentation they have. That just isn't so. But I don't mind that heat because I really don't care, if it is $173 million. But they are going to have to justify it.

Now, the basic thing wrong with the Avondale case today is what I have termed outside, unreasonable outside pressure, Senator Proxmire. Unreasonable outside pressure, that has been brought to bear by the claimant.

I think you know me well enough, when I see something wrong in our spending of the taxpayers' money in the Navy or by a contractor, you know I am going to talk about it and try to do something about it and make constructive suggestions.

Congressional Pressure

Now, I think that I also should point out when I see things wrong that bear congressional flavor. There is this because of unreasonable outside pressure in this case. It is a new dimension, Senator. I have never seen it. I have never seen it in a claim's case.

Chairman Proxmire. When you say, "unreasonable outside pressure"——

Mr. Rule. Yes.

Chairman Proxmire. Do you want to be more specific?

Mr. Rule. I would be delighted to.

Chairman Proxmire. To whom are you referring?

Mr. Rule. Let me preface what I am going to say, though, with saying that I am fully aware of legitimate inquiries by Senators and Congressmen. About 2 months ago, I had a call from a man who identified himself as Senator Proxmire's administrative assistant, because I was reviewing a claim from a Milwaukee businessman. He was very nice and he said, anything you can do to expedite, we certainly would appreciate.

I said, well, if that is all you want, I will act on it today, and he said, oh, no, take your time, but anything you can do we will appreciate.

That claim I rejected, I am sorry. It wasn't a big one, but I rejected it. And I never heard——

Chairman Proxmire. We didn't ask you to accept it; we just asked you to expedite it.

Mr. Rule. That is right. That is absolutely right. And I never heard another word. Those inquiries are perfectly legitimate.

I am going to speak now, if you don't mind, as Gordon Rule.

It is my personal opinion and, indeed, conviction that unreasonable outside pressures were brought to bear in the Avondale claims to such an extent that it was almost impossible to rely strictly on merit and objectivity in the handling of these claims.

Let me state very clearly if a claimant can reasonably prove his claim to the Navy, he will be paid and it is not necessary to bring outside, unreasonable outside, pressure to get it paid.

I fully appreciate, Senator Proxmire, that what in my personal opinion amounts to unreasonable outside pressure may not add up to that in the minds of other men. It is something that I personally feel strongly about because I have been working on these things for so many years. Normally, claims go through without this pressure. When anything happens outside that normal, you begin to wonder about the merits of the claim. It is just part of the business. Because a lot of people will substitute, or try to substitute pressure for merit.

I am, however, entitled to my opinion, and that is that in these claims the following facts—and these are facts—add up to unreasonable pressure. This isn't speculation. These are three facts I am going to give you.

Fact No. 1: Navy officials have been summoned to the office of Congressman Boggs of Louisiana to discuss the Avondale claims with the Avondale people in attendance. Present also were Congressman Hébert and the administrative assistants from Senator Ellender's and Senator Long's offices.

Now, I am not saying, nor inferring, Senator, that such practice is criminal in nature or violates any law, but I certainly feel as a citizen and taxpayer that to call a meeting in the office of a Member of Congress with the constituent claimant and Navy officials to discuss a multimillion-dollar claim, pending claim, is dead wrong and constitutes raw pressure on behalf of the constituent claimant. That is fact No. 1.

They had the meeting and discussed the claim.

Subsequent to the meeting, it may just be complete irony, the claim went up, the settlement went up.

Fact No. 2——

Chairman PROXMIRE. I am sorry, I didn't quite understand, the settlement went up, the size of the claim was increased?

Mr. RULE. We had offered this man, Avondale, a certain amount. He had refused it. He said, I am going to get congressional assistance on this. Then they had a meeting in a Congressman's office with another Congressman there, two A.A.'s from the two Senators, the claimant himself, and the Navy officials. Subsequent to that, the amount of the claim was settled, for—it went up $1.9 million.

Fact No. 2: The claimant and Mr. Boggs set up a meeting with the contracting officer in charge of the Avondale claims in Mr. Packard's office to discuss the settlement of these claims while they were pending.

Again, it is my personal opinion that such tactics to settle a constituent's claims are improper and add up to unreasonable pressure. Clearly, Mr. Packard should not be subjected to such demands on his time.

Fact No. 3: I show you a letter, Senator, dated December 1, 1970, to the Secretary of the Navy, Chafee, regarding the Avondale claim.

You will note this letter is signed by Senator Ellender, Senator Long, Congressman Hébert, and Congressman Boggs.

Insofar as the Department of Defense in general, and the Navy in particular, are concerned, these four gentlemen from Louisiana constitute the most powerful single congressional delegation and, in my opinion, any letter signed by all four of them which relates to a claim by a constituent adds up to rather clear and, I suggest, calculated pressure which I consider unreasonable and unnecessary.

Those are three facts, they are in existence, nobody denies that those things took place.

Chairman PROXMIRE. Without objection, this letter will be printed in the record at this point.

(The letter referred to follows:)

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D.C., December 1, 1970.

Hon. JOHN H. CHAFEE,
Secretary of the Navy,
The Pentagon, Washington, D.C.

DEAR MR. SECRETARY: We are enclosing a copy of a self-explanatory letter jointly directed to us by Mr. William J. Boyle, Jr., President of Delta Marine Contractors, Inc. of New Orleans, Louisiana. As you will note, Mr. Boyle has contacted us about the 27 Destroyer Escort Program contracts awarded to Avondale Shipyards, Inc. and sub-let to his firm.

Delta Marine has offered considerable evidence in support of its position in this matter and the hardship created for the contractor and sub-contractor as a result of various delays. We would hope these claims could be promptly adjudicated and will appreciate your Department's every consideration toward that end. Please let us have a full report after you have had an opportunity to look into the situation.

With appreciation and kind personal regards, we are
Sincerely,

ALLEN J. ELLENDER.
RUSSELL B. LONG.
F. EDWARD HÉBERT.
HALE BOGGS.

[Enclosures.] [1]

Mr. RULE. Right. As I say, men can come to different conclusions on it. I come to the conclusion it is outside unreasonable pressure, and I think that is one of the basic things that has gotten Avondale in trouble.

There have been dozens and dozens of phone calls from the offices of those four gentleman to the Secretary and people in the Navy. I can't document them. They know how many they made. The thing was always in the atmosphere of very intense congressional pressure. It is a new dimension, Senator; I think it is wrong. I would hope you would agree and I would hope specifically that Congressional Rules of Conduct should prohibit the kind of actions I have described that took place in these Avondale claims. I hope you will be able to do something about it.

Chairman PROXMIRE. Well, I appreciate that suggestion. You are giving me quite an order. You are talking about the chairman of the Appropriations Committee of the Senate, the chairman of the Finance Committee in the Senate, and the chairman of the Armed Services Committee in the House, and the majority leader in the House.

[1] Not supplied for the record.

As you say, this is by far the most powerful delegation.

Mr. RULE. This is quite a letter. Would you think, if you got that letter, if you were Secretary of the Navy, that that was a little leaning on you?

Chairman PROXMIRE. Well, I think I would understand what these gentlemen wanted and, as you say, they have considerable power.

Mr. RULE. Senator, I want to say this. I really don't want you to think I am a Boy Scout about this. If these people want to call up all over Washington to get a constituent a job, that is one thing. If they wanted to go all out to get a river and harbor project for their State or their county, I don't care. But we are talking about claims, unilateral claims filed by constituents.

Now, I know that Avondale is the largest single employer in the State of Louisiana and I don't blame these people for being interested. But I say, when multimillion-dollar claims of the taxpayers' money are pending it is wrong to go about it the way they went about it, and in my personal opinion it is really unreasonable outside pressure.

Chairman PROXMIRE. Let me just clarify this. You did give one fact there, that following this action there was an increase in the claim of $1.9 million.

Mr. RULE. Yes, sir; and I can't say that that came about in that meeting. I am only saying what the record shows.

Chairman PROXMIRE. Let me read the letter. It is very short. I think, in fairness, I should read it.

We are enclosing a copy of a self-explanatory letter jointly directed to us by Mr. William Boyle, Jr., President of Delta Marine Contractors, Inc., of New Orleans, Louisiana. As you will note, Mr. Boyle has contacted us about the 27 Destroyer Escort Program contracts awarded to Avondale Shipyards, Inc., and sub-let to his firm.

Delta Marine has offered considerable evidence in support of its position in this matter and the hardship created for the contractor and sub-contractor as a result of various delays. We would hope these claims could be promptly adjudicated and will appreciate your Department's every consideration toward that end. Please let us have a full report after you have had an opportunity to look into the situation.

With appreciation and kind personal regards, we are,
Sincerely,
(signed) Allen J. Ellender, United States Senator
(signed) Russell B. Long, United States Senator
(signed) F. Edward Hébert, Member of Congress
(signed) Hale Boggs, Member of Congress.

What that means, if I understand it, without having a letter from Mr. Boyle, is that they wanted the claims settled one way or the other promptly.

Mr. RULE. That is right; I agree.

Chairman PROXMIRE. I don't see any implication, at least in this letter, that they felt that the claims should be settled favorably or unfavorably, although I am sure they wanted it favorably settled. Here, what they asked for was more prompt action; is that correct?

Mr. RULE. That is exactly what they asked for. It is signed by four people, the most powerful congressional delegation vis-a-vis DOD.

Chairman PROXMIRE. And did you imply that because these men have this kind of immense power in the Congress and in the country, that there would be pressure on the Navy to settle one way rather than another, or would you say that simply it would mean pressure on the Navy to settle more promptly?

Mr. RULE. Well, Senator, there are a lot of people in the Navy who disagree with me. I am sure Admiral Sonenshein is going to say he disagrees. I am sure that almost every member of the Secretariat who are on the receiving end of these calls will say the same thing. I don't think they can say anything else. But suffice to say, when the claim was turned down, Mr. Hébert's committee in the House called for the entire Navy file. They have the entire Navy claims file and all of the correspondence. Why, I don't know.

Chairman PROXMIRE. Before I call on you, Admiral Sonenshein, let me say this: That I want to be as fair as I can in this. As you pointed out, you started out by saying you received a call from my office, from my AA, asking to expedite a particular case, and you decided against it, and that was the last you heard of it. But we asked you to expedite it. You said there was nothing wrong in that.

Just because these men have these powerful positions that they occupy, far more powerful than mine, and there are four of them, would you say that in this case, you wouldn't argue in that case, they can't ask you to expedite a case?

Mr. RULE. Not standing alone, not that letter standing alone.

Have you ever heard of—bearing in mind we are talking plain—have you ever heard of a Congressman, a whole delegation, calling the Navy people up and the contractor and asking discussing price? Have you ever heard of that?

Chairman PROXMIRE. They did discuss price?

Mr. RULE. Yes, sir.

Chairman PROXMIRE. That is different.

Mr. RULE. Would you do it?

Chairman PROXMIRE. I hope not.

Mr. RULE. Thank you.

Chairman PROXMIRE. Admiral Sonenshein.

Admiral SONENSHEIN. Mr. Chairman, I don't want to enter into a debate with Mr. Rule, but he has made many statements that I think I can illuminate for your benefit.

Chairman PROXMIRE. Very good.

SONENSHEIN CLAIM SETTLEMENT QUALIFICATIONS

Admiral SONENSHEIN. First, I would like to say that I stand on my position as stated in my statement, that as head of the procuring activity—the Naval Ships Systems Command—it was entirely appropriate for me to participate in the settlement of these major issues. The question was raised about my experience in this field. My entire Naval career since 1941 or 1942 has been devoted to the matter of ships—their design, their construction and their maintenance—in one part of the country or another, and in many capacities. Being involved in contractual situations has become almost second nature.

I think the first time I ever engaged in a contractual operation was in 1945, when I negotiated a contract with a university in California, to support a research project of which I was in charge. Since then, through the years, I have been involved in ship acquisition. In fact, in 1965, 1966, and 1967, which was not too long ago, when I was the program manager for the now defunct FDL project, I had the wonderful opportunity of working under the direct tutelage of Mr. Banner-

man, who was the Assistant Secretary of the Navy for Installations and Logistics at that time. He passed away this year and was, I believe, one of the outstanding procurement experts in this country.

His loss to the Navy when he retired and went to other fields was keenly felt, particularly by me personally, but I did have an opportunity to work with him on structuring shipbuilding contracts in considerable detail, clause by clause, in fact, in developing new approaches to ship acquisition. So I don't feel unfamiliar in the conduct of this business.

Second, I want to emphasize, reemphasize, as I stated in my remarks earlier, that we formed a special team for this claim, we had a special assistant for contract claims settlement who was a Navy Supply Corps captain especially experienced in contract claims settlement. He was the one who was directly in charge, he was the supervisor of this operation and we relied on him considerably.

Now, Mr. Rule has stated that he rejected the claim from the Avondale Co. on certain fundamental issues.

As I stated earlier, we cannot in this public hearing get into the merits of the claim or its component elements and argue the rightness or wrongness of his judgments versus other people's judgments, but what I want to emphasize is that in claims settlement we are dealing in highly judgmental fields and when I say that I include every aspect. We have to make judgments in engineering, we have to make judgments on the contractual side, and we have to make judgments on the legal side. I think you can appreciate that.

Chairman PROXMIRE. Let me interrupt by asking, Admiral, don't you think it is unusual, however, for you in your position with your prestige and the position you occupy in the Navy to get into a particular kind of negotiations? You are a man of fine judgment, you undoubtedly know a great deal about these matters, but you cannot know as much about the details of a particular situation as the men who have worked on it intensely and who are directly responsible. As Mr. Rule suggested, you might have a very important role to play as a kind of a court of appeals in a later stage. To inject yourself at this point seems to me compromises any possibility you could do that.

Admiral SONENSHEIN. I want to say as a repeat of what I said earlier, we had a very, very large problem. You have described it yourself in your opening comments. A very large problem. It was one to which my superiors told me to give personal attention. I was held to produce——

Chairman PROXMIRE. That explains it right there. Your superiors told you to get into it?

Admiral SONENSHEIN. Correct. Because it was a matter of major——

Chairman PROXMIRE. Your superiors being the Secretary of the Navy?

Admiral SONENSHEIN. In this case the Chief of Naval Material who has since retired. We have another one now.

I do want to emphasize that even in the legal entitlement areas one can get great arguments going on both sides of what is entitlement and what is not entitlement. As I am sure we have seen when cases go to the courts, they get ruled one way at one level and changed and reversed at higher ones, which is indicative of the kind of uncertainties that exist in this field.

I want to emphasize again this area is one not subject to precise legal entitlement or to engineering exactitude in the determination of responsibilities and costs.

Outside Pressure on Claims

I would like to go on to the subject of outside pressure. Mr. Rule has stated the facts that I am sure are correct about the meetings and phone calls. I want to tell you unequivocally that I had not attended any meeting such as was described nor did any of my claim settlement team or special assistant or members of the team attend such a meeting. In fact, I didn't know they had happened until recently. As for the meeting in Mr. Packard's office that was alluded to, I presume it happened.

Chairman Proxmire. Let me interrupt. Who in the Navy had attended that meeting in Mr. Boggs' office?

Mr. Rule. This meeting I didn't even know took place until I got the clearance from Admiral Sonenshein on the Avondale claims and there is a chronology of events submitted as attachment No. 4 with the claim that points out the highlights of the claims.

Admiral Sonenshein. None of my claim team members nor I attended such a meeting.

Mr. Rule. The meeting was attended by Mr. Carter and Mr. Bruner of Avondale, Congressmen Boggs and Hébert, the administrative assistants to Senators Long and Ellender, Secretary Sanders and Captain Buteau.

Chairman Proxmire. Secretary Sanders and Captain Buteau.

Admiral Sonenshein. Yes, sir. They are not in my organization.

Chairman Proxmire. What is their relationship to your shop, Mr. Rule?

Mr. Rule. Mr. Sanders was Assistant Secretary of Navy I. & L. and you have had many meetings in his office to get on with these claims, I know, Admiral, and so have I. He wanted the claim settled. I don't mean any innuendo by that. He was after us all the time to settle these claims.

Chairman Proxmire. Mr. Sanders was in charge of procurement?

Mr. Rule. I cannot answer that categorically because the Assistant Secretary of I. & L. sits out here sort of on the sidelines from the real flow of procurement responsibility. Under the unilinear system in the Navy, Admiral Zumwalt, CNO, is in charge of procurement in that he is directly over CNM who now is Admiral Arnold.

Chairman Proxmire. Would either one of these gentlemen be in the position, on the basis of this meeting, to exert any influence on the nature of the settlement, either the size.

Mr. Rule. I don't know that they did exert any.

Chairman Proxmire. I said would they be in a position to do so, have the authority to do so? What is Mr. Sander's connection aside from the fact that he is a high-ranking official.

Mr. Rule. What is his what?

Chairman Proxmire. What is his connection with this particular claim: how would he have any influence or authority over its settlement?

Mr. Rule. I am not going to speculate on that. I only know what came to me in the chronology. On October 23, 1970, Mr. Carter re-

jected $71.6 million after stating that he would ask for congressional assistance and go to the ASBCA.

This meeting was set up on November 3, 1970, after the October 23 meeting where Mr. Carter rejected $71.6 million that Admiral Sonenshein had offered him.

The chronology goes on down here. At the conclusion of the meeting Secretary Sanders agreed to call Mr. Carter on November 23 and advise him when the Navy would make a decision. NAVSHIPS previous $71.5 million reaffirmed, presumably by Mr. Sanders. December 1 meeting, Admiral Sonenshein, his deputy, Messrs. Carter and Bruner, tentative settlement of $73.5 million agreed to by both parties. That is the chronology. I don't know what the hell happened.

Chairman PROXMIRE. All right, sir. Go ahead, Admiral.

Admiral SONENSHEIN. The chronology is correct, obviously, as reported. I can assure you unequivocally that Mr. Sanders never tried to direct an amount of settlement. He never spoke to me as to what the amount of settlement should be.

Chairman PROXMIRE. Did he speak——

Admiral SONENSHEIN. He urged me on the schedule as did others. I think that Mr. Shillito when he testified before you here last May or June, this past May or June, spoke about the urgency of getting on with the processing of claims, and the thing that generated the urgency, the pressure, was the need to get this big problem behind us. We needed to get our contractual relationships with the shipbuilder, there are many others besides Lockheed and Avondale involved, in order.

Chairman PROXMIRE. Did anybody not directly engaged in the negotiation process speak to you at all about the size of the settlement?

Admiral SONENSHEIN. No, sir.

Chairman PROXMIRE. At any time?

Admiral SONENSHEIN. No, sir. That is unequivocal. The whole settlement evolved from my claim settlement team headed by the Special Assistant for Claim Settlement who developed for me what he considered the boundaries within which we could negotiate.

Chairman PROXMIRE. As far as you are concerned the only pressure you got——

Admiral SONENSHEIN. Was to get on with the job. In fact, I was frequently called down to account for why we were not meeting our milestones, but never as to the quantum.

Chairman PROXMIRE. In your statement you say this additional information has been requested from Avondale as indicated by the GAO report and the Todd claim.

Doesn't the Rule report suggest other steps be taken by your office? What about the following findings in this Rule report, (*a*), that someone in the Navy helped the contractor prepare his claim? Does this appear to you to be a conflict of interest and what are you doing about it?

Admiral SONENSHEIN. I would like to address that, if I may.

Chairman PROXMIRE. It seems to me very shocking that someone in the Navy would assist a contractor with a claim against the Government, somebody working for the Government assist the contractor in a claim against his own employer, the Government.

Admiral SONENSHEIN. Let me respond to that, sir.

Chairman PROXMIRE. Yes.

Admiral SONENSHEIN. When a claim is received—I skipped that in my oral testimony but I described the procedure in some detail in the written statement—the team has to investigate the assertions. The assertions frequently are general. They may be broad in nature, they may be not sufficiently detailed to appraise. When an investigator starts to develop the information relating to the claim and develops additional facts that surround that circumstance, he writes that data into his report, his technical analysis report or any other kind of report he may prepare.

One can look at that and say, "Well, that is preparing his claim." That is not so. He is developing the facts surrounding the claim, and the more fully he can develop those facts the better job he does. I think that is the way it should be regarded.

Chairman PROXMIRE. I think that kind of situation is understandable. I don't think that was necessarily what Mr. Rule had in mind. How about it, Mr. Rule?

Admiral SONENSHEIN. The claim is written by the contractor and submitted by him. Some of these come in pretty big stacks, about so high, in fact, and that is one of the reasons it takes so many months to analyze.

Chairman PROXMIRE. It is one thing to explain what you have in the package and it is something else to assist the contractor in preparing his claim against the Government.

Admiral SONENSHEIN. I would agree with that. The kind of things that I am acquainted with that were done by the claim team were to investigate, develop facts surrounding the events, and write them into the technical analysis report. Someone could judge that is not adequate, that is all right, that is a matter of judgment. But this is my understanding of the situation.

Chairman PROXMIRE. Well, do you then deny an employee of the Navy assisted——

Admiral SONENSHEIN. To my knowledge, that is right.

Chairman PROXMIRE (continuing). The contractor in preparing his claim against the Navy?

Admiral SONENSHEIN. To my knowledge.

Chairman PROXMIRE. What was behind your statement, Mr. Rule?

"RIPPLE EFFECT"

Mr. RULE. Well, the Admiral can easily find out. We didn't dream that statement up. There is a large amount of money involved in this Avondale claim and I am not going to get into it, Admiral, too much. In a theory called the ripple effect, it is a new concept, they are trying to say that what happened on the 1052's rippled over to the 1078's. It is a new theory and it is going to become quite controversial.

Chairman PROXMIRE. What I am talking about is the specific statement.

Mr. RULE. The company was asked to give examples of what it was that happened on the 1052 that rippled over to the 1078 because they put millions of dollars in for ripple and they couldn't do it. They couldn't give examples of what it was that rippled. So the engineer sat down and he admitted in a briefing——

Chairman PROXMIRE. The engineer from——

Mr. RULE. Team engineer. He looked back and he found items that he said rippled, and to that exent——

Chairman PROXMIRE. Will you identify that person? Who was the engineer?

Mr. RULE. Mr. Schempp.

Chairman PROXMIRE. He was an employee——

Mr. RULE. He was the claim settlement team.

Chairman PROXMIRE. For the Navy?

Mr. RULE. That is right. And he found these examples of things that he thought rippled but the contractor didn't point them out.

Admiral SONENSHEIN. This is again, Mr. Chairman——

Mr. RULE. That just isn't investigation, in my opinion.

Admiral SONENSHEIN. This is a matter of how do you appraise that action. Mr. Schempp, who is a very experienced engineer in this kind of work, was involved in investigating the aspects of the so-called ripple and it has been reported to me that in developing the facts surrounding that he wrote up a report which developed the case more fully than the contractor's own general assertion which I mentioned earlier.

That, in my view, is not writing the contractor's claim. That is an analysis, it is an investigation, and it is a report to the special assistant for claim settlement who then appraised it in the whole.

Mr. RULE. Our position is if he makes assertions there is a ripple effect and he puts $20 million next to it and he can't show specific examples of the ripple, the claim for that ought to be denied.

Chairman PROXMIRE. And you shouldn't have a Navy employee coming over to try and help him show that?

Mr. RULE..Precisely.

CONTRACT "BUY-INS"

Chairman PROXMIRE. This finding in the Rule report that there may have been a buy-in to the contract, have you done anything about that possibility?

Admiral SONENSHEIN. That is a very difficult area to discuss without getting into specifics again and I think we should avoid those substantive issues in the public discussion for the reasons that I think we understand. But my recollection is, and I think the record will show, that at the time these ships were awarded competitively, in the era of 1964 and 1965, the price bid by the various shipbuilders in the country were relatively close to each other and that the independent cost estimate prepared in the Naval Ship Systems Command by the estimating branch at that time fell within the range of the estimates. On that basis, the contracts were awarded. Certainly at that time, if there had been a concern for buy-in, the contracts should not have been awarded until that issue had been resolved. So to assert that there was a buy-in is a matter of judgment. All I can say is that the record shows there was a competition, the prices were close to each other, they were in a competitive range and the independent estimate at that time, according to the records that I remember seeing recently, did not indicate a buy-in.

Chairman PROXMIRE. We are always going to have this kind of problem, buy-ins, rarely are conspicuous. Occasionally you do have a

situation, unusual stuation, where a contractor will admit, concede, it was a buy-in. That doesn't happen very often, with that exception couldn't you always make this kind of statement, almost always make this kind of statement that it is hard to tell, you can't determine whether it was a buy-in or not and, therefore, no action was taken?

Admiral SONENSHEIN. Well, I just repeat, Senator, I hate to repeat myself in this regard, the judgments had to be made at the time and I would like to add to that, if I may, another thought. We have been talking today all about the settlement of claims for the most part. I had alluded in my statement to some positive measures being taken to avoid or minimize the possibility of future claims and I believe one of the measures we have instituted and which relates directly to this point is the fact that on major procurements of this type we have moved away from the fixed price competitive award of a contract. Recognizing in hindsight that not only in these instances but in other instances which occurred in that era the complexity of the programs is just too great to permit intelligent bidding on a competitive fixed-price basis without the opportunity for negotiations as to the nature of the work, clarification of the specifications, the exposure and illuminating of any difficulties that might ensue in the construction of the ships. That is an important point, I believe.

Chairman PROXMIRE. As to the wisdom of these two methods of procurement, let me ask Mr. Rule if you would comment on the performance of the Navy in relationship to the buy-in.

NAVY RELATIONSHIP TO "BUY-INS"

Mr. RULE. Senator, buy-in is a real tough nut, especially in these ship contracts. They were advertised procurments. They weren't negotiated. They were straight formal advertised bids where the low man takes it. Avondale was low, I think. There is nothing in ASPR that says how or when you disqualify a man for a buy-in. There is really no guidance on it. Everybody talks about it a great deal as being a poor thing, and it is, but about the only way you can get at it is if somebody has guts enough to refuse to make what has to be made; namely, an affirmative determination that a contractor is responsible, if you think he is buying-in you have to make this determination before you get a contract. If a contracting officer with guts will refuse to make that determination this would surface one of these cases and see what we can do about it.

Chairman PROXMIRE. Well, then, your assertion in your report there may have been a buy-in simply goes to that fact that you can't do anything about this situation now but in the future these should be challenged where there may well be a question as to the capacity of the contractor to perform at this price?

GAO RECOMMENDATIONS

Mr. RULE. That is right. That statement, in answer to that question, there was evidence of buy-in, again came from Mr. Schempp, the engineer who investigated. We asked him this question and he answered that way. But, Senator, on the type of contract that Admiral Sonen-

shein just mentioned, I would like to, on the question of what I would like to recommend that you do, there is a pretty good GAO report that is out on this subject on what Ships is doing, what they are planning to do and what they are doing to minimize or preclude claims. It talks about type of contract, it says it is not as important as people make it out to be, that the thing that is really bad are the defective specs.

Chairman PROXMIRE. Has that report been printed or is that a draft?

Mr. RULE. I have it in draft.

Chairman PROXMIRE. We haven't seen it.

Mr. RULE. You ought to get it because it recommends certain things Congress should do.

But it goes through these points that cause claims, the type of contract, the lead/follow yard situation, ship specs, GFM, Government-furnished material and late Government information, material and information, quality assurance requirements and constructive change orders. It lists in the report what Ships has said they are going to do. It says they haven't done quite as well as they think they should do and it says that the corrective action that has been taken is spotty. That is exactly their term. They point out that there have been manuals issued and directives issued and procedures established and, of course, some people embrace the philosophy if you issue a manual or if you issue a directive you have cured everything and you don't have to have controls to follow up and see that it is done. But they do recommend certain things that Congress do in appropriations hearings, for example. They recommended that the Ships people be asked what have you done to correct the lead/follow yard defective plan situation that has caused many claims. What have you done to preclude it, and if you don't have that report——

Chairman PROXMIRE. I will certainly get it.

Admiral SONENSHEIN. May I comment on a few of those points?

Chairman PROXMIRE. Yes.

Admiral SONENSHEIN. This is very basic to our operation. The GAO report that Mr. Rule alludes to is in draft form. I recently had an opportunity to review it and I alluded to it in my statement as soon to be issued.

My impression of their evaluation of the corrective measures that we have instituted under the shipbuilding and conversion improvement program was generally gratifying to me because they are pretty hardnosed and I think they gave us a reasonably good upcheck considering the complexity of the whole problem and the large number of measures that have been initiated to bring about improvement.

When we started this about 2 years ago I felt it would take several years to achieve substantial progress because we were moving in rather fundamental ways on fundamental matters and we have, and I can enumerate them very quickly, areas in which I think there have been solid improvement. One is the concurrency issue. I described that in some detail in my statement and I won't repeat but I think the Navy has made substantial progress in minimizing the claims and difficulties in increased cost that might arise from concurrent developments that are called out to be included in a ship.

Access to Contractor's Books and Records

Chairman Proxmire. Let me get into one more aspect of this Rule report. The hour is late and I don't want to detain you gentlemen too long. How about the one other finding in the Rule report that the Navy did not have adequate access to the contractor's books and records in the investigation of the claim? Do you think this is a problem?

Admiral Sonenshein. I can't comment on that because I was not aware that this was the case.

Chairman Proxmire. It is an assertion in the report.

Admiral Sonenshein. My recollection in the case of the Avondale matter was that it was agreed that the Navy investigators would have access to the books of the Avondale Corp., and in fact there was access also to the corporate, to the upper corporation, records. This was not done by the claims settlement team but the Navy Material Command, and Navy Comptroller's Office looked into the corporate records. So, I don't know the basis for that statement.

Chairman Proxmire. Mr. Rule, how about the basis for that statement?

Mr. Rule. Well, sir, Avondale retained a Washington law firm, the Vom Baur firm, and they in turn—I don't know who had hired whom—but they usually work in a team with Arthur Anderson, Accounts. The Arthur Anderson people were at Avondale and the DCAA audit people had to work through them. I have never seen a situation like it. They could not go to the books of the company or deal directly with the company audit people. Anything they wanted they had to go to Arthur Anderson who was a middleman and they would go and get the information. The audit people didn't mind Arthur Anderson being there, as a matter of fact, they asked them, we know you are a very fine firm, if you are in here to help prepare this claim, will you, after you prepare and give us the information, get up the contractor's data, will you give some sort of a certification to the data—like you do when you audit the books of a firm, because if you will do that it can save us an awful lot of work and we will rely on what you tell us. They said , "Hell, no," they are not going to do that, they will just turn over the information that the company gives them and it was just that back and forth situation.

Chairman Proxmire. That seems to me, Admiral Sonenshein, to be a pretty clear indictment.

Mr. Rule. I don't know whether it is an indictment.

Chairman Proxmire. Maybe I should say confirmation of the assertion in the report that the Navy did not have access, certainly did not have direct access.

Mr. Rule. It is certainly a tortuous way to go about justifying a claim.

Admiral Sonenshein. Access was had. I never had any reports to me that we didn't have access to the records where they were available.

Chairman Proxmire. Only through a contracting firm hired by the employer which would not certify or officially certify what they made available.

Admiral Sonenshein. But, nevertheless, the data was provided or there was access to records and I didn't have any instance where access was denied.

Provisional Payments

Chairman Proxmire. Last April Secretary Shillito promised that no payments would be made on the Avondale and Lockheed shipbuilding claims until the Navy had received complete legal analyses of the issues involved. But since then the Navy advised me that approximately $47 million has been paid to Lockheed and $22 million to Avondale.

Have any additional payments been made since I learned about these payments?

Mr. Rule. May I have the date of that again?

Chairman Proxmire. Last April.

Mr. Rule. April 1971?

Chairman Proxmire. Yes, that is correct. This is when Secretary Shillito promised no payments would be made and since that date the Navy advised me that about $47 million had been paid to Lockheed and $22 million to Avondale, provisional payments.

Mr. Rule. I am familiar with a provisional payment to Lockheed of $20 million which the CCCSG approved.

Chairman Proxmire. I was notified it was $47 million.

Mr. Rule. That is total.

Chairman Proxmire. That was to Lockheed, and $22 million in addition to Avondale, a total of $69 million.

Mr. Rule. That is the total of all of the provisional payments that have been made to Lockheed. It is actually $48.4 million.

Chairman Proxmire. Well, is this statement wrong, that is not since April. Since April, I was told $47 million has been paid to Lockheed.

Admiral Sonenshein. If I may, I think I can elucidate on that. The total number of dollars in provisional payments made to Lockheed, the last one being February 24, 1971, according to my notes, total $49.2 million.

Chairman Proxmire. All right.

Admiral Sonenshein. The total number of provisional payments or dollars worth of provisional payments to Avondale total $23 million, as you had.

Chairman Proxmire. That is very close to what I have. It is not precisely the same, a little more.

Admiral Sonenshein. December 19, 1970.

Mr. Rule. I don't think any have been made since.

Admiral Sonenshein. March 17 is the last one.

Chairman Proxmire. You are right, Mr. Rule, I understand that the last payments were made in February.

Mr. Rule. Yes, sir.

Chairman Proxmire. No payments have been made since April.

Mr. Rule. No, sir.

Chairman Proxmire. That was one of my questions, have any additional payments been made since February. To the best of your knowledge, none?

Mr. Rule. That is right.

Legality of Provisional Payments

Chairman Proxmire. What is the legal basis for the Navy making payments to contractors on claims before fully investigating the claims and determining that the contractors are legally entitled to payments?

Admiral SONENSHEIN. I would like to respond to that, if I may. This goes back to an earlier step, not claims, but any change order to a contract. It involves the same principles. If the Navy directs or desires to have a change made to the original scope of the work, to add something, or to modify, as the construction is in progress, a unilateral determination can be made that that scope shall be changed. The Navy can then make its own estimate by using engineering personnel and others and issue the order to proceed under that determination and increase the base price of the contract by that amount without profit. This then permits progress payments against the work to be calculated against the new expanded base by the increment that it has been expanded due to the change order. Subsequently, when the change order is negotiated as to price and the profit is included, a second adjustment is made.

Now, when this action is taken to unilaterally direct a change, the Navy will normally, as a matter of equity, make a provisional increase to the base price of the contract, not a payment, but provisional increase to the base price of the contract, something in the order of 75 percent of the value less profit in order to provide this as a matter of equity.

Subsequently, when the negotiations are completed, the profit is added on and the base is further adjusted and progress is calculated in on that base and paid for in the normal fashion under progress payments.

A similar thing, for example, happened in the Avondale case. In that instance change orders in the amount of new work, additional scope, in roughly the amount of $27 million were included in the proposed tentative settlement. Therefore, as a matter of equity again, the Navy made provisional payments under the same logic, in the amount of $23 million to Avondale on the basis that the hard core change orders were in excess of those provisional payments.

In any event, and this is true also in the Lockheed case, any provisional payment that is made has a caveat with it that in the event the final adjudicated cost is less, the contractor will return the excess including interest thereon. That is the situation.

Chairman PROXMIRE. Well, I understand that. You have explained that extraordinarily well. It is clear. But I still can't understand how any cash can be distributed to anyone or how you can justify it without determining whether it is legally entitled. It seems to me this is just so fundamental. You can make a case on almost any ground. The payments can be made to assist a contractor perhaps. But it seems to me you certainly ought to have a finding as to whether or not that payment of government money is legally permissible.

Admiral SONENSHEIN. Well, certainly, Senator Proxmire, if a change order is issued to accomplish new work, that certainly is inherently entitled.

Chairman PROXMIRE. How about it, Mr. Rule?

Mr. RULE. Sir, I think you are really talking about these provisional payments.

Chairman PROXMIRE. Yes.

Mr. RULE. That are made on account of claims. I wrote to the Office of General Counsel and asked them for a legal memorandum on our authority to make those provisional payments and they wrote back

and the substance is that the contractor is not as a matter of right entitled to a provisional payment; however, as a matter of equity if someone in authority will make a determination that the legal entitlement is such that it will as a minimum be x number of dollars, you can then as a matter of equity, to help the company in the high interest rates situation, help them out, and make a provisional payment.

Chairman PROXMIRE. It is your understanding this was done in the Lockheed and Avondale cases, or was not done?

Mr. RULE. It was done.

Chairman PROXMIRE. So the legal entitlement on the basis of this interpretation was met, it was valid?

Mr. RULE. Yes, sir. The gentleman sitting behind Admiral Sonenshein made it. If you would like for the record a copy of this legal memorandum, I shall supply one.

Chairman PROXMIRE. We would like to have that.

Mr. RULE. And the justification.

(The following was subsequently supplied for the record:)

OFFICE OF THE GENERAL COUNSEL,
Washington, D.C., June 26, 1969.

MEMORANDUM FOR MR. GORDON W. RULE, DIRECTOR, PROCUREMENT CONTROL AND CLEARANCE DIVISION, MAT 022

SUBJECT: PROVISIONAL INCREASES IN CONTRACT PRICES ON ACCOUNT OF CLAIMS

1. In your memorandum of 4 June 1969, you requested our advice as to the legality and propriety of making provisional payments on account of unadjudicated claims.

2. Your inquiry embraces two questions: (a) whether a partial or provisional payment may lawfully be made of a claim before the total amount due has been determined, and (b) assuming that it is within the Navy's discretion to make or not to make such payments, whether it is prudent to do so.

3. It is axiomatic that any payment under a contract must be in discharge of an obligation properly created thereunder. Our contracts impose obligations on the Government to compensate contractors for increases in the cost of contract preformance under various circumstances, such as for changes, for late delivery of Government furnished material, etc. There is no legal requirement that these payments be made in one lump sum, although there are obvious practical advantages to making a single payment that is complete and final.

4. Hence, if it is determined (a) that the Government is legally obligated to compensate the contractor in some amount and (b) that the amount of that compensation when finally determined will exceed the amount of the proposed interim payment, there is no legal objection to making a provisional payment on account of the claim. That is not to say that the Government is required to make such payment, but only that it may do so if it chooses.

5. Our contracts do not—and probably could not—define exactly what constitutes an equitable adjustment in contract price. Essentially, it is the right of the contractor to be compensated for the additional costs and burdens it incurs on account of a Government action for which an upward adjustment of the contract price is authorized. The manner of making such adjustment is not specified, except that it is to be equitable, which in substance is whatever is fair, just and reasonable under all the circumstances.

6. There are manifest disadvantages to making partial payments of claims which have not been fully adjudicated. Bargaining leverage is weakened in almost direct proportion to the amount of the claim which is paid without obtaining a total settlement. There is also a possibility that the value of the claim will be overstated and that the provisional payment will exceed the amount ultimately determined to be due. To guard against this possibility, it would be prudent to obtain the contractor's agreement to repay any excess provisional payment with interest. As a practical matter, provisional payments tend to be in amounts well below the true value of the claim, and I am not aware of any case in which a repayment has been necessary.

7. In the *Todd* case to which you referred in your memorandum, we understand that NavShips' contracting personnel determined that the total amount due the contractor would exceed the 55 million dollars which was paid on account of those claims before final adjudication. As you know, the estimate turned out to be conservative.

8. Even though the detrimental impact on negotiation of a total settlement is recognized, there may be cases when provisional payment of unadjudicated claims is proper and practically unavoidable. It is indisputably burdensome, and perhaps inequitable, to require the contractor to carry additional expenses occasioned by Government action for a protracted period of time, particularly if the delay in settling the claim is attributable in whole or in part to the Government. The Government's failure to make available funds to compensate for the costs of Government action may impair the contractor's ability to perform the contract, as, for example, when the contractor is in danger of becoming bankrupt or otherwise financially handicapped, and may give him a possible excuse for nonperformance. Moreover, there is a trend in cases in the Court of Claims and the ASBCA to allow interest as an element of cost in an equitable adjustment where the contractor is required to borrow extra money to finance performance of a change or on account of some other Government action for which an equitable adjustment of the contract price is authorized. To the extent such interest costs would be allowed as a part of an equitable adjustment, the Government avoids the additional cost by making provisional payments before the total amount due is finally determined.

9. In our judgment, it is much preferable that claims be totally adjudicated when this can be done within a reasonable time with confidence in the amount. When it can be determined that the contractor is legally entitled to an equitable adjustment but the amount cannot be determined with certainty within the time that the contractor can, or reasonably should, carry the cost without payment, a partial provisional payment of an amount which is less than the estimated value of the claim may be the lesser evil. For added caution, it would be desirable to obtain the contractor's agreement in such cases to repay any excess payment, preferably with interest.

ALBERT H. STEIN,
Deputy General Counsel.

Chairman PROXMIRE. Is it correct that the Navy recently decided to suspend all provisional payments on outstanding claims?

Admiral SONENSHEIN. I don't believe that statement is quite correct. We did issue an instruction to our supervisors of shipbuilding that, in adjudicating change orders, where they felt that the contractor was not negotiating in good spirit, that they should withhold provisional payments.

Chairman PROXMIRE. Have they in fact been suspended in the last couple of months?

Admiral SONENSHEIN. That was issued about 6 or 7 weeks ago.

Chairman PROXMIRE. Well, if it is proper and equitable and necessary, as both of you gentlemen seem to suggest it could be, why did they suspend it?

Admiral SONENSHEIN. This was in the instance of change orders being negotiated locally wherein the contractor was not negotiating in a willing and cooperative attitude.

Chairman PROXMIRE. Then it is a limited suspension?

Admiral SONENSHEIN. That is right.

HIGH-COST CONTRACTORS AND HIGH PROFITS

Chairman PROXMIRE. There was testimony before the committee last April, Admiral Rickover cited a case where one contractor's costs were 45 percent more than another contractor's for comparable work. Both contractors are shipbuilders. Yet, the Navy paid the high-cost

contractor about 18 percent more profit than it paid to the lower cost contractor. How can the Navy avoid waste when it rewards high cost with high profits?

Admiral SONENSHEIN. I am not precisely sure of what the issue or the case in point there is.

Chairman PROXMIRE. I was going to ask you to identify the shipyards, if you could.

Admiral SONENSHEIN. I think I know the case and it involves two shipyards wherein we overhauled submarines, and they are private shipyards. Both are doing extremely well in quality and in timeliness of work.

In the one case, the cost for accomplishment of similar work packages is running about 30 percent higher in one yard than another. We have been aware of this, have been sensitive to it for some time and sent a special team to the higher cost yard to analyze the differences. This becomes very difficult, I can assure you because, as you probably know yourself from other activity, the industry does not have a uniform cost accounting system, and I think if we did have this would facilitate——

Chairman PROXMIRE. Was this assertion by Admiral Rickover correct or incorrect, the high-cost shipyard received 18 percent higher profits?

Admiral SONENSHEIN. According to the Armed Services Procurement Regulations, the fees are calculated on the costs and the higher cost is accompanied by a higher fee, but our analyses are not finished. We have not given up on trying to establish the comparability of cost groups.

Chairman PROXMIRE. Shouldn't we revise those ASPR's, that seems to be extraordinarily unfair.

Admiral SONENSHEIN. I want to make a further comment, if I may. In making comparisons of this kind it is not possible to just pull one ship out of context at one yard and another one out of context at another yard and make direct comparisons because that ignores the local environment at the yards.

In one case we have a yard which has many, many projects, considerable flexibility in managing its personnel and work force and can, I believe, operate more efficiently in this regard whereas in the other case we have one devoted exclusively to submarine work with limited flexibility as between the succeeding ships. This makes a big difference in efficiency. We see this same thing in naval shipyards. When one tries to make comparisons of this nature he runs into difficulty because of the environments being different and influencing the operations at the different places. However, I am in agreement with him that we should minimize this difference to the greatest degree possible and we have active efforts to identify these differences underway now.

Chairman PROXMIRE. I would certainly like some kind of a memorandum from you at least indicating what is being done to correct this kind of a situation. Could you identify these two shipyards?

Admiral SONENSHEIN. Well, it happened——

Chairman PROXMIRE. Why not?

Admiral SONENSHEIN. I guess not. One case is Electric Boat Division, Groton, Conn., and the other is Newport News. I presume that is the case he is talking about.

Chairman PROXMIRE. Which is the high cost?

Admiral SONENSHEIN. Electric Boat Division.

Chairman PROXMIRE. What is the second?

Admiral SONENSHEIN. Newport News, Va. You see, there is a major difference in the kind of work being undertaken in the one shipyard—constructing surface ships, building submarines, overhauling submarines. They have a great diversity of operations going on and considerably more flexibility than the other one which is devoted exclusively to the overhauling and construction of submarines.

Chairman PROXMIRE. Would you comment on this?

Mr. RULE. I am happy to say that Admiral Sonenshein is now in his field and I agree with him.

Chairman PROXMIRE. Very good. I am happy to hear that.

Mr. RULE. I am not sure though that what Admiral Rickover said—it is true what he has said—but I am not sure that it is wrong. What has happened I think basically is the overhead at Electric Boat, which only does work on submarines and, as the Admiral says, Newport News is just full of work, diversified work and that sort of thing, and this is something that we are facing, Senator, not just at Eelctric Boat but as the defense work falls off in industry generally the overhead goes up and if we want to use that manufacturer or that yard we have to pay it and I personally in my office have to approve those overhaul contracts.

Chairman PROXMIRE. I am not sure they are complaining about using them. I understand that is necessary. But to have 18 percent higher profits in the higher cost shipyard doesn't make sense.

Mr. RULE. That doesn't mean either one are getting unreasonable profits. It does not mean that.

PROFIT GUIDELINES

Chairman PROXMIRE. I would like to ask both of you gentlemen this question.

Within the last year there has been considerable discussion and support of the concept that the Department of Defense should recognize contractor capital investment in determining profits on defense contracts. Admiral Rickover has testified that the current policy of basing profits on incurred costs results in high-cost shipyards receiving the highest profits on Navy contracts and that there is a negative incentive for shipbuilders to invest in cost-saving equipment and facilities. GAO has confirmed this in their study of defense profits. The GAO report indicates that the current DOD profit policy is, in fact, partly responsible for the increasing costs of military hardware. Although we may disagree and I did disagree to some extent with the recommendations in the policy position taken by the GAO in that, I think that they came down hard, as I do, on the emphasis in trying to shift the profit base to contractor investment rather than to sales. What problems would you expect to encounter in applying the capital investment concept in determining profits on shipbuilding contracts?

Admiral SONENSHEIN. We have given a lot of thought to this subject in the last year and a half and as a matter of fact we have developed a prototype, you might say, case as an experiment to apply in one acquisition. It happened to be a submarine again, and we de-

veloped with the help of others an approach to weighting the investment effort by the contractor.

It remains to be seen whether this test which we are trying to initiate will bring us any meaningful results. I am a little bit leary of that personally because it take a long time to find out whether in fact there is any, for example, encouragement to invest. That is one of the basic purposes of this approach—is to get contractors to enhance their facilities by making such investments and thereby improving their productivity and ultimately reducing their cost.

Chairman PROXMIRE. That is why we were so interested in——

Admiral SONENSHEIN. We are, too. However, my own view at the moment is that it should be a factor, it should not be the only factor in appraising profitably.

Chairman PROXMIRE. Have you ever considered modifying your current profit guidelines to include investment as a factor in negotiating shipbuilding contracts?

Admiral SONENSHEIN. Only to the extent that I described that we have developed this test approach in one contract but to my knowledge——

Chairman PROXMIRE. How long will the test take?

Mr. RULE. That is being considered right now by the ASPR committee.

Admiral SONENSHEIN. I don't believe there is any guideline to include that.

Chairman PROXMIRE. Any idea how long it is likely to take to get a conclusion on that?

Admiral SONENSHEIN. I can't say.

Chairman PROXMIRE. A matter of weeks?

Admiral SONENSHEIN. I wouldn't comment.

Mr. RULE. I doubt it is a matter of weeks.

Chairman PROXMIRE. Do you have any other comment on that?

Mr. RULE. This is a very tough subject. Most of the theories that I have seen, most of the problem resolves around what is capital, what is capital investment. Most of the theories look at money and brick and mortar and that sort of thing. I thought we went into this, I am not sure, once before. I remember discussing capital investment concept of profit with the Bell Lab people and they say sure we could do it but every one of our high-paid engineers and technicians and scientists are part of our capital investment and we are going to weight that. We want some weight given to that. And Newport News wrote a very good letter. We tried to get Newport News on a contract there to go along with us on a test case. You remember that, Admiral.

Admiral SONENSHEIN. Yes.

Mr. RULE. I forget which one recently. Would they try it out because you have to try these things. And they wrote a very fine letter as to their reasons why it would be difficult. They didn't say they wouldn't but they did say that they were going to want to grind into any equation their old-time shipbuilders and all their know-how that they have had down there which makes them one of the finest shipyards.

Chairman PROXMIRE. With great respect for you gentlemen when you take a united front I hate to disagree with you, but I disagree with you on this, I think it is one of the simplest things in the world

to determine the rate of return on invested capital itself. Done all the time. Every investor wants to know when he makes an investment in a corporation, this is what the investment analysts look for and what they can determine. You can invent all kinds of complications such as how you might capitalize the people who work for you and develop that into some kind of concept. I am talking about the very simple concept of the amount that is on the books and recognized as invested in bricks and mortar, as you say, in any money aspect, inventory and so forth, the return on that capital both, and GAO made the study, as you know, they have completed it now, of return on capital. They did it on two bases. One, the return on overall capital and the other on net capital. And I don't think that would necessarily be an extraordinary complicated or difficult measure.

Mr. RULE. I can only say that I heard Mr. Petty, who heads DCAA, say that you will have innumerable problems on determining what is capital and I am reluctant personally to impose any greater burden on our negotiators that sit on the firing line negotiating contracts and we are always after them to compress the leadtime it takes to make a contract and I hope we don't come up with something that is going to greatly lengthen that procurement leadtime.

Chairman PROXMIRE. I wouldn't favor this unless it can be done simply and clearly and I think it can be. I may be wrong.

Mr. RULE. That is why Ships under Admiral Sonenshein does have the pilot case that is ongoing right now.

Senator PROXMIRE. I would feel a little better if you could tell me they are going to have a report to you in a few weeks or couple of months.

Admiral SONENSHEIN. The reason I was reluctant——.

Chairman PROXMIRE. It sounds like several years away.

Admiral SONENSHEIN. The other party to this, of course, is the contractor and we can't predict how fast he will move in accepting this approach.

Chairman PROXMIRE. I see. All right, gentlemen, I want to thank both of you. You have been most responsive. This has been one of the best mornings of testimony we have had and it is so useful to have you gentlemen together. You have disagreed vigorously.

Mr. RULE. Wait until we walk out of this room.

Chairman PROXMIRE. The subcommittee will reconvene tomorrow morning at 10 o'clock, in S-407 in the Capitol to hear Henry Durham, a former employee of Lockheed-Georgia, Marietta, Ga., who has made some sensational and profound charges against the Lockheed Co. efficiency and Mr. H. L. Poore, vice president, operations of Lockheed, who will respond.

(Whereupon, at 12:35 p.m., the subcommittee recessed, to reconvene at 10 a.m., Wednesday, September 29, 1971.)

THE ACQUISITION OF WEAPONS SYSTEMS

WEDNESDAY, SEPTEMBER 29, 1971

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON PRIORITIES AND
ECONOMY IN GOVERNMENT OF THE
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room S-407, the Capitol, Hon. William Proxmire (chairman of the subcommittee) presiding.

Also present: Richard F. Kaufman, economist; Lucy A. Falcone, research economist; Walter B. Laessig, minority counsel; and Leslie J. Bander, economist for the minority.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The subcommittee will come to order.

This morning I have a statement from Senator Ellender in connection with the hearings that were held yesterday, and I would like to read that first before we proceed with the witnesses.

SENATOR ELLENDER LETTER

Senator Ellender has given me this statement and asked me to read it at the hearing this morning.

He says:

"Neither in the Avondale case, nor in any other case, have I applied pressure on the Navy. Like any good representative of his people, I do make routine inquiries as to status on any case, military or otherwise, in which a constituent feels that he is being unfairly treated by a Federal agency.

"My inquiry several weeks ago into the status of this case was prompted by several factors.

"1. The case had been under study and review of various kinds since September 1969.

"2. Not only Avondale but some of its subcontractors were being severely damaged by the long delay in settlement of the claim.

"3. The proposed settlement had received preliminary clearance from appropriate technical, financial, and legal panels in the Navy.

"4. The proposed Avondale settlement was substantially less on a per-ship basis than other settlements expeditiously approved at an earlier date by Mr. Rule's group in parallel contracts with other shipyards.

"Under the circumstances, I felt it was not only proper but that it was my duty to the constituent company, its 12,000 employees, and its many subcontractors to make a status inquiry and a simple request that the claim be 'promptly adjudicated.' "

And that was as I say, from Senator Ellender.

I would like to add to that. I have talked with some of those involved in the Avondale incident that was discussed before the committee yesterday, Tuesday, September 28, and to the best of my knowledge, based on this information, there is no evidence whatsoever that any pressure was brought to bear on any public official, to settle the Avondale claim, in any way except strictly on its merits.

To the best of my knowledge the only effort by Members of Congress, in this connection, was to secure prompt action on the matter.

Now, that is done routinely. As a matter of fact, yesterday Mr. Rule pointed out that I had done it, my administrative assistant had done it in connection with a Milwaukee firm which was interested in a contract, and he called up and asked that they be given expeditious treatment. And he indicated that he thought there was nothing unethical or improper or unusual about that.

And in the case of Avondale, there seems to have been specific avoidance of any effort to influence the Navy with respect to the amount of the settlement.

C–5A COST OVERRUNS

Now, with respect to the hearing today, I ask our two witnesses, Mr. Durham and Mr. Poore, to come forward to the witness table here.

Gentlemen, may I say that one of the major purposes of these hearings is to inquire into the causes of large cost overruns on major weapons systems. It is, of course, not possible to discuss the subject of cost-overruns without referring to the C–5A cargo plane.

The existence of a large overrun on the C–5A was first publicly disclosed in hearings held by this subcommittee in November 1968. During those hearings, we learned that the Government would have to expend approximately $2 billion more for this program than was originally planned.

It was an astonishing revelation. Equally astonishing was the reaction of those responsible for managing the program.

The Air Force at first denied the fact of the overrun. Later, it conceded only a portion of it.

Not until recently has the Air Force admitted the full extent of the cost problems of the C–5A.

The original estimated cost of 120 C–5As was $3.4 billion, including spares. By 1968, the price had risen to over $5 billion.

Now, the program has been reduced from 120 planes to 81 planes. But the costs of the 81 are estimated currently at $4.9 billion, almost as much as what the full program was supposed to cost after the costs had gone through the ceiling.

After adjusting for the reduction in quantity, the dollar increase of the planning estimate is now $2.2 billion. On a unit price basis, it has risen from $28 million each to $60 million each.

Whether we have seen the last of the cost increases in this program remains to be seen. A recent crack in the wing of the C–5A that was being tested is not encouraging. Cracked wings seem to be a chronic

problem for the C–5A. Perhaps one of the witnesses here today will be able to enlighten us on the wing problem and tell us how much it will cost and who will pay to make the necessary improvements.

In truth, although a lot is known about cost overruns, their magnitude and their frequency, not much is known about their causes.

Why do cost overruns occur, and why do they occur with such regularity?

The position of the Air Force and the Department of Defense has been that cost overruns on the C–5A were brought about through unexpected technical difficulties and unanticipated inflation. In retrospect, the total procurement concept, under which the C–5A contract was awarded, is generally blamed as an unworkable method of procurement.

The explanation given by the Government for overruns on the C–5A is usually ascribed, more or less, to conditions beyond anyone's control.

Is this how cost overruns really happen? This committee has been unable to penetrate much beyond official explanations. The General Accounting Office has never conducted a comprehensive audit of the C–5A program. Most of us on the outside simply have no good way of knowing what went on and what is going on inside the plant where the C–5A is being produced.

What we hope to do today, for the first time, is to hear from a longtime former employee of Lockheed and a current employee of Lockheed, both of whom have had long experience with the C–5A, and what actually goes on in the production of a major weapons system.

Henry M. Durham was employed by the Lockheed Aircraft Corp. for 19 years, from 1951 to 1970, and served, prior to his separation from the company, as general department manager in charge of production control activities in the flight line, flight test, and avionics area for the C–5A program.

Mr. H. L. Poore is executive vice president—operations, for the Lockheed-Georgia Co. at Marietta, Ga., where the C–5A is produced.

Mr. Durham, before you proceed with your remarks, I want to read into the record the letter of recommendation of the Lockheed Corp. and the commendation you received from Lockheed a little over a year ago. I know that you plan to refer to these statements in your own testimony, but I would like to do so first because I believe they are important and ought to be emphasized.

A copy of an official company letter to the Lockheed professional personnel department was sent to you by your employer in February 1970. The letter states:

> With regard to corporate policy as set forth in referenced memo, we recommend Henry M. Durham, employee No. 526 798, as a potential candidate for interdivisional transfer at the division management level. This recommendation is made as a result of long association with, and close observation of Mr. Durham in his professional duties.
>
> He joined Lockheed in August 1951, and his record has been one of steady unbroken progress. Starting as an assembly dispatcher in production control, he now fills the responsible position of night division manager.
>
> Among his many qualifications are unquestioned loyalty, energy, initiative, product and corporate knowledge, ambition, and an insistence on a job well done—first of all by himself and secondly by all reporting to him.
>
> It is our unqualified opinion that Mr. Durham would represent a real asset to any organization to which he might be assigned.

For a job well done under adverse conditions, this company expresses its sincere appreciation.

I would suggest that we proceed first with Mr. Durham, and then Mr. Poore, and then we will get into the questioning.

Mr. Durham, you may proceed.

STATEMENT OF HENRY M. DURHAM, FORMER EMPLOYEE, LOCKHEED-GEORGIA CO., MARIETTA, GA.

Mr. DURHAM. First of all, I would like to say that I appreciate the opportunity to be here. And I will skip over the portion there that you have just covered.

PERSONAL BACKGROUND

My qualifications regarded as outstanding for 19 years, somehow changed almost overnight, after I met with Mr. R. H. Fuhrman, president of the Lockheed-Georgia Co., in an effort to get the company to reform.

In July and August of 1969, as general department manager in charge of all production control activities in the flight line, flight test, and avionics area, I initiated an investigation into serious deficiencies and discrepancies appearing in C–5 aircraft when they were moved from the final assembly area to the flight test or flight line areas.

I not only uncovered mismanagement and waste in all areas, but also what I consider improper practices and what appears to be collusion with the Air Force to receive credit and payment for work on aircraft which had not been accomplished. I also uncovered serious procurement abuses.

I went to all levels of management, including the president of the Georgia Co., and received an adverse, and in many instances, hostile reaction. At one time I was instructed to hide a certain missing parts report so, in my superior's words, "The Air Force wouldn't see it." True facts, data, and conditions were swept under the rug; much of it by very big brooms.

At one time I became disillusioned and disgusted and asked for a transfer to anywhere in the world. Then I realized that this was running away from the problem, rather than facing it. I resolved to fight because I knew I was right.

The arrogance and attitudes of high members of management I approached can be seen in the last encounter I had with Mr. W. P. Frech, the director of manufacturing at the Georgia Co., when he asked if I knew what had happened to Mr. Fitzgerald who went to Washington with some Lockheed problems

When I said I didn't know, Mr. Frech said that Mr. Fitzgerald was now chief sh— house inspector for the civil service and would never be able to get a good job. I considered this intimidation and the inference of course was that anyone who bucks Lockheed or the Air Force is in for trouble for the rest of his life.

I would like to discuss the more critical aspects of my testimony in detail during the question and answer period, since I possess in most instances both documentary and physical evidence to substantiate my claims. The evidence will be of importance to the committee.

Allegations Against Lockheed-Georgia Co.

I. MISSING PARTS

First, it is necessary to know that aircraft are built in sections, such as the forward fuselage, mid fuselage, nose, wings, et cetera. The sections are joined together. Certain parts as specified by engineering are called out on installation documents to be installed in each one of these specific positions as the work progresses through various stages of completion on a prescribed schedule. Installations and sequencing should obviously be carefully planned because one part is attached to another, and another part is attached to that one, et cetera. Procedure calls for quality control to inspect and verify installations by stamping installation paper and retiring the completed and stamped paper to inspection records. This action gives Lockheed credit for the work. Obviously, installation paper should not be stamped and retired until parts are installed and the work accomplished. By the time an aircraft reaches the flight line or flight test, it is supposed to be complete except for a few programed engineering changes, a small amount of work held up for shortages, or technical problems, and installations normally installed on the flight line.

(*a*) I found aircraft to be completely out of control. Thousands of parts were missing from aircraft when according to Lockheed records, they had been installed. The installation paper had been stamped and retired to inspection records to erroneously reflect that the work had been accomplished.

(b) Most of the missing parts problem originated in structural sections, including feeder plants. Missing parts consist of everything from small bits and pieces to major assemblies and included thousands of expensive purchased, subcontracted and machined parts.

(*c*) Illegal removals were rampant. A part, for example, would be installed on a lead aircraft and sold to inspection. Then it would be cannibalized and installed on the next highest aircraft. Many illegal removals were made to replace damaged parts which were thrown away rather than presented to inspection for proper rejection action and accountability. This practice covered up the true amount of butchery and reduced the officially reported rejection rate.

(*d*) The vast majority of missing parts are caused by the company moving major assemblies and aircraft on the prescribed schedule regardless of the state of completion in order to make milestones and get credit for being on schedule. In order to do this, thousands of pieces of installation paper representing tens of thousands of parts were stamped by both production and quality control and retired to inspection records to signify that the parts had been installed although they had not. It was deliberate subterfuge on the part of the company, and I believe the Air Force, also. Showing a good schedule position seemed to be paramount.

(*e*) As I reported in a letter to Mr. Haughton, there was danger because many missing parts were discovered shortly before aircraft were scheduled to fly.

(*f*) Parts would be called for but couldn't be installed because the parts they were supposed to be attached to were missing. Thousands of uninstalled parts were piled up in corners, lying on tables, under tables, on the floor, et cetera. No one had any accountability. Thou-

sands of parts thought to be lost were reprocured at premium prices, only to have the original parts reappear.

(*g*) The condition existed not only on low serial aircraft, but high serials, as I shall show.

II. FAILURE OF MANAGEMENT TO TAKE CORRECTIVE ACTION

On March 16, 1970, I sent a report to management criticizing the continued existence of unacceptable conditions. The report points out the dishonest reporting of aircraft status and the involvement of quality control. The report also criticizes management for failing to act.

III. VALUABLE SMALL PARTS (VSP)

As of May 1, 1970, the company was facing a $30 million cost overrun on VSP due to overprocurement resulting from wasteful practices. This dollar figure was given to me by the industrial engineer assigned to solving the problem and developing a procedure for controlling VSP. I included this information in the package I gave Mr. Fuhrman.

IV. PROGRESS REPORTS

I shall present copies of certain progress reports sent to my superiors reporting on serious conditions and asking for help in solving them. For example, one report mentions the fact that 2,000 parts delivered to an aircraft were actually not needed. Another report shows that as of June 12, 1970, 15,291 missing parts had been delivered to ships 0009 through 0014 after the units had arrived at the flight line. These were parts which, by Lockheed records, had already been installed and the company had been credited accordingly.

V. MULTIPLE ORDERING, ISSUES, AND REPLACEMENTS

I shall present specific documentation showing that part losses and lack of controls caused parts to be delivered several times. A part would be delivered and lost—redelivered, et cetera. The cost in terms of lost man-hours, reprocurement, air express shipments, and overtime was great.

VI. USAGE OF KITS IN THE FIELD

I shall present a report reflecting on extremely poor and costly handling of parts and part kits in the field.

VII. PROCUREMENT ABUSES

I shall present documentation and examples proving such practices as:

(*a*) Exorbitant prices paid to vendors for material when the same material was available in Lockheed stores for a fraction of the price paid to the vendors. Strangely, the practice continued despite my objections.

(*b*) Excessive prices paid to vendors for other material.

(*c*) Questionable practices in procurement of plant maintenance bolts, nuts, screws, and similar items at the Chattanooga plant.

VIII. WASTE OF TOOLS AND EQUIPMENT

I shall show that as of May 1971, there was no checkout control system at the Chattanooga plant to control disbursement of standard tools, such as expensive carbide cutters, drills, et cetera. Several hundred dollars a week was being spent to replace pilfered or lost standard tools. I shall also show examples of expensive tools found rusting in old water-filled, dirty containers in the yard at Chattanooga. The condition had existed for over 4 years.

Chairman PROXMIRE. We want to bring out as much as we can of this in the question period, Mr. Durham. And I suggest that to the extent we can we will certainly keep it in the record so that we have a complete and full record of all this, because you referred to them so briefly in your presentation.

Go right ahead.

Mr. DURHAM. Yes, sir.

IX. MISHANDLING OF MATERIAL

Material (raw stock such as extrusion, bar stock, sheet metal, et cetera) was completely out of control. Expensive material was continuously ordered when sufficient quantities were actually available. Expensive material was rusting away. Titanium, costing over $20 a pound, was corroding. Material had been constantly ordered, lost, and reordered, adding to the "pile." Finally, 42½ tons of accumulated material which had rusted and corroded beyond recognition was dumped to clear the way for straightening out identifiable material. This is a matter of record. Expensive castings were found rusting in old barrels filled with rain water. Expensive rubber-faced steel plates purchased for over $300 a sheet were corroding and ruined.

X. PURCHASED PARTS—EXORBITANT AND QUESTIONABLE PROCUREMENT PRACTICES AND PARTS CONTROL

Purchased parts and miscellaneous small parts (MSP) were being blindly purchased when sufficient quantities were already in stock. This practice had existed for years and resulted in hundreds of thousands of dollars worth of unneeded parts lying in parts bins gathering dust.

XI. MSP (MISCELLANEOUS SMALL PARTS)

A typical example of poor management was the fact that the Chattanooga MSP parts crib contained over 4,894 different items, when actually only 813 were required. A critical aspect was that many of the unneeded parts at Chattanooga were desperately needed in Marietta. Marietta people were buying parts that were available in Chattanooga. The large overage of MSP had resulted from poor management, such as the blind purchase of MSP mentioned earlier. One Lookheed plant closed and sent all of its MSP and purchased parts to Chattanooga,

where they layed around in piles for almost 2 years, out of control. I found much of it needed in Marietta.

XII. MANLOADING PROBLEM

Lack of foresight in manloading added to costs. For example, in a panic, the Lookheed Chattanooga Co. layed off over 20 machinists, and then recalled them within a couple of weeks. The work had existed all along. Poor shop loading was the problem.

XIII. C–5 REFURBISHMENT PROBLEMS—FLIGHT TEST AIRCRAFT

Notes made in a meeting held to discuss the refurbishment (update remodeling) of ship 0002. Much concern was expressed over what to tell the customer about poor structural conditions existing on ship 0002, which would be uncovered and revealed when outside skins were removed to facilitate remodeling activities. The report also mentions a typical example where over 10,000 parts were delivered to ship 0008 after it was delivered to the flight line. Later, approximately 4,000 were returned as not needed. The cost of delivering these parts originally in terms of overtime, premium transportation, et cetera, was stupendous.

XIV. TYPICAL CALL SHEET

Ship 0020. Detail parts (components) are shipped from Marietta to various feeder plants located around the country to be made into assemblies. I shall present a typical call sheet requesting the return of components from feeder plants, which were missing from assemblies. Thousands of parts had to be road tested back to Marietta because they had not been installed. This was extremely costly in terms of air express, special trucks, overtime, lost production time, damage, et cetera.

XV. SAMPLE—SHIP 0023 OPEN ITEMS

The company constantly released false reports of aircraft condition or status. For example, when ship 0023 moved from preinstallation position to final assembly on March 11, 1970, the company officially reported a total of 30 open items as agreed to by quality control. I proved by an audit that over 1,000 items were actually open.

XVI. SCRAPPAGE OF PURCHASE PARTS

In a letter to President Fuhrman dated April 17, 1970, I pointed out that untold dollars worth of expensive purchased parts were erroneously scrapped and sent to the dump.

XVII. EGLIN REPORT

I shall show a report depicting wasteful and costly malpractices existing in the field on aircraft undergoing up-date (remodeling) and testing.

XVIII. DISCREPANCY REPORTS (DRS)

I shall present a chart showing the great number of rejections written on aircraft after arrival at the flight line. There were thousands of rejections and each one necessitated some type of procurement effort. Most of the butchery had actually taken place in structural areas, but had been ignored in order to sell work and move aircraft "on schedule" at all costs.

XIX. ASTOUNDING NUMBER OF PARTS DELIVERED TO AIRCRAFT AFTER ARRIVAL AT THE FLIGHT LINE OR FLIGHT TEST

I shall present the draft of a report given to my superiors showing that over 128,000 different parts were delivered to ships 0001 through 0016 after they arrived at the flight line area. These deliveries were made to aircraft which by company records were complete except for a few open engineering jobs and work planned for installation at the flight line. The parts were delivered at great expense under panic conditions.

XX. CHATTANOOGA STOCKROOM PROBLEM AND OTHER UNSATISFACTORY CONDITIONS

A report to management criticizes the unsatisfactory condition of the stockroom at Chattanooga which was completely out of control resulting in great loss and costly replacement of parts.

XXI. CHATTANOOGA TIE-IN

I will show a letter addressed to the Chattanooga plant manager dated May 10, 1971, reflecting on conditions corrected during my stay and, more importantly, on the continued existence of unsatisfactory and costly conditions such as failure to install a standard tool checkout control system in 4 years.

XXII. AEROSPACE GROUND EQUIPMENT (AGE)

The design concept and cost of C–5 aerospace ground-handling equipment should be investigated. Equipment used for hauling baggage, missiles, landing gears, engines, and miscellaneous items on the ground is made to aircraft specification. Therefore, exorbitant prices are paid for parts used to manufacture such equipment. Therefore, prices paid by the Government to Lockheed for finished products are also exorbitant. I believe costs could be substantially reduced. Also, I believe there is a motive behind the design concept which is not in the best interests of the Government.

XXIII. AUDITING—NOTES AND RECOMMENDATIONS

The Lockheed internal auditing system is obviously ineffectual or else not allowed to function properly. I suspect a combination of both conditions.

XXIV. OVERALL RECOMMENDATIONS

I would appreciate the opportunity to make recommendations based on facts presented in testimony.

Thank you.

Chairman PROXMIRE. You can make those recommendations any time you wish, this morning, if you wish. How long would it take for you to make those recommendations?

Mr. DURHAM. They are actually included in the last part of my testimony, sir.

Chairman PROXMIRE. Would you expect to deliver them just before you are dismissed?

Mr. DURHAM. Yes, if I may.

Chairman PROXMIRE. Very good.

(Mr. Durham's prepared statement follows:)

PREPARED STATEMENT OF HENRY M. DURHAM

In order to better understand the testimony to be presented it is necessary to know that aircraft are built in sections in what is known as structural areas. Then the various sections are put together to form larger sections, etc. For example, the forward fuselage is assembled in one area, the mid-fuselage in another area, the aft-fuselage in another area, the wings in another, the nose in another, and many other large and small assemblies in various other designated areas or *positions* as they are known in the aircraft business.

Of vital importance is the fact that certain parts and assemblies as specified by Engineering are called out on installation documents to be installed in each one of these specific positions as the work progresses through various stages of completion. Installations and sequencing must be carefully planned because one part is attached or connected to another and another part attached to that one, etc.

It is the responsibility of quality control to inspect and certify all installations as being complete and proper by stamping the installation paper and retiring the stamped documents to *Inspection Records.* This action certifies the work to be completed and gives Lockheed credit for the work.

Everything is geared to move or progress on a predetermined, approved schedule. For example, picture the fuselage sections as tubular in general shape. On the predetermined schedule, the supposedly completed fuselage sections are moved to an area or position known as body-mate where they are joined together into a long cigar shaped section. The aircraft gradually takes shape as it moves down the production line so that when it goes through final assembly it looks like an aircraft except for the empennage or tail section.

As stated earlier, an aircraft receives certain parts and installations specifically called out for each position it goes through and quality control stamps and retires installation paper to signify completion of scheduled work.

By the time an aircraft completes final assembly and the empennage installation it is supposedly complete except for a few late engineering changes and normal installations specifically planned for the flight line. Installation paper remaining open on the aircraft supposedly represents the *true condition of the unit.*

PRELIMINARY, BACKGROUND AND PERSONAL

Before getting into the main body of my testimony I would like to touch on the events leading up to the present situation.

I.—In July and August of 1969 as General Department Manager in charge of all production control activities in the flight line, flight test and avionic areas, I began to notice serious deficiencies in C–5 aircraft when they were moved from assembly areas to the flight test or flight line positions.

One of the serious conditions for instance, was that thousands upon thousands of parts and assemblies which Lockheed inspection records showed to be installed were in fact missing from the aircraft and had not been installed. Aircraft, which according to company records were complete except for planned flight line installations and a few engineering jobs, were in fact virtual shells.

I was greatly concerned and began to closely monitor the situation to confirm my findings. I spent most of August 1969 screening production control call sheets

(special forms on which production personnel write in requests for parts), making counts and verifying facts.

In September 1969, I verbally reported the condition to my superiors and expected everyone to be shocked and come to the rescue. Failing to get a positive response and, in fact a negative response, I contacted other members of management and received an adverse reaction wherever I turned. I arranged to secure the use of a highly qualified man to physically audit and verify conditions on aircraft and resorted to a series of written reports beginning in October 1969. The response was not only negative but hostile. I was told to shut up and even to hide the reports.

I pursued the matter vigorously but in time became so disgusted, disheartened and disillusioned at the attitude and lack of response that in February 1970, I even requested transfer to another Lockheed Company and said I would transfer to anywhere in the world. Shortly afterward I reconsidered that decision having realized that I had been running away from the problem and taking the lazy way out rather than facing the situation squarely and doing my duty. I resolved to see it through regardless of the consequences. I felt that if I could somehow get to the right people, positive action would be taken. Everyone I contacted was hostile. I was rebuffed at every turn.

Finally, I decided to make an appointment with Fuhrman, the President of the Georgia Company. On March 23, 1970 I called for an appointment. Mr. Poore's secretary answered the phone and said that Mr. Fuhrman had left for the day. She asked that I leave my name and number. Shortly afterwards (the same afternoon) my boss demanded to know what I was doing contacting Mr. Fuhrman—I had been cut off at the pass. I was instructed to report to my superior's office the following morning. After an unproductive discussion with R. C. Goddard, my immediate superior, and V. H. Brady, the Assistant Director of Manufacturing Control, I reiterated my desire to talk to Mr. Fuhrman but agreed to talk to W. P. Frech. The meeting was absolutely fruitless. Mr. Frech talked in the clouds about engineering and other unrelated subjects. He apparently had no desire to discuss the real issues and problems. I had to ask him more than once to read a document pertaining to some of the problems which I had handed him when first entering the office. After the meeting I decided to wait a couple of weeks to see if any positive action was taken but frankly, I didn't want to hold my breath.

By this time I was really in hot water. I was ostracized, criticized, pushed in a corner and even warned by my immediate superior that I would never get up on the right side of the bed if I went to see Fuhrman and continued to persist in seeking reforms.

After realizing that no action was being taken I managed to contact Mr. Fuhrman in the middle of April and met with him for approximately one hour and fifteen minutes. I presented him with a large package containing reports, audits, documents and related data proving mismanagement, waste and costly malpractices.

Mr. Goddard was right about getting up on the wrong side of the bed. I was in more trouble than ever. My job was abolished in May and I was downgraded to a lower classification. I decided to take a lay-off in lieu of downgrade which allowed me to collect severence pay and other fringe benefits. I had to protect my family as much as possible.

I felt I had to get out—away from the plant and pursue the matter. I wrote my superiors a letter dated May 11, 1970 advising them of my decision. In the letter I wrote, "In view of my personal situation and opinions regarding company activities, I have decided to accept lay-off from the position of Night Division Manager in lieu of downgrade to the position of Department Manager, effective 23 May 1970. I have given much thought to this decision. Although I have always acted in what I considered the best interests of the Company, I now realize that my philosophy of management differs from what is expected of me. I do not have the audacity to say I am always right. However, I do plan to always act in accordance with my honest opinions, principles, and convictions, regardless of the consequences."

The reason I had wanted to remain with the company until May 23rd was to give two weeks notice and to train the young manager selected to take my place as much as possible. I felt I owed it to him. However, on the following day, Tuesday, May 12, 1970, I was literally *run out of the plant.* I had gone to R. C. Goddard's office to attend to a routine meeting and was asked to remain afterwards. There, I was told with absolutely no explanation that I would have to

leave the plant that very day. I wasn't even allowed to turn in my keys and had to pay for them. A week later in a letter to Fuhrman I said, "After 19 years of dedicated service I was rushed out of the plant with an initial refusal even to let me gather my personal belongings. Such treatment usually was reserved for a person who has been fired." "It was monstrous."

Despite all of this, I somehow wanted to have faith in the corporation and sent Mr. Haughton a letter dated May 25, 1970, accompanied by a large package of documentary evidence. In the letter I told of a call from V. H. Brady directing me to, "keep quiet and hide" a specific missing-parts report; of a dawning "horrible realization" that data were being withheld and of "charts produced to illustrate how beautiful everything was rather than the true facts." I also told Haughton of what I choose to call the "Lockheed Georgia Management Protective Society". To be a member, one must worry more about protecting his hide and the hides of his superiors than working in the best interests of the company and the country.

Haughton, replying almost at once, said he had read the letter, perused the documentation and planned an investigation.

Mr. Haughton's letter said that when the investigation was completed I would be contacted by either him, Rieke (the Corporate Vice President) or Fuhrman on the results. No one has ever contacted me.

During the last week of June 1970, I received an unexpected call from W. P. Frech, Director of Manufacturing, who asked me if I would come back to work. I told him no—not for the same people. Mr. Frech said that E. G. Mattison, Vice President of Industrial Relations was looking for a position for me and that he, Frech, would talk to me later. On July 29, 1970, Frech called again and said the only position open anywhere at that time was at Chattanooga as a section supervisor. I finally said I would take the position despite a great reduction in pay. In a letter, I told Mr. Frech that I would continue to give my best skills and abilities to my job. At the same time I would always exercise my value judgment.

The only reason I went back to the company was that I wanted to have faith that Haughton would investigate the situation as stated in his letter and take positive remedial action. I had to have some kind of faith—however, *I couldn't have been more wrong.*

In Chattanooga I found unbelieveably poor management resulting in great inefficiency and waste. I went to work on this immediately but received little help. The management in fact resented problems being brought out in the open and allowed bad conditions to exist day after day.

I wrote Mr. Haughton a letter in late November of 1970 to check on the situation and received a reply omitting any information on the investigation if there really was an investigation. Finally, this spring I asked to see someone in upper management who would tell me what reforms and corrective measures, if any, the company intended to make. I had been in close contact with people at Marietta and could see no improvements at Chattanooga except those I had managed to install.

In March, 1971, Mr. Frech came to Chattanooga and met with me in the plant manager's office. When C. L. Starnes, the plant manager brought up the fact that I had said I would press for reforms even if I had to do it on the outside, Mr. Frech asked if I knew what had happened to Mr. Fitzgerald who had gone to Washington with some Lockheed problems. When I said I did not, Mr. Frech said that Mr. Fitzgerald was now the Chief SH House Inspector for the Civil Service and that he would never be able to get a good job. I consider this to be intimidation. The inference was that anyone who bucks the Lockheed Company or the Air Force is in for trouble the rest of his life. Frech also said he might be worried about what I might say if I held a higher position. I say, how can a price tag be placed on integrity. Right is Right.

I could stand it no longer. I knew by then (and admittedly should have known much earlier) that Lockheed management had no intention of reforming.

I wrote a 23 page letter to C. L. Starnes, the Chattanooga plant manager, outlining improvements already made and including instructions for correcting existing problems.

So, surrounded by disorganized and shabby management, I asked to be layed off again to provide some protection for my family although I would have resigned if necessary. I resolved to pursue this matter because I strongly believe that such waste, mismanagament, improper practices, and dishonesty should not be allowed to exist in this country.

II.—Management of a production control organization requires great knowledge of manufacturing scheduling, program coordination, aircraft status, manufacturing paper, aircraft parts requirements and installation paper. Anyone who knows anything about the aircraft business could substantiate this.

The position I held while managing a large production control organization required experience gained from nineteen years of service, an intimate knowledge of aircraft scheduling, aircraft installation paper and documentation and knowledge of aircraft status. The position also required organizational ability and product knowledge. I had the responsibility for directing, managing, and coordinating the procurement, stocking, kitting, disbursement and delivery of parts, material, assemblies and kits used in the assembly of C–5 aircraft. In addition, production control personnel work directly with manufacturing people. Production control also has the responsibility to forecast all parts requirements in advance of need utilizing manufacturing planning paper, schedules and aircraft status.

In February 1970, prior to my attempt to talk to President Fuhrman, I received an official company letter from my superiors to the Lockheed Professional Personnel Department which reads as follows:

"With regard to Corporate policy as set forth in referenced memo, we recommend Henry M. Durham, Employee No. 526 798, as a potential candidate for interdivisional transfer at the division management level. This recommendation is made as a result of long association with, and close observation of Mr. Durham in his professional duties.

"He joined Lockheed in August 1951, and his record has been one of steady unbroken progress. Starting as an assembly dispatcher in Production Control, he now fills the responsible position of Night Division Manager.

"Among his many qualifications are unquestioned loyalty, energy, initiative, product and corporate knowledge, ambition, and an insistence on a job well done—first of all by himself, and secondly by all reporting to him.

"It is our unqualified opinion that Mr. Durham would represent a real asset to any organization to which he might be assigned."

Also, as late as May 1970, I received a commendation for outstanding performance which reads in part:

"For a job well done under adverse conditions, this company expresses its sincere appreciation."

I present these facts to establish my credibility since some attempt may be made to discredit me.

My qualifications, once regarded as outstanding, somehow changed almost overnight after my visit to Fuhrman and subsequent activities.

I am not asking anyone to form any opinions until I present the positive documentary and physical proof contained in the testimony. I assure you it is honest and factual.

Attachments follow:

LOCKHEED-GEORGIA COMPANY,
February 24, 1970.

To Professional Personnel Department.
From R. C. Goddard.
Subject: New opportunities program.
Ref: Management memo, Serial No. 766, Dated December 10, 1969.

With regard to Corporate policy as set forth in referenced memo, we recommend Henry M. Durham, Employee No. 526798, as a potential candidate for interdivisional transfer at the division management level. This recommendation is made as a result of long association with, and close observation of Mr. Durham in his professional duties.

He joined Lockheed in August 1951, and his record has been one of steady unbroken progress. Starting as an assembly dispatcher in Production Control, he now fills the responsible position of Night Division Manager.

Among his many qualifications are unquestioned loyalty, energy, initiative, product and corporate knowledge; ambition, and an insistence on a job well done—first of all by himself, and secondly by all reporting to him.

It is our unqualified opinion that Mr. Durham would represent a real asset to any organization to which he might be assigned.

R. C. GODDARD,
Manager, Production Control Division (Assembly).

LOCKHEED-GEORGIA COMPANY,
Marietta, Ga., March 10, 1970.

COMMENDATION

This is to commend H. M. Durham, Employee No. 526798 of department 35–10 for Recognition of his efforts to secure, coordinate and expedite the shipment of parts during Prosect Wing Strap Addition. For a job well done, under adverse conditions, this company expresses its sincere appreciation.

R. C. GODDARD, *Department Head.*

MAY 25, 1970.

Mr. D. J. HAUGHTON,
Chairman, Board of Directors,
Lockheed Aircraft Corp., Burbank, Calif.

DEAR MR. HAUGHTON: I have been a dedicated Lockheed employee and member of management for almost nineteen (19) years. I have a good record and until fairly recently was proud to be a member of Lockheed management. I can no longer say I am proud, and as a result am no longer with the Company.

Around July or August of last year when I was a General Department Manager in charge of Production Control activities at the Production Flight Line and Flight Test areas, I found that C–5 aircraft moving to the Flight Line were in deplorable condition from a quality standpoint. ASCR paperwork was worthless and meaningless. Thousands of parts not shown open on paper had to be called for and delivered. ADSL and ABNI paper was non-existent or worthless. The conditions were so critical that I resolved to determine the causes and take corrective action.

My investigations proved that installation paper was being sold and retired when parts had not been installed, illegal removals were rampant, etc. In other words, *thousands* of parts were missing from aircraft, ships paper was worthless and the situation was totally out of control. There were many other associated or related problems which I have facts and data on, but won't dwell on here. I just want to give you a good general picture of the total problem.

I first reported the problems verbally but realized I would have to go in writing when no action was taken. When the first written report was produced in October I expected all concerned to run to the rescue. Instead, I received a very adverse and negative reaction from everyone including my immediate superiors. I was shocked. At that time, I could not understand why anyone would not give immediate and positive attention to a problem that was not only costing the Company untold dollars in lost parts, re-procurement, overtime and the like but gave a totally false picture of the aircraft. However, I was determined and continued to audit aircraft and produce reports. I talked to both high and low members of management and thought sure I could make someone realize or recognize the magnitude of the problem. I was worried. What if the customer found the thousands of installations were being reported as sold that had not been installed? Since missing parts could only be detected when installations were made, I was concerned that some critical part might be missing and cause a possible crash. Many missing parts were found only hours or shortly before aircraft were scheduled to fly. I was also greatly worried and concerned about our integrity. I was determined and continued to audit aircraft and produce reports.

I talked to all levels of management. The most positive reaction at this time was a call from Mr. V. H. Brady to keep quiet and hide the reports. A typical example was the day I told Mr. Brady that Mr. C. H. Bollech had casually mentioned he might give one of the missing part reports I had given him to Mr. Rieke. Mr. Brady's response was to call me back later and order me to "get that report back from Bollech fast". When Mr. Bollech refused to give the report back, both Mr. W. B. Witcher and Mr. V. H. Brady requested that I try to stamp it "Confidential". I knew they were acting on instructions from a high source.

I personally contacted Internal Auditing who investigated and substantiated my findings. At that time, I was told by Mr. Brady that I should not have contacted Auditing. A member of the Auditing Department told me later that the report had been "watered down." I noticed later that Mr. Brady was saying he contacted Audting but it is really an insignificant point.

At any rate, I came to the horrible realization that data was being withheld from corporate management to the detriment of the entire C–5 Program and the corporation. I admit that this realization angered me. I vowed I would get

to the right people in the Company but knew I was in for a rough time. In the course of my investigations and talking to high members of Management, I discovered the existence of what I choose to call the "Lockheed-Georgia Management Protective Society." It is a very sick group comprised of people who are afraid to stand up for truth and honesty and dedicated to the protection of each other. I have reason to believe it extends from the Vice Presidential level on down. To be a member, one must compromise his principles, forfeit his integrity and worry more about protecting his hide and the hides of his superiors than working in the best interests of the company and the country. The facts and data I possess pretty well substantiate these conclusions.

It is a sickening situation. For months I saw charts produced to illustrate how beautiful everything was rather than true facts. Being charter members of the "Protective Society", my bosses were afraid to step forward with the truth. I talked to Mr. Brady and people such as Mr. R. A. Shettel "eye-to-eye" and received a lot of "high fidelity mumbo jumbo."

Mr. Haughton I know of what I speak. I firmly believe if the problems existing on the C–5 had been truthfully and factually presented to corporate management at an early stage many of them could have been solved and possibly millions of dollars saved. Also, many of the festering sores plaguing the company today could have been healed. I am confident there are enough brains and ability in those ranks to have arrived at the best solution for the company. This is what I wanted to accomplish.

To be honest and straight forward, one must throw all of the cards out on the table and call straight shots. When I pointed this out to Mr. Brady the other day he said "to have informed Mr. Rieke would have created a panic and caused more confusion". I am sure he would deny making such a statement, but as God is my witness he said it. I think this one statement is pretty indicative of the total situation.

Realizing I was getting nowhere and still determined to help the company, I made an appointment with Mr. Fuhrman. My first attempt to make an appointment was "cut off at the pass" by Mr. Poore. However, I managed to see him later. Mr. Fuhrman was very cordial. I gave him a package of information and did my best to get my points across. Although Mr. Fuhrman was receptive, I am not sure I did a good job of presenting the facts. I do not know what action has been taken.

I was told I would never get up on the right side of the bed again if I met with Mr. Fuhrman. This is certainly true. I was ostracized, criticized, pushed into a corner and eventually downgraded. I took layoff instead. I was accused of stepping on peoples toes and "running over people" to get the job done. The truth of the matter is that I ruffled some of the feathers that Mr. Brady and Mr. Witcher and others are afraid to ruffle. A "yes man" will always react in this manner. Many times I have seen facts twisted and turned around to present a more acceptable picture. I refused to do it.

Mr. Haughton, I know that many statements made by outside sources regarding Lockheed management are true as far as the Georgia Company is concerned. However, I do feel that Lockheed management as a whole throughout the corporation is beyond reproach. I know the Lockheed Corporation had to be built on integrity to be as large as it is and to have enjoyed the respect it has gained through the years.

I became totally disgusted with my boss, his boss, and on up the line for lacking the courage and fortitude to do the right thing or to go to the top if necessary. However, if one is playing the game he will not jeopardize his position even if it means not being truthful and honest.

Before I conclude, I want to make it clear that I am not seeking revenge, requesting re-instatement or asking for a job. I couldn't be paid enough to be connected with the calibre of people I have been working under. Incidently, no one ever showed any appreciation for what I was trying to do—not a word; only the reaction as stated. If an apple grower places apples in several barrels he must frequently inspect each barrel and throw out the rotten apples. *Who missed the Georgia Barrel?*

In the Marines one always looks to see who is in the foxholes to the right and to the left because when it comes to "cold steel" it's the man that counts. I must tell you that I would not trust these people and would dig another foxhole. This is exactly what I am doing.

Mr. Brady told me I couldn't fight company politics. I refuse to engage in so-called politics. Is this the kind of management you want? Countless times I have

told aspiring young supervisors or managers that the only way to get ahead is by hard work, dedication and honesty. I believed it and still believe it is true in most companies because it is the right way and the American way. I have confidence I will find a position where these principles count.

Mr. Haughton, somebody had better start sweeping and throwing out those rotten apples before it is too late. The "yellow jackets" are swarming.

Enclosed find some examples of some of the reports I mentioned and some interesting facts. The letters to Mr. Fuhrman were sent to him by registered mail but may have been intercepted before he personally received them.

Oh! What a Tangled Web We Weave When First We Practice To Deceive.

Very truly yours,

H. M. DURHAM.

cc: Mr. W. B. Rieke.

MAY 11, 1970.

To: R. C. Goddard.
From: H. M. Durham.
Subject: Layoff in lieu of downgrade.

In view of my personal situation and opinions regarding Company activities, I have decided to accept layoff from the position of Night Division Manager in lieu of downgrade to the position of Department Manager, effective 23 May 1970.

I have given much thought to this decision. Although I have always acted in what I considered the best interests of the Company, I now realize that my philosophy of management differs from what is expected of me. I firmly believe and know from our recent conversations that my methods of operating, beliefs and activities has seriously jeopardized my career, chances of advancement, and future with the Company.

I do not have the audacity to say I am always right. However, I do plan to always act in accordance with my honest opinions, principles, and convictions regardless of the consequences.

Very truly yours,

H. M. DURHAM.

ccs: V. A. Brady, W. B. Witcher.

EXHIBIT 1.—MISSING PART REPORTS [1]

Shows missing part reports beginning October 3, 1969. Also various other documents and reports reflecting the deplorable "out of control" condition of aircraft and aircraft paper in general. The missing parts reports were not only produced by me. Many are co-signed and/or approved by other competent members of management.

The reports conclusively show a high percentage of parts missing from aircraft and the existence of an unknown condition on C–5 aircraft undergoing manufacture.

The most serious and costly condition was the selling of installation paper in order to collect payment and receive credit for work which had *actually not been accomplished.*

By the time an aircraft reached Pre-Installation, Final Assembly, the Flight Line or Flight Test positions, it would be in deplorable condition—completely out of control. Thousands and thousands of parts would be missing, but nobody knew which ones. The installation paper had been retired and stored away. Each aircraft was an unknown.

For example, an aircraft would arrive at the Flight Line a virtual shell—missing thousands of parts and assemblies—when, according to Lockheed records it was complete except for a few engineering changes and the work normally planned for installation at the Flight Line, such as radar gear, some electronic equipment, etc.

This of course resulted in chaos because no one knew which parts and assemblies were missing because the aircraft paper calling for installation had been closed to Inspection Records, to erroneously reflect that all of the work had been accomplished when in fact it had not.

Most of the missing parts problem originated in structura sections, including Feeder Plants. This is when sections such as the Forward Fuselage, MID Fuselage, Wings, etc., are being assembled. Missing parts consist of everything

[1] Retained in committee files.

from small bits and pieces to major assemblies, and included thousands of expensive purchased subcontracted and machined parts.

Illegal removals were also rampant. A part, for example, would be installed on a lead aircraft and sold. Then it would be illegally removed and installed on the next highest assembly or aircraft. The thousands of illegal removals, while extremely serious, accounted for less than 10 percent of the missing parts.

Another factor contributing to illegal removals was that time after time, parts would be damaged through mishandling or in the process of installation. Instead of presenting the damaged part to Quality Control for proper dispositioning and accountability, the part would be thrown away and a replacement cannibalized from another aircraft or assembly.

Many times such parts could have been saved by reworking them instead of throwing them away. One reason this was done was to hide the amount of butchery, that is, to hold down the officially reported rejection rate by throwing damaged parts and assemblies away rather than prepare discrepancy reports.

The vast majority of missing parts was caused by the company moving major assemblies and aircraft on the prescribed schedule *regardless of the state of completion* in order to collect progress payments as related to milestones and of course credit for being on schedule. In order to do this, thousands of pieces of installation paper, representing tens of thousands of parts, were stamped off by both Production and Quality Control and retired to Inspection records to signify that the parts had been installed—*although they had not.*

As stated—this action—

(a) Paid Lockheed for completion of work although it had not been accomplished.

(b) Reflected a "psuedo" on schedule condition.

(c) Reduced open item counts, thereby painting a very rosy picture of aircraft condition.

The missing parts condition on each aircraft of course "snowballed". The reason for the snowball condition was that parts slated for installation in the next positions could not be installed because attachment parts were missing—and on and on. So, as I said, by the time an aircraft had reached Final Assembly or the Flight Line (or even earlier) it was in a wretchedly deplorable condition.—Completely out of control.

Hundreds of thousands of dollars in the form of manhours, overtime, materials replacements, parts replacements reprocurement, etc., were spent seven days a week around the clock. It was chaos—premium shipping charges were paid to air express thousands of parts.

A missing part is detected only when a workman making an installation found he couldn't do the job because the attaching structure or parts were missing. Therefore, many missing parts were discovered only shortly before aircraft were scheduled to fly, and many after flight. I was very concerned that a plane might crash.

In a letter to Mr. Haughton dated May 25, 1970. I wrote that I talked to both high and low members of management and thought sure I could make someone realize or recognize the magnitude of the problem. I was worried. What if the customer found that thousands of installations were being reported as sold that had not been installed? Since missing parts could only be detected when installations were made, I was concerned that some critical part might be missing and cause a possible crash. Many missing parts were found only hours or shortly before aircraft were scheduled to fly. I was also greatly worried and concerned about our integrity.

In addition to the missing parts problem, many parts were installed, but the installation paper not stamped to show it. Unstamped paper indicated an open requirement for parts.

This is the reverse of the missing part problem. When an aircraft moved from one position to the next, such as from the Pre-Installation position to Final Assembly, Production immediately requested all parts and assemblies shown as required (Unstamped paper). Thousands of parts would be rushed to the aircraft only to be left lying on the floor or somewhere because when a Production man started to install a part he would find one already installed and toss it aside. Thousands of parts were scattered and piled everywhere—completely out of control. It was a lost part condition that generated replacement action to re-procure or re-fabricate thousands of parts that were not needed had anyone known where anything was. Again, the overtime, manhours, premium freight, re-ordering, paper shuffling, searching, crying and panic decisions made by man-

agement cost untold dollars. It was like a thousand blind dogs turned loose in a meat market.

Therefore, thousands and thousands of parts were delivered only to find they were not needed. As a result, thousands of parts were lying in piles, in corners, on tables—all over the place out of control and not needed on the particular aircraft to which they had been delivered. Many times parts would be lost and replaced (that is, replacements bought or fabricated depending on the type of part) only to have the original turn up later.

The fact that the Air Force (Government) would condone the erroneous selling of work and pay for it, to me, is monstrous, both on Lockheed and the Air Force parts. It was in fact collusion between the Company and the Air Force to make the C–5 program look better than it was, keep Lockheed paid and hide the true picture.

It is the complete lack of integrity on Lockheed's part (the management) that has prompted me to do what I am doing.

EXHIBIT 2.—AIRCRAFT CONDITION REPORT, DATED MARCH 16, 1970 [1]

A report citing and criticizing the continued existence of serious and deplorable conditions and asking management why corrective measures aren't being taken by responsible management. The report mentions missing parts and the fact that thousands of parts issued to aircraft on request were being returned as not required. This was not the Flight Line, but Final Assembly and Pre-Installation.

The report points out the improper or dishonest reporting of aircraft conditions and the fact that all organizations, including Quality Control, played a part in it. The fact that the very organization entrusted to maintain quality was involved, was to me inexcusable.

EXHIBIT 3.—VALUABLE SMALL PARTS PROBLEMS (VSP) [1]

Report shows that as of May 1, 1970, the Company was facing a $30,000,000 cost overrun on VSP due to over-procurement resulting from failure to control parts in production areas and cribs—mostly production areas. The report shows that VSP cost per aircraft is approximately $560,000. However, the cost was exceeding $1,000,000 per ship.

This information was verified by the Company Industrial Engineer assigned to trying to straighten out the mess (Dewey Cook).

Mr. Cook, in attempting to arrive at a solution discussed the problem with me in depth. He was talking to many people.

This was money straight down the drain, impossible to be recovered. The best the Company could ever hope to do would be to bring the cost per aircraft back down to what it was supposed to be ($560,000) at some point.

At the time I checked, Ships 0025 and 0026 were in final assembly and had therefore received most of the VSP, since 95 percent or more is installed above—(or earlier than Final Assembly). For the sake of even figures, a $500,000 overrun on 26 aircrafts would be $500,000 times 26 aircrafts, would be $13,000,000.

I don't know when or if ever it was recovered but it was somewhere above Ship 0026.

VSP was scattered on floors, tables, in boxes, heaps—all over the place. It was being swept up and dumped. Finally, somebody caught on and started sending it to the Lockheed Ventura Company to be sorted out at 6 cents per item.

The cost of VSP averaged 16 cents to $37.50 each, according to Mr. Cook.

No one knew what or how much had been disbursed out to the shops.

Basically the reason for the over-run was not due to cost but to misuse and failure to establish and maintain an adequate inventory accountability system.

I sent copies of this report to Mr. Fuhrman, President of the Georgia Company, and Mr. Haughton.

EXHIBIT 4.—PROGRESS REPORTS [1]

Certain progress reports reflecting on missing parts, erroneous ASCR's etc. (ASCR—Assembly Statement of Condition Report). One report dated November 24, 1969, shows that approximately 2,000 parts previously procured for Ship 008 against open paper were returned as not needed. This represented time and money.

[1] Retained in committee files.

Each one of those parts had been individually procured or fabricated at great cost—only not to be needed. This amounted to a waste of thousands and thousands of dollars—not only the cost of the parts but the overtime and man-hours that had been spent to procure them. Ship 0008 of course was not the only one—it happened on all ships constantly. I picked this one as one illustration.

This also causes unnecessary procurement and fabrication of thousands of fabricated purchased and subcontracted parts in this way:

Parts were issued and installed on an aircraft in a structure area but the installation paper left open.

When the aircraft reached the Flight Line or Flight Test, the parts would be requested again because of the open paper.

This constituted a double issue and therefore generated replacement action in the form of re-procurement.

The unneeded parts would rot for months in an area where they were not needed but in many cases urgently needed in other areas.

Another progress report notes that approximately 40 MCN Kits (Manufacturing Change Notice—a kit is a package containing more than one part) for ship 0012 will not be needed. We asked Production to check the aircraft as a test to determine the magnitude of the problem. It turned out to be tremendous. Thousands of parts were procured, kitted and stocked to be used on aircraft when called for by Production Personnel. However, a serious problem connected with Planning Paper caused the same part numbers to be issued from another source and installed. However, the left hand didn't know what the right hand was doing so the kits were issued only not to be needed. This resulted in additional thousands of parts scattered around the area. These parts were out of control and considered lost, so replacements would be procured or fabricated, adding to the already dismal mess.

Kits containing thousands of parts were stored for months waiting to be used on aircraft when they were actually not needed. Many of these parts were expensive subcontracted and purchased parts costing thousands of dollars each—and many of them were used only on certain aircraft configurations—for example Ships 0032–0038 only.

Suppose a $5,000 part is designed by Engineering to be used on Ships 0032–0038 only and seven parts are purchased accordingly. Now suppose parts are installed on Ships 0032 and 0033 but because the installation paper isn't stamped. two parts are kitted and held at the Flight line pending installation. This would leave the last two ships (0037–0038) short parts. In a panic, parts would be purchased at premium cost from vendors and shipped air express—while all the while, the parts purchased for Ships 0037 and 0038 were rusting away in a kit held for Ships 0032 and 0033, which already had parts installed. This mess occurred day after day costing untold dollars in terms of procurement, re-procurement, air express shipments, material, overtime and panicky, irresponsible management decisions.

Frequently a vendor would have completed commitment to build a certain number of parts to cover a specific range of aircraft and would charge premium prices to re-tool and make parts to replace units lost by Lockheed.

Another progress report shows that 15,291 parts-missing calls and 5,294 calls against rejection were made against Ships 0009 through 0014—after the Ships arrived at the Flight line. This is an astounding figure but small compared to some later data I will furnish.

EXHIBIT 5.—DOUBLE ORDERING, MULTIPLE ISSUES AND REPLACEMENTS [1]

(Shows specific examples of Multiple Ordering and Deliveries)

The Call sheet for Ship 0021, for example, shows double and triple deliveries, etc., and dates parts were previously signed for. The Call sheet represents one day's activity only—thousands of parts would be delivered only to be lost before they were installed or else they could not be installed because of a missing attachment part and was subsequently misplaced in the maze and lost. Maze is a good term. Picture a huge aircraft or aircraft section cluttered with thousands of loose parts on the floor, on table, in people's pockets, under tables—with people shuffling and sifting through the mess which was completely out of control.

[1] Retained in committee files.

Another report shows where Production requests were made against a Lost Parts Authority when actually, parts had been rejected. This was one of the most unnecessary and costly conditions I investigated.

A part would be rejected and a Discrepancy Report (DR) written to state the condition of the part (what was wrong with it). The DR is authority to order another part when properly verified and signed by Quality Control. In this case, Production to obtain a part (replacement) quickly would order it against an LPA (Lost Part Form) which is also authority to re-order or procure parts.

So parts would be delivered and replaced through the system using the LPA Form and, when the DR went through the system it would deplace the same part again. Thousands of parts were double ordered and double procured at great cost.

EXHIBIT 6.—RETURN OF KITS FROM PALMDALE (USE OF KITS IN THE FIELD) [1]

This is a report showing typically poor Flight Test and Program Control during Field Update. In this particular case, 92 Kits were being returned from Palmdale, California, back to Marietta because they weren't needed. More often than not, the Kits were requested on a "panic" basis necessitating overtime and air express shipment at great expense. The cause for most of this was poor Program Control in determining which kits were to be installed to meet the desired configuration. Also, erroneous planning paper created havoc.

Planning erroneously failed to reflect many needed parts on installation paper. Therefore, these specific Kits could not be installed because they did not contain all of the parts, and systems could not be connected. Frequently, attempts were made on a panic basis to air express "left out" parts to the field. Many times Kits would be opened in the field and installation started before it was discovered that planning had failed to include all of the parts. This would leave a residue of parts left over from partially used kits cluttering the area—out of control and lost again. This resulted in having to buy replacements.

In addition, the terrible expense of rounding up thousands of parts, kitting them and shipping air express when they actually were not needed was outrageous. We were continuously having purchased parts shipped in air express from vendors so they could be placed in Kits and subsequently flown to the field air express.

EXHIBIT 7.—PROCUREMENT ABUSES AND EXORBITANT COSTS—MATERIAL [1]

This section shows numerous abuses in the procurement and control of material. Parts purchased years ago are still in stock (no longed needed). This in most cases is the result of parts being lost or out of control necessitating reprocurement—with the original parts turning up from out of the woodwork later.

I will show examples of exorbitant prices paid to vendors for material when the same material was available in Lockheed stores for a fraction of the price paid to the vendors.

I also have examples of excessive prices paid for material from Tull metals or other vendors.

The practice of buying material from vendors instead of obtaining it from stores persisted despite repeated complaints on my part. Finally, a strong letter stopped it temporarily.

Perhaps a quiet investigation should be made to determine if there are any connections between any Lockheed people and Tull people. There may be a problem here.

Another example of procurement abuses is the way plant maintenance, bolts, nuts, screws and similar items, were procured at the Lockheed Chattanooga Plant.

In this case I am referring to regular hardware-type bolts and nuts used to make maintenance repairs and upkeep around the Plant.

I could not believe anyone would tolerate such practice—and it required pressure to get it stopped, for some reason.

The problem was that:

A salesman from one company would come to the Plant, look in the bins and supply whatever he thought was needed. The problem is that he supplied far more expensive parts than were needed and as many as he thought he could get in the bins. For example, he sold Lockheed steel high-tensile bolts, plated bolts, etc.,

[1] Retained in committee files.

when plain old common stove bolts would do. No one in management questioned anything and went right on paying the bill. No bids were taken. A check showed that a Company such as the Chattanooga Bolt Company or a regular hardware supply company could supply parts much cheaper. A real peculiar situation developed when this same salesman changed companies. The bolt account went with him. This is highly irregular. Lockheed is supposed to obtain parts by bid from companies—not individuals.

EXHIBIT 8.—WASTE OF TOOLS AND EQUIPMENT [1]

Standard tools of Chattanooga were completely out of control. (Standard tools consist of such items as drills, carbide cutters, bits, etc.) Many are very expensive. Incredible as it seems, there was no check-out control system or any effective controls. No one knew where anything was or who checked it out. The tool engineers in charge of security told me that $250 to $300 a week was being spent to replace pilfered or lost standard tools. He said this was a conservative figure. I found perfectly good tools rusting away in the back yard of the plant.

Example: Rusty drills found in an old water-soaked cabinet thrown out in the back yard. They were immersed in water and ice when I found them. Since I had no jurisdiction over tools, I immediately pointed the condition out to the plant manager in person. Six months later, they were still there, along with other costly equipment and material—rusting away.

I took a small quantity of the tools as an example.

Management people walked through this jungle every day and took no action to correct it. First of all, they did not have the initiative to correct it. Also, I don't believe they knew how. Worst of all, they didn't try.

A control system for tools still had not been established by May of this year (1971).

To let a condition such as this go on for over four years is a crime. For some reason, it was not only tolerated, but even defended. Suppose we take the low weekly loss figure: $250.00 × 52 weeks=$13,000 loss per year on standard tools only from one area. (Think of what it must be throughout the Corporation.)

Instead of showing interest in an offer to get the area under control, the people were incensed at the condition being pointed out. (For some reason, this is the attitude of many high-ranking members of Lockheed management today, and until it is corrected, Lockheed doesn't have a chance.) I might add, a good audit system would have detected it long ago. I will cover auditing later.

EXHIBIT 9.—MISHANDLING OF MATERIAL [1]

Material (raw stock such as extrusion, bar steel, sheet metal, aluminum stock, etc.) was completely out of control and one of the most deplorable and inexcusable conditions imaginable. No one knew where anything was, including expensive castings and forgings. Material (including castings and forgings) were being ordered every day when it was actually available if anybody had known it or knew where it was. Old scrapped material, new material, old rusty pipes, maintenance equipment, rubber goods, dirt, wood, trash, and other debris were all heaped together. Expensive castings and forgings were piled in old, rusty, water-filled barrels or buried in the muck.

Material was constantly being ordered, lost, and re-ordered, adding to the pile. It was incredible. Expensive rubber-faced armor plate ordered for a project which everybody meant to start but never did was rusting away in the back yard at over $300.00 per sheet.

Titanium costing $20.00+a pound was stuffed in boxes eroding away. Yet, titanium was being bought regularly.

Like the tool crib, it had existed for years, but no one did anything. Herds of people were constantly shuffling and searching through the mess. I did manage to get this cleaned up by dumping 42½ tons (a matter of record) of old material which had rusted and corroded beyond recognition. This enabled us to sort out what was left and get it under control. I established a catalogue control system and set it into motion.

It was inexcusable to let this condition develop and a crime to let it exist.

According to a tool analyst for GELAC, the Company is running 45% to 50% replacement activity out of the total, creating a serious problem. This of course has tremendous influence on the cost over-run.

[1] Retained in committee files.

EXHIBIT 10.—PURCHASED PARTS—EXORBITANT AND QUESTIONABLE PROCUREMENT PRACTICES AND PARTS CONTROL [1]

Purchased parts and MSP (miscellaneous small parts) were being purchased when sufficient quantities were already available in the plant. Also, examples of small parts purchased at exorbitant costs.

For years, parts had been purchased with no one giving any thought to establishing a check system to avoid ordering parts which were already available. The practice has cost untold thousands of dollars. Inept and inefficient management allowed this condition to develop and exist.

EXHIBIT 11.—MSP (MISCELLANEOUS SMALL PARTS) [1]

The Chattanooga MSP crib was tremendously over-stocked and completely out of control. The first item of business was to realign everything in numerical sequence in an orderly manner. Then, the Engineering requirements were checked to determine what the requirements actually should be.

Different items (part numbers) were in stock	4,894
Actual requirements	813
More than needed	4,081

The critical aspect here was that many of the unneeded parts at Chattanooga were critically needed in Marietta and Chattanooga had been sitting on them for years. The truth of the matter was that no one knew what was available. Marietta people were out buying parts right and left that were available in Chattanooga. This was hardly surprising since Chattanooga was out buying parts that were available in Chattanooga stock in sufficient quantities.

Another example of costly but typical bungling was that several thousand MSP requirements (parts) had been sent to Chattanooga by the Lockheed Industrial Products Company (LIP) when that company closed. All miscellaneous parts (MSP and some purchased parts) were sent to Chattanooga in one of the worst messes imaginable and it lay around in the same mess in Chattanooga for almost two years. No one made an effort to sort it out and find out if it was needed. Chattanooga was purchasing parts that lay in the pile.

When I finally managed to find out that much of it was needed in Marietta, thousands and thousands of dollars had been spent at Marietta for parts which were available in Chattanooga if anyone had known.

One of the worst and most costly problems encountered at Chattanooga was the situation when MSP and purchase parts were *blindly* ordered according to engineering requirements when many of them were already available in stock in sufficient quantities to satisfy the requirement. This had been going on for years. I couldn't believe that any management, however inept, would fail to set up the elementary and rudimentary systems necessary to prevent this type of activity.

Adding tremendously to the cost was the fact that most of these parts were ordered from vendors even if they were available in Marietta stock at a fraction of the cost.

EXHIBIT 12.—MAN-LOADING PROBLEMS [1]

Lack of foresight and planning by management in shop loading added greatly to costs. For example, in a panic, the Chattanooga Company was forced to lay off people, including machinists, at great expense. The problem in this case is that the workload existed all the time and was reflected in various ways, but management failed to capitalize on the knowledge.

Proper management of the load would have been to pull the work in early (shop orders and material were available) and spread it out. This would have avoided a panic resulting in the laying off and almost immediate re-hire of people. This, of course, is an example of very poor and short-sighted management.

EXHIBIT 13.—C-5 REFURBISHMENT PROBLEMS—FLIGHT TEST AIRCRAFT [1]

Typical situation where, in a meeting there was concern expressed by a Production Division Manager about what to tell the customer about poor conditions existing on Ship 0002.

[1] Retained in committee files.

The memo entitled C–5 Refurbishment Problems shows where over 10,000 parts were delivered to ship 0008 and later, 4,000 were returned as not needed. This was caused by the highly inaccurate condition of the aircraft paper resulting in an unknown condition of the aircraft.

Actually, Ship 0008 was just another example of a common problem existing on all aircraft. As indicated earlier, aircraft arriving at the flight line were practically shells although, according to Lockheed records, they were complete.

As previously mentioned, the subterfuge began on Saturday, March 12, 1968, with the roll-out of Ship 0001, and continued. It rolled out with slave landing gears, false leading edges, dummy visor (nose of aircraft) and other faked components.

EXHIBIT 14.—TYPICAL CALL SHEET—SHIP 0020 [1]

This is a typical example of a call sheet requesting the return of components from feeder plants.

Thousands of feeder plant parts (components) were missing from feeder plant assemblies (assemblies made at feeder plants and shipped to Marietta), such as doors, side panels, bulkheads, etc. Some of this was the result of poor planning and some of it from poor workmanship. Much of it was caused by selling assemblies green in order to get credit and rushing them to Marietta.

This problem created a miserable condition to say the least. Feeder plants (excepting Chattanooga) do no manufacturing, but perform assembly work only. Parts or components are sent from Marietta to feeder plants located in such places as Logan, Ohio, Uniontown, Pennsylvania, or Martinsburg, West Virginia, where they are used or made into assemblies. Then the completed assemblies are shipped to Marietta by truck or rail, depending on size and configuration. It is expensive to ship items hundreds of miles to be maintained and then assembled in a feeder plant, when the work could be performed more cheaply at Marietta. Add to this the fact that untold dollars are spent in road-testing thousands of parts back to Marietta because they had been left out of the assemblies. As in other missing parts cases, no one knew parts were missing until a problem was encountered during installation. The costs in terms of man-hours spent in telephoning, double handling, double shipping, special trucks, air express, and replacement of parts lost and reordered was doubtless astronomical. Missing feeder plant parts were encountered daily by the hundreds, adding up to thousands.

EXHIBIT 15.—SAMPLE—SHIP 0023 OPEN ITEMS [1]

When Ship 0023 moved from the pre-installation to final assembly Wednesday night, March 11, 1970, the ASCR (Assembly Statement of Condition Report) and the ADSL (Assembly Department Shortage List) reported 18 items remaining open in the wing section, and 12 items remaining open in the pre-installation section, for a total of *30* open items. The documents were signed by Quality Control and Production certifying that they represented the true condition of the aircraft. Production Control signed acknowledging any shortage conditions. Knowing that the aircraft was actually in poor condition, I decided to run an audit to test the accuracy of the paper.

I found that 1,080 open items existed, rather than the 30 reported. This was astounding, but not surprising. I wondered what it would have been had all the open paper been checked.

It was another deliberate case of false reporting to cover up the amount of incomplete work.

I was strongly criticized for making the report, chastising Quality Control, and rocking the boat.

The method of handling Ship 0023 was not unique, but typical. The company's contention that a few problems existed on the first couple of aircraft doesn't hold water.

Where were Air Force inspectors? What were Lockheed Quality Control personnel doing? In my opinion, the Air Force was in collusion with Lockheed to sell work when the work had not been accomplished, and to falsify records, or else the Air Force is blind.

EXHIBIT 16.—SCRAPPAGE OF PURCHASED PARTS (LETTER TO FUHRMAN) [1]

The letter to R. A. Fuhrman dated April 17, 1970, points out serious problems that I felt were not emphasized strongly enough in the meeting I had with him.

[1] Retained in committee files.

Erroneous scrappage of purchased parts—millions of dollars worth of purchased parts were scrapped and thrown away due primarily to erroneous dispositions reflected in planning paper. It occurred as follows:

Frequently due to engineering changes, parts must be removed from aircraft and replaced with later or higher configurations. Where possible, planning calls for purchased type parts to be removed and returned to vendors for updating (Lewk) at factories. Small fabricated-type parts which cannot be reworked are dispositioned shop. The problem was that the planning paper called for thousands upon thousands of parts to be scrapped, which should have been returned to vendors for rework. A company auditor trying to find out what was causing overprocurement and re-purchasing activities discovered the problem. I went out to the ship area and saw some myself. Untold dollars went down the drain.

In my opinion, the Planning Division faced with a voluminous backlog of paperwork resulting from engineering changes, was unable to process work package on schedule. Under great pressure, bordering on panic to reduce the number of behind schedule engineering packages, they took the esay way out and coded the paperwork scrap rather than taking time to perform the necessary research and call for paper dispositions. Usually the name of the game in any situation was to make schedule, regardless of the price. Shoddy, incomplete work was acceptable if it meant an "on schedule" position could be shown.

Lockheed management constantly resorted to "flat rocking" techniques rather than stopping long enough to honestly lay all the cards on the table and call straight shots.

A good showing was more important than a good job.

The letter for Fuhrman also points out other problems, such as multiple deliveries of parts, resulting from losses, and the subterfuge and underhanded methods employed by Production Managers to hide incompleted work by having Planning ship it to other unrelated paper, etc.

EXHIBIT 17.—EGLIN REPORT [1]

An investigating report showing a *typically* unsatisfactory condition existing in the field on aircraft undergoing up-date and testing.

This report specifically covers Ship 0005 at Eglin Air Force Base, Florida.

Conditions at Eglin were deplorable in terms of controls and costs. Again, Planning paper and documentation coupled with shoddy controls created serious difficulties.

As a result of findings at Eglin, I made plans to check conditions at Edwards Air Force Base, California. I wanted to take steps to prevent similar problems at both Edwards and Palmdale. However, I was blocked from going by the Assistant Director of Manufacturing, who obviously didn't want me to observe those areas. The unsatisfactory performance at Eglin caused the company to miss the Alaska Climatic Testing schedule.

EXHIBIT 18.—DISCREPANCY REPORTS (DR)[1]

When a part is mutilated or damaged, a Discrepancy Report (DR) is supposed to be written and attached to the damaged part.

This chart shows the great number of rejections (DRs) written on aircraft after arrival at the flight line. Each rejection necessitated procurement action of some nature and in turn, generated replacement action.

Much of the butchery had actually taken place in structure areas but had been ignored by Quality Control in order to sell the aircraft and show an "on schedule" condition at all costs.

Thousands of hours of overtime were spent and thousands of parts ordered from vendors at premium prices and shipped air express.

The amount of DR (rejection) activity coupled with the almost insurmountable missing parts problem, illegal removals, etc., ran costs out of sight.

EXHIBIT 19.—REPORT SHOWING ASTOUNDING NUMBER OF PARTS DELIVERED TO AIRCRAFT AFTER ARRIVAL AT FLIGHT LINE ON FLIGHT TEST [1]

The significance of this is that all of these calls were over and above normal flight line installations—that is, parts planned and scheduled for flight line or

[1] Retained in committee files.

flight test installation. They were missing parts, rejections, losses, etc. Also parts represented by legitimate paper which had not been installed in structures or other areas because of missing structural parts, butchered structure, etc.

EXHIBIT 20.—CHATTANOOGA STOCKROOM PROBLEM AND OTHER UNSATISFACTORY CONDITIONS [1]

Report criticizes deplorable condition of stockroom at Chattanooga.

The Chattanooga stockroom was completely out of control. Parts were lost and could not be found. Quality was nonexistent; the condition resulted in many parts being replaced because the ones supposedly available could not be located. Parts were piled up on old, dirty shelves, hanging out of racks, etc. Parts were not stocked anywhere close to military specifications and should have been closed down by Quality Control and the Air Force. It was absolutely disgraceful.

Also shown in this exhibit is a copy of the report given to the Chattanooga Plant Manager dated 9/8/70 citing serious and costly problems existing at Chattanooga.

EXHIBIT 21.—CHATTANOOGA TIE-IN [1]

Letter dated May 10, 1971, addressed to C. L. Starnes, the Chattanooga Plant Manager. The letter reflects on conditions corrected during my stay at Chattanooga, but more importantly, cites such existing problems as standard tools completely out of control for over four years.

EXHIBIT 22.—AEROSPACE GROUND EQUIPMENT (AGE) [1]

The Design Concept and cost of C–5 aerospace ground handling equipment (AGE) should be investigated. Equipment used for handling baggage, missiles, landing gears, engines and miscellaneous gear on the ground is made to aircraft specifications.

This means that all parts and components used to manufacture AGE must be procured from companies specializing in aircraft parts rather than from commercial sources. Since aircraft bolts and nuts are many times more expensive than commercial hardware because of close tolerances and other specifications the cost of AGE equipment is tremendously high. I have seen chrome plated rod ends, cadmium plated nuts and bolts, costing thousands, being used when in fact, plain old commercial hardware parts could be used. I recall one case where a methods engineer told me that silver plated nuts were used on one piece of equipment to hold on the wheels.

AGE equipment for other programs, such as the C–130 and C–141 used commercial parts. Why did the C–5 have to be different and add millions to the cost?

I believe the principal reason is that it keeps the AGE business in the Lockheed family, preventing competitive bidding and making an exhorbitant profit.

I saw examples of exhorbitant prices paid to vendors for hardware and enclose one example I picked out of many to show where Lockheed paid one price on one occasion for an expensive rod end, and less than a year later, paid over a hundred dollars more (each) from the same vendor.

Totally inaccurate records were maintained. No one was tracking parts ordered or delivered, and worse, absolutely no price and cost control procedures with regard to purchasing were maintained at Chattanooga. Chattanooga manufactured much C–5 AGE equipment.

EXHIBIT 23.—AUDITING—NOTES AND RECOMMENDATIONS [1]

This exhibit contains a recommendation for improving the ineffectual auditing performed by the Lockheed Auditing Department.

Chairman PROXMIRE. Mr. Poore.

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[1] Retained in committee files.

STATEMENT OF H. LEE POORE, EXECUTIVE VICE PRESIDENT, OPERATIONS, LOCKHEED-GEORGIA CO., ACCOMPANIED BY W. H. CONE, LEGAL AND CONTRACT STAFF

Mr. POORE. Thank you, Mr. Chairman. I appreciate the opportunity of appearing before you this morning.

Chairman PROXMIRE. We are very happy to have you here.

Incidentally, I invited Mr. Haughton to appear, and he said you were by far the best man to do this, you were more familiar with this situation then anyone else, and he recommended that you would be the best witness.

Mr. POORE. I appreciate Mr. Haughton's confidence in me.

On my right is Mr. W. H. Cone. He is with our legal and contract staff, and has been closely associated with the C–5 program and its very complicated contractual terms and conditions. So I brought him just in case we might want to discuss some of those areas.

I am from the Lockheed-Georgia Co., which is the home of the C–5A Galaxy, the C–141 Starlifter, the C–130 Hercules, and the C–140 Jetstart. We were also the builder of 394 Boeing, designed B–47's—constructed under a three-company agreement during the Korean war.

Chairman PROXMIRE. Before you go ahead, would you describe your position and your responsibilities?

Mr. POORE. Yes, sir. I am the executive vice president of operations at the Lockheed-Georgia Co. I sit for the president when he is out of town. And my basic functional responsibility is manufacturing, material, and logistics support as well as the organizations reporting directly to me.

Chairman PROXMIRE. You are the principal man in charge of that phase of the operation.

Mr. POORE. Yes, sir.

Chairman PROXMIRE. Go ahead..

Mr. POORE. I am really not here this morning to defend the C–5A as an airplane or weapons system, because I feel none is required. I hasten to add, we have made mistakes on the C–5A—we made some on earlier previous models. We are only people, that make up the management team. We consider we are pushing in the forefront of technology. We do a lot of things, and as with other people in other endeavors, we are not perfect in all we do.

In winning the C–5 competition in 1965, we realized that total package procurement would differ from other types of contracts, under which we had designed, developed, and produced earlier aircraft.

We did not foresee, however, the severe inflationary effects which were forthcoming almost immediately on business generally and on aerospace in particular. And neither did the Government agencies with whom we worked and consulted in estimating our costs and determining our schedules. As we have stated previously, the technology required to build such a large airplane with extremely sophisticated systems meeting very demanding and exacting requirements challenged our design and manufacturing skills to an unexpected degree. But our prime goal throughout the program has been to deliver airplanes that meet those requirements and guarantees.

Total Package Procurement Concept

I want to discuss the C–5 work in some detail, but first I think perhaps it is pertinent to recount a brief history of our accomplishments before we became involved in the total package procurement concept. As you know, it has since been abandoned by the Department of Defense as essentially unworkable.

When the Government decided to reopen Air Force Plant 6 at Marietta, Ga., in 1951, Lockheed Aircraft Corp. was selected to operate the plant on a contract basis.

During the 20 years that we have been there, we have managed a series of successful modification and production programs. Our first work in 1951 was modifying B–29 bombers. From that starting point, we continued without interruption on aircraft update work and by early September this year we had completed modification work on 4,516 airplanes. Work of this nature is highly competitive. Cost performance on previous contracts greatly influences the Government when it solicits bids for new work. The fact that our modification activity has remained unbroken over such a long period speaks favorably to our cost and quality efforts.

Under license, production of 394 B–47 bombers began at Marietta in 1953, and continued into 1957. In 1956, we won an Air Force competition and started production of the C–130 Hercules, the first Lockheed designed and developed aircraft to come from the Georgia facilities. Our overall performance and the continual product improvement of the C–130 design has attracted Government and commercial customers in 25 different countries. As of today, we have delivered 1,157 Hercules—and we still have orders on the books into 1973. Many of these are repeat orders, indicating high customer confidence and satisfaction.

The C–141 was designed in Georgia. This was a very successful program, producing 248 airlifters in approximately 5½ years. It is presently the backbone of the MAC fleet.

The same team of management people, are and have been, working on the C–5A.

I shall not belabor the complete production record, other than to state that as of September 1, we had produced and delivered 2,024 new aircraft and that we still have on our lines in Marietta, the C–5, various models of the C–130, and the Jetstar business jet transport.

On none of the other contracts have we attracted criticism like that leveled at the C–5. We feel much of the criticism resulted from the restrictions and inflexibility of the total package procurement approach.

As previously stated, the Department of Defense has chosen not to continue with total package procurement. A salient part of the concept, also since discarded, is concurrent development and production, wherein the contractor keeps building airplanes while development tests are underway. Concurrency's important advantage is that it delivers airplanes with major operational capability several years sooner than would be possible if deliveries awaited full systems development and completion of all testing.

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PARTS SHORTAGES AND OTHER PROBLEMS

Concurrency—with its advantages and disadvantages—came with the C–5 contract. It was not a management prerogative. It did not result from a Lockheed management decision. We accepted it, and the inherent products of its environment. Numerous engineering changes were necessary due to development and test results and were all serialized to Airplane No. 1. This caused parts shortages which in turn caused work to be performed out of station, and parts to be installed later on the assembly line. Just as other manufacturers would do in a new program, we made decisions to move some subassemblies and assemblies to the next station with shortages.

We did not hesitate to decide in favor of line station moves with known shortages. To do otherwise would have increased customer costs by stopping subassembly production, creating an idle work force, disrupting supply lines, and delaying schedules. One should recognize that these parts are "missing" only in relation to their normal point of incorporation in the production line. All necessary parts are installed before the airplane is flown and delivered.

We believe it is good business and management judgment, when problems such as parts shortages occur, to establish "work-around" procedures and schedule the parts to be installed during a later phase of assembly.

In working toward the stringent schedules mentioned earlier, our management determined it was more prudent to be overzealous in providing parts early in a program wherever possible than to err on the short side of supply. Thus, there were some instances when duplicate orders arrived at the point of need because aggressive supervision wanted to eliminate the possibility of delay. In these cases, the extra parts and materials were returned to stock for later use on other assemblies or aircraft.

Many different review boards monitored program progress and initiated action, when deemed necessary, to either solve or avoid problems. Some of these include the C–5 special schedule review, special Saturday or Sunday review meetings, steering committee review meetings, all of which were attended by Lockheed-Georgia Co. management and corporate management representatives. Regular bimonthly meetings were also held and attended by company and in some instances by corporate management representatives.

A flight line control center proved so beneficial that a similar program compatible with assembly techniques was implemented in the final assembly line. Further, the internal audit department reviewed the accuracy and status of completed assembly operations, and parts installed on aircraft when they went to the flight line. Manufacturing and quality management issued specific instructions concerning parts control.

In the early stages of C–5 development and production we did encounter problems. And to a certain extent, we still do. But even with current problems, we were as much as 2 weeks ahead of schedule prior to the AVCO strike, which affected C–5 wing deliveries. However, airplane deliveries will remain on schedule the balance of this calendar year. The AVCO work stoppage is going to have some effect on 1972 deliveries but we cannot assess the impact until AVCO has

returned to work and has supplied us with their delivery capability on the components which they supply.

Building airplanes, like building anything else of comparable complexity, is a matter of problem solution. The important thing is that we recognized the problems, developed solutions, took appropriate action, and proceeded through the development and production cycles without halting or disrupting the entire manufacturing process. Even more important is the fact that we neither flew nor delivered any airplanes configured in any way to detract from required quality standards.

The 49th C–5 is ready for delivery—2 weeks ahead of schedule. The first operational cargo flight was a year ago this past July. To date, approximately 34,000 hours of test and operational flying have been accomplished. The airplane is operating from three operational bases and one training base. Testing and development work is still going on—will be for some months yet. There are still some restrictions on the airplanes—as is the case on many airplanes that have been in service for years. Some of the special avionic systems are still being refined and structural testing is continuing. The facts are that in spite of this, the airplanes are out in the system working—doing a good job, with complete safety.

The people most qualified to judge our product are those who use it. The following are some quotes from persons in the military who are qualified to judge.

A lieutenant colonel—aircraft commander:

It is a great bird. It is comfortable. It handles beautifully. It is a pleasure to fly.

A technical sergeant—loadmaster:

She is really ticking along like a mess kit full of Seikos. (The Seiko is a precision Japanese watch.)

Staff sergeant—maintenance supervisor:

The people who manufactured this aircraft had the maintenance man in mind. It is truly one of the best planes to work on—it is a dream to service.

Rebuttal of Durham Allegations

My purpose in reporting to the committee is not to engage in a point-by-point rebuttal of charges and allegations. But two points I will need to address: The first is the allegation made by Mr. Durham and printed in the press, dealing with Air Force payments to Lockheed. Mr. Durham has contended that Lockheed has certified that sections of the aircraft were complete in order to obtain payments from the Air Force, when in fact, he states, there was work yet to be accomplished. This is positively incorrect.

It is true that the airplanes did progress through the various manufacturing stages with a certain number of shortages, which is normal in the early development and production stages of any airplane program. However, this did not affect the progress payments to Lockheed since such payments were based on the percentage of the costs that were incurred. The movement of production sections of the airplane down the assembly line has absolutely no effect on progress payments.

Prior to final delivery of the completed aircraft, all remaining short-

ages were either installed or the Air Force was so notified. This permitted the Government to withhold funds from the final payment until corrected. The Air Force has stated that such shortages did not affect safety of flight and were acceptable to the Air Force pending later availability and installation. All payments to Lockheed were carefully controlled and audited by both the Air Force plant representative and the Defense Contract Audit Agency (DCAA) auditors located at the Marietta facility, constantly.

The second point I need to address is: Mr. Durham charged that on March 2, 1968, when President Lyndon B. Johnson flew to Marietta for rollout ceremonies for the first C–5 airplane, number 0001, major portions of the airplane, including the nose cap were not functional.

The nose cap, terminology referred to by Mr. Durham, is not recognizable, but he is most likely referring to the visor. At rollout, the visor was fully functional on airplane 0001. In fact, the visor was raised during ceremonies and selected dignitaries walked through the aircraft. As a matter of fact, I think I recall President Johnson swinging his little grandson on the forward ramp of the airplane for the benefit of the crowd.

It is true that certain systems of the aircraft were not functional, nor were they required for the rollout ceremony.

More important, it should be mentioned that while airplane 0001 rolled out on March 2, 1968, on schedule—its first flight was scheduled and accomplished 4 months later, on June 30, 1968. The rollout ceremony was a mere formality and there was certainly no intention to deceive anyone.

I feel that it is most unfortunate that the statements of this one individual, with only partial information, receive and require the attention of so many other people who are dedicated to the C–5 program, its efficient execution and completion.

Since the end of 1969, the same management that he feels obliged to condemn has reduced Lockheed-Georgia Co. personnel from more than 31,000 to approximately 18,000, eliminated better than 1,000 management and supervisory positions, reduced direct overtime and ceased paying overtime to salaried personnel, cut executive salaries, maintained weekly payroll cost per person to $210 over this period despite inflation, maintained management and supervisor salaries below major competitors, reduced the weekly payroll from $6.8 million to $3.7 million, reduced total overhead from $270.5 million in 1969 to a projected $187 million in 1971, and reduced fixed asset allocations from $13 million in 1969 to a projected $1.2 million in 1971.

Conclusion

Finally, I want to state that Lockheed-Georgia Co. currently is meeting estimated costs to complete the C–5 program. We are bettering all projected learning curves (a measurement of overall effectivity for fabrication of parts, assembly, and production flight).

You can't have a successful manufacturing operation, of any kind, unless all disciplines, skills, and services cooperate. Lockheed-Georgia Co. encourages different branches, divisions, departments, and employees to be aggressive and innovative. But not, however, at the expense of the overall company goal. They must not interfere with established functions and responsibilities.

The engineer constantly seeks design improvements and would like limitless time to perfect his invention. Tooling and fabrication personnel are impatient for the final design. Manufacturing, with jigs and fixtures installed, presses fabrication and purchasing for parts delivery. Production control monitors the receipt and dispersion of parts. Flight test evaluates the finished product and may recommend changes that challenge the flexibility and resourcefulness of all branches back to preliminary design.

And quality assurance and inspection interject their requisites at each step in the intricate process that transforms lines that are on paper to living mechanisms.

Without disciplined disciplines and a willingness to relinquish individual aims for the good of the whole, the process would falter and finally fail. It must include a certain amount of flexibility. Each unit in the complex organization must at times agree to compromise—not in quality or safety, but in function—if that is the best way to get the job done.

Every company is an entity. The elements within it are not. So the company is run to satisfy its commitments, and separate elements that combine to make it an entity must relegate themselves to roles in support of the company charter. Self-serving for the sake of self-service weakens the ability of any industrial organization to serve its customers and honor the confidence shareholders place in it.

I have been in this aircraft business since 1936. And I am proud to have been associated with the Lockheed Aircraft Corp. since January 1939; and the Lockheed-Georgia Co. since February 1951. I know of no other company, or group of people, who could have met so well the many challenges we faced in the past 5 years.

Thank you, sir.

Chairman PROXMIRE. Thank you, Mr. Poore.

EXAMPLES OF EXORBITANT PRICES

Mr. Durham, in exhibit 7 of your prepared statement you show examples of exorbitant prices paid for material. Can you show us these examples?

Mr. DURHAM. Yes, sir.

On May 12, 1971, Lockheed received 14 pieces of sheet steel, size 2 inches by 2 inches, 0.035 thick, from Tull Metal, at a cost of $1.71 each, or a total of $23.94. The official computer inquiry, Lockheed's computer inquiry, showed 468 square feet available in Lockheed's Marietta stores at slightly over 67 cents per square foot. Lockheed could have obtained 1 square foot at its own stores for 67 cents instead of paying Tull Metal $23.94.

Here is a shop order, requisition, and a Lockheed computer sheet.

Another example: On May 2, 1971, Lockheed ordered 14 pieces of sheet steel, size 2 by 2, 0.035 thick, the same size, for $1.38 each, a total of $19.32, paid to Tull Metal. An official Lockheed computer sheet showed 468 square feet again available in their Lockheed stores at 67 cents, the same cost.

So, obviously, they could have paid 67 cents instead of $19.32.

Chairman PROXMIRE. You say that in both these cases the inventory records show that there was plenty available when these additional purchases were made?

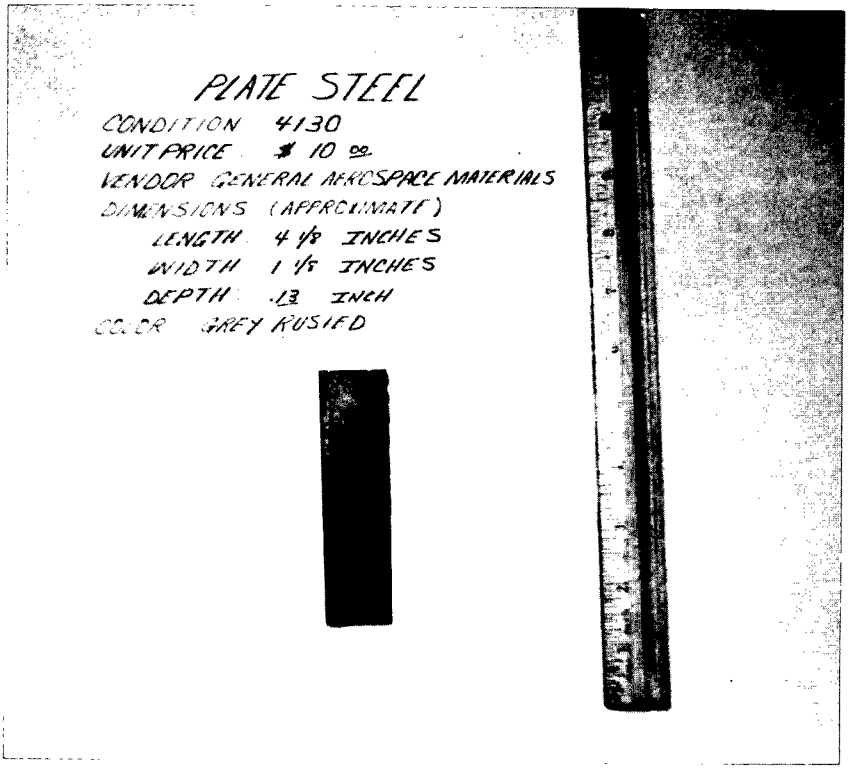
Mr. DURHAM. Absolutely. And I have a copy of those records.

Chairman PROXMIRE. Do you have actual hardware samples to show?

Mr. DURHAM. Yes, sir; I have some.

This piece of metal I show here was going to be thrown out. And in the process of trying to audit and find out what the problems were and how to solve them, I found that for this piece of metal, 0.13 by 1.0 plate steel 4130, 4 inches long, Lockheed paid $10 to the General Aerospace Metals Corp., Dixie Metals Division.

(A photograph of the piece of metal referred to above follows:)



Chairman PROXMIRE. How much do you think that is worth?

Mr. DURHAM. I would not give you more than a couple of dollars for it, myself, if that much.

Chairman PROXMIRE. How do you evaluate whether the $10 is excessive or whether it is correct?

Mr. DURHAM. I promise you that anybody familiar with metals will tell you that this piece of metal is not worth $10.

Chairman PROXMIRE. Mr. Poore, would you like to comment on this?

Mr. POORE. I am sorry, I can't. I do not know what the content of the metal is.

I would like to comment on the two previous areas, with which I am somewhat familiar.

Chairman PROXMIRE. Before you come to that—could you give us any estimate on what the cost of that metal is per foot, Mr. Durham? Do you have any information on that?

Mr. DURHAM. No, sir. I would say that this piece of metal is probably worth a couple of dollars in my estimation. No more.

Chairman PROXMIRE. So, you think they paid five times what it was worth?

Mr. DURHAM. Yes, sir.

Chairman PROXMIRE. That is your estimate?

Mr. DURHAM. Yes.

Furthermore, this piece of metal was being thrown away because they had plenty of it available in Chattanooga, and I picked it up in the process of my investigation.

It was going to be scrapped. It still had the requisition with it. Lockheed had some material already available in the shop. So, they used it on the shop order that this material was purchased for. Therefore, they really did not need it in the first place.

Chairman PROXMIRE. Mr. Poore, would you want to comment on the first two examples?

Mr. POORE. Yes, I would, sir.

Mr. Durham is correct to some extent. We had material in our basic stores at Marietta, but Tull Metal, like metal companies generally, provides a service to save us in labor costs.

When you stop to consider writing a requisition at Chattanooga and getting it to Marietta, running that requisition through the normal stores, checking out a piece of raw stock, shearing it up into 14 or 18 sections and adding up your labor costs, your overhead costs, packaging it according to the procedures that are required, shipping it from Marietta to Chattanooga, receiving it there by procedure, packing it and then putting it to work—when you stop to consider all of that, $19.32 for 14 pieces is not an exorbitant cost.

Chairman PROXMIRE. Why do you keep stock in Chattanooga, then? What good is it?

Mr. POORE. I do not think he said the stock was in Chattanooga; I think he said it was in Marietta.

Chairman PROXMIRE. As I understood you, you said it was cheaper just to go out and buy it than to use what you have in your own stock.

Mr. POORE. For that quantity of pieces to be used at Chattanooga and to get them from Marietta, which I believe Mr. Durham's statement was.

Chairman PROXMIRE. I see. It was a matter of moving, then, from Marietta to Chattanooga.

Mr. POORE. That is right. It was in the stores in Marietta, our major material stores.

Mr. DURHAM. I might add one thing to that. As a result of my efforts in this area, the plant manager in Chattanooga agreed to stop, because he agreed that it was highly irregular to go and pay exorbitant prices for material to vendors when it was available in the Lockheed stores in Marietta.

Senator PROXMIRE. So, this situation was corrected when you called it to his attention?

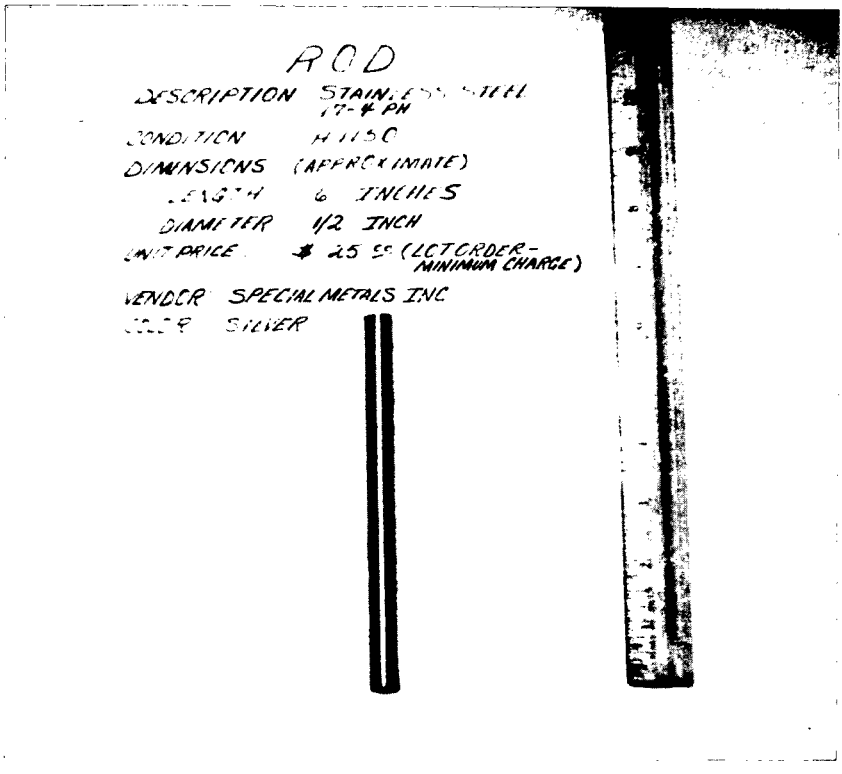
Mr. DURHAM. Yes; he finally agreed to stop.

I have a copy of a letter that I wrote which is really critical because I had been to him many times. Finally he agreed to stop it.

Chairman PROXMIRE. Go ahead.

Mr. DURHAM. Here is another piece of metal. This is a stainless steel rod, a half inch in diameter and 6 inches long. I also took this out of metal that was going to be scrapped. The requisition is still attached. And Lockheed paid $25 for this piece 6 inches long.

(A photograph of the steel rod referred to above follows:)



Chairman PROXMIRE. Again, in your judgment, what is that piece of metal worth?

Mr. DURHAM. I would say this piece of metal here is not worth over $2.

Chairman PROXMIRE. In this case, they paid 12 times what it was worth?

Mr. DURHAM. I would say so, in my estimation.

But on top of that, there were four 3-foot pieces already available at Chattanooga from which they could have cut a piece. So, they did not need to purchase this in the first place. It was lost in the mill and was going to be thrown out. I made a note at the time, that there were four 3-foot pieces available from which they could have cut a piece to satisfy the requirement.

This was the type of thing I was complaining about so bitterly at Chattanooga. I could not see this type of money being spent when it

was really due to lack of controls, failure to install proper management systems and procedures and to have control over the business. And this is just one example of many, I might say.

Chairman PROXMIRE. The examples you are giving represent very, very small amounts of money, although they may be symptomatic of an enormous cost.

Can you tell us why spending $10 in one case and $25 in another would result in hundreds of thousands or perhaps millions of dollars in excessive costs?

Mr. DURHAM. Well, for example, as I mentioned in my oral statement, I have documentation that shows that Lockheed scrapped 42½ tons of material, which was steel, primarily, that had rusted and corroded beyond recognition. It was stacked in a backyard on racks completely out of control. It has been there so long that even the quality control people and others that I contacted could not identify it as being safe for usage on aircraft. As you probably know, aircraft parts have to be made precisely. You have to be sure what type of material it is; you can't guess, obviously. So, we scrapped the material. I have the record. Forty-two and a half tons of steel.

(Photographs of above-stated conditions follow:)

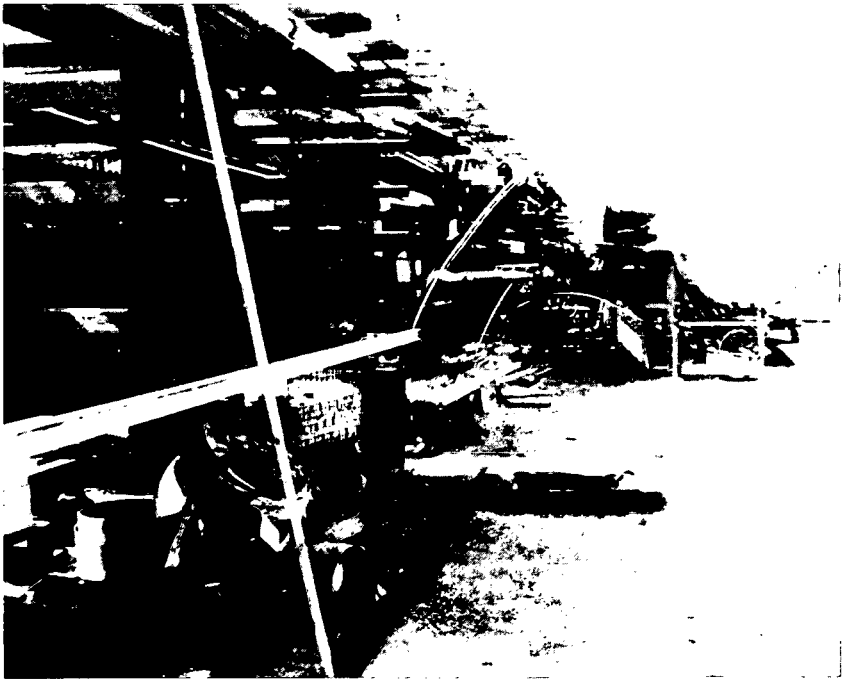


FIGURE 1.—View of material racks containing titanium at over $20 per pound.

FIGURE 2.—Armorplate still in crates, very expensive, rusting away according to stripper; purchased several years ago; over $300 per sheet.

FIGURE 3.—Another view of armorplate with rubber facing rotted off.

FIGURE 4.—Titanium out of control; buying every day.

FIGURE 5.—Partial view of material racks. Typical out-of-control condition. Impossible to find anything except by searching or attempting to comb area.

Mr. DURHAM. And a lot of that was material which was still in the cut sizes that came from various vendors at one time or another.

Chairman PROXMIRE. What then would you estimate the value of that to be or the cost?

Mr. DURHAM. It would have to be in the hundreds of thousands of dollars.

However, Lockheed received from Siskin Steel a little over a thousand dollars for the steel because by that time it was just rusted steel being sold as scrap. And that type of thing just stuck in my craw.

Chairman PROXMIRE. Mr. Poore, do you want to comment on that?

Mr. POORE. This is something new that I have not heard of before, Mr. Chairman. I will be glad to look into it and submit our findings for the record, if you desire.

(The following information was subsequently supplied for the record:)

Lockheed did in fact sell 85,850 pounds of miscellaneous steel scrap, among other material at the Chattanooga Plant, to Siskin Steel and Supply Company. This transaction is documented on Lockheed MSO (Material Sales Order) No. 43873, dated 5–5–71. Sale price for this line item of scrap was $1,158.98.

It is Lockheed policy to sell scrap to the highest bidder on the basis of a semi-annual competitive award. Siskin Steel and Supply Company submitted the high bid for scrap for the 6-month period during which the aforementioned activity transpired.

Included in this line of steel scrap was a large test fixture moved from LIP (Lockheed Industrial Products) of Atlanta, Georgia, to the Chattanooga Plant for possible use. Later this fixture was dispositioned for scrap at Chattanooga since no use was evident. This one item alone weighed 8 tons (16,000 pounds). Also included in this lot of scrap material was structural mono-rail removed from LIP as well as redundant steel material resulting from cancellation of Aerospace Ground Equipment orders originally ordered from Chattanooga by the Air Force.

The scrap steel generated by both LIP and Chattanooga was rounded up during the course of a routing clean-up effort. Dispositioning and sale of this material was in accord with procedures approved both by the Company and the Air Force.

Finally, it should be noted that none of the scrap material resulted from air vehicle requirements. The sale of this amount of steel material was the result of a Lockheed decision to dispose of otherwise unusable bits and pieces of fabricated, partially fabricated and stock material. Although with no identifiable need, most of the material had been held for varying periods of time in anticipation of a need.

Any implication that material disposed of in this transaction was procured without justification, disposed of without due consideration to requirements or that needed material was ineptly stored or handled is not correct.

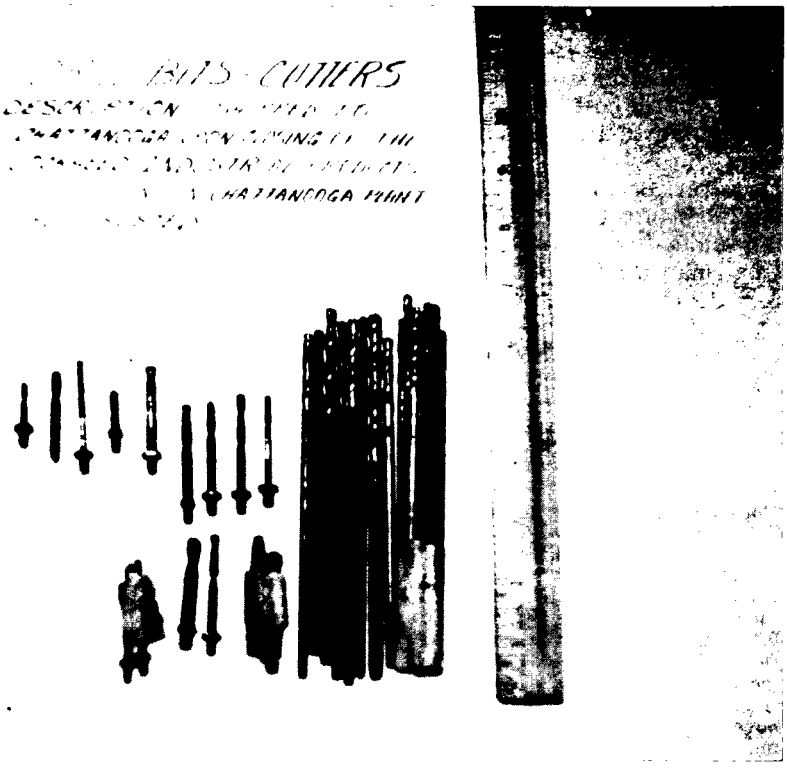
Chairman PROXMIRE. On your exhibit 8, you state that you took samples of expensive tools left out and left to rust, Mr. Durham.

Can you show us examples of these?

Mr. DURHAM. Yes, exhibit 8.

I want to say here now that these tools I am going to show were found in the backyard at Chattanooga. I personally found them rusting in an old dirty, trashy waterfilled container. I pointed this out to the plant manager because at the time I did not really have any jurisdiction over that portion of the business. Months later, the stuff was still there. This is an example of it.

(A photograph of the tools referred to above follows:)



Mr. DURHAM. I went back and really rubbed his nose in it, to be honest. They are good tools. These particular ones are drills. They do not give these tools away. It is exactly the condition that I found them in, except there were many, many more——

Chairman PROXMIRE. Could you give us an idea roughly of what that would cost?

Mr. DURHAM. Really, not to be in the tool end of the business, I should not comment, but I know they are fairly expensive drills. These are aircraft drills.

Chairman PROXMIRE. On the order of $20?

Mr. DURHAM. I would say probably $10 apiece at least.

These are not all of them. There are some more drills in here. I have several types.

Here is one. It is rusty.

Some of these are known as angle drills. They are rusted almost beyond recognition.

Chairman PROXMIRE. And these would cost about $10?

Mr. DURHAM. Yes, sir. These are more expensive than the others. There was a tremendous container of them.

Finally, I just retained a sample of them—and personally had the rest of them delivered to the plant manager to do something with them. I do not know what he finally did to be honest with you.

Chairman PROXMIRE. Mr. Poore, do you have any judgment as to what these were?

Mr. POORE. Yes, sir, I do.

I think you are overstating it somewhat.

And I would like to make one other statement at this time.

Chairman PROXMIRE. You say they are overstated somewhat. What does that mean?

Mr. POORE. He said $15 for one of these extension drills. And I would say it is more like $2 to $3.

We have looked at this item very carefully that Mr. Durham brought up. We have an answer to this which I will submit for the record if it is all right with you.

(The following information was subsequently supplied for the record:)

As a result of closure of the LIP (Lockheed Industrial Products) facility in Atlanta, Georgia, considerable stock and equipment was transferred to the Chattanooga Plant. Included among this transferred equipment were several up-right metal cabinets (with drawers) and some metal work benches (with drawers). Since these items were of negligible re-sale value and could not be readily used at Chattanooga they were temporarily placed in an outside storage area until use or disposition of them could be made. In this outside area water accumulated in some of the drawers due to rain and ice. Several miscellaneous used drill bits not removed prior to shipment from LIP remained in a few of the drawers of cabinets and tables. The number of drill bits remaining in the drawers is not exactly known, but when picked-up the volume of drills would only have filled approximately half a shoe box.

After these used drill bits were found, as the result of a clean-up, they were submitted to Tool Inspection for dispositioning. Usable drills were sharpened and returned to Tool Stores; the more worn drill bits were submitted to Salvage for sale.

POORE ALLEGATION

Mr. POORE. One other thing that I would like to state at this point: It seems our security is a little worse than I thought it was. I did not realize that we had all this material out floating in Washington. This is all Lockheed material that is floating around. I hope we do not have too many leaks like that.

Chairman PROXMIRE. What does that mean, Mr. Poore?

Mr. POORE. I say, I hope we don't have too many——

Chairman PROXMIRE. We asked the witness to come up here and testify. He is giving examples. And it seems to me that by having this material here he can better dramatize and demonstrate the situation than if he simply told us theoretically.

You are not implying that there is anything unethical or improper, are you?

Mr. POORE. No, sir. You misunderstood me.

Mr. DURHAM. I will be glad to give them back to him.

Mr. POORE. My statement was that I hoped that there was not too much of this material out anywhere in the country because, again, we consider all of this as a loss, and it is not humorous matter. I did not mean it in that context.

But one point I would like to have made. I said that we have made mistakes. Our people make mistakes. And we are looking at a handful of tools here when, within the whole complex of the Lockheed-Georgia plant and at Chattanooga, to put this in proper context, there are several millions of these tools.

And, as part of this record which I will submit, primarily the thing that Mr. Durham is speaking of—and I do not mean to justify it as being right—is an accumulation of things that came with that par-

ticular facility when we purchased it 3 or 4 years ago from the Gordon Street Co., plus an accumulation of things which we did not need at the Lockheed-Georgia Co. in Marietta but figured that sometime in that machine-shop-type environment they might be usable.

And, so we put it back there in the back in an old shed. And if there were jobs or conditions that came through that required these particular types of tools, we would get them and clean them up and use them.

Chairman PROXMIRE. In this case, Mr. Durham called it to the attention of the appropriate authorities, and they looked at it and they were aware of it, and he went back months later and nothing had been done. And they were rusted and in such a condition that obviously their worth was diminished considerably.

Mr. DURHAM. These, by the way, are good tools currently used at Lockheed. They are usable tools.

EXORBITANT SMALL PARTS PRICES

Chairman PROXMIRE. Well, in exhibit 10 to your prepared statement, you make the very serious charge that small parts were purchased when they were already available in the Lockheed plant, and also that exorbitant prices were being paid for small parts. Can you show us illustrations of such situations?

Mr. DURHAM. Exhibit 10? Yes, sir.

This is an example here. I have several.

On February 16, 1970, Lockheed purchased five rod ends from the Southwest Products Co., Monrovia, Calif., at a price of $336.38, a total of $1,681.50. On February 15, 1971, a year later, Lockheed purchased four rod ends, the same part numbers as above, for $437.30 each, from the same vendor, Southwest Products Co., a total of $1,749.20. In other words, $101 difference in the price a year later.

Chairman PROXMIRE. $101 difference per unit?

Mr. DURHAM. Yes, sir. Four units cost more than five units, $67.50, to be more precise. This is just an example. I picked it at random.

Another one here: On February 5, 1969——

Chairman PROXMIRE. In that case, they paid 30 percent more; something like that?

Mr. DURHAM. Yes, sir. This is for aerospace ground equipment, too, which we will probably get into later.

On February 5, 1969, Lockheed purchased eight parts from Avondale, Inc., Burbank, Calif., for $3.47 each, a total of $27.76.

On April 1, 1969, approximately 2 months later, Lockheed purchased eight of the same parts from the same company for $5.45 each, a total of $43.60.

Chairman PROXMIRE. Can you, again, show some of the parts here?

Mr. DURHAM. I do not have the parts here, but on these particular ones I have documentation, the requisitions that the parts were received on in both cases, which I shall submit as evidence as proof positive.

Chairman PROXMIRE. When you have the parts, show them to us.

Mr. DURHAM. Yes, sir. I do have some here, and I will get to those.

On March 10, 1967, going back some, Lockheed received four shims from the Dutch Valley Co., at a cost of $5 each for a total of $20. On May 16, 1967, approximately 2 months later, Lockheed received

four each of the same part from the Dutch Valley Co, at a cost of $7.50 each, for a total of $30.

Now, here is the actual requisiton attached that was with the parts. The important fact is that all eight parts were still in stock in March 1971.

This is another case where parts were ordered, lost, reordered. The stocking system up there was so terrible that parts would be received and put into what was called the system and then lost, so that when the time came for parts to be used, when they would need them for a specific program, the parts would not be available, and they had to go hurly-burly out real fast and get some more.

Chairman PROXMIRE. In your judgment, Mr. Durham, is there logic in the possibility that it would be inefficient to move these from Chattanooga to Marietta and back, and to come for them, and so forth?

Mr. DURHAM. These parts here were being ordered directly to Chattanooga from the vendor, and they had different prices.

Chairman PROXMIRE. Do you want to comment on that, Mr. Poore?

Mr. POORE. I would, on the rod end which is primarily one situation I am familiar with.

The others I have no familiarity with at this point.

In respect to the cost cited by Mr. Durham, two rod ends were purchased on the 14th of April 1969, on purchase order PX–58802, for $336.30, plus a $300 set-up charge, which costs out at $486.30, two years later, in February of 1971, on purchase order AF26946 the four rods that he is referring to were purchased at a cost of $437.30, which is $49 less. Primarily, the difference is that there were no set-up charges on the second order. And I think that results in a reasonably good buying job by a buyer on repeat parts. You can't expect a machine shop initially to supply you a small number of parts without charging you their costs, which include set-up costs. And that is the reason for that.

Chairman PROXMIRE. Does that seem logical, Mr. Durham?

Mr. DURHAM. It does not seem logical to me.

Chairman PROXMIRE. Why not?

Mr. DURHAM. I do not see the set-up charge. I feel that Lockheed is paying a vendor, and they should get the best price they can in every case. It was over 2 years later so I do not believe that set-up costs had anything to do with it. This is just my opinion. I think the set-up was historical and would not have any effect on it.

I have some hardware type of items here.

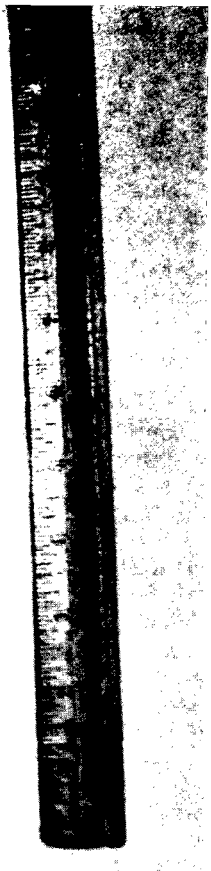
Chairman PROXMIRE. Yes, sir.

Mr. DURHAM. This requisition I have here is the official requisition—for four bolts, dated September 29, 1967. These bolts were still in the original box and attached to it was the requisition for four bolts on April 29, 1971, over three and a half years later. Now, Lockheed paid $65 each for these bolts, or a total of $260 for four bolts used to manufacture aerospace ground equipment.

Here is a bolt right here. It cost $65.

(A photograph of the bolt referred to above follows:)

BOLT
PART NUMBER: NAS 1628-50
UNIT PRICE: $65.00
VENDOR: DUTCH VALLEY SUPPLY CO
DIMENSIONS: (APPROXIMATE)
LENGTH: 3 1/2 INCHES
HEAD: 15/16 DIAMETER
BASE: 3/8 DIAMETER
COLOR GOLD



Chairman PROXMIRE. $65 for that one bolt?

Mr. DURHAM. Yes, sir. And I have the requisition to prove it.

Chairman PROXMIRE. You say $65?

Mr. DURHAM. Yes, sir.

Chairman PROXMIRE. Mr. Poore, would you comment on that? That seems extraordinarily high.

Mr. POORE. I am afraid I can't comment on that. I don't know what the bolt is, what material. I do not know whether it is titanium, platinum, or just what it is.

Chairman PROXMIRE. Do your records indicate what the material is, Mr. Durham?

Mr. DURHAM. No, sir, but it is a standard NAS bolt, standard aircraft bolt.

Mr. POORE. I would be very happy to look into this and report back to the committee in detail.

(The following information was subsequently supplied for the record:)

Despite diligent effort including a search of records at Chattanooga and Marietta, Lockheed has been unable to identify the bolts allegedly purchased for $65 each. Without further identification, such a search is almost an impossible task in view of the thousands of procurement transactions that have taken place at Lockheed-Georgia during the past few years. If we could be furnished part numbers or preferably copies of the requisitions in Mr. Durham's possession, we will pursue the matter and should be able to obtain the facts with minimum delay.

Chairman PROXMIRE. What do you think it is worth, Mr. Durham?

Mr. DURHAM. I think it is worth less than $10, probably. This was another case of a part being used for aerospace ground equipment and left around.

Chairman PROXMIRE. Can you buy that in any kind of a commercial hardware establishment?

Mr. DURHAM. In my opinion—this is just my opinion, aerospace ground equipment could use commercial hardware rather than paying exorbitant prices for aircraft bolts, aircraft nuts, and those types of parts. I really can't see this. And in some of my testimony I want to discuss that a little further.

Chairman PROXMIRE. How much would a commercial bolt like that cost?

Mr. DURHAM. I do not know, but I would say it would cost $2 or $3 at the most, in my opinion. I am not a bolt man. If I was going to fix something at home, I promise you I would not pay $65 for a bolt.

Chairman PROXMIRE. Would 65 cents seem more appropriate?

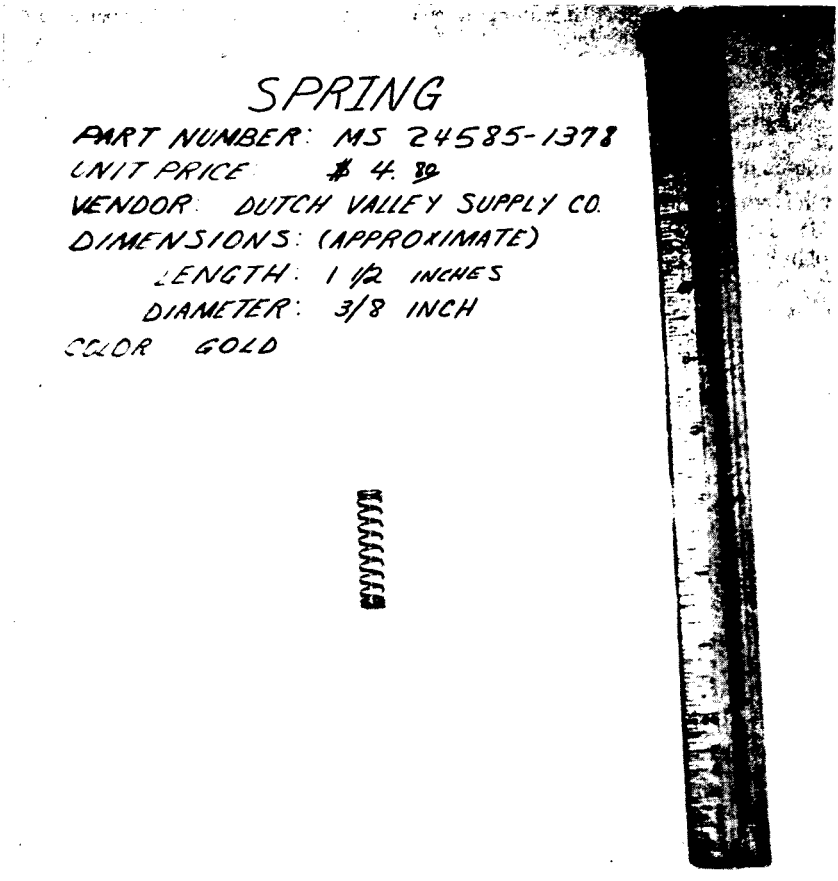
Mr. DURHAM. It would see so to me.

On August 22, 1969, Lockheed purchased 16 springs from the Dutch Valley Supply Co. As of April 29, 1971, a year and 9 months later, the springs were still in stock in the original container with the original requisition attached. This is another case where the parts were brought in, lost, and I found them later.

Lockheed paid $4.80 each for these springs.

I will pull one out of the bag. Here is the spring.

(A photograph of the spring referred to above follows:)



Chairman PROXMIRE. How much was paid for that little spring?

Mr. DURHAM. $4.80 each.

Of course, they bought six of them. But, anyway, in my opinion, it is not worth $4.80.

These are just good examples.

Chairman PROXMIRE. What is it worth?

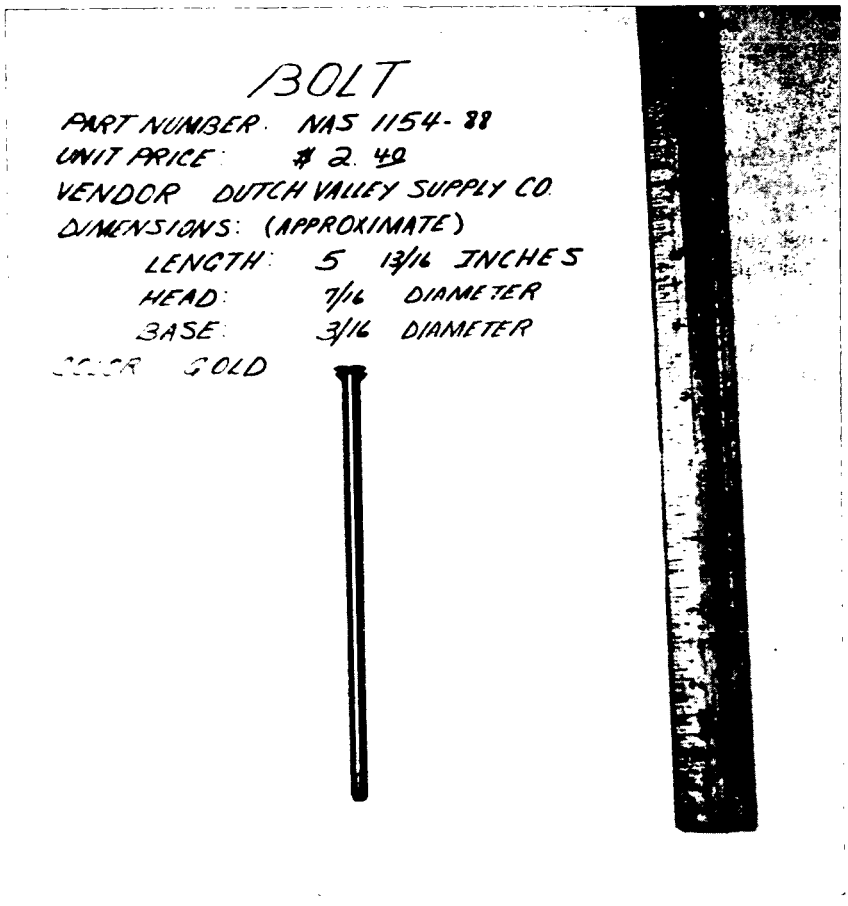
Mr. DURHAM. In my opinion, maybe a dollar.

And besides that, I believe you can use commercial stuff for this, too. Anyway, $4.80, to me, is a terribly exorbitant price.

You must bear in mind, sir, that these things, I am just showing you, are examples of many.

On April 1, 1969, Lockheed purchased 240 bolts from the Dutch Valley Supply Co. As of April 26, 1971, the parts were still in stock with this requisition.

(A photograph of the bolt referred to above follows:)



Mr. DURHAM. As I say, in each of these cases, I have the requisitions. And Lockheed paid $2.40 for 240 of these or $576 total.

On October 10, 1969, approximately 2 months later, Lockheed paid $2.95 apiece for 80 of the same identical bolts from the same vendor. This time Lockheed paid $236 for 80 bolts. In other words, they paid 55 cents more per bolt approximately 2 months later, directly from the vendor, for Chattanooga. This is the bolt right here. It is sort of a long, slim job. But 55 cents difference in price 2 months later——

Chairman PROXMIRE. Can you explain that kind of action, Mr. Poore, why they would pay so much more over a period of time?

Mr. POORE. Occasions like this, sir, could happen according to the quality of bolts that you have got to buy. Now, if a vendor has to special-make three or four bolts of that type, you are going to pay a reasonably high price because of the set-up——

Chairman PROXMIRE. What were the quantities, Mr. Durham?

Mr. POORE. May I finish, please, sir?

Chairman PROXMIRE. Yes, I beg your pardon.

Mr. POORE. If you wanted to compare the costs of buying two or three when you are in an emergency and need these things to that of buying 2,000 or 3,000, there is a tremendous differential in price.

Chairman PROXMIRE. It would depend on whether they are in stock or not, wouldn't it?

Mr. POORE. Depending on whether they are in stock, and how urgent the need is, and whether they would have to be made primarily from a forging or a casting or a bar stock. I have no way of telling what Mr. Durham is speaking of here. And that makes a tremendous amount of difference, I think, as you and I well know.

If you go and buy something that is on a hardware shelf it does not cost you very much, but if you go and order something and have them make it for you special, the cost is five, 10 to 15 times as much.

Mr. DURHAM. I reached the opinion, in looking at an awful lot of this—and as I say, this is just an opinion—but I fear that sometimes vendors—I got the impression that vendors sometimes charge whatever they think they can get for aircraft parts.

Now, maybe it is not in every instance, but I think I have seen enough of it to believe that.

CALL FOR GAO INVESTIGATION

Chairman PROXMIRE. We have a situation here that is hard to resolve right here this morning.

And, so, I would like to ask Mr. Durham to submit all the exhibits and documents and hardware to the committee.

And I will say this morning that I intend to ask the General Accounting Office to investigate every charge and to evaluate all the evidence presented by you and to report back as soon as possible.

These are serious charges. If they are true, it is gross negligence, waste, and mismanagement at the least, and, perhaps, violations of the law have occurred.

And I think that is one way to resolve this. And that is the way the committee will pursue it.

C–5A WING CRACK

Mr. Poore, recently we learned of another C–5A wing crack. Could you give us the details of this mishap?

Mr. POORE. We were running static tests, in the maximum wing upbending case with maximum fuselage cargo, a very severe maneuver, and somewhere around approximately 130 percent of design load we suffered that crack in the wing. We are still undergoing complete investigation: we are studying all the data that was picked up by the numerous instrumentations on the static test article. We do not have the final answer.

Chairman PROXMIRE. When did that occur?

Mr. POORE. This occurred the 13th of the month.

Chairman PROXMIRE. How many similar instances have occurred in the C–5A program?

Mr. POORE. We have not had any other instance such as this one.

Chairman PROXMIRE. There was another wing crack——

Mr. POORE. We had another wing crack, yes, sir.

Chairman PROXMIRE. One other, two others, or what?

Mr. POORE. I think possibly two others, one very minor, and one of a somewhat major nature.

Chairman PROXMIRE. Was there ever an instance of very severe structural damage during structural performance demonstrations? Has an entire wing ever been pulled off the airplane in such a test?

Mr. POORE. Would you please repeat the first part of that question for me?

Chairman PROXMIRE. First, was there ever an instance of very severe structural damage during structural performance demonstrations?

Mr. POORE. Structural performance demonstrations of a flying airplane?

Chairman PROXMIRE. As I understood, this was a ground test.

Mr. POORE. Yes, we had a very serious failure—and it is public knowledge—it has been made public—of the right hand wing undergoing certain tests. In the static tests of an unflyable product that was made for test purposes.

Chairman PROXMIRE. What happened to the wing?

Mr. POORE. Primarily, it was understrength.

Chairman PROXMIRE. Was the entire wing torn off?

Mr. POORE. We had a major crack in the right-hand side, yes.

Chairman PROXMIRE. Did it come off?

Mr. POORE. It did not drop on anybody, but it came off.

Chairman PROXMIRE. As far as I know, there was a wing-crack report, but I have not heard before that the wing came off.

Mr. POORE. The wing did not come off. It was taken off later.

Chairman PROXMIRE. Did or didn't it?

Mr. POORE. No, it did not drop off, as the result of any damage occurring from a structural test.

Chairman PROXMIRE. Precisely, what did occur?

You said it was major damage.

Mr. POORE. We had a crack, a very severe crack. But there was not any faulting of the wing anywhere.

Chairman PROXMIRE. How severe was the crack?

Was the wing hanging on the fuselage?

Mr. POORE. No, it was outboard the fuselage that this occurred; it was not hanging on the fuselage, it occurred outboard of the fuselage. You have all sorts of structural jiggery and walking beams that are applying pressure to the wing. And when you have a structural failure and have a crack, you immediately stop testing and try to determine what was the reason, why it occurred and what was the reason.

Chairman PROXMIRE. Mr. Durham, are you familiar with the wing that broke off in the test?

Mr. DURHAM. The latest one that was published in the press not too long ago? No; I am not. But there was an earlier break in the wing which occurred when I was there. And in that case, I did not actually see it occur, but I was there within a day after it occurred. And when it broke, the supporting structure—which was under the wing—fell underneath it, and it looked like a pretty severe break to me, but I am not an engineer. I do know that we had to procure and obtain literally thousands of parts to fix the problem. It looked fairly serious to me. But, as I say, I am not an engineer. When I saw it, it was lying on the floor, and the supporting braces had broken, which I guess they obviously would with the weight of the wing. Whether it was broken completely off at the time it fell, I do not know. It was lying there when

I saw it. In other words, I do not know whether it bent down or actually cracked and snapped off.

Chairman PROXMIRE. Can you tell us when this occurred, Mr. Poore?

Mr. POORE. The exact date, Senator, I do not recall.

This was somewhat better than a year ago. I will check that for you and determine the date.

(The following information was subsequently supplied for the record:)

On July 13, 1969, the wing of the static test article fractured while it was being loaded to determine its ultimate strength for a critical fuselage design condition. The failure source was determined and the modifications needed were installed on this specimen and the complete C-5 fleet. The retest was completed successfully on the modified test article in June, 1971, to the requirement of 150 percent of limit flight loads.

Chairman PROXMIRE. When was this reported to the Air Force?

Mr. POORE. The Air Force was there; it did not have to be reported to the Air Force. We were monitored by the Air Force.

Chairman PROXMIRE. They were monitoring that particular test?

Mr. POORE. Yes, sir.

ADDITIONAL COSTS TO TAXPAYERS

Chairman PROXMIRE. How much did it cost to strengthen the wing structure following that test?

Mr. POORE. I believe that has been a matter of public knowledge—in the press. It has been stated as $100,000 an airplane.

Chairman PROXMIRE. How much?

Mr. POORE. $100,000 an airplane.

Chairman PROXMIRE. How many planes had to be retrofitted with the "fix"?

Mr. POORE. Approximately 40.

Chairman PROXMIRE. Who bore the expense of strengthening the wing and retrofit?

Mr. POORE. This was a "cost" contract at this point.

Chairman PROXMIRE. So, it was borne by the Federal Government?

Mr. POORE. Yes, sir. However, a part of this particular situation occurred prior to the changing of the contract, and part of it is in the $200 million Lockheed loss.

Chairman PROXMIRE. How much of it?

Mr. POORE. I can't tell you how much of it; I do not know, but a portion of it.

Chairman PROXMIRE. Have there been instances of damage to any part of the airplane during test operations, such as landing on unpaved fields?

Mr. POORE. None on the airplane of any serious nature.

Now, we did have some damage to landing gear doors that was caused because some of the matting that was supposedly put down was not put down securely. That is the only damage to the airplane that I am aware of.

Chairman PROXMIRE. What was the cost of that damage?

Mr. POORE. I am not familiar with that, but I can get it for you and submit it, if you would like to have it.

(The following information was subsequently supplied for the record:)

Ship 0003 encountered minor damage on August 24, 1970, while performing Air Force mat runway landing evaluations at Dyess Air Force Base, Texas, as a result of the matting coming loose and obstructing the aircraft as it rolled to a stop. The cost of repairing the airframe was $11,917.45.

Chairman PROXMIRE. How many planes have been damaged in other accidents, C–5A's?

Mr. POORE. Damaged? I guess I don't really understand that terminology. We have lost two airplanes.

Chairman PROXMIRE. Two airplanes have been totally destroyed?

Mr. POORE. Yes. Both ground accidents, however.

Chairman PROXMIRE. Was there a loss of life in one explosion that took place initially with the C–5A?

Mr. POORE. Yes, there was, last year.

Chairman PROXMIRE. One man was killed?

Mr. POORE. Yes.

Chairman PROXMIRE. And how many others injured?

Mr. POORE. One minor injury, but not serious.

Chairman PROXMIRE. What is the total cost of the planes damaged or destroyed?

Mr. POORE. I guess you could take the average of the 81 airplanes and apply that average. That is one figure. If you take the point in time that the airplane was built and apply the R.D.T. & E. and the other costs at that point, that is another figure. I think we have to talk apples and oranges.

Chairman PROXMIRE. What would be the range of cost?

Mr. POORE. I would gladly submit to you a figure for the replacement cost of those two airplanes. I would have to work that out.

Chairman PROXMIRE. $20 to $30 million for each plane?

Mr. POORE. Possibly in that neighborhood.

Chairman PROXMIRE. Again those costs would be Government costs, because of the contractual change; is that right?

Mr. POORE. Bill, is that correct?

Mr. CONE. Yes.

MARCH GAO REPORT

Chairman PROXMIRE. Earlier, I understood you to indicate the damage during test operations such as landing on unpaved fields was not great. I would like to read from a GAO report in March of this year. This says:

Although the landing gear was designed to permit landing and take-off from forward area runways, the aircraft had been restricted to hard-surface runways. Flight tests on unimproved runways caused severe damage to jet engines, matted runways and the aircraft. The tests were subsequently discontinued.

So, they report severe damage to the engines, to the runways and to the aircraft.

Is this report in error?

Mr. POORE. No, sir.

You asked me "damage to the aircraft," and I assumed that you meant at that point the Lockheed responsibility, and that was in the context in which I answered your question.

If we are talking about the whole airplane—I understood you to say "airframe." I am sorry. The engines were damaged because of dust ingestion.

Chairman PROXMIRE. Well, tell me what was the total cost in your estimation, not only as to the engines and the aircraft but also to the runways.

Mr. POORE. I do not have that figure. I do not know whether we have even got the runway figure. We could get the engine figure from the U.S. Air Force; they buy the engines. And we could supply what our costs were on the damage to the airframe. Indeed, we will be happy to do that.

(The following information was subsequently supplied for the record:)

The cost of repairing the engines (for damage resulting from dust ingestion) and the cost of the damaged matting are not available to Lockheed. These costs are understood to be minor.

Chairman PROXMIRE. Now, in addition to that, in a March of 1971 GAO staff study, it was found that—

The Air Force is accepting C–5A aircraft with significant deficiencies. For example, existing deficiencies restrict the aircraft to performance of its basic cargo mission in that it cannot perform its tactical mission until such time as certain deficiencies are corrected.

This seems to be a common problem. We learned yesterday that the Navy had accepted LBD shipments produced by Lockheed with deficiencies. Can you comment on the GAO report?

Mr. POORE. Yes, sir. As I commented in my opening statement, this is part of the environment that occurs with concurrency. One of the advantages, as I said, with concurrency is that prior to completion of all development and testing of all complicated systems, you get airplanes out in the system working and doing a portion of the job which they are designed for and meant to do. There are restrictions on the airplane. We have an 80-percent structural restriction that happens with all airplanes until such time as you have finished both a certain percentage of your static testing and your design strength testing on a flight-test airplane. That is a restriction.

There are still some restrictions on some of the complicated avionic systems that were required to be developed and which pushed the state of the art considerably forward on this airplane. Again, as I say, this is one of the things that goes along with the concurrency.

Chairman PROXMIRE. There is no question about the weakness of concurrency and the recognition by many, many authorities of the great desirability of following a "fly-before-you-buy" test program before you produce.

You seem to agree that that would be much wiser and better. Is there anything that can be done at this point, at this stage, in the contract; or is that impossible, to provide an improvement?

Mr. POORE. I think you misread me somewhat. I did not say I agreed with nonconcurrency. I think there are advantages on either side, depending upon specifically what the case in issue might be at the time.

Chairman PROXMIRE. What I should have referred to was what you said in your statement:

More important is the fact that we neither flew nor delivered any airplanes configured in any way to detract from required quality standards.

That seems to be in direct contradiction of the GAO finding. They say:

Existing deficiencies restricted the aircraft performance of its basic cargo missions in that it cannot perform its tactical mission until such time as certain deficiencies are corrected.

Mr. POORE. I think possibly we are using the word "quality" in a different context, Senator. I guess I am referring to the basic standard quality of the workmanship on the airplane throughout, and you are possibly referring to the word "quality" as complete performance. And there is a difference. I think we are talking about different applications of the word.

Chairman PROXMIRE. It just seems commonsense that one of the aspects of the quality standard would be that it can perform its mission and meet its standards.

Let me point out that you quoted a maintenance man who called the C–5A "The maintenance man's dream." The GAO report says this:

An inordinate number of maintenance man-hours were required at the Charleston Air Force Base in June and July, 1971, to maintain landing gear of three C–5A's.

That seems to be a common weakness of the C–5A.

Do you dispute that landing gear maintenance problem?

Mr. POORE. The C–5A landing gear is a very complicated piece of equipment, and I hate to say this, but like other things it is still undergoing some improvement. And it will possibly continue to undergo some improvement. But I guess the landing gear on this airplane in itself is far more complicated than some complete airplanes.

PROGRESS PAYMENTS AND MISSING PARTS

Chairman PROXMIRE. You also say in your statement:

Lockheed's progress payments on the C–5A were based on the percentage of the costs that were incurred.

What was that percentage, Mr. Poore, at the outset of the program, and what is it now?

Mr. POORE. 90 percent progress payment prior to the restructuring of the contract.

Chairman PROXMIRE. It has been 90 percent?

Mr. POORE. It was 90 percent up until the time——

Chairman PROXMIRE. What is it now, 100 percent?

Mr. POORE. It is 100 percent, of course. Bill, will you comment?

Mr. CONE. Yes, Senator, it is 100 percent, subject, of course, to disallowances and the $100 million investment that we have had to maintain.

Chairman PROXMIRE. When were you paid the portion that was withheld, that is, the 10 percent? You said that it was 90 percent.

Mr. POORE. The 10 percent was to be paid at the time the airplane technically was DD–250'd, a form that the Air Force uses to reflect acceptance from the contractor.

Chairman PROXMIRE. You have been paid that now?

Mr. POORE. They are still withholding, I believe, on practically every airplane that is out, because there are items still on our list, the list that is submitted by Lockheed or any other contractor to the Air Force on the work that still needs to be done. These can be either parts that were not available at the time of the delivery or they can be improvements—changes that the Air Force or the customer has approved

that are serialized for that airplane and that will be performed at a later date.

Chairman PROXMIRE. Did you collect any of that 10 percent?

Mr. POORE. Some, yes, sir.

Chairman PROXMIRE. How much?

Mr. POORE. The exact figure, I cannot give you. I can again submit to you for the record——

Chairman PROXMIRE. $100 million or $200 million, or less than that?

Mr. POORE. No, there is not that much left of the 10 percent at the time they are DD–250'd. But we can get those figures for you, and we will be happy to.

(The following information was subsequently supplied for the record:)

The original C–5A contract provided for progress payments to Lockheed at the rate of 90% of allowable costs incurred under the contract. The contract also provided that upon the delivery of each airplane, Lockheed could bill the Government at the contract price for the airplane after deducting for the progress payments previously received with respect to the costs of that airplane and also deducting for shortages or variances to the specification.

For example, through May 31, 1971, the effective date of contract restructure, Lockheed had delivered 34 production airplanes for which the cumulative total contract billing prices were $609.5 million. The amounts billed, paid and withheld were as follows (amounts in Millions):

Estimated progress payments of costs incurred with respect to the 34 airplanes	$542.9
Received on delivery (DD–250) of the airplanes	54.1
Total billed and received as of delivery	597.0
Withheld for shortages and variances to specification	12.5
Contract billing price	609.5

Subsequent to the delivery of the airplanes, a significant portion of the shortages and variances were billed.

As of May 31, 1971, the contract was converted to a cost reimbursement contract with Lockheed being reimbursed for 100% of cumulative allowable costs less a $100 million fixed investment and with the proviso that Lockheed would pay an additional $100 million plus interest to the Government in installments beginning in 1974. Under this restructured contract, therefore, Lockheed does not receive any further progress payments, but receives 100% of allowable costs incurred. This type of contracting eliminates any further requirements for billings upon delivery of aircraft and specific dollar withholdings for shortages. The "withholdings" for shortages or incompleted work is automatic since the costs have not been incurred and therefore are not billable to the Government. While detailed records are maintained by Lockheed and the Air Force identifying the remaining specification deficient items from the 34 deliveries as well as those applicable to subsequent deliveries, no records of the dollar values have been maintained since May 31, 1971.

Chairman PROXMIRE. Now, in your statement, you say:

"All necessary parts are installed before the airplane is flown and delivered." And you underline the word "necessary."

You concede that there were missing parts in the plane at one stage or another.

Who makes the decision as to which of the thousands of parts are "necessary," and on what basis is the decision made?

Mr. POORE. Primarily, those decisions are made by technically qualified people, usually with engineering degrees, who are familiar with the system, and they are made in agreement with the Air Force.

Chairman PROXMIRE. According to Mr. Durham's statement, the production and inspection records did not accurately reflect the true

omission-of-parts situation. The records showed that parts were installed at times when they were not installed. Do you disagree with Mr. Durham's assertion?

Mr. POORE. No, sir. I think there were times that there were some mistakes in paperwork done by so many thousands of people.

I would like to point out, when we talk about parts missing and parts shortages, that there are better than a half million parts on each C–5A airplane. And as I said in my opening remarks, people do make mistakes, and we have made some, but I don't agree with the Durham statement completely.

Chairman PROXMIRE. Some parts are, in fact, missing; are not installed, according to the schedule. How do you know which parts are "necessary" or "unnecessary?"

Mr. POORE. Again, most of these parts, including those to be done at a later date, are all recorded——

Chairman PROXMIRE. What I am getting at, is there an official document that spells out, that specifies, which are necessary and which are not necessary?

Mr. POORE. Yes, sir.

Chairman PROXMIRE. And when you say are not necessary, are you referring to the official situation?

Mr. POORE. Yes, sir; I am referring to the official situation.

Chairman PROXMIRE. And all that was deemed to be necessary by the documentation were there?

Mr. POORE. There was a decision made because of shortages on the spot to install those particular parts at a later time in the production plan.

Chairman PROXMIRE. So there may have been parts that were necessary, but were not installed because they weren't available, and the plane was delivered without them?

Mr. POORE. They were not necessary to the basic manufacturing plan in that position. And these parts in the main, most of them, were later installed prior to releasing the airplane for flight, or for delivery to the Air Force. But, in the meantime, there were decisions being made by a number of people day in and day out to overcome problems that you get in earlier production.

Chairman PROXMIRE. Isn't it possible that delayed installation of parts can increase costs?

Mr. POORE. Yes, sir.

Chairman PROXMIRE. And this seems to be very substantial in the case of the C–5A, on the basis of the testimony of Mr. Durham this morning.

Mr. POORE. I believe again that from the things that I have been privy to, the newspaper articles and the things that Mr. Durham referred to, that he is speaking of less than three-tenths of 1 percent of the total parts content on any one airplane.

Chairman PROXMIRE. Well, the fact is that no one person could very well come up with much more than Mr. Durham has, it seems to me, under any circumstances. You can't expect him to come up—10 percent of the parts on the C–5A would fill this room a couple of times. It is a huge plant. What he has done is come up with parts that are symptomatic, and he said that.

Mr. POORE. I think the parts that he has shown here this morning—that he has discussed—primarily come out of the Chattanooga facility,

which is a facility that has a charter to manufacture AGE for our products, or to sell that service to outside people not dealing directly with the airplane product, as such. I would like to say again that the examples he has been using here at this time relate to about 300 people in an organization in which at that time there was somewhere in the neighborhood of 25,000 to 28,000 people.

Chairman PROXMIRE. Yes, of course. But what I am talking about is that this represents what appears to be gross negligence and disregard for maintaining tools, which would suggest a symptomatic situation, especially in view of the instances of cost overrun involved here.

Mr. Durham, would you like to comment?

Mr. DURHAM. Yes, sir; I would like to have a few minutes to comment on the missing parts.

Mr. Poore referred to the Chattanooga plant. I did bring some evidence from the Chattanooga plant. However, on the missing parts my evidence had to do with the main plant only, the Lockheed-Georgia plant.

Starting back in July and August of 1969, I detected some very serious deficiencies on the C–5A aircraft that were arriving at the flight line for flight test. In fact, they were unknown conditions. On October 13, 1969, after having gone to my superiors and receiving what I thought was an adverse reaction, I put out a report—this was the first of many—just taking it in part, I said:

> One of the most serious problems confronting us today is what can be termed the unknown condition of aircraft moving from one position or area to another. The problem has serious impact, when aircraft are moved to the flight line. Specifically, we are concerned about the number of calls received from production, or part calls received from production, with authority shown as "part missing from aircraft." Since the preliminary investigation showed that parts should have been installed, by Lockheed reports, of course, and were in fact missing, we secured the service of a man from the C–5 production Task Force.

Going a little further in this same report, we proved in the actual audit that of the calls from production (requests for parts), 67.5 percent of those calls were parts missing from aircraft, and the installation paper had been closed and retired in the structural areas, signifying that the work had been done when, in fact, it had not. When a person would go to make an installation, for example, he would have an authorized piece of paper there saying, install this clip. And he would go up to make the installation, but the structural part that it was supposed to have been attached to would be missing with no paper since the paper would have been falsely closed.

Chairman PROXMIRE. Do you have a report from a company audit on this problem?

Mr. DURHAM. Yes, sir, I do.

I would like to go a little bit further. I would like to comment on this. In December 1969, I became so concerned with the complete lack of action on the part of upper management that I, personally, contacted an auditor from the internal auditing department whom I knew and asked him to come and see me to discuss the problem. I didn't tell my superiors, because I knew they would stop it, at least, I thought they would. The auditor, when apprised of the situation, agreed to verify my findings. This was his report. I asked him if a detailed report spelling out all of the gruesome findings would ever be published. And he said, no, it had to be held down. These are his

words. My superior told me I shouldn't have contacted auditing. At any rate, here is an official report. It is just a preliminary report from Lockheed's auditor. He says in this report "During our examination we were told by production flight and by flight line control management employees"—that is me and my people—"and our own tests confirm the fact that an unusually large number of parts were missing from C–5A airplanes delivered to the flight line, although the airplane records indicated that the parts had been installed. Furthermore, a list"——

Chairman PROXMIRE. Do you want to read that over again?

Mr. DURHAM. The auditor said: "During our examination we were told by production flight and by flight line control management employees"—those are my people—"and our own tests confirmed the fact that an unusually large number of parts were missing from C–5 airplanes delivered to the fllight line, although the airplane records indicated that the parts had been installed."

I would like to show just a couple of other things. Here is a list of slides made in connection with the first report that I talked about under date of October 13. In an effort to try to get somebody to do something I had a Lockheed photographer come down and take pictures of some of the particular areas that were involved in missing parts. And this is a list of the slides that were made. Now, after we made this list of slides, we attempted to set up a meeting to show the slides to upper management in an effort to try to generate some action, but were never able to set up a meeting. In other words, I couldn't find anybody who wanted to do anything about it.

This is another one. This report dated April 8, 1970, is entitled, "Missing parts activity versus total parts issued." This is signed by W. T. Garrison, who was the manager in charge of production control of final assembly at the time. The report shows the very high number of parts delivered to aircraft 20 through 24 (we are talking about and getting up into some pretty high ship serials) as a result of parts missing. The report covers a month's period of time, from March 6, 1970, to April 6, 1970. In some cases over 90 percent of the parts delivered were to cover missing parts or unknown holes in airplanes, the same thing. In other words, if somebody allegedly installed a part and closed the paper although it wasn't actually installed, that is a void. This is an unknown condition.

Here is the official report. It shows on ship 20, for example, from March 6, 1970 to April 6, 1970, total parts issued, 1,356 of which 893 were missing parts.

Ship 21, the same period of time. Total parts issued, 1,533, of which 1,038 were delivered as a result of missing parts.

Ship 22, total parts issued, 1,492, of which 1,120 of those deliveries were as a result of parts missing, holes in the airplane, and so on. I wanted to show examples.

Here is a report on unauthorized removal of parts. This is from a department manager to his superior dated April 1, 1970, entitled, "Unauthorized Removal of Subcontract Detail Parts." An audit was conducted on April 1, 1970, by the production department, of landing gear parts. The purpose of this audit was to determine if parts have been illegally removed from these assemblies. The below-part numbers in quantities indicated were missing on ships 33 through 36. And in this particular case, a total of 26 parts were found to be missing.

The letter goes on to say that their visual observation of the assemblies indicate that the parts had been removed after receipt. There were 26 very expensive parts in this particular instance.

This is another list that was made by a quality control supervisor who was working with me at the time. It is a list of parts cannibalized from 14 main landing gears and one nose landing gear. The components were cannibalized while the assemblies were in storage. The total of 69 different parts were cannibalized from the main landing gears, and one from the nose gears. In other words, a total of 70 cannibalized parts in this particular instance, of which 54 were very expensive components manufactured by the vendor. This represented a loss, now, just in this particular case of $50,056.01. And here is the list. And it shows that the cost to replace the main gear parts was $44,629.84—these are subcontractor components—$44,629.84, and the cost to replace the nose gear component that was illegally removed, $5,426.17. In other words, a total of $50,056.01, just in this particular case of cannibalized landing gear parts. Cannibalization results in reprocurement. In many cases, parts were cannibalized to replace damaged parts which might have been discarded somewhere.

Causes of Cost Overrun

Chairman Proxmire. I would like to get back, Mr. Poore, to your explanation that this overrun, this increased cost is the result of inflation, and of concurrency primarily, and not the parts problem, for example, that we have been discussing now. According to the Air Force, in September 1968, Lockheed estimated its costs for the C–5A development programs plus 1A at $2.335 billion. The breakdown of the various cost elements—labor, material, overhead, and so on—showed a $1 billion overrun. Based on this breakdown of Lockheed's estimate, a copy of which I have obtained from the official Air Force Report, $432 million or 44 percent of the total estimated overrun was traceable to increased material costs.

Doesn't this suggest to you that Mr. Durham's charges of waste and excessive payments for material might have some validity? If not, what is your explanation for the enormous increase in material costs?

Mr. Poore. The increase in material costs, that the Air Force is speaking to there, and that we experienced, was due primarily to spiraling inflation, and what was happening in the whole marketplace, and especially in the aerospace business.

Chairman Proxmire. There are several indications that that isn't the case. No. 1, we have the fact that wholesale prices during this period went up very little. The wholesale industrial prices, a very small increase, 2 percent a year. And you have written into your contract, of course, and we anticipated inflation of about 3 percent on these contracts.

Furthermore, you have the fact that the report itself shows that only 6 percent of the increase was the result of prices, and 35 percent material volume. the very thing that Mr. Durham has been making his point on this morning, the fact that you have to replace these things, you lose them, you can't find them in your own inventory, and you have to get more.

So it is the volume it seems to me that makes it clear that there was an additional cost, a very substantial additional part of this cost because of the inefficiency of handling material.

Mr. POORE. Senator, we were not dealing in the bread and butter commodity market, when we were buying these products, we were dealing in the aerospace business, which caused our basic increase in material costs. Now, I think if you look at what happened in the aerospace supplier industry, if you take a hundred percent as a base, considering the years 1956 through 1964, which were the years on which we based our initial bid estimate, and take a look at what happened in 1965, 1966, the Vietnam war, the fact that in this period there was the highest number of orders that were ever placed for commercial airplanes in the whole history of the aerospace industry, I believe that you will find that by 1968 or 1969 that 100 percent had increased to 148 percent.

Chairman PROXMIRE. I am not talking about any theory, any index, I am talking about what the official Air Force report showed as to the impact of increased prices, which was 6 percent, and increased material volume, which was 35 percent, or six times as great.

Mr. POORE. I am also talking about what happened in the aerospace business.

Chairman PROXMIRE. Your volume was up six times as much as your price, you just had to have more parts than were estimated before.

And I think Mr. Durham has come in and documented very precisely and specifically examples—true, they are only examples—of how and why this occurred.

Mr. POORE. Senator, I would like to point out once again, for the benefit of you and the people here, we did make some mistakes. Everybody makes mistakes at the early start of any program. I would like to submit something for the record on this. However, to put things in the proper context we are still talking about the numbers that Mr. Durham has quoted here. He is talking somewhere in the neighborhood, when he is talking 15,000 to 20,000 parts, about less than 0.3 of 1 percent of the parts content of an airplane.

(The following information was subsequently supplied for the record:)

COMMENTS ON THE MISSING PARTS PROBLEM

As has been stated many times, by Air Force spokesman and Lockheed, the C-5 was and still is being developed under a concurrent development and production program. Under a program of this type it is inherent that when initial production units are delivered there will always be some systems that are less than fully capable, and some operational restrictions must be observed until testing is fully completed. Similarly, concurrency results in a number of parts that fail tests and must be redesigned and remanufactured as the production line continues to move and accelerate.

Parts shortages, missing parts, and out-of-station work (installed later on the production process) are an inherent product of the environment of a concurrent development and production program in its early stages.

These problems were recognized and acted upon by management independently of Mr. Durham and prior to any suggestions by him. All of the conditions, relating to parts problems, were well known to Lockheed top management. Coordination meetings were held weekly for the purpose of reviewing production schedules, changes, and parts availability to ensure that parts shortages were handled properly. Bi-monthly meetings were held between officials of the Lockheed-Georgia Company and Corporate officials to bring additional management attention to these conditions. In 1968, 1969, and 1970 a series of special Saturday and Sunday C-5 Program Review meetings, between Lockheed-Geor-

gia and Corporate Management, were held specifically to review the status of missing parts and out-of-station work. Internal audits reflect continuing improvement in this area resulting from constant management attention to the problem.

Prior to final delivery of the completed aircraft all necessary parts are installed. However, due to material or parts shortages at Lockheed, a vendor or subcontractor, or due to a late engineering change, a relatively few shortages may exist at the time of delivery. The Air Force has been notified of this condition in each case by the use of the SHO-VAR (shortage and variance) system. This system is carefully monitored by both Air Force and Lockheed's configuration management.

Further, the system permits the Government to withhold funds from the final payment until all items are corrected. The Air Force has stated that such shortages do not affect safety of flight to either the aircraft or air crew, and are acceptable pending later availability and installation.

Chairman PROXMIRE. I am talking about 35 percent of the increase in cost, according to the Air Force's own report, material volume, $368 million increase, and then a $64 million increase, or 6 percent in material prices.

Mr. POORE. I can't speak to an Air Force report, I am probably not privy to it. But I think we know what happened to our costs.

Chairman PROXMIRE. I understood you to say that you couldn't comment on the Air Force report, you are not privy to it. But this is Lockheed's own report. According to the Air Force, this is Lockheed's report. This is a Lockheed estimate, the material volume increase of 35 percent. And that is what the Air Force told us was the Lockheed estimate.

Would you want to comment, Mr. Durham.

Mr. DURHAM. Yes, sir. Mr. Poore made reference to the fact that I am talking about a thousand or 1,500 parts. I am talking about thousands.

I will just give you one example. I have many. This progress report to my superior dated January 12, 1970, says in part:

> As of January 9 we have received 15,291 parts missing calls, and 5,294 calls against rejections on ships 9 through 14 alone. Needless to say, this is an astounding figure.

Now, in every case this was a delivery to fill a hole when the Lockheed records already showed the part installed at an earlier time. It involves overtime, and in many cases premium prices paid for material and parts, to resupply this stuff. And in my opinion it was serious. So I am not talking about a small amount, I am talking about a large amount.

PRESENT SMALL PARTS PROCUREMENT

Chairman PROXMIRE. Now, let's get into the future of this, Mr. Poore, what we can expect in the future. As you have indicated to us, we have a contract now on which Lockheed takes a very large loss, and from there on the Federal Government has to pay the whole thing, kind of a loss-plus contract.

Many of the allegedly overpriced items shown to us by Mr. Durham had Lockheed part numbers. Are such items likely to be furnished as spare parts in the future for either aircraft or aerospace ground equipment? Are these items likely to be furnished as spare parts in the future?

Mr. POORE. The items that he has shown here this morning, the parts?

Chairman PROXMIRE. Items of that kind, yes.

Mr. POORE. I don't think those pieces of steel will be. But the bolts possibly, the manufactured parts, will possibly be available for spares usage. And if there is a surplus of this sort of thing. The thing that happens, that is all the Air Force's own material, and they will make the final disposition as to whether it goes to Air Force or whether to go ahead and scrap it and realize the revenue from the scrap price.

Chairman PROXMIRE. Let me just go a little further, and maybe we can understand a little better what I am getting at. Isn't it correct that parts with Lockheed numbers are likely to be replaced in the future by Lockheed, and isn't it also true that parts so obtained will be procured on a sole source basis? In other words, isn't it probable that parts with Lockheed numbers on them will not be procured competitively, and will therefore cost more than if they were purchased from commercial sources.

Mr. POORE. I guess I would have to know the specific part we are talking about to compare it with commercial sources as to whether or not it could be bought competitively.

Chairman PROXMIRE. I am talking about parts with Lockheed numbers on them.

Mr. POORE. The Air Force and all services buy on a competitive basis a number of spares and parts that did bear Lockheed numbers at one time.

PHYSICAL THREATS ON DURHAM

Chairman PROXMIRE. Mr. Poore, according to reports we received, threats against Mr. Durham's life were so widespread that an official Lockheed policy letter was issued on the subject. Can you enlighten us on this point? Can you provide us with a copy of that letter?

Mr. POORE. I can supply you with a copy of the letter; yes, sir.

(The following information was subsequently supplied for the record:)

EXHIBIT "A"

SPECIAL BULLETIN

ALL DIVISIONS, ALL PLANTS, ALL OFFICES—JULY 22, 1971

To the Men and Women of Lockheed:

There have been reports that apparently some Lockheed employees are threatening Lockheed critics in various ways during the Congressional debate on the loan guarantee issue.

It is understandable that we would become emotional about others' threats to our jobs and our futures but it is not acceptable for anyone to make threats of any type to our critics.

During the next week or two our elected representatives in Congress will determine our fate. Their debate and their voting judgments must be allowed in an atmosphere of calm deliberation and free opportunity for expressions from all sides. It is the only way the American system can continue to be the best and the fairest for all people.

In spite of our strong feelings, I hope you will join me in expressing those feelings in a calm and considered manner worthy of the tradition of the men and women of Lockheed.

DAN HAUGHTON,
Chairman of the Board,
Lockheed Aircraft Corp.

Mr. POORE. This is something that we heard very sorryfully. And certainly it was not the intent of any of the Lockheed Co. officials to do any harm to Mr. Durham. We are very indebted to Mr. Durham for 19 years of very fine, dedicated effort. He was a very fine employee during the time that he was with us, and advanced thus so. And the management of both the corporation and the company felt that it would be a horrible thing if something were to happen to a man who chose to use the freedom of speech to say what he felt he needed to say.

Yes; we had some concern. And we didn't want it to happen. We didn't want, first, the rest of the community in which we reside, or our other employees, to feel, from a company policy standpoint, that we wanted Henry Durham harmed. We didn't.

OTHER WITNESSES OF PARTS IRREGULARITIES

Chairman PROXMIRE. Mr. Durham, can your charges regarding parts irregularities be confirmed by other former or present Lockheed employees?

Mr. DURHAM. I have an example here. This is testimony from a former Lockheed member of management who held a responsible position, was well thought of, but resigned. He writes about a few of the problems, to give examples of serious and inept management—I will not repeat his name, although he signed this document, because he is in fear of reprisals both jobwise and possibly physically—

> In support of those persons who have an interest in the welfare and continued existence of the aircraft industry I wish to shed some light on some of the areas which have plagued Lockheed for the past several years and contributed to its rapid decline as the leader in this field. Lockheed problems are widefield and come to my attention with the introduction of aircraft 0001 of the flight test program. This ship which was supposed to be complete in every detail, except for scattered engineering changes came into the test program a virtual skeleton, missing many large structural assemblies——

CHAIRMAN PROXMIRE. Let me ask you, why were these people reluctant to come forward? What did they fear?

Mr. DURHAM. Primarily, of course, if they are Lockheed employees—and I have heard from several—they fear the loss of their jobs, and possibly threats to their lives, such as occurred to me.

If they are members of the community, as in the case of this person—he works in Cobb County where Lockheed is located and feels that if his name is used he stands a good chance of losing his job, his livelihood. In fact he felt very strongly about this, and asked that I put this in testimony because he wanted it in, but he did not want his name mentioned.

Chairman PROXMIRE. Did any of your former associates witness incidents such as disastrous structural failures which they have not revealed because of fear of reprisals?

Mr. DURHAM. This particular letter refers to that, further into the letter.

Chairman PROXMIRE. You said at the beginning that you had a statement that you would like to make before we were through. Would you like to make that now? It is rather brief.

It is one page, I think.

RECOMMENDATIONS

Mr. DURHAM. Also, in addition to that statement, I did have some recommendations and comment I would like to make.

Chairman PROXMIRE. All right, make those first and then make your statement.

Mr. DURHAM. Make the recommendations first, sir?

Chairman PROXMIRE. Yes, sir.

Mr. DURHAM. In view of the testimony presented it should be abundantly clear that Lockheed's real problem stems from poor, and in some cases less than honest, management. And of course this is my opinion. During the past several years Lockheed had developed what I called the Lockheed protective society. It is comprised of people who are dedicated to the protection of the company and each other rather than to the best interests of the country.

I strongly recommend that no further Government contracts, including C–5A's or C–130's be awarded until Lockheed purges its management and reorganizes accordingly.

I am just reading this in part.

Something is unquestionably wrong with the Government's auditing system. The type of auditing performed by the GAO is probably necessary. However, an organization should be established which would go to companies engaged in manufacturing military hardware and specifically audit basic control systems, such as stock controls, shop controls, material handling, controls of tools, parts control, purchasing procedures and practices, bidding, and very importantly, by checking manufacturing records versus hardware, the actual status of items being manufactured against reported status.

The grass roots nuts and bolts and manufacturing areas are where vast sums of money go down the drain. Such an organization should be separate and apart from other Government auditing organizations, and should be a good, clean, hard-hitting, no-strings-attached organization.

I believe much money could be saved, and I would be glad to provide any suggestions on that.

The relationship between military plant representatives and company management should be examined. I have already pointed out that both civilian Air Force inspectors and Air Force military personnel allow totally unacceptable conditions to exist on C–5 aircraft undergoing manufacture, and fail to report out-of-control conditions such as cannibalism, and the vast amount of work being sold and credited to Lockheed which has not been accomplished.

A questionable practice is placing ex-Air Force officers in Lockheed management positions. When Col. W. A. Harmon, the chief Air Force representative at the Lockheed-Georgia plant, retired, he was given a lucrative job as plant manager of the Shelbyville, Tenn., feeder plant. Was that a proper practice? Or what had earned him the post?

I suggest a strong look be taken at the costly practice of establishing feeder plants in various areas for what I feel are political purposes. The cost of making or purchasing thousands of parts, material and equipment, and shipping them hundreds of miles to elaborate

and costly plants located in distant States to be assembled into assemblies which are shipped back to Marietta is prohibitive, in my opinion. Many assemblies require special shipping facilities, railroad cars, and so on.

Perhaps some type of protection should be provided for people who want to report corruption, mismanagement, dishonesty, or improper practices by companies working on Government contracts, or anywhere else, when the welfare of other citizens or the country is jeopardized.

I am convinced that many Government workers or industrial employees who are basically honest would come forward with information except for great fear of economic loss and even physical violence.

I also feel that something is drastically wrong when a system allows a person who wants to be honest and help his country to suffer for his efforts.

That is about all I would say on this.

Concluding Statements

Chairman Proxmire. Why don't you read your concluding statement, then? I would appreciate it.

Mr. Durham. When the facts contained in this testimony were first made public, the reaction against me and my family was not only fantastic, but absolutely unbelievable. It started with an apparent organized telephone attack threatening in almost every instance my life and frequently the lives of my wife and children. They were more frequent in the early evenings and continued until we took the telephone off the hook in order to get some rest at night. We took these cases rather lightly at first, but the offensive language and brutal tones of the voices we listened to quickly made us realize that some of these people, at least, had murder in their minds. Had the U.S. marshals not been sent in to protect us, I am certain that we would have been subjected to violence against our property and persons.

Of lesser import, some neighbors stopped their children from playing with ours, and told our children to stay off their property. With a few exceptions, our circle of friends and acquaintances stopped communicating with my family. Not one newspaper, civic or religious organization has lifted a hand to lighten the threats against us.

Now what had we done to deserve these furious attacks and public bitterness? We simply released to the public certain information and company records we originally put together to show the president of the Lockheed-Georgia Co. that gross mismanagement, waste, and questionable practices involving huge amounts of public money were rampant at Lockheed. That is all. Such a heavy burden that my family is now having to bear would seem to be entirely out of line with the criticism I have made of management and practices in the Georgia-Lockheed plant. Such a heavy price should not be placed on conscience or honesty of purpose.

I hope you gentlemen will continue to help me protect my family until we can hope to live without the fear of extreme violence.

Chairman Proxmire. I understand the marshals are here in this room, and they are accompanying you, and will continue to do so to protect you as you request.

Mr. DURHAM. Yes, sir.

Chairman PROXMIRE. Mr. Poore, would you like to make a concluding statement, sir.

Mr. POORE. I would like only to say, Senator, audit reports are meant primarily to point up the weaknesses that we find in our management and procedures. We use audit reports, we respect audit reports, and encourage and instruct our auditors to go through with these reports.

I would like to say too from a shortage standpoint, the airplanes that are currently ready for delivery today, at the point that Henry was speaking of, the flight line, have possibly somewhere in the neighborhood of 30 to 40 part shortages at this time. This comes about primarily because of the improvement in our learning curve and having things in the proper place and with the decreasing changes activity that has occurred.

I think it is extremely unfortunate that the situation, as Mr. Durham sees it, has been presented in the light in which it has been presented. You must remember that Mr. Durham was one of 30,000 employees. I guess we are always going to have a few people that get disgruntled when something personally happens to them. Most of these things—a lot of these things—Mr. Durham has brought to the attention of his management, and upper management was aware of them, and these things were discussed in weekly meetings as problems so we could find solutions and develop actions to do something about them.

That has been done. It will continue to be done. And I just feel that this thing ought to be put in the proper context.

And we are sorry that Henry feels the way he does about the company. He didn't quite feel this way for 19 years, up until a point that something personally affected him. And then the effect seemed to be exaggerated.

Thank you, sir.

Chairman PROXMIRE. Thank you very much, Mr. Poore. I appreciate your coming.

You have had a very difficult task and you have performed it very well, I think.

Mr. Durham, I can't tell you how much I admire your courage, remarkable and unusual courage. Very few people are called upon to demonstrate the kind of guts that you have in this case, very few have the very deep conscience that has persuaded you to stand up under these very difficult circumstances and speak out.

It may be that many people disagree with your position. And it may be that in some respects you are wrong. But the fact that you have the courage to persist in what you think is right as clearly as you have and as emphatically as you have certainly is a great tribute to you and your family too, which bears this burden with you.

And if it weren't for people like you we would have a far poorer country.

I want to thank both of you gentlemen very much for appearing.

The subcommittee will stand in recess, subject to the call of the Chair.

(Thereupon, at 12:15 p.m., the subcommittee was adjourned, subject to the call of the Chair.)

THE ACQUISITION OF WEAPONS SYSTEMS

MONDAY, MARCH 27, 1972

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON PRIORITIES AND
ECONOMY IN GOVERNMENT OF THE
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 1202, New Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senators Proxmire and Percy.

Also present: John R. Stark, executive director; Richard F. Kaufman, economist; George D. Krumbhaar, Jr., and Walter B. Laessig, minority counsels; and A. E. Fitzgerald, consultant.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The subcommittee will come to order.

Last September, Mr. Henry M. Durham testified before this subcommittee about waste, mismanagement, and misrepresentations in the performance of the C–5A contract.

Mr. Durham was employed by the Lockheed Aircraft Corp. for 19 years, from 1951 to 1970, and was, prior to his separation from the company, general manager in charge of production control activities in the flight line, flight test, and avionics area for the C–5A program at the Lockheed plant in Marietta, Ga. His testimony concerned some of the most extreme excesses in defense contracting that I have ever heard of and which was carefully documented with voluminous records, reports, invoices, and physical evidence.

Among other things, Mr. Durham charged that: (1) Air Force progress payments to Lockheed were excessive; (2) erroneous company records generated erroneous parts requirements; (3) parts were improperly removed or cannibalized after being installed in aircraft and inspected; (4) valuable small parts were overpriced and misused; (5) exorbitant prices were paid to vendors of material when the same material was available in company stores for a fraction of the price paid to vendors; (6) thousands of tools were wasted, unnecessarily damaged, or stolen; (7) reworkable parts were erroneously scrapped; (8) Lockheed's inventory systems and cost controls were inadequate; and (9) Lockheed's and the Air Force's audits were ineffective.

Because of the seriousness of the charges, the amount of public funds involved, and the possibility that illegal as well as improper actions were involved, I asked the General Accounting Office to immediately investigate Mr. Durham's allegations and to verify the accuracy of the evidence presented to us.

GAO commenced its investigation and has completed the fieldwork portion of the inquiry. I am today releasing the GAO staff study made on the basis of the field investigation.[1]

Generally speaking, the staff study corroborates nearly every aspect of Mr. Durham's charges. All of his documents and materials were found to be authentic, and additional evidence was discovered by GAO in support of what Mr. Durham said and in support of some malpractices that even Mr. Durham was not aware of.

One of the most blatant abuses concerns a large overpayment to the contractor.

GAO found that the Air Force paid about $400 million in excess progress payments to Lockheed because the company understated the value of the work completed and overstated the value of the work in process. As I understand it, the Air Force made payments for cost overruns when that was not permissible under the terms of the contract.

GAO's finding is based on a 1970 report issued by the Defense Contract Audit Agency, the audit arm of the Department of Defense. The subcommittee has obtained a copy of this report, dated February 20, 1970, and I am releasing its contents to the public this morning.[2]

The memorandum transmitting the report to the Air Force shows that another report had been sent to the Air Force a month earlier indicating that Lockheed had received excess progress payments. The memorandum then states the following, and I quote:

> Based on a further analysis of the contractor's progress payment requests, the attached report indicates that current overpayments on Contract No. AF 33 (657)-15053 amount to about $400 million. This exceeds the entire net worth of the Lockheed Aircraft Corporation as of December 29, 1968, as shown on its published report to the stockholders. The overpayment condition results from cost overruns attributable to delivered items. The report explains that the contractor has been computing the progress payment limitation by using the contract price of the delivered items rather than the experienced costs of delivered items, thereby inflating the cost eligible for progress payment.

The report itself states that the computation on which the estimated overpayment is based is conservative.

In any event, the document shows that the Air Force was officially notified by DCAA in early 1970 that it had paid Lockheed at least $400 million more than it was entitled to be paid. The evidence, in other words, shows that the Air Force overpaid its contractor; but the Air Force did nothing to correct the situation. In fact, the Air Force made things worse by paying Lockheed an additional $705 million in progress payments through May 31, 1971.

The contrast between this action and the steps that might be taken were a similar problem to arise in a civilian agency with an ordinary citizen is striking. If a welfare or a social security overpayment is made, the welfare mother or the retired widow is either cut off from further benefits until the overpayment is liquidated or a refund is required.

Instead of moving to correct its mistakes, the Air Force compounded it. Lockheed was allowed to hold on to the excess $400 million and was promptly paid another $705 million.

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[1] See GAO staff study, p. 1408.
[2] See report on C-5A progress payment cost limitation, p. 1430.

Finally, the Defense Department, the Air Force and Lockheed agreed to convert the C–5A contract from fixed price to cost plus and the conversion was made retroactive. This was a key decision in letting the Air Force and Lockheed off the hook. Once the contract was made cost-plus, any and all payments, whether or not they were allowable under the original agreement were given the Government's seal of approval.

I question the legality and the propriety of what has been done and I am asking the Criminal Division of the Justice Department to investigate the circumstances surrounding the excess payments, whatever false reports and misrepresentations were made, the concealment of the audit report for more than 2 years and the many other questions raised by Mr. Durham's charges and the findings of the GAO investigation. I am also asking the GAO to continue its inquiry and to issue a final report to this subcommittee as soon as possible.

You know, it is just incredible that funds appropriated by Congress can be so misused by a governmental agency. If no violation of law has been committed, then there is a loophole in the law as large as a C–5A. If that is the case, legislation ought to be enacted at the earliest possible time to prevent such a situation from recurring.

Our witness this morning is Elmer B. Staats, Comptroller General of the United States, and I must say that Mr. Staats has an excellent report. He always spends most of his time on claims which he, of course, has had an opportunity to develop fully.

Very briefly, it discusses what I have just been discussing, and that is understandable because that report has only been made available to the Comptroller General within the last few hours, really, a couple of days.

I have read your statement and the staff report on the Durham charges, Mr. Staats, and I want to congratulate you in advance for the fine job that you have done.

You can proceed in any way you wish. We are hopeful that we will have time for substantial discussion on this matter as soon as you are finished. Go right ahead.

STATEMENT OF HON. ELMER B. STAATS, COMPTROLLER GENERAL OF THE UNITED STATES, ACCOMPANIED BY ROBERT F. KELLER, DEPUTY COMPTROLLER GENERAL; RICHARD W. GUTMANN, DIRECTOR, PROCUREMENT AND SYSTEMS ACQUISITION DIVISION; JAMES H. HAMMOND; AND L. NEIL RUTHERFORD, AUDIT MANAGER, SEATTLE REGIONAL OFFICE

Mr. STAATS. Thank you very much, Mr. Chairman.

As you will recall from our telephone conversation on Thursday of last week, I indicated our testimony today would have to be limited to the subject of shipbuilding claims, cost controls and competition in the shipbuilding industry.

We had hoped to be able to complete our review of the charges of waste and mismanagement at Lockheed/Marietta placed before this committee by Mr. Henry Durham, a former employee of Lockheed, a review undertaken by the GAO in your request of October 12, 1971. This has not been possible.

At your request, however, we have provided an unreviewed and unevaluated draft prepared by our Atlanta regional office. We consider this an incomplete draft, as I shall outline later in my statement this morning, at which time I will have some suggestions as to how we believe the material might be utilized.

So I would like to turn then to my testimony today, which as far as the substance is concerned, will be limited to the shipbuilding reports that we have prepared.

Recent Reviews of Shipbuilding

Perhaps it would be useful to start with a brief recapitulation of our major findings on the general subject of shipbuilding.

We have devoted a considerable amount of attention to this matter of shipbuilding claims. Last April we reported to the Congress on the Navy's settlement of claims submitted by three contractors including one very large claim by Todd Shipyard Corp. for $114 million which was settled for $96 million.

We pointed out that in these settlements the records we examined established no relationship between the additional costs claimed and the actions by the Navy which, the contractors contended, caused them to incure these costs.

Earlier this month we reported on the settlement of a claim by Lockheed Shipbuilding & Construction Co. Here, again, the reasonableness of the settlement is uncertain because of the absence of data to show the extent to which the Navy's actions contributed to the delays and disruptions experienced by the contractor.

At last year's hearing we testified that we were starting a review of various actions being implemented by the Navy which were designed to eliminate or at least minimize claims for price increases under future shipbuilding contracts. We submitted a report to the Congress last month on our evaluation of the Navy's efforts. We believe these changes hold considerable promise for reducing the number and size of claims. At the same time, however, it is important that the contractors, submitting claims based on actions of the government, be required to maintain and furnish records in support of the claims which will clearly show the relationship of the additional costs incurred to the Government's actions.

In the latter part of 1970, Mr. Chairman, you asked us to examine into the extent of competition in the shipbuilding industry and the effectiveness with which shipbuilding contracts were being administered. You submitted a series of questions, along with reports prepared by Admiral Rickover and copies of an exchange of correspondence over a period of time between Admiral Rickover and Navy officials, dealing with cost control and procurement practices at certain shipyards, as well as various other ship construction contractual matters.

Last August we submitted a report to you pointing out that only a limited number of shipyards can compete for certain types of ship construction work. We reported that even where competition is obtained the advantages of competition are often negated because of the prevalence of numerous and costly change orders, sometimes priced after the work is substantially completed, which are negotiated in a noncompetitive atmosphere.

In January of this year we submitted a report to this committee on our review of cost controls at Newport News Shipbuilding and Dry Dock Co., pointing out the ineffectiveness of the contractor's budgeting system in promptly pinpointing cost overruns, in addition to some serious weaknesses in the contractor's procurement practices. And just last week we reported to the committee on a similar review we made at the Litton Industries, Inc., shipyard in Pascagoula, Miss., where we found that much can be done by the contractor and the Navy to reduce shipyard costs and, in turn, costs to the Government.

I should now like to take up each of these matters—shipbuilders' claims, competition in the shipbuilding industry, and cost controls—in greater detail.

Shipbuilding Claims

Contractors' claims for price increases have been a recurrent element in Navy shipbuilding programs. Claims are submitted on the premise that the Government's failure to comply fully with its responsibilities under the contracts and additional requirements imposed by the Government after the award, caused the shipbuilders' production costs to increase and the contractor is therefore entitled to additional compensation.

Although such claims are not new, the size of the claims has grown significantly in recent years, both in terms of total dollars and as a percentage of shipbuilding contract prices. Claims still to be settled exceed $800 million, the earliest dating from January 1969.

Our most recent review of claims showed that claims settlements were averaging 37 percent of the total contract prices as they stood before the settlements.

FACTORS GIVING RISE TO CLAIMS

Our reviews have shown that the four principal factors giving rise to claims were: (1) inaccurate lead-yard plans; (2) poorly written specifications; (3) unanticipated increases in quality assurance requirements; and (4) late delivery of Government-furnished equipment and information.

In the settlements covered in our April 1971, report which I mentioned at the outset, the contractors contended that their operations were delayed and disrupted because of the Government's imposition of impossible specifications, because of its late delivery of material as well as its furnishing of defective material. The three contractors involved did not provide specific information to show that the amounts claimed as additional costs were caused by the Government's actions. Without information linking the additional costs to the actions of the Government, we believe that the Government had insufficient assurance that the settlements made were fair and reasonable.

TODD SHIPYARD CLAIMS

The largest claim was that of Todd Shipyard Corp. in the amount of $114.3 million for additional costs the contractor claimed were incurred, or would be incurred, as a result of actions of the Navy during the construction of 14 ships of the destroyer escort 1052 class.

Todd contended that the Navy specifications for dynamic analysis, shock resistance and noise reduction were defective, were impossible to achieve within the time and monetary constraints of the contract, and delayed construction progress for more than a year. Also, Todd attributed a large part of its claim to the Government's failure to provide design information and equipment when needed. Todd contended that this interfered with its ability to construct the ships as planned.

In its claim, the contractor estimated that government-caused delays and disruption resulted in its incurring an additional 5.6 million labor hours over the original amount estimated to complete construction of the ships involved. We found that Todd calculated the increased labor hours by subtracting from its estimate of the total hours it would actually incur, the labor hours originally bid for the ships, and then reducing this by the increased hours judged by the contractor to be due to its own inefficiencies. Initially, the contractor was willing to assume responsibility for 10 percent of an additional 4,181,179 labor hours incurred, or 418,117 labor hours. Subsequently, Todd increased its estimate of the additional labor hours incurred to 5.6 million but was unwilling to assume responsibility for more than 418,117 hours.

The claim was settled for $96.5 million, or about 60 percent of the total contract price.

LOCKHEED SHIPBUILDING CLAIM

The Lockheed claim which I mentioned earlier was for $46.3 million. It covered five fixed-price contracts for destroyers, destroyer escorts, a hydrofoil, oilers, and ammunition ships whose original prices totaled $83 million.

Lockheed's claim was based on a number of underlying causes such as late and defective Government-furnished material, defective or impossible Government specifications, late and defective lead-yard plans, increased inspection requirements, work in excess of specification requirements, delays and disruptions caused by change orders and various constructive changes.

For example, Lockheed claimed in excess of 243,000 additional production man-hours attributable to late delivery of Government-furnished boilers for the construction of two destroyer escorts. Lockheed contended that delivery of the boilers for one of the ships had been delayed 14 months and for the other ship 7½ months.

In another instance, Lockheed claimed that almost 8,800 additional production man-hours were attributable to work not required by contract specifications to correct an overweight condition of a hydrofoil. Lockheed contended that a defect in the governmental specifications caused the ship to be overweight and that it had to conduct a comprehensive, far-reaching research and engineering developmental effort to reduce the weight of the ship.

Lockheed's cost accounting system and other records did not relate its additional costs to governmental actions: therefore, the effect of these actions on the contractor's costs was difficult to establish. In the absence of such accounting records, Lockheed based its claims largely on engineering estimates.

The Navy spent approximately 1 year in evaluating Lockheed's claim with the help of the Defense Contract Audit Agency. The audits

of each contract showed that a significant portion of the claims was inaccurate and lacked adequate supporting documentation. The advisory audit reports questioned about $8.9 million of the amounts claimed by Lockheed including $2.2 million of additional labor costs questioned on the basis that they exceeded recorded labor costs. A Lockheed official told us that the company believed its claim was proper because when added to the basic contract price, the total price did not exceed recorded costs plus a 10-percent profit.

The Navy found that the installation of boilers in one escort had been delayed 48 working days and the installation of boilers in the second escort had not been delayed at all. In evaluating the additional hours claimed by Lockheed, the Navy determined that 24,960 man-hours of delay were caused by the late delivery of Government-furnished boilers compared with 243,334 man-hours included in Lockheed's claim for the late delivery.

In May 1970, the Navy negotiated a settlement in the amount of $17.9 million. Because of the significant number of engineering and technical judgments that entered into the settlement and because of the lack of available documentation against which to verify the extent of the Government's responsibility, we are not in a position to express an opinion on the reasonableness of the settlement.

CONTRACTOR RECORDS NECESSARY TO SUPPORT CLAIMS

We believe that the Navy should require contractors to maintain records in support of claims. We have discussed the issue of adequate recordkeeping with the Navy. Navy officials advised us that they were exploring with an industrial group problems that might be anticipated in requiring contractors to segregate direct costs for contract changes. In addition, the Navy stated that offices had been established at three supervisor-of-shipbuilding locations to study estimating and pricing techniques of major private shipbuilders constructing Navy ships.

To improve the ship procurement process, the Navy has undertaken an extensive program which includes a number of tasks intended to eliminate or minimize claims for price increases under future shipbuilding contracts.

In our February 1972 report to the Congress, we reviewed a number of these actions. They include programs to improve ship specifications, to minimize delays and defects in Government-furnished equipment and information and to promote a common understanding of quality assurance requirements. We suggested in our report that in considering requests for shipbuilding authorizations and funds the Congress may wish to inquire about the specific claims prevention measures that the Navy plans to apply in carrying out proposed ship construction programs.

COMPETITIVE PRESSURES IN THE SHIPBUILDING BUSINESS

Although there is a certain amount of competition in the award of contracts for ship overhauls and construction, the benefits of competition are reduced by the limited number of contractors capable of constructing certain types of vessels and by the large number of changes and claims negotiated after the award.

Newport News and the Electric Boat Division of General Dynamics, for example, are the only private shipyards which can construct missile-equipped nuclear submarines and these two shipyards along with the Ingalls Shipbuilding Division of Litton, are the only private shipyards which can construct other nuclear submarines. In addition, Navy officials told us that heavy workloads at times prevent shipyards from competing for contracts while at other times shipyards in need of work are given a contract to help them maintain their capability.

Changes are numerous in ship construction and overhaul contracts. For construction contracts on ships that were completed in 1970, we found that changes added $103 million to the cost, or about 22 percent of original contract prices. In a prior review of ship overhaul contracts, we found supplemental work of $23 million increased contract costs by about 35 percent. The changes, of necessity, are negotiated on a sole-source basis with many changes negotiated after the work has been completed.

In the final analysis, then, many contracts are priced to a large extent on the basis of incurred costs. This, and the lack of competition, reduces the incentive for shipbuilders to produce economically. We believe it essential, therefore, that the Navy exercise close surveillance over contractors' operations and costs.

Cost Controls

The profit motive and other incentives may motivate a contractor and its employees to hold the line on costs. But the Government cannot afford to rely entirely on the contractor to exercise restraints and should take the initiative to insure that the contractor is using every means at its disposal to keep contract costs at a reasonable level.

In theory, the type of contract can serve to some extent as a deterrent to inefficiency and waste. Firm fixed-price contracts, for example, or other types of contracts with price ceilings, might encourage contractors to strive for better cost control. But all too often, as pointed out earlier, negotiated change orders and claims add significantly to the cost so that the final contract price exceeds the original ceiling and it is not always clear that the Government is justified in paying the higher price.

The Government must therefore assure itself that contractors are making a conscientious effort to keep costs down by such measures as buying competitively, maintaining appropriate accounting procedures to insure that costs are properly charged to the contracts, and maintaining a budgeting system which will disclose in a timely fashion the possibility that the budgeted costs may be exceeded and that prompt management action is therefore needed.

The supervisors of shipbuilding, conversion, and repair—commonly referred to as the SupShips—are responsible for administering the Navy's contracts at commercial shipyards. The SupShips are located in proximity to the larger commercial shipyards in the United States and exercise surveillance over the contractors' operations. Surveillance consists of a continuing analysis and evaluation of the shipyards' contracting policies, practices, records, and reports. It should include the verification and enforcement of corrective action by the contractor to insure conformance to contractual requirements.

Both at Newport News and at Litton, we found a need for more aggressive following up of action being taken by the shipyards to correct deficiencies disclosed during surveillance. Litton's East Yard, for example, has been unable to get its purchasing systems approved since 1969; and the system at Newport News has been in an approved status for only a brief period within the past 3 years.

The SupShips at Newport News and at Litton were assisted in their reviews of the contractors' operations by a staff of DCAA auditors. The auditors made periodic management and financial type audits during which they examined the contractors' cost charging practices.

CONTRACTORS' SUBCONTRACTING PRACTICES

For proper control of contract cost, it is essential that shipyards attempt to obtain maximum competition for their subcontract work or, where competition is lacking, that they employ effective procedures for negotiating reasonable prices.

It is the SupShip's responsibility to assure that the contractor's practices are consistent with these objectives. This it does by reviewing the contractor's purchasing system. Where the SupShip has satisfied itself that the system contains the necessary elements for effective control, by such means as competitive buying practices and appropriate negotiating procedures, the system is approved. From then on the Government relies on the adequacy of the system to insure proper control over subcontracting with only periodic surveillance. If, however, the contractor's purchasing system is found wanting and until such time as the deficiencies in the systems are corrected, the Government generally reserves the right to review and consent to the awarding of individual subcontracts—generally those in excess of $100,000.

At Newport News, approval of the contractor's purchasing system was withdrawn by the Navy after a review made in May 1969, and was again withheld after a review made in June 1970.

The Navy in its reports cited source selection deficiencies, the lack of documentation in the files to explain the large volume of single-source procurements, the lack of a capability for performing effective cost or pricing analysis, the fact that attempts were not made to get cost or pricing data on certain steel procurements, and the need for updating the purchasing manual.

Approval of the purchasing system at Litton's east yard was withdrawn in August 1969. The Navy cited as reasons the nonexistence of procedures for making cost analyses, incomplete bidders' lists, the need for criteria for conducting negotiation discussions, and the fact that the contractor's purchasing manual did not include procedures for fully implementing the requirements of the Truth-in-Negotiations Act. The Navy, in again reviewing the purchasing system in September 1970, found that most of these deficiencies had not been corrected.

In view of the Navy's withdrawal of its approval of the systems at both Newport News and Litton, the Navy's consent to the award of subcontracts took on additional significance. We found that this requirement for subcontract approval had not been made part of one of the three prime contracts we examined at Newport News. The

result was that none of the purchase orders awarded under this contract were reviewed by the Navy.

At Litton's east yard, Navy consent to 31 subcontracts was not issued until 3 to 207 days after they were awarded. At the west yard, we reviewed 146 subcontracts in excess of $100,000 and found that the contractor failed to submit 14 for approval before award. The contracting officer's consent to these procurements was not obtained until 10 to 168 days after award.

OPPORTUNITIES FOR INCREASING COMPETITIVE PROCUREMENT AT NEWPORT NEWS

In reviewing Newport News' subcontracting practices, we found that the contractor was not making a sufficient effort to obtain maximum practicable competition. It is therefore not surprising that only one supplier bid, or that only one supplier was considered responsible in about 42 percent of the $125 million of subcontracts let in 1970 at that yard. This is equivalent to $52 million of procurements. The contractor's records identify about $13 million of this as being for proprietary items. We believe that better source selection procedures would have brought to light the existence of additional suppliers for many items other than those which were proprietary.

Newport News, for example, did not publicize proposed purchases to obtain additional sources. Only some of its buyers update their lists of suppliers by contracts with vendors or by identifying additional sources through publications. In most cases, buyers rely on lists of suppliers compiled from the history of prior procurements, catalogs, requests from vendors to be placed on the lists and their personal awareness of potential sources.

In a number of cases, the contractor solicited fairly large numbers of sources but only one qualified bid was received. Many solicited sources could not make the desired time. This would indicate that the contractor's lists of suppliers needed screening, expansion and updating so that unqualified suppliers can be removed and additional qualified suppliers added.

As an example, for a $116,000 June 1970 procurement of air-operated hoists, Newport News solicited bids from four of eight suppliers solicited for an earlier procurement of this item, and from six additional suppliers, a total of 10. Nine declined to bid, seven because they did not manufacture the item, and two because the required equipment was the standard product of another vendor.

We examined one of several national publications which list suppliers for various commodities. This publication identified many other firms who manufactured air hoists. The buyer for this item said that, although it was possible that some of the suppliers listed in the publication could supply the air hoists, it was difficult to find a supplier who could manufacture this item in accordance with military specifications.

We compared the suppliers solicited for specific commodities purchased under several purchase orders where Newport News had received responses from but a single qualified supplier, with the suppliers listed in one publication. We found that there were between 15 and 290 listed suppliers not solicited by Newport News. Buyers we questioned expressed reservations about the ability of many of these

suppliers to manufacture to governmental specifications. The procurement files at Newport News, however, contain little data as to the qualifications of suppliers and their interest in competing for orders.

SUBCONTRACTS AWARDED BY LITTON

Litton's east yard solicited two or more sources for the majority of its subcontracted work and two or more responsive bids were received for the larger subcontracts. However, for many small subcontracts which we examined, only one of the bids received was considered by Litton to be responsive.

The following is our analysis of 295 subcontracts awarded under two submarine contracts, one a construction contract, the second for overhaul. The 295 which we examined represented about 64 percent of the dollar value of all subcontracts awarded under the two contracts.

I will not read these figures, Mr. Chairman, but of the total number of subcontracts, it amounted to about $25 million.

(The figures referred to follow:)

	Number of subcontracts	Amount (million:)
Purchased under pooling arrangement whereby lead-yard on submarine construction contract selects supplier and arranges price	43	$4.3
Only 1 responsive bid received	161	3.0
2 or more responsive bids received	91	17.7
Total	295	25.0

Mr. STAATS. At the West Yard, we examined 194 subcontracts having a value of $366 million awarded under two construction contracts, one for general purpose amphibious assault vessels, commonly referred to as LHA's; and one for destroyers, DD-963.

For 150 of the 194 subcontracts, Litton solicited two or more sources. In all but a few instances, the number solicited ranged from three to 18; however, in 18 of the 150 procurements, having a value of $62.6 million, only one bidder was considered responsive by the contractor.

For the remaining 44 subcontracts, valued at $2.3 million, Litton solicited only one source and appeared to have reasonable justification for doing so; that is, Litton determined that only one supplier could meet the delivery requirements, or that it was impractical to change suppliers on follow-on awards.

LOWER PRICES POSSIBLE THROUGH HOLDING NEGOTIATION DISCUSSIONS WITH OFFERORS

Of 224 negotiated subcontracts we looked at, awarded by Litton's East Yard, we found that competitive proposals had been obtained in 79 cases. In 62 of these, involving procurements totaling $11 million, we found no evidence that oral or written discussions were held with offerors. Holding such discussions is required of Government procurement officers by the Truth-in-Negotiations Act in the absence of a clear demonstration that they are not needed to obtain fair and reasonable prices. Discussions need not be held if all offerors are advised that the award might be made without them. Litton officials told us

that references to negotiation discussions are not always documented in their files.

In 24 instances, including 17 competitive and seven noncompetitive procurements, we found evidence that discussions were held and that East Yard negotiators reduced the prices initially proposed from $8.8 million to $8 million. Litton's Marine Technology Division, making purchases for the West Yard, was able to reduce prices initially proposed on subcontracts awarded for the LHA program, from $134 million to $117 million following discussions with offerors.

COMPLIANCE WITH THE TRUTH-IN-NEGOTIATIONS ACT

As part of our reviews at Newport News and Litton, we looked into the degree of their compliance with the provisions of the Truth-in-Negotiations Act requiring prime contractors to obtain cost or pricing data from vendors on subcontracts over $100,000 awarded without adequate competition.

During 1970, Newport News issued purchase orders costing $125 million. About half this amount was subcontracted under three fixed-price incentive prime contracts. On a statistical sampling basis, we selected for review 177 purchase orders issued under the three contracts. The 177 orders were awarded in amounts totaling $17.8 million. There were 65 purchase orders subject to the act.

In all 65 instances, Newport News attempted to obtain cost or pricing data and was successful except for procurements involving high-yield steel. The contractor referred these to the Navy which made additional unsuccessful efforts to obtain the data and finally consented to Newport News awarding the contracts.

At Litton, we found that both yards were obtaining cost or pricing data when required except for the procurements based on prices arranged by the lead yard on the submarine construction contract. Litton officials explained that they had relied on the lead yard to obtain data and pricing certificates. They propose to obtain these in future procurements irrespective of actions taken by the lead yard.

BUDGETING AND COST CONTROL SYSTEMS

One of the matters you asked us to look into was the effectiveness of the shipyards' budgeting and cost control systems in providing proper controls over labor and material costs on Navy ships.

We were unable to make this type of evaluation at Litton. The systems at the West Yard, a relatively new yard, had not been fully developed and implemented at the time of our review. Construction on the DD–963 contract had not begun. The LHA's were in the early stages of construction, and detailed budgetary data were not yet available.

Neither could we make this evaluation at Litton's East Yard because Litton's officials said it was their policy not to release budgetary information to our office. In effect, the company took the position that we were not entitled to this information under our access-to-records clause. The contracts we reviewed at the East Yard also did not require Litton to furnish budgetary information to the Navy.

We believe that the system at Newport News was not adequate for insuring proper cost control. This is because it did not provide for a

breakdown of costs at a sufficiently low level to permit pinpointing areas of the ship where overruns are likely to develop. Labor is budgeted for all the departmental and system levels. Material cost is budgeted for the entire ship, not for individual structural sections; therefore, a comparison of actual and budgeted costs below the level of the entire ship cannot be made.

Costs of a particular item or group of items of material may run higher or lower than the material cost estimate included in the budget, but the system only reveals the material variance for the entire ship. We feel that tracking costs at a lower level is needed so that management can identify areas of the ship where costs are running higher than anticipated and take the necessary action to bring them under control.

RELEASE OF BUDGETARY INFORMATION

Senator PERCY. Mr. Staats, are you saying that the reason you feel that Litton officials would not release budgetary information to your office is not just that it is their overall policy or that they feel it is an invasion of their privacy to reveal cost information, but that they simply could not defend the system they had and they are now revising it?

Mr. STAATS. They could have given us this information. This has been an issue, I think, generally, within the Defense Department. They have argued that future budgetary information comes under the prohibition directive of the executive branch. We are firmly of the view that this is not the intent of the directive. Rather, we think it has been taken advantage of by the contractors to avoid furnishing budgetary and cost information if it involves future years, you see. We are not asking for budget—approved budgetary information in the Federal budget; what we are really asking for is a cost to complete broken down by time period, and we do not feel that that comes within the limitation.

Senator PERCY. Do you consider that the request made of you and your office by this subcommittee that you look into the effectiveness of the shipyards' budgeting and cost control system and the providing of proper controls over labor and material costs, was a proper congressional oversight request?

Mr. STAATS. Oh, yes.

Senator PERCY. Is it accurate to say that you were frustrated then in your attempt to get the information and you could only draw conclusions based upon what might be inadequate information?

Mr. STAATS. That is correct.

Senator PERCY. If the company had an adequate system, it would have helped you, but you simply had to deduce, then, that the system was not adequate? I thank you.

Mr. STAATS. That is correct.

NEWPORT NEWS REVISED COST CONTROL SYSTEM

Newport News is currently designing a revised cost control system. At this time, of course, we are unable to conjecture on how effective the new system will prove to be.

Both at Newport News and at Litton we examined the contractors' procedures for charging material and labor costs to the Navy con-

tracts. Our tests did not turn up any serious problems in this area. The controls in force seem to be adequate to accurately show labor and material contract costs.

PROPRIETY OF OVERHEAD CHARGES

Although your request did not touch on the propriety of overhead charges, we did some limited work in this area at Litton after we noted that the Defense Contract Audit Agency had recently questioned the charging of certain overhead expenses by the west yard.

Up to now, most of the west yard's construction activity has been confined to its commercial ship contracts. Work on the LHA and the DD–963 contracts has involved material purchases and engineering design, accomplished primarily by Litton's Advanced Marine Technology Division, and assembly and testing of electronic components performed primarily by Litton's Data Systems Division. Both divisions are located in the Los Angeles, Calif., area.

The Defense Contract Audit Agency found that during the period 1969–71 the Navy contracts were charged about $7 million for overhead expenses applicable to Litton's commercial work carried on at the west yard. The Defense Contract Audit Agency attributed the greater portion of the overcharges to (1) Litton's including in material cost, for the purpose of allocating material burden of the west yard between Government and commercial, Marine technology costs such as direct labor and overhead-type costs; and (2) Litton's charging Marine technology—where work was almost wholly on governmental contracts—with general and administrative costs incurred at that facility which were applicable, in part, to the west yard. In addition, general and administrative expenses incurred at the west yard—engaged primarily in commercial work—were allocated on the basis of the costs incurred at the two locations recorded as a direct cost of the west yard. The Defense Contract Audit Agency reported that this resulted in inequitable charges to the Navy contracts inasmuch as west yard activities included commercial as well as Navy ship construction.

Our selected review confirmed that these practices were resulting in Navy contracts bearing some of the west yard's commercial overhead. The Navy currently has this matter under consideration.

PROPORTION OF GOVERNMENT VERSUS COMMERCIAL ACTIVITIES

Senator PERCY. Mr. Staats, do you have the figures available as to what proportion of the west yard's activities are governmental and what proportion are commercial?

Mr. STAATS. Perhaps one of my colleagues could answer the question. I do not.

Senator PERCY. Just in rough terms?

Mr. STAATS. Mr. Gutmann—he is head of our Procurement and Systems Acquisition Division.

Mr. GUTMANN. It is predominantly commercial. I think we may have a figure.

Chairman PROXMIRE. Why don't you go ahead; we can pick that up in a minute or two.

NAVY SURVEILLANCE OVER SHIPYARD PROCUREMENT AND COST CONTROL PRACTICES

Mr. STAATS. At Newport News, Navy surveillance was being carried out by a staff of about 400 people, 38 of whom were military personnel. Of the total, 278 were involved primarily in quality assurance, planning, and control of material. There were 36 people involved in surveillance over procurement, cost control, and cost charging. The remaining personnel were primarily administrative.

A recent reorganization of the SupShip staff contemplates an increase in the number of procurement analysts and pricing analysts. Also, a so-called business review staff, consisting of a supervisory business analyst, an industrial engineer, and a financial analyst, was established which is responsible for maintaining surveillance over the contractor's cost and labor control.

The SupShip at Pascagoula maintains supervision over both the east and west yards of Litton, with a staff of about 300. A branch office in Culver City, Calif., with a complement of 17 people, has surveillance responsibility over the Advance Marine Technology Division's operations. We were informed that a business review staff is also being established at Pascagoula with responsibility for surveillance over various aspects of Litton's business practices, including management objectives and policies, work operations and progress, resources utilization, and cost control and reporting systems.

I have stated earlier that the Government's surveillance exercised by the SubShips with the assistance of the Defense Contract Audit Agency, has identified some significant weaknesses in the purchasing systems at both contractor operations. The Navy has also been critical of the budgeting system at Newport News. In a March 1971 report, a Navy audit team pointed out that budgets at the working level were not related to contract price and that labor and material costs were not related to budgets in a way that would identify potential overruns or underruns in time for corrective action to be taken. This is partial corroboration of the point made in response to Senator Percy's question a few minutes ago.

The Navy has made specific recommendations for correcting the deficiencies found. We believe that aggressive followup action by the SupShips is needed to insure that the contractor take timely action to implement the recommendations. In addition, the SupShips should exercise closer surveillance over subcontracting practices, particularly in the light of the limited competition obtained for numerous awards.

Chairman PROXMIRE. Before we go ahead, do you have the answer to the question that Senator Percy raised as to the proportion of commercial and governmental business?

Mr. GUTMANN. No; we don't have that yet, sir.

Mr. STAATS. Mr. Chairman, this completes the statement relating to shipbuilding claims and controls and competition in the shipbuilding industry.

Chairman PROXMIRE. May I say at this point, we will put in the record the reports of January 13 and March 23 on shipyard costs, and so forth.

(The following information was subsequently supplied for the record:)

REPORT TO THE JOINT ECONOMIC COMMITTEE, CONGRESS OF THE UNITED STATES

REVIEW OF CONTROLS OVER SHIPYARD COSTS AND PROCUREMENT PRACTICES OF NEWPORT NEWS SHIPBUILDING AND DRY DOCK COMPANY, NEWPORT NEWS, VA.—DEPARTMENT OF THE NAVY

(By the Comptroller General of the United States—Jan. 13, 1972)

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
Congress of the United States.

DEAR MR. CHAIRMAN: Your letters of August 18 and December 10, 1970, requested that we review the efforts by the Navy and its contractors to control ship construction costs at major private shipyards. As you know, on June 4 and August 23, 1971, we furnished you with data on some of your questions.

In this report we deal with the remaining questions relating to the adequacy of controls over shipyard costs and procurement practices as exercised by both the contractor and the Government. To answer these questions we reviewed the operations of two major private shipyards. This report concerns our review of the Newport News Shipbuilding and Dry Dock Company, Newport News, Virginia, a subsidiary of Tenneco Corporation. A report on our review of the facilities of the second shipyard, Litton Industries, Inc., at Pascagoula, Mississippi, will be furnished at a later date.

Official comments on the matters discussed in this report have not been requested or obtained from the contractor or the Navy. We plan to make no further distribution of this report unless copies are specifically requested, and then we shall make distribution only after your agreement has been obtained or public announcement has been made by you concerning the contents of the report.

Sincerely yours,

ELMER B. STAATS,
Comptroller General of the United States.

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CHAPTER 1—INTRODUCTION

In accordance with letters of August 18 and December 10, 1970, from the Chairman, Joint Economic Committee, we have reviewed the adequacy of controls over shipyard costs and procurement practices as exercised by both the Government and the Newport News Shipbuilding and Dry Dock Company, Newport News, Virginia, a subsidiary of Tenneco Corporation.

Newport News, a major private shipbuilder, had billings of $356 million for 1970, of which $317 million, or 89 percent, was applicable to contracts for new construction, overhaul, and refueling of Navy ships. Our review concentrated on three Navy contracts for new ship construction which were to be completed during the next 5 years and which were valued at about $935 million.

Generally it appears that much can be done by both the contractor and the Navy to reduce shipyard costs and, in turn, the cost to the Government. Our findings indicate that Newport News' budgeting system is ineffective in promptly pinpointing areas of the ship where overruns can develop and where greater cost control may be needed. The shipyard's procurement practices do not ensure that the most competitive prices are obtained, as evidenced by the very high percentage of procurements on which only one supplier competed for the award and by the Navy's withholding its approval of the contractor's purchasing system after reviews of the system in each of the last 2 years.

In our report of August 23, 1971 (B-133170), we stated that it was essential that the Navy exercise close surveillance over contractors' operations and costs since real competition was lacking for a significant part of the Navy's ship repair and construction program. Although the Navy has identified numerous deficiencies in the shipyard's operation, it has not been aggressive in following up to see whether the contractor has taken corrective action.

The questions asked in the Chairman's letters, together with our answers, follow.

"Are shipyards' budgeting and cost control systems adequate to ensure proper control of labor and material cost on Navy ships?"

We believe that the current budget and cost system of the contractor does not effectively ensure proper control of costs on Navy ships. Budgeted labor cost for a contract is established by department (trade) as well as by ship system, whereas budgeted material costs are established for an entire ship. Therefore a comparison of budgeted and actual costs which would include both material and labor is not possible below the ship level. To be meaningful the comparison should measure all elements of cost by recognizing physical progress at a sufficiently low activity or organizational level to provide the detail necessary to identify areas of potential overruns and underruns so that timely corrective action can be taken.

In addition, the contractor's system does not provide for segregating actual costs of change orders to permit comparison with budgets to evaluate change-order pricing and performance. The contractor contends that it is not feasible to maintain cost records for change-order work.

SYSTEM CURRENTLY IN USE

In proposing a price for negotiating a Navy ship construction contract, the contractor's cost engineers develop proposals which show a cost breakdown for labor, material, and overhead. The proposal summarizes costs for major ship structures.

Subsequent to the award of a contract, labor costs are broken down in greater detail for budget and cost accumulation purposes. The budgeted costs bear a relationship to the negotiated contract price. The breakdown is by ship system, such as rudders, as well as by department. A ship could have anywhere from 200 to 800 systems depending on the size and complexity of the ship. The work is done by up to about 70 departments. Each system is assigned a cost number, and direct labor and direct material charges are collected at that level. The contractor, however, budgets material for the entire ship rather than for each system.

Neither the system budget nor the department budget is broken down at a lower level. More detailed estimates for a part of direct labor, however, are made after design drawings have been firmed up.

As the work is scheduled, each system is broken down into work packages, each representing a definite quantity of material to be manufactured, erected, or installed. A work package usually requires from 4 to 6 weeks of effort to complete. In terms of magnitude a submarine would have about 7,000 packages compared with 30,000 for a carrier. No cost estimate is made at this time, nor are actual costs accumulated at the work package level.

Work packages are detailed into specific tasks as described on work orders. The contractor estimates that roughly half the work orders require the use of direct labor where incentive work is not involved. For these work orders no estimate of direct labor is made. For incentive work labor hours are estimated for each work order after the detailed drawings have been prepared. For this reason the estimated hours shown on the work orders often are more realistic than the budgeted hours for the various ship systems, which are estimated without benefit of the detailed drawings. Budgeted hours are not adjusted on the basis of these estimates. Throughout the period of construction, actual labor hours, as accumulated by work order, are compared with budgeted hours by department and system.

The contractor has a contract change-order control system, the purpose of which is to identify needed engineering changes and to determine the effect on schedule, cost, weight, and other technical design considerations. The system is oriented primarily toward ensuring full consideration of all technical factors bearing on the change rather than toward providing management control of the related costs associated with the change. The contractor's system does not provide for segregating actual costs of change orders.

GAO evaluation

The contractor's budget and cost control system contains the elements which would permit comparisons to be made of estimated and actual costs but does not permit pinpointing areas of the ship where overruns are developing so that management can direct its attention to those cost areas which may need greater control.

For example, since material cost is budgeted for the entire ship only, not at the system level, the comparison which the contractor makes of budgeted and actual costs at the system level is not complete. The contractor may pay more or less for a pump or other part than the related estimated price included in the overall budget for material, but only the material variance for the entire ship—not the variance for the individual part—is identified.

Another weakness in the contractor's cost control is the lack of separate identification of actual costs of change orders. Contractor officials informed us that they had studied on several occasions the feasibility of accurately segregating and accounting for such costs and that, under the terms of a contract for construction of two aircraft carriers, the feasibility was again under study. They added that, to date, these studies indicated that a system to account separately for change-order costs would be costly and probably would result in incomplete and unreliable cost data.

It seems essential that the Navy have a reasonable cost estimate before authorizing changes in work and that the prices for the work involved be negotiated before the work is started. Where feasible the actual costs of change-order work should be maintained. This would permit a comparison of actual costs with estimates to provide a check on performance under change orders. We recognize that there are situations where it may be difficult to break down actual costs for a change from the costs for the remaining part of the original work ordered. In these cases it is particularly important that the change-order prices be negotiated before work is started.

REVISED SYSTEM

The contractor currently is designing and implementing a revised labor-planning and cost system which will add control on the basis of space. Contractor officials told us that they planned to use this system on future construction contracts but not on existing contracts and that implementation began early in 1971 under a letter contract for the DLGN-38 Guided Nuclear Frigate. The frigate will be divided into 20 structural sections, 50 design areas, and 110 space control units. Budgeting for labor and collecting labor cost under the revised system will be by shipyard department and space control unit. A ship coordinator will be assigned to each area and will be provided with the plans, budgets, schedule, material, and allocation of manpower. Although variance between budgeted and actual costs will be tabulated only at the space control unit level by department, estimates and actual costs by work package will be available for an in-depth analysis of variances.

The contractor has established a Progress Analysis and Manpower Planning Division. According to contractor officials this division initiated a procedure for measuring the construction progress of a ship. In measuring the progress under each contract, the division will gather direct-labor information by contract from the various departments to determine the percentage of completion. This percentage will be verified to the physical progress of each department. Man-hours expended will be compared with the estimated man-hours to measure the accuracy of estimates. The division also will establish standard manpower curves for future projects.

Since the revised system had not been installed at the time of our review, we could not evaluate its effectiveness.

DEFENSE CONTRACT AUDIT AGENCY AND NAVY REVIEWS OF THE CONTRACTOR'S SYSTEM

The Defense Contract Audit Agency (DCAA) reviewed the budgeting and cost control system in 1970 and reported that the system did not adequately disclose variances between actual and budgeted costs to permit timely corrective action to be taken. It reported also that the system should extend to the lowest level of supervisory responsibility so that performance could be measured.

DCAA reported further that reviews by the contractor's internal audit staff were concerned primarily with financial matters. It recommended that the staff be increased and that emphasis be placed on management-type reviews.

A Navy audit team reviewed the contractor's operations. Following are some of the findings included in its March 1971 report.

1. Budgets and incentives at the working level are not related to contract price. It is possible to meet all working-level (apparently work order level) budgets and still overrun a contract because contract budgeting stops at the department level.

2. Labor and material costs are not related to budgets in a way that identifies potential overruns or underruns as work progresses in time for corrective action to be taken.

3. Existing cost control reports do not promptly identify budget variances and the factors giving rise to the variances.

A Navy official advised us that suggestions for improvement had been made to the contractor and also informed us that the contractor had initiated corrective actions. He advised also that the Navy planned to follow up on the actions.

CONTRACTOR'S INTERNAL REVIEWS

The contractor has an internal audit staff of 11 and plans to increase the staff to 14 by June 1972. We discussed with the internal auditor his findings covering calendar years 1969 and 1970. The findings indicate that the internal audits were concerned primarily with financial matters dealing with payroll, bank reconciliations, vouchers, purchases, scrap sales, etc., rather than with cost controls.

We believe that the internal audit staff would more effectively assist management if it would broaden the scope of its audits to include reviews of cost controls.

"Are there adequate contractor and Government controls over labor and material charging practices?"

The contractor has established procedures for controlling charges of material and labor to specific systems of a ship. The contractor's organization includes a section responsible for verifying the accuracy of labor charges. Government control is exercised through review and analysis of the contractor's cost-charging practices by the Supervisor of Shipbuilding, Conversion, and Repair (SUPSHIP) and DCAA.

On the bases of our test of the contractor's system for charging costs and our review of the Government's surveillance over the charging procedures, we believe that controls over the charging of labor and material generally are adequate. Two exceptions are the failure of the contractor's system to account for idle time and the absence of an internal control procedure which would provide for the results of floor checks to be reported to a level higher than that of foreman.

CONTRACTOR'S MATERIAL-CHARGING PRACTICES

The contractor's policy on material charging provides that material that can be reasonably identified with a particular job order should be charged directly. Material consumed in routine shop and plant operations or material used for repairs and maintenance of buildings, machinery, tools, or other plant equipment is charged to departmental expense accounts and is distributed through overhead.

Direct purchase

Purchase orders are identified by ship, cost, and sequence numbers. A purchase order number is placed on all correspondence, invoices, packages, and shipping papers related to the purchase and is stenciled on the material. The cost of the purchase is charged to the appropriate ship system, such as rudders.

Stores issues

The contractor issues, in addition to material purchased specifically for a ship, material from stores to the various departments on the basis of a requisition signed by an authorized person. Stores issues include common-type items, such as pipe, fittings, and paint, which are described on the work order for a specific task. The cost of a stores issue is charged to the ship by system.

Excess material

During the performance of a contract, unused stores materials are required to be returned for credit to the contract during the month that such materials are found to be excess.

Unused direct-purchase materials usually are returned at completion of the contract. Recently the contractor has attempted to identify surplus prior to contract completion, such as surplus occurring as a result of a change order. When this surplus is identified, whether during or at completion of the contract, a list of excess materials is prepared.

The list is reviewed by design departments which determine any one of four different dispositions: (1) forwarding to the ship such items that may, in fact, be components required for the ship or be spare parts, (2) transferring the

material to a new ship and crediting the completed ship, (3) placing the item in stock if possible and crediting the completed contract, and (4) designating as contract surplus other items for which there is no known present or future need.

The contractor sends the list of contract surplus items to SUPSHIP where it is reviewed for reasonableness. Where SUPSHIP believes that the surplus arose from the contractor's improper action, it will consider this fact in final negotiations.

DCAA reviews

DCAA made six reviews of the contractor's material control practices during the year ended May 31, 1971. The results of these reviews were reported to the Navy, and most of the findings were discussed with contractor personnel. DCAA found no mischarging of cost between ships and made no comment as to lack of control.

GAO evaluation

We selected 177 purchase orders to determine whether material costs had been properly charged. We traced purchase order data through the contractor's records and to progress billings to the Navy. Also we physically verified the existence of materials purchased, except for some items whose identification had been lost in installation. Our verification of material charges and our physical verification of material showed no deficiencies.

We reviewed the stores issues procedures and compared recorded amounts with progress billings to the Navy. To test the stores issues procedures and cost-charging practices, we analyzed the manner in which welding rods were handled. Our tests disclosed no mischarging.

CONTRACTOR'S LABOR-CHARGING PRACTICES

Labor hours are accumulated for each ship by system and by department. The contractor's control of cost charging for labor is placed primarily with the foreman who is responsible for the performance of work of from four to 20 workers and the proper charging to cost numbers. Time is charged for 21,900 workers by use of gate cards, data pathing, or time sheets.

The contractor has a labor incentive plan under which productive direct labor is compared with predetermined estimated hours specified on work orders for performing a task. The predetermined hours are based on standards, work sampling, similar work done previously, and best judgment in the case of nonrepetitive work. Productive direct-labor workers receive a 100-percent share of the savings based on the hours by which the predetermined hours are underrun. On the other hand, piece-rated workers, such as welders, are paid on the basis of quantity produced.

Gate cards

Each of about 13,100 employees receives a gate card as he enters the yard. The employee records his name and shop number on the card and presents it to his foreman. The foreman assigns tasks and at the end of the day records the time by cost number on the card.

Data pathing

Time for about 3,300 employees is gathered on 73 data-pathing machines throughout the yard and is recorded on one central computer. When an employee enters the yard, he punches in at one of the machines by using his photo identification badge. He than reports to his foreman and is assigned a job and is given a prepunched card containing the cost number for the job. The employee then again punches the machine using his badge and the card and thereby records his assignment to the cost number. If he changes jobs during the day, he receives another card and repeats the procedure. The machine automatically checks him out at the end of the shift.

Time sheets

Approximately 5,500 salaried employees record their time manually on biweekly time sheets and present them to their supervisors for approval.

Data collection and control department

The Data Collection and Control Department has six men assigned to check the reliability of labor charges by interviewing selected individuals three times daily and verifying the results against a printout of labor charges. In addition,

the Navy requires that charges against cost numbers be edited to ensure that noncurrent cost numbers are not charged. The contractor has assigned nine men to this function. Each review team, however, reports the results only to the foreman responsible for the charges. The department has about 70 piecework counters who physically check each welder to verify the inches of weld made during his shift.

DCAA reviews

DCAA made seven reviews of the contractor's labor charges for the year ended May 31, 1971. The results of these reviews were reported to SUPSHIP and discussed with contractor personnel. Some of the reported findings follow.

In its June 1970 review of timekeeping procedures, DCAA reported that there was no accounting for idle time and recommended that such time be charged to a separate code. The contractor told us that this would be impractical because benefits would not justify the cost of such accounting.

DCAA reported also that in its floor checks it had discovered isolated cases of mischarging of labor cost but no instances of flagrant or widespread mischarging. As suggested by DCAA the contractor has reclassified consistently for all departments certain direct labor operations, such as those performed by indoor crane operators, as indirect labor. Also after DCAA raised a question about the system of allocating overhead on the basis of total direct labor dollars, including overtime and night premium costs, the contractor agreed to exclude premium costs from the base starting in 1972.

DCAA has just begun a review of labor controls built into the computer. This review is being performed by a DCAA specialist in the data processing field.

GAO evaluation

We tested the contractor's system for charging labor and found that generally it was satisfactory. To obtain an understanding of the system, we discussed labor-charging controls with contractor and Navy personnel and reviewed the contractor's instructions. We observed employees and supervisors in their recording and approving of labor charges and accompanied contractor personnel in their verification procedures. We observed also a floor check by DCAA.

We found that the contractor did not account for idle time even where the idle time occurred between assignments. For example, under the data-pathing system, an employee punches in when reporting to work in the morning. When he punches the machine again after he has been assigned a job code, his time for that job code reverts to his starting time. The idle time between his reporting to work and his starting an assignment is charged to the job. Similarly time between assignments during the day is charged to the job.

We believe that idle time should be reported or accounted for in order that its extent and significance may be determined and that steps may be taken to control it as necessary.

We noted some instances of improper charging between cost numbers. Each charge, however, was made to the proper ship so that the total cost to the Government was not affected.

We accompanied contractor personnel on their checks of charges to cost numbers. We found that the personnel followed through and obtained corrections for any discrepancies noted. A report of the discrepancies is made to the foreman. We believe that it is essential for proper internal control that the reports made by the review teams on the results of their floor checks be reported to a management level higher than that of foreman. Also it appears to us that the work of the nine men assigned to detect charges against noncurrent cost numbers could be performed more economically by a computer.

CHAPTER 3—SHIPYARD CONTROLS OVER PROCUREMENT

The questions on this subject are concerned with the shipyard's efforts to obtain competition in subcontracting and, in the case of noncompetitive subcontracts, to comply with the provisions of the Truth-in-Negotiations Act.

The specific questions are restated below along with the information we obtained.

"In awarding subcontracts do the shipyards employ safeguards comparable to those used by the Government in awarding prime contracts?"

In general, the contractor's procurement policies, as prescribed in its procurement manual, incorporate many of the safeguards used by the Government, such

as competitive solicitation of bids, negotiation of prices when competition is not considered present, obtaining cost or pricing data in the circumstances prescribed by Public Law 87–653 (the Truth-in-Negotiations Act), and approval of specific procurements by progressively higher levels of authority depending on the amount of the purchase. One exception we noted was the lack of a policy to test the market before exercising contract options to ascertain whether prices lower than the option price could be obtained.

In addition, our test of purchase transactions showed that Newport News could obtain increased competition by improving its procedures for establishing and updating lists of supplies so as to have greater assurance that it was soliciting a sufficient number of qualified sources. Both of these matters are discussed in detail in connection with the next question.

"Do shipyards seek to establish maximum practicable competition in subcontract procurements?"

Newport News purchasing procedures do not ensure that maximum practicable competition in subcontract procurements will be established. In a number of cases in which the contractor had solicited fairly large numbers of sources, only one qualified bid was received.

The contractor does not publicize proposed purchases to obtain additional sources. The Commerce Business Daily, for example, is a Government publication which is available at no charge to prime contractors, as well as Government procurement agencies, to make their requirements known to the public. Suppliers may express their desire to compete by contacting the requiring activity.

In most cases buyers rely on lists of suppliers compiled from the history of prior procurements, catalogs, requests from vendors to be placed on the lists, and their personal awareness of potential sources. Two buyers told us that they updated their bidders lists by contacts with vendors and by identification of additional sources through publications.

During 1970 Newport News issued 33,000 purchase orders for materials and services costing $125 million. On a statistical-sampling basis, we selected 177 purchase orders for detailed analysis from 5,700 purchase orders with aggregate prices of $68 million under three prime contracts. Following is the contractor's classification and our related sample.

	Purchase orders		
		GAO sample	
	Amount	Amount	Number
Awarded to lower of 2 or more acceptable responsive bidders	$55,415,000	$6,643,000	77
Awarded under 1 of 2 or more identical bids [1]	9,096,000	2,055,000	15
Awarded to only source	52,043,000	9,086,000	53
Delivery schedule, small orders, and miscellaneous categories	9,071,000	21,000	32
Total	125,625,000	17,805,000	177

[1] Most of these are purchases of high-yield steel.

LIMITED NUMBER OF QUALIFIED SOURCES SOLICITED

We found that the contractor had not exerted sufficient effort to establish maximum practicable competition. For example, the contractor awarded nine purchase orders amounting to $1,254,505 to single qualified bidders but did not solicit other potentially qualified suppliers.

For seven purchase orders the contractor received one or more responses; however, only one qualified supplier bid in response to each solicitation. Several of the purchase orders were for more than one item. For most of the items, we found that little data were available in the contractor's procurement files as to the qualifications of suppliers and their interest in competing for the orders. Action was not taken to establish the qualification of other potential suppliers.

Buyers have available national publications which list suppliers for given commodities. We compared the suppliers solicited for the nine orders with the suppliers listed in one such publication for the specific commodity and found that there were between 15 and 290 additional suppliers not previously solicited. We asked each of the buyers why he had not considered these other suppliers. The

general reply was that the buyer had solicited only suppliers on the bidders lists because of the difficulty in finding additional suppliers who could manufacture according to Government specifications. Examples follow.

A purchase order was awarded in June 1970 at a price of $116,500 for air-operated hoists for the carrier CVAN–68. The most recent purchase for this item was in May 1966 for the carrier CVA–67. At that time eight suppliers were solicited. Four declined to bid because they did not manufacture the item, two declined to bid with no explanation, and another submitted an incomplete bid. Only one submitted a qualified bid and was awarded the purchase order. In June 1970 the contractor had a requirement for these hoists for the carrier CVAN–68. It solicited bids from four of the above eight suppliers and from six additional suppliers. Of the 10 solicited, nine declined to bid, seven on the basis that they did not manufacture the item and two because the required equipment was the standard product of another vendor. The only bid received was from the same manufacturer that had supplied the air hoists for the CVA–67.

One national publication that we examined showed that many other firms not previously solicited by the contractor manufactured air hoists. The buyer for this item said that he felt that he had solicited a sufficient number of sources for this item although it was possible that some of the suppliers listed in the publication, but not solicited, could supply the air hoists. He said that it was difficult to find a supplier who could manufacture this item in accordance with military specifications.

Another purchase order, awarded in November 1970, was for air-operated valves costing $7,522. The most recent prior purchase of this item was in November 1969. Both the 1969 and 1970 purchases were for the guided missile frigates. For the 1969 purchase five sources were solicited. Three declined to bid, two without explanation and one because it did not manufacture the required valves. Another submitted an unacceptable bid. The sole qualified bidder was awarded the purchase order. For the purchase made in 1970, five sources also were solicited, two of those solicited in 1969 and three additional firms. Four declined to bid, one without explanation and three because they did not manufacture the item. The bid was received from the recipient of the 1969 award, and the 1970 order was placed with that firm.

The publication lists many additional sources of supply for air-operated valves. The buyer stated that only a few of these sources had ever been solicited for valves of that nature. He also indicated that, on the basis of his buying experience, he felt that some of the sources not solicited would not or could not supply those valves.

We feel that, where practicable, additional efforts should be made to identify qualified sources. Where the qualification of none or only one supplier is known, an effort to determine qualification could be made in advance so that solicitation could be made from qualified sources. A method that could be used is sending preinvitation notices to suppliers listed in national publications, advising of the planned purchase and requesting notification of qualification and interest in quoting. A qualified bidders list then could be prepared from the responses and solicitations could be made from that list.

FAILURE TO TEST MARKET PRIOR TO EXERCISE OF OPTIONS

Six of the purchase orders included in our sample were awarded by Newport News through the exercise of options which had been in effect from 15 to 24 months. Despite these extensive periods, the market was not tested to determine whether other suppliers could offer prices lower than the option price. The Armed Services Procurement Regulation provides that Government buyers ascertain whether more favorable prices are obtainable before exercising the option.

For example, in September 1968, Newport News awarded a purchase order for eight pumps at a price of $104,310 to be used on the carrier CVAN–68. The contractor had received quotes from two qualified sources, and the low bidder was awarded the purchase order which included an option to buy an additional eight pumps for $91,143.

In September 1970 Newport News exercised this option and purchased eight additional pumps for the carrier CVAN–69. Although 24 months had elapsed since the last purchase, quotes from other suppliers were not solicited for comparison with the option price.

We believe that the contractor should request additional quotations for comparison with the option price when an option has been in effect for an extended period of time.

"Is there evidence of undue subcontracting by shipbuilders to other subsidiaries of their parent firms?"

We did not find evidence of undue subcontracting by Newport News to its affiliated companies. Of 5,700 purchase orders amounting to $68 million awarded under three selected contracts, only 106 purchase orders valued at $1.3 million were awarded to four Tenneco affiliates.

We reviewed 12 purchase orders on a test basis and found that the affiliates were low bidders for nine purchase orders and were sole bidders for two. The 12th order went to a subsidiary which was furnishing the same item to the Electric Boat Division of General Dynamics Corporation, the lead yard for the type of vessel being constructed.

The largest single award, for butt weld fittings, was made to Gas Equipment Engineers, Inc., an affiliate, in the amount of $80,467. Gas equipment was the lower of two bidders.

"What percentage of subcontract procurements are sole-source?"

Under the contractor's classification about 42 percent of the $125 million of subcontracts let in 1970 by Newport News were let on a sole-source basis. The contractor classifies as sole source all procurements made when only one bid was received compared with the Armed Services Procurement Regulation classification of sole source for purchases of products which can be obtained from only one supplier. The contractor's classification of these sole-source procurements follows.

Contractor's reason for sole-source purchase	Amount (millions)	Percent of total purchases
Same supplier solicited to obtain duplication of existing equipment	$27.5	22
Proprietary item, by name, design, or specification	12.9	10
Only qualified bidder	7.4	6
Only qualified manufacturer	3.5	3
Other	.7	1
Total	52.0	42

"Are the shipyards in full compliance with the Truth-in-Negotiations Act?"

We found that Newport News had attempted to obtain cost or pricing data where required by the Truth-in-Negotiations Act in each of the 65 procurement actions in excess of $100,000 that we examined. These actions were all the subcontracts in excess of $100,000 that were included in our random selection of 177 purchase orders awarded in 1970.

Some steel contractors refused to supply the data after submitting apparent identical bids. These refusals were referred by Newport News to the Navy which made additional efforts to obtain the data. The Navy consented to the placement of subcontracts on high-yield steel, even though it had been unsuccessful in its efforts to obtain cost data. In granting the consent the contractor was advised that the consent did not release it of any obligation that it might otherwise have under the contract.

At the request of the Navy, the contractor on March 24, 1970, asked three major steel suppliers their reasons for not furnishing cost or pricing data. One answered that the high-yield steel was a catalog item priced in the same manner as all other alloy steel products. A second supplier saw no basis for furnishing cost data on procurements made by prime contractors when the Government consistently had not requested such data on its direct procurement for more than the last 2 years. The third cited adequate price competition for its refusal to submit cost data.

We are separately reviewing high-yield steel (HY80 and HY100) procurements made not only at Newport News but also at the Electric Boat Division of General Dynamics Corporation, Ingalls Nuclear Shipbuilding Division of Litton Industries, and the Defense Industrial Supply Center. A copy of our report on this review will be furnished to you.

CHAPTER 4—NAVY'S SURVEILLANCE OVER THE SHIPYARD'S PROCUREMENT AND COST CONTROL PRACTICES

Two questions were raised concerning Navy surveillance of shipyard operations.

"Does the Navy maintain effective surveillance over shipbuilders' procurement, cost control, and cost charging practices?"

"Is closer Navy surveillance of shipyards' operations needed?"

In our report of August 23, 1971 (B–133170), we stated that real competition was lacking for a significant part of the Navy's ship repair and construction program and that, for this reason, it was essential that the Navy exercise close surveillance over contractors' operations and costs to ensure that shipyards were being properly managed and that the Government paid only those costs necessary for the efficient performance of the contract.

SUPSHIP at Newport News is the organization responsible for administering the contracts at the shipyard. In this capacity it exercises surveillance over the contractor's operations, which consists of a continuing analysis and evaluation of the shipyard's contracting policies, practices, records, and reports, including verification and enforcement of corrective action by the contractor to ensure conformance to contractual requirements. To carry out this surveillance, SUPSHIP, as of December 31, 1970, had a staff of 361 civilians and 38 military. Of the total, 278 were involved in direct surveillance of the contractor's operations, mainly in the areas of quality assurance, planning, and control of material. There were 36 others directly involved in surveillance over procurement, cost control, and cost charging. The remaining personnel were involved primarily with administrative matters.

Newport News, by virtue of the size and types of contracts it has with the Navy, is required to have its purchasing system reviewed and approved annually. The objective of the review, an Armed Services Procurement Regulation requirement, is to ensure that the contractor's purchasing practices are efficient. As part of this review, an evaluation is made of the contractor's efforts to obtain competitive prices in its subcontracting. When a purchasing system is not approved, a clause is to be inserted in certain prime contracts requiring the contractor to submit certain proposed subcontracts (generally those which exceed $100,000) to the contracting officer for approval.

Approval of the contractor's purchasing system was withdrawn after reviews by SUPSHIP in May 1969 and again in June 1970 when it was determined that the system did not ensure that materials would be obtained at the lowest price consistent with quality and delivery requirements.

SUPSHIP surveillance is augmented by DCAA, Newport News, which on December 31, 1970, had a staff of 15 auditors. A major part of the DCAA surveillance effort is in the area of cost control. In addition to making its usual preaward and postaward audits, it makes periodic management and financial-type audits. These audits are scheduled on a cyclical basis of 12, 24, or 36 months depending on their importance. During fiscal year 1971 it scheduled and performed audits in such areas as performance and financial control, material, labor, overhead, and Government-furnished property. A report on its findings, as well as on action planned or taken by Newport News, was sent to SUPSHIP who maintained contact with the contractor to determine the extent and propriety of action taken.

To improve surveillance over shipyards, the Naval Ship Systems Command recently has increased and has reorganized the staff at the SUPSHIP office.

SUPSHIP, in turn, has established a position of procurement analyst and has plans for an additional procurement analyst and two pricing analysts. These persons will be reporting to the assistant contracts officer. In addition, a business review staff consisting of a supervisory business analyst, an industrial engineer, and a financial analyst was established. This staff will be responsible for maintaining surveillance over the contractor's cost and labor control and will report to SUPSHIP. These positions have been established only recently; therefore, we cannot comment on the effectiveness of these changes.

GAO evaluation

Closer surveillance of the contractor's subcontracting practices appears necessary. As discussed on pages 14 through 17, the contractor has not always made the necessary effort to identify additional sources of supply. Such action, we

believe, would reduce the number of purchases being made on an only-source basis. We believe that SUPSHIP should more closely review the awards submitted for approval where effective competition has not been obtained and determine whether sufficient action was taken by the contractor to obtain competition.

Concerning the submission for prior approval by SUPSHIP of proposed subcontracts, we found that this requirement had not been made part of one of the three prime contracts which we examined. The Naval Ship Systems Command attributed the omission to an oversight. The result was that none of the purchase orders awarded by Newport News were submitted for approval.

The reviews by the Navy and by DCAA showed that improvements in the shipyard's budget and cost control procedures were needed. We believe that more aggressive follow-up action by SUPSHIP is needed to ensure that the deficiencies in need of correction are acted on by the contractor.

REPORT TO THE JOINT ECONOMIC COMMITTEE, CONGRESS OF THE UNITED STATES

CONTROLS OVER SHIPYARD COSTS AND PROCUREMENT PRACTICES OF LITTON INDUSTRIES, INC., PASCAGOULA, MISS.—DEPARTMENT OF THE NAVY

(By the Comptroller General of the United States, March 23, 1972)

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C.

B-133170.
Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
Congress of the United States.

DEAR MR. CHAIRMAN: Your letters of August 18 and December 10, 1970, requested that we review efforts by the Department of the Navy and its contractors to control ship construction costs at major private shipyards.

On June 4 and August 23, 1971, we furnished you with data on some of your questions. The remaining questions related to the adequacy of control over shipyard costs and procurement practices as exercised by both the contractor and the Government. To obtain answers to the remaining questions, we reviewed operations of two major private shipbuilders, and on January 13, 1972, we reported to you on the operations of Newport News Shipbuilding and Dry Dock Company. In this report we deal with the operations of the Litton Industries, Inc., facilities at Pascagoula, Mississippi, and in the Los Angeles, California, area.

It appears that much can be done by the contractor and the Navy to reduce shipyard costs and, in turn, costs to the Government. We found that Litton did not always follow effective procurement procedures to ensure that the most favorable prices were obtained for some purchases. We noted that the Defense Contract Audit Agency had questioned the contractor's cost-charging practices which had resulted in allocating to Navy contracts costs relating to Litton's commercial work. Our selective examination confirmed that certain inequitable cost allocations had been made.

We could not evaluate the effectiveness of the contractor's budgeting and cost system, because the contracts we reviewed at one of the shipyards did not require the contractor to furnish or make available budget information to the Government and because the system had not been fully developed for the contractor's other and newer shipyard.

Official comments on the matters discussed in this report have not been requested or obtained from the contractor or the Navy. We plan to make no further distribution of this report unless copies are specifically requested, and then we shall make distribution only after your agreement has been obtained or public announcement has been made by you concerning the contents of the report.

Sincerely yours,

ELMER B. STAATS,
Comptroller General of the United States.

CHAPTER 1—INTRODUCTION

In accordance with letters of August 18 and December 10, 1970, from the Chairman, Joint Economic Committee, we have reviewed the adequacy of controls over shipyard costs and procurement practices as exercised by both the Government and Litton Industries, Inc., Pascagoula, Mississippi.

Litton has two shipyards located in Pascagoula—Litton Ship Systems (West Yard) and Ingalls Nuclear Shipbuilding (East Yard). The two are independent of each other, each having its own separate management and organizational structure and each following different procurement and cost control practices.

The West Yard is engaged in the modular construction of surface ships for the Navy and for private companies. At the time of our review, the value of the contracts being worked on totaled about $3 billion. About 93 percent, or $2.8 billion, was for Navy ships to be constructed under fixed-price incentive contracts, although up to that time the West Yard was devoting its construction effort primarily to commercial vessels.

Litton's Data Systems Division assists the West Yard and is responsible for assembly, test, and evaluation of electronic components which it purchases or which are furnished by the Government under the Navy contracts. Litton's Advanced Marine Technology Division purchases most of the other major components and provides engineering-design services for the West Yard. Both organizations are located in the Los Angeles, California, area.

The East Yard is engaged in the conventional construction and overhaul of submarines and the construction of Navy surface ships. This yard also constructs commercial ships for private companies. At the time of our review, the value of Navy contracts being worked on at the East Yard totaled about $266 million. This total included $113 million for a fixed-price (formally advertised) contract, $107 million for a fixed-price incentive contract, and $46 million for cost-plus-incentive-fee contracts.

Questions raised by the Chairman covered three subjects—cost controls, shipyard controls over procurement, and Navy surveillance over the shipyards' procurement and cost control practices. The questions are restated in the chapters which follow, along with the information we obtained in our review.

CHAPTER 2—SHIPYARD CONTROLS OVER PROCUREMENT

The questions on this subject are concerned with the shipyards' efforts to obtain competition in subcontracting and, in the case of noncompetitive subcontracts, to comply with the provisions of the Truth-in-Negotiations Act.

For the two East Yard contracts we reviewed, amounting to about $120 million, the contractor awarded subcontracts totaling about $39 million. Data on subcontracting as of January 1971 and the number of items selected for our review follow.

	Prime contract amount (millions)	Subcontracts			
		Total		Selected for review	
		Number	Amount (millions)	Number	Amount (millions)
SSN-637 class submarines	$107.4	3,922	$37.4	182	$24.0
SSN-612 submarine overhaul	12.5	1,612	1.7	113	1.0
Total	119.9	5,534	39.1	295	25.0

We examined 194 subcontracts, amounting to $366 million, out of the 222 subcontracts, amounting to $372 million, awarded by Litton through December 31, 1970, for work done by the West Yard on the LHA and DD–963 ships.

We examined purchasing records and held discussions with contractor and Navy officials in Pascagoula and at the assisting organizations in California that purchased most of the components for the Navy ships to be constructed by the West Yard.

The specific questions and the information we obtained follow.

"In awarding subcontracts, do the shipyards employ safeguards comparable to those used by the Government in awarding prime contracts?"

EAST YARD

The contractor's policies provide for some of the safeguards used by the Government. We noted some exceptions—Litton did not obtain cost and pricing data for certain subcontract awards that were required by the Truth-in-Negotiations Act (see p. 1372) and did not hold discussions with all responsible offerors before awarding negotiated subcontracts (see p. 1370).

We also found that price histories of prior buys and price estimates for current purchases generally were not available to assist in determining the reasonableness of subcontract prices. Also in one instance we found that proper consideration had not been given to splitting a procurement to obtain lower subcontract prices.

Price histories and estimates not available

The purchase order files we examined, which covered larger buys, generally did not contain price estimates for the current buy or price histories of prior buys to assist in determining the reasonableness of subcontract prices. Department of Defense regulations provide that the contracting officer, before soliciting quotations, develop, where feasible, an estimate of the proper price level or the value of the product or service to be purchased based on prior purchases and other data.

We found that files for 122 of the 181 subcontracts for procurements of $2,500 or more showed no indications that price estimates had been prepared. In only a few cases did not find evidence that current quotes had been compared with prices paid in prior procurements. Although it does not necessarily follow that the subcontract prices were unreasonable, the contractor had foregone the opportunity offered by those safeguards for determining whether it was paying fair prices.

East Yard procurement officials informed us that they recently had instituted a new requirement for the preparation of price estimates and a system for recording pricing data relating to prior procurements.

Opportunity to obtain lower prices by splitting awards

Government regulations and Litton's procurement manual required that, if appropriate, individual prices be evaluated to determine whether awards to more than one offeror would be advantageous.

In our examination of 32 subcontracts in excess of $100,000, we found that one subcontract could have been split between two suppliers and that as a result lower prices could have been obtained. An award for $343,217 was made to a subcontractor for various ball valves even though a lower price for some of the valves had been proposed by another responsive, qualified firm. Two firms proposed individual prices for 34 line items of ball valves. The solicitation was not on an all-or-none basis. One firm proposed prices that were lower for each of 16 items but higher for each of the remaining items. If two contracts had been awarded, for 16 items to one firm and for 18 to the other, the cost of 34 items would have been approximately $21,000 less than the amount of the single award. An East Yard procurement official agreed that this order could have been split to obtain more favorable prices.

WEST YARD

The procurement policies of the West Yard and the assisting organizations provided for many of the safeguards used by the Government. These included making preaward surveys to determine subcontractors' capabilities, soliciting competitive bids, obtaining cost or pricing data in the circumstances prescribed by the Truth-in-Negotiatons Act, and performing price-cost analyses to evaluate the reasonableness of subcontract prices offered. We noted no deviations from these policies.

"Do shipyards seek to establish maximum practicable competition in subcontract procurements?"

EAST YARD

For a few subcontracts, representing the major portion of the amounts of the subcontracts we reviewed, the East Yard made awards on competitive bases. The East Yard, however, did not make maximum efforts to obtain lower prices for a large number of subcontracts. In addition, we found no evidence that Litton had held negotiation discussions on 200 of the 244 awards we examined. We did find a questionable justification for several awards made to one subcontractor which had not been the low offeror.

Conduct of negotiation discussions

The shipyard apparently did not hold negotiation discussions for most of the subcontract awards we reviewed. As a result the lowest available subcontract prices may not have been obtained. The Truth-in-Negotiations Act provides that Government procurement officers hold such discussions in the absence of clear

demonstrations that fair and reasonable prices can be obtained without holding such discussions. Discussions are not required when all offerors are notified that the awards might be made without such discussions.

Our review of 224 subcontracts showed that the files for 200 of the procurements contained neither evidence of negotiation discussions with offerers nor evidence of offerors' having been notified in the requests for proposals that the awards might be made without such discussions. Litton officials stated that their procurement files not always were documentert to show evidence of negotiations. We noted that negotiation discussions in connection with 24 awards had resulted in reductions in initial proposed prices from $8.8 million to $8 million. It therefore appears that, through added emphasis on the use of this negotiation technique, the contractor might have realized further price reductions.

It is of interest to note that the Advanced Marine Technology Division, a major procuring activity for the LHA ship construction program, follows an extensive practice of conducting negotiation discussions with offerors. We reviewed subcontracts, totaling about $117 million, awarded for the LHA program and found that such negotiations had reduced initial proposed prices by about $16.9 million.

Awards to other than low offerors

In several cases where the contractor awarded subcontracts to other than the low offerors, the contractor's justifications appeared to be reasonable. These included instances where the low offerors were considered to be nonresponsive, were not qualified, or were unable to meet delivery requirements.

One subcontractor, however, who was not the low offeror, received seven awards on the basis of proposed earlier deliveries where such deliveries were not essential. These awards totaled $57,539. Had these awards been made to the low offerors, the contractor could have realized savings of $29,913—the difference between the low proposals and the successful offeror's prices.

WEST YARD

We found that competition had been sought for the West Yard's purchases. The contractor solicited two or more sources of supply for 150 of the 194 subcontracts we selected for examination. Of the 150 subcontract awards, 99 were for amounts over $100,000. In all but a few instances, Litton solicited from three to 18 sources.

For the other 44 purhases, amounting to $2.3 million, Litton appeared to have had sufficient justification for soliciting only one source. In the award of one contract to Sperry Rand Corporation in the amount of $1.6 million, Litton had concluded, on the basis of its procurement records, that Sperry Rand was the only qualified source capable of providing certain navigation equipment in the required time frame. Most of the remaining $0.7 million had been awarded without attempting to obtain competition because Litton believed either that only one source could meet delivery schedule requirements or that it was impracticable to change suppliers when awarding follow-on subcontracts.

"Is there evidence of undue subcontracting by shipbuilders to other subsidiaries of their parent firms?"

EAST YARD

We found no evidence of undue subcontracting by the East Yard to its affiliated companies. In our sample of 295 subcontracts selected from 5,534 subcontracts awarded under two contracts we reviewed (see p. 3), we found that only one award had been made to an affiliate. In addition, the contractor furnished us with a listing of all subcontracts awarded to subsidiaries of Litton, which showed 25 awards, including the one we had found in our test, totaling about $123,800 under the two Navy contracts.

WEST YARD

In relation to the current value ($2.8 billion) of the two Navy contracts, we found no undue subcontracting by Litton with its subsidiaries or affiliates.

There were 12 subcontracts, amounting to about $14 million, which had been awarded to subsidiaries or affiliates. All but $26,000 worth had been awarded on the basis of price competition.

"What percentage of subcontract procurements are sole-source?"

EAST YARD

The contractor had no classification of subcontract procurements to show the extent of awards on a sole-source basis. In our review of the 295 subcontracts, amounting to $25 million, we found that only one responsive bid had been received in each of 204 procurements, or 69 percent of the subcontracts. The 204 procurements amounted to $7.3 million, as shown below.

	Quantity	Amount (millions)
SSN-637 class of submarine	105	$6.8
SSN-612 submarine overhaul	99	.5
Total	204	7.3

Of the procurements amounting to $6.8 million, procurements amounting to $4.3 million had been based on a pooling arrangement with the Electric Boat Division of General Dynamics Corporation to obtain lower prices on selected items. Electric Boat is the lead yard for the SSN–637 class of submarines.

With respect to the overhaul contract, the contractor stated that the reasons for single, responsive bids had been the restricted number of qualified sources capable of meeting the requirements of the submarine overhaul program and that the replacements of many system components had been required to be procured from the original source.

WEST YARD

Under its two prime contracts for the LHA's and DD–963's, Litton awarded 222 subcontracts amounting to $372 million. We examined 194 subcontracts awarded for $366 million and found that 62 had been awarded on sole-source bases. The sole-source awards totaled $64.9 million, or about 17.5 percent of the value of all subcontracts awarded. A tabulation of the sole-source awards follows.

	Number of awards	Amount (millions)
Multiple solicitations but only 1 responsive bid	18	$62.6
1 source solicited	44	2.3
Total	62	64.9

"Are the shipyards in full compliance with the Truth-in-Negotiations Act?"

EAST YARD

For the two contracts that we reviewed, we examined all subcontracts in excess of $100,000 and found that the East Yard had complied with the requirements of the Truth-in-Negotiations Act, except for 20 procurement actions which had been based on prices arranged with Electric Boat.

Litton explained that it had relied on Electric Boat to obtain the required pricing certificates and cost or pricing data from the subcontractors. Therefore we made a review of the 20 procurements at Electric Boat and found that 12 had been subject to the act. In four instances the required data and pricing certificates were obtained. In four other procurements, data and/or pricing certificates had not been obtained. In the remaining four instances, Electric Boat had requested but had been refused the cost or pricing data.

Electric Boat officials stated that the requirements of the Truth-in-Negotiations Act had not been completely understood by some of its buyers and vendors at the time the awards we examined into had been made. They said, however, that contractor procurement system reviews performed by the Navy at Electric Boat in October 1969 and December 1970 had led to a better understanding of the act. They stated also that the shipyard's current subcontract awards compiled with the cost or pricing data requirements of the act. On a limited basis we examined

current awards and found that in each instance the required pricing certificate and cost data had been obtained.

East Yard procurement officials stated that for future procurements they would obtain cost and pricing data and pricing certificates without relying upon the other shipyard to do so.

We also reviewed tabulations by subcontractors of 1969 and 1970 procurements, to determine whether the East Yard had attempted to avoid the cost or pricing data requirements of the act by splitting awards into amounts below $100,000. We found no evidence of such splitting.

WEST YARD

We believe that Litton awarded subcontracts in compliance with the cost or pricing data requirements of the Truth-in-Negotiations Act. Of 194 subcontracts we selected for examination, 11 subcontracts, amounting to about $63 million, were subject to the cost or pricing data requirements of the act. We reviewed each of these subcontracts and found that Litton had obtained the required certificate and cost or pricing data in each case.

We reviewed also selected subcontracts to determine whether contractor had attempted to avoid the cost or pricing data requirements of the act by splitting into amounts below $100,000. We found no evidence of such splitting.

CHAPTER 3—COST CONTROLS

"Are shipyards' budgeting and cost control systems adequate to ensure proper control of labor and material cost on Navy ships?"

EAST YARD

We could not evaluate the effectiveness of the contractor's budgeting and cost control systems because the contracts we reviewed at the East Yard did not require the contractor to furnish, or to make available, budget information to the Government. For that reason we did not have the information necessary to evaluate the effectiveness of the system. We did note, however, that the contractor's system did not provide for segregating actual cost of change orders to permit comparison with budgets in order to evaluate change-order pricing and performance. The Navy and the contractor contended that it was not practicable to segregate costs of changes and that to do so would be very costly.

WEST YARD

Unlike the contracts at the East Yard, the contracts at the West Yard required the reporting of budgetary data to the Navy. We could not evaluate the adequacy of the contractor's budgeting and cost control system, however, because it had not been fully developed and implemented. The LHA ships were in the early stages of production, and Litton officials told us that detailed budgetary data were not yet available. Construction of the DD–963 ships had not started. We noted that the contractor's system did not provide for segregating actual costs of change orders to permit comparison with budgets in order to evaluate change-order prices and performance. The contractor and the Navy contend that it would be impracticable to segregate costs of changes and that to do so would be extremely costly.

System description

The description which follows relates to the system to be used by the West Yard to control production costs on LHA ships.

After the contractor submitted a price proposal for a Navy ship construction contract, the Navy and the contractor negotiated target cost, target profit, target price, and ceiling price. The target cost of the contract was the basis upon which budgets were to be prepared.

The contract provided for the quarterly reporting of development and production costs in terms of budgeted costs, actual costs, and the value of the physical progress. The development costs consisted of costs for such major groups as design and engineering, peculiar support equipment, common support equipment, training, and data. Production costs will be broken down into nine major groups (systems), such as hull structure, propulsion, and electric plant. The hull

structure will be broken down into 33 smaller groups, such as superstructure, main deck, and inner bottom. There will be 175 smaller groups within the nine major groups. At the time of our review, the Navy and the contractor had not decided on the extent of reporting for the smaller groups.

Litton plans to budget material and labor costs by systems. Labor costs also will be budgeted by function for the contractor's internal purposes. There will be about 15 functions or tasks, such as design, procurement, and manufacture.

The work to be performed by the functional organizations will be stated in a management work package. This package will contain a time-phased budget and a schedule of performance and will identify the manager responsible for accomplishing the task. The package will contain also data for converting from the functional basis to the systems basis. As yet management work packages have not been put into use. In addition, hardware work packages will be developed for use at the shop level.

In negotiating change-order prices, a minimum or maximum provisional price, rather than a fixed price, was agreed to between the Navy and the contractor before change-order work was authorized. Final prices were to be adjudicated at a later date. Navy officials stated that most of the change orders issued had been design changes. The provisional price system was employed so that change-order work could be authorized promptly to prevent the accumulation of unnecessary costs.

GAO evaluation

We were unable to evaluate the East Yard's budgeting and cost control systems, because the contractor would not make budget data available to us and because the contracts we reviewed did not require Litton to furnish such information to the Government.

At the West Yard we were unable to determine the adequacy of its budgeting and cost control system because it had not been fully developed at the time of our review.

The cost control systems for both yards do not identify separately the actual costs of change orders. Navy and contractor representatives told us that it would be impracticable and very costly to segregate change-order costs. They also stated that generally a price was agreed to before change-order work was started. We believe that, where firm prices are not established before significant changes in work are started, the segregation of change-order costs, where feasible, is needed to provide a sound basis for negotiating change-order prices.

"Are there adequate contractor and government controls over labor and material charging practices?"

EAST YARD

The contractor has established procedures for controlling material charges to specific systems and for controlling labor charges to work packages of a ship. Government control is exercised through review and analysis by the Defense Contract Audit Agency (DCAA) of the contractor's cost-charging practices.

On the basis of our test of the contractor's system for charging costs and our review of the Government's surveillance over the charging procedures, we believe that the controls over the charging of labor and material are adequate.

Up to March 31, 1971, $81,694,207 had been charged to two Navy contracts whose prices totaled about $120 million, as shown in the following schedule.

	3 SSN–637 class submarines	1 SSN–612 submarine overhaul	Total
Material	$37,879,693	$2,196,467	$40,076,160
Labor	15,201,656	6,907,849	22,109,505
Overhead	14,691,139	4,817,403	19,508,542
Total	67,772,488	13,921,719	81,694,207

Material-charging practices

The contractor's policy on material-charging practices provided that material which could be identified to a particular ship was to be charged direct. Material consumed in routine shop and plant operations or material used for repairs and maintenance of buildings and equipment was to be charged to overhead expense accounts.

Direct purchases

Purchase orders were identified by ship and by system. A purchase order number was placed on correspondence, invoices, and packages related to the purchase. The cost of the purchase was charged to the appropriate ship and system.

Stores issues

The contractor, in addition to purchasing material specifically for a ship, issued material from stores to the various departments on the basis of a stock control stores requisition signed by an authorized person. Stores issues included common-type items, such as rivets and pipe. The costs of stores issues were charged to the appropriate ship and system.

DCAA reviews

We reviewed the recent DCAA reports of the contractor's material control procedures and practices. DCAA found no mischarging of costs between contracts.

GAO evaluation

We selected for examination 41 direct purchases and 71 stores issued recorded during 1 month, to determine whether material costs had been charged properly. We traced material transactions from the source documents, through the intermediate accounting records, to the general ledger work-in-process account. Also we physically verified the existence of individual purchases costing more than $1,000. Our verification of material charges and our physical verification of material revealed no mischarges.

Labor-charging practices

Labor hours were accumulated for each ship by cost center, operation, system, and work package. The contractor's control of cost charging for labor was placed primarily with the workers' supervisors.

Time cards

Hourly employees received prepunched time cards at gate racks as they entered the yard. Information such as the employee's name, badge number, and rate of pay was preprinted on the card. The employees reported to their assigned work areas and punched in at nearby clock stations. The supervisors entered the hours worked on the cards by hull, cost center, operation, system, and work package.

Time cards for salaried employees were issued and prepared on a weekly basis. Salaried employees followed the same procedure in recording their time as did the hourly employees.

Payroll department timekeepers audited time cards for proper signatures and for valid hull, system, and work-package numbers.

DCAA reviews

We reviewed the audit reports and supporting workpapers covering three DCAA audits of the contractor's labor-charging practices and procedures. The reports showed only minor mischarging of labor costs between contracts.

GAO evaluation

To determine whether labor costs had been charged properly, we traced 113 direct labor transactions recorded during 1 week from the time cards, through the intermediate accounting records, to the general ledger work-in-process account. Our verification revealed no mischarges between contracts.

On the basis of our review and the work performed by DCAA, we concluded that the contractor's accounting practices were adequate to accurately record labor costs.

WEST YARD

For our review of contractor and Government controls over labor- and material-charging practices we made a random selection of 83 material transactions and 98 labor transactions at the West Yard; 19 other direct costs and 59 labor transactions at the Advanced Marine Technology Division; and 21 material transactions and 53 labor transactions at the Data Systems Division. In our review we traced each of the above transactions from the source document, through the intermediate accounting records, to the general ledger accounts. We found that these charges had been made to the proper contracts.

Marine technology costs

DCAA found that, during the period 1969 through 1971, Navy contracts for the LHAs and DD–963's were charged about $7 million for overhead expenses applicable to Litton's commercial work.

DCAA's reports indicated that this had resulted from (1) Litton's including in material cost, for the purpose of allocating material overhead of the West Yard between its Government work and its commercial work, the costs incurred on the two contracts by Marine Technology in California, none of which were for material but rather were for direct labor, overhead, other direct costs, and general and administrative expenses and (2) Litton's charging Marine Technology (where work was almost wholly on Government contracts) with general and administrative costs incurred at that facility which were applicable, in part, to the West Yard. In addition, general and administrative expenses incurred at the West Yard (engaged primarily in commercial work) were allocated on the basis of the costs incurred at the two locations. This resulted in inequitable charges between Litton's Government work and its commercial work. According to DCAA the activities at Pascagoula and California were so integrated that the treatment of the two organizations as separate entities with separate general and administrative pools was unrealistic.

Although we did not review Litton's overhead-charging practices in detail, our selective examination indicated that they were resulting in the Navy contracts' bearing some of the overhead expenses applicable to the West Yard's commercial work.

Litton takes the position that there are no inequities in the direct- and indirect-costing practices. The treatment of labor, material, and overhead costs of an assisting division as material costs at the prime division has been in effect at the East Yard since before the construction of the West Yard. The contractor is considering changing its allocation method beginning with fiscal year 1972. The contractor believes that an adjustment should not be made for prior year's costs.

GAO evaluation

Our limited review confirmed the DCAA finding that the contractor's method of charging costs incurred by Marine Technology had resulted in Navy contracts' bearing certain overhead costs applicable to commercial work. The Navy currently has this matter under consideration.

CHAPTER 4—NAVY'S SURVEILLANCE OVER THE SHIPYARDS' PROCUREMENT AND COST CONTROL PRACTICES

Two questions were raised concerning Navy surveillance of shipyard operations.

"Does the Navy maintain effective surveillance over shipbuilders' procurement, cost control, and cost charging practices?"

"Is closer Navy surveillance of shipyard operations needed?"

The Navy's Supervisor of Shipbuilding, Conversion, and Repair (SUPSHIP) at Pascagoula is the organization responsible for administering the contracts at the East and West Yards. In this capacity it exercises surveillance over the contractor's operations to ensure conformance with contractual requirements. To carry out this surveillance, SUPSHIP, as of November 1971, had a staff of 275 civilians and 19 military personnel. This staff was involved in surveillance of such contractor operations as quality assurance, planning, control of material procurement, and cost control.

EAST YARD

The Navy had reviewed the East Yard's purchasing system in accordance with an Armed Services Procurement Regulation requirement. Approval of the contractor's purchasing system was withdrawn following a procurement review in August 1969 when the Navy determined that the purchasing manual did not fully implement the requirements of the Truth-in-Negotiations Act; the bidders' lists were incomplete; criteria for conducting negotiation discussions were needed; procedures and capabiliy for making cost analyses did not exist; and adequate documentation to enable reconstruction of purchase transactions was not present.

In a later review, in September 1970, the Navy found that most of the deficiencies previously disclosed had not been corrected.

Litton was required by the contract for construction of the SSN–637 class of submarines to submit proposed subcontracts which exceed $100,000 to the con-

tracting officer for consent. There were 69 such subcontracts. We reviewed the 69 subcontracts and found that 11 had not been submitted to the Navy. The contracting officer stated that these subcontracts were issued before the establishment of controls to ensure that the contractor submitted the subcontracts for Navy consent. The Navy did not consent to 31 subcontracts until 3 to 207 days after they were awarded.

SUPSHIP surveillance was augmented by DCAA at Pascagoula. In November 1971 nine of DCAA's auditors were assigned to the East Yard. During fiscal year 1971 DCAA performed audits in such areas as financial control, material, labor, and overhead. Reports on its findings, along with the contractor's comments, were sent to SUPSHIP. SUPSHIP and DCAA periodically discussed with the contractor the extent and propriety of corrective action taken.

WEST YARD

In addition to having its staff at Pascagoula, SUPSHIP had a branch office at Culver City, California, with a staff of 10 civilians and seven military personnel. This staff had surveillance responsibility over Marine Technology's operations.

The surveillance responsibility at the Data Systems Division was delegated by SUPSHIP to the Defense Contract Administration Services Office, Woodland Hills, California.

Contractor procurement system reviews were made at the two California organizations but not at the West Yard. Marine Technology's procurement system was approved informally after a review by the Navy in August 1970. The Defense Contract Administration Services Office, after its reviews, approved the procurement system of the Data Systems Division for a period of 1 year, which started in January 1971. Notwithstanding the system approvals, the contracts require prior written consent by the contracting officers of individual procurements in excess of $100,000 for the LHAs and the DD–963's. We reviewed 146 subcontracts in excess of $100,000 and found that the contractor had failed to submit 14 procurements for consent before the awards. The contracting officers' consent to these procurements was not obtained until 10 to 168 days after they were awarded.

SUPSHIP surveillance at the West Yard and at the two organizations in California was augmented by DCAA. During the fiscal year ended June 30, 1971, DCAA performed audits of financial reporting, financial management, costs, overhead, general and administrative expenses, and other matters.

To improve its surveillance over shipyards, SUPSHIP was establishing a business review staff consisting of a supervisory business analyst, an industrial engineer, and a financial analyst. The staff was to be responsible for maintaining surveillance over all aspects of the contractor's business practices, including management objectives and policies, work operations and progress, resources utilization, and cost control and reporting systems.

GAO evaluation

Surveillance over the cost-charging practices at Litton has been adequate. Closer surveillance of the contractor's subcontracting practices, however, appears necessary. As discussed on pages 3 through 10, the East Yard did not always follow effective procurement procedures to ensure that the most favorable prices were obtained in some subcontract procurements and there were considerable delays at both yards in approving subcontracts as required by the Navy's contracts.

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., March 15, 1972.

B–133170.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
Congress of the United States.

DEAR MR. CHAIRMAN: Pursuant to our letter to you of June 16, 1971, and in continuation of our evaluation of the disposition of shipbuilders' claims for price increases on contracts awarded by the Department of the Navy, we have examined into the circumstances surrounding the initiation, evaluation, and settlement of five consolidated claims made by the Lockheed Shipbuilding and Construction Company. The claims amounted to $40.9 million as of August 22, 1969, and this amount was evaluated by Navy technical personnel. Subsequent to August 22, 1969, Lockheed informally revised the claims, which increased the total

to $46.3 million. In May 1970 the Navy negotiated a settlement in the amount of $17.9 million.

The enclosure to this letter contains information on five Lockheed contracts, including the types of vessels involved, contract prices, delivery dates, and claim settlement amounts. The contracts were awarded on a fixed-price basis in the total amount of $83.5 million. The final amount paid, however, including additional amounts for escalation clauses, change orders, and claim settlements, was about $121 million.

LOCKHEED'S DEVELOPMENT OF CONSOLIDATED CLAIMS

A company official advised us that Lockheed, upon realizing that it was getting into a serious loss position on its Navy contracts, decided in 1966 to develop claims and to submit them to the Navy for the recovery of additional costs. Lockheed believed that the losses had been caused by actions for which the Government was at fault. During 1967 Lockheed established a team to develop claims for reimbursement of costs above those normally resulting from formal change orders or other written directions from the Navy.

The claims were based on a number of underlying causes, such as late and defective Government-furnished material, defective or impossible Government specifications, late and defective lead-yard plans (working plans and other design data prepared by the contractor that had constructed the first ship of a new design class), increased inspection requirements, work in excess of specification requirements, delays and disruptions caused by change orders, and various constructive changes (directions by the Government for changed or additional work not covered by formal change orders).

The contracts required Lockheed to accumulate and maintain data on a total-cost basis. Also Lockheed's cost accounting system did not provide for linking additional actual costs incurred to individual events or changes. Amounts claimed by Lockheed were established by estimating the amounts of additional labor and overhead which might have been expended because of Government actions plus the actual or estimated cost of additional materials used.

The Navy established a special task force for evaluating the claims and negotiating an equitable settlement with Lockheed. The task force consisted of a contracting officer in charge, a negotiator, a counsel, an engineer, an auditor, and a separate three-member technical evaluation team for each of the claims. Each three-member technical evaluation team consisted of an engineer, a counsel, and a technical analyst. The task force was able to get assistance as needed.

The Navy's task force spent approximately 1 year in evaluating Lockheed's claims. The task force auditor was provided by the Defense Contract Audit Agency and was responsible for determining the financial accuracy of the claims. The audits included such tests as verifying to the accounting records the labor and overhead rates and the material prices used by Lockheed to establish the amounts claimed. The audits showed that a significant part of Lockheed's claims included erroneous cost data and lacked adequate supporting documentation. The advisory audit reports recommended disallowance of about $8.9 million of Lockheed's claims, including $2.2 million of additional labor costs which exceeded actual recorded labor costs.

The technical evaluation teams were responsible for determining the reasonableness of the labor-hours and material items claimed. We found that generally they had evaluated each claimed item by (1) reviewing pertinent Navy and Lockheed records, such as letters and memorandums, to determine whether the event actually had happened as claimed, (2) reviewing Lockheed's claim-support records, such as cost-estimate schedules and ship-compartment diagrams, and (3) using their own experience and professional judgment to make an estimate of the number of labor-hours and the amount of material that they considered reasonable. The following two examples illustrate the reviews made by technical teams.

1. Lockheed claimed 243,334 additional production man-hours attributable to late delivery of Government-furnished boilers for the construction of two destroyer escorts. Lockheed contended that delivery of the boilers for one of the ships had been delayed 14 months, or 424 days, and for the other ship had been delayed 7½ months, or 226 days.

To arrive at these figures, Lockheed evaluated the effects of the late deliveries on its ship construction plan by (1) developing from its records the total actual expended man-hours by month for each ship and (2) having a team of Lockheed

employees who had been directly involved in the work on the two ships estimate the amount of additional production man-hours attributable to the late delivery of the Government-furnished boilers. In a technical advisory report, the Navy stated that it (1) had divided man-hours claimed by Lockheed between the two ships by using a ratio developed from Lockheed's claim of the number of days' delay on each ship, (2) had investigated the ship compartments whose construction Lockheed claimed had been disrupted by the late delivery of the boilers, and (3) had compared the actual boiler-installation dates with the scheduled boiler-installation dates for each ship.

The Navy found that the installation of boilers in one ship had been delayed 48 working days and that the installation of boilers in the second ship had not been delayed. In evaluating the hours claimed by Lockheed for the ship for which delivery of the boiler had been delayed, the Navy found that Lockheed's claim was based on the use of 65 men each day. By applying the 65-man figure to the 48 working days' delay on the ship, the Navy determined that 24,960 man-hours of delay had been caused by the late delivery of Government-furnished boilers compared with 157,167 man-days determined by the Navy to be the part of Lockheed's claim applicable to the late delivery. The Navy evaluator recommended disallowance of the excessive man-hours claimed, including all the 86,167 man-hours of labor determined by the Navy to be the hours claimed by Lockheed as applying to the second ship, for which the installation of boilers had not been delayed.

2. Lockheed claimed that 8,796 additional production manhours were attributable to work not required by contract specifications to correct an overweight condition of the hydrofoil. Lockheed contended that the contract provided that the shipbuilder fabricate the hull and structure in accordance with certain specifications furnished by the Government and that, because of a defect in the Government specifications which caused the ship to be overweight, Lockheed had had to conduct a comprehensive, far-reaching research and engineering development effort to reduce the weight of the ship. Lockheed calculated the additional production manhours required to correct this defect by (1) estimating the production man-hours expended to fabricate the hull and structure and (2) subtracting from this number the production man-hours estimated to have been originally bid for the hull and structure fabrication. In the technical advisory report, the Navy evaluators accepted Lockheed's contentions and concluded that, due to the extra effort involved, the 8,796 additional production man-hours claimed by Lockheed were reasonable.

CONCLUSIONS

Lockheed's cost accounting system and other records did not relate its additional costs to Government actions; therefore the extent to which the Government was responsible for these costs was difficult to establish. In the absence of such accounting records, Lockheed based its claims largely on engineering estimates.

Because of the significant number of engineering and technical judgments that entered into the settlement and because of the lack of available documentation against which to verify the extent of the Government's responsibility, we are not in a position to express an opinion on the reasonableness of the settlement. We believe, however, that, under the circumstances, the Navy made a commendable effort to effect a reasonable settlement, and we did not find any basis for questioning the reasonableness of the settlement made.

We believe also that the Navy should require contractors to maintain records in support of claims. We have discussed the issue of adequate recordkeeping with the Navy. Navy officials advised us that they were exploring with an industry group problems that might be anticipated in requiring contractors to segregate direct costs for contract changes under the "Change Order Accounting" clause. The Navy also presented for the group's review a proposed "Estimating System Criteria Specification." In addition, the Navy stated that business reviews offices had been established at three supervisor-of-shipbuilding locations to study estimating and pricing techniques of major private shipbuilders constructing Navy ships.

In a report issued in February 1972 entitled "Causes of Shipbuilders' Claims for Price Increases" (B-133170), we reviewed other Navy actions designed to minimize the number and dollar value of shipbuilding claims and concluded that the Navy's actions held considerable promise for achieving their objectives. The

Navy's actions include programs to improve ship specifications, to minimize delays and defects in Government-furnished equipment and information, and to promote a common understanding of quality assurance requiremments.

We did not obtain agency or contractor comments on the matters included in this report.

We plan to make no further distribution of this report unless copies are specifically requested, and then we shall make distribution only after your agreement has been obtained or public announcement has been made by you concerning the contents of the report.

If we can further assist you in this matter, please let us know.

Sincerely yours,

ELMER B. STAATS,
Comptroller General of the United States.

Enclosure.

DESCRIPTION OF 5 LOCKHEED CONTRACTS

	NOb's 4516	NOb's 4619	NOb's 4645	NOb's 4680	NOb's 4758	Total
Type of contract	Fixed price	Fixed price	Fixed price	Fixed price	Fixed price	
Award date	January 1962	March 1963	March 1963	July 1963	March 1964	
Type of work	Construction	Modernization, renovation, and conversion.	Construction	Construction	Conversion and repair.	
Number of ships	3	2	2	1	2	10.
Type of ship	Guided missile destroyer escorts.	Fleet oilers	Destroyer escorts.	Hydrofoil	Ammunition	
Original delivery dates	February, June, and October 1965.	June and September 1964.	March and July 1966.	November 1965.	July 1965 and January 1966.	
Actual delivery dates	March 1966, May 1967, and May 1968.	December 1964 and February 1965.	March and October 1968.	March 1969	June 1966 and November 1968.	
Original contract price	$28,453,995	$14,949,563	$19,721,200	$11,795,000	$8,545,615	$83,465,373
Causes of price increases:						
Change orders	3,182,855	5,112,776	547,421	182,458	8,606,934	17,632,444
Escalation	1,585,400		403,693			1,989,093
Claim settlement	4,247,000	1,727,000	3,811,000	4,000,000 +	4,115,000	17,900,000
Final contract price	37,469,250	21,789,339	24,483,314	15,977,458	21,267,549	120,986,910
Consolidated claim:						
Original	9,590,353	6,413,343	9,359,031	4,649,851	6,066,752	36,079,330
Revised Aug. 22, 1969	10,464,258	6,238,187	10,231,615	6,782,536	7,214,661	40,931,257

Mr. STAATS. You can well imagine that from the statement which I made that work we have done has involved a tremendous amount of effort on our part. This is the kind of information that does not come easily and it has represented a considerable effort to provide it.

CHARGES CONCERNING CERTAIN ASPECTS OF LOCKHEED'S MANAGEMENT OF THE C–5 PROGRAM

DURHAM'S CHARGES

I would like to turn now to our investigation of the charges of Mr. Henry M. Durham before the subcommittee last September. Following that hearing, you wrote me on October 12, 1971, requesting that we

investigate the charges and verify the evidence presented to the subcommittee by Mr. Durham. You also requested that our report of the investigation not be circulated in draft form to the Defense Department, the contractor, or any other persons outside the General Accounting Office.

The assignment was made to our Atlanta regional office, and audit work began immediately. Due to the scope and complexity of the matters presented, and the requirement to perform work at two locations, the staff study was not available from the regional office until March 8.

DRAFT GAO REPORT REVIEW

Because of other pressing work, neither Mr. Keller nor I have had an opportunity to review the draft, nor has it had the normal review in the division, in the Office of General Counsel, nor the Office of Policy and Program Planning, which would be normal for any report coming from our Office.

We have thus not had sufficient time to complete a full review of the facts or conclusions in the staff study.

Furthermore, I find that while the staff study has been made available to Mr. Durham for review, a similar opportunity has not been afforded to the contractor or the Department of Defense. I have concluded that if we are to perform an adequate evaluation of the matters covered, the comments of these parties would be essential.

In the meantime, your staff requested that we furnish you such information as we have obtained in advance of today's hearings. Accordingly, on Friday, March 24, I authorized the Director of our Procurement and Systems Acquisition Division, Mr. Richard Gutmann, to my left here, to furnish you the unevaluated staff study as prepared by the Atlanta regional office. We will be pleased to have the Audit Manager who supervised this work discuss the study with the staff of the committee if that should serve any purpose.

OBTAINING VIEWS OF CONTRACTOR AND DOD

We believe the staff study by our Atlanta regional office provides an adequate basis for obtaining the views of the contractor and the Department of Defense and for any further hearings the committee may wish to have. We believe this would be a satisfactory way to proceed.

SUGGESTIONS FOR FUTURE ACTION

I suggest that attention also be given to the following:

First, evaluate the awareness of the contractor of the problems cited by Mr. Durham, and the timeliness and effectiveness of the actions taken, including the communication of such actions to Mr. Durham and others in the contractor's organization.

It appears from an initial review of the staff study that management attention was being given to the missing parts problem at the highest company levels while Mr. Durham's observations were being made during the summer and fall of 1969 in his capacity as general department manager in charge of production control activities in the flight line, flight test, and avionic areas. It is not clear what manage-

ment actions had taken place before, during, and after Mr. Durham's observations, and why they were not apparent or effective at Mr. Durham's level.

Second, ascertain how Lockheed's experience on the C–5 compares with its past experience and with that of other major aircraft companies, at similar points in the production of new aircraft systems. In the absence of such data, conclusions cannot be drawn as to whether the problems cited—about which there can be no doubt—were similar to, less than, or more than those experienced in other programs in the past.

Third, evaluate the awareness of and the actions taken by the Air Force in respect to these matters, and the extent to which contractual arrangements then in effect proved an obstacle to more adequate supervision by the Air Force.

Fourth, examine the progress payment practices in effect prior to the restructuring of the contract, to ascertain the extent to which they resulted in payments in advance of contract requirements and over what period of time.

We believe that the staff study, along with an exploration of the above matters by your committee with the contractor and the Department of Defense, would provide the committee a comprehensive basis for evaluating the matters on which Mr. Durham testified last September.

This completes our statement. We will be happy to answer any questions.

In addition to myself here this morning, Mr. Keller to my right, Deputy Comptroller General; Mr. Gutmann I have introduced; and Mr. James Hammond who is one of his associates.

Total Amount of Shipbuilding Claims

Chairman Proxmire. Thank you very much, Mr. Staats. I want to get very much into the Durham matter a little later. Before I do that, however, I think we have uncovered a real mare's nest in the shipbuilders' claims, some very serious questions that should be answered.

First, before asking you about the Lockheed claim settlement to which you referred, I want to mention the total amount of recent claims—those settled, those pending, and those about to be filed. Last year you provided me with a breakdown of claims by contractor and the amount. We asked you to update the data for these hearings. I wonder if you have any data to be submitted for the record?

Mr. Gutmann. Yes, sir; we have a listing of the outstanding claims, over $5 million as of February 28, 1972, which we can submit for the record.

Chairman Proxmire. What do those total now? What is the new total?

Mr. Gutmann. This total is $845.2 million.

(The following information was subsequently supplied for the record:)

Outstanding shipbuilding claims summary—claims over $5,000,000 as of Feb. 28, 1972

[In millions of dollars]

Avondale Shipyards, Inc.	142.2
Bethlehem Steel	53.6
Defoe Shipbuilding	5.4
Dillingham Shipyard	14.2
General Dynamics	204.6
Ingalls Shipbuilding	174.6
Lockheed Shipbuilding	139.6
Newport News Shipbuilding	111.0
Total	845.2
Cases over $5,000,000 (4)—Armed Services Board of Contract Appeals	69.5

Source: Letter, Headquarters Naval Material Command, Department of the Navy, dated Mar. 21, 1972, to General Accounting Office.

AMOUNT OF SETTLED CLAIMS

[Dollar amounts in millions]

	Program	Amount of claim	Amount of settlement
Todd Shipyards Corp	Destroyer escort (14 ships)	$114.3	$96.5
Lockheed Shipbuilding & Construction Co	Oiler (2 ships)	7.9	1.7
	Destroyer escort with guided missiles (3 ships)	11.5	4.2
	Destroyer escort (2 ships)	12.9	3.8
	Hydrofoil (1 ship)	6.4	4.0
	Ammunition ship (2 ships)	7.5	4.1
Subtotal		46.3	17.9
General Dynamics Corp., Electric Boat Division	Nuclear submarine (1 boat)	8.1	6.7
Tacoma Boatbuilding Co., Inc	Patrol gunboat (7 boats)	6.1	3.4
Total		174.8	124.5

Lockheed Claim Settlement

Chairman Proxmire. Lockheed, as you know, has a $159.2 million claim pending and, in addition, the Navy paid it $17.9 million for a claim settled in 1970. The latter is the one you discuss in your present testimony. Several aspects of that claim, Mr. Staats, are very disturbing.

In the first place, the Navy audits and your review showed a substantial part of Lockheed's claim contained erroneous data and lacked adequate supporting documentation. You go over this in your report and you point out that the Navy disallowed $8.9 million of the original claim. But it seems to me that the disparity between what Lockheed was claiming in additional man-hours and what the records showed was just too great to be considered a simple error. When a contractor claims that a ship was delayed 14 months and it turns out that the delay was only 48 days, about 1½ months, that suggests to me something more than a mistake. And when a contractor claims a delay of 7½ months and it turns out after an audit that there was no delay, no delay at all, then I am convinced it was something more than erroneous data involved.

How do you explain such large variances from the facts?

Mr. GUTMANN. Well, Senator, the Lockheed Co., I believe, probably would be in better position to explain these discrepancies, but certainly the data upon which they based their claim, as we have stated previously, are really not detailed enough to provide a basis for an intensive analysis.

By that I mean necessarily there have to be a lot of estimates made. When delays are incurred by the contractor during the course of construction of a vessel, they could be caused by any number of things—his own inefficiency, for example. They could also have been caused by actions of the Navy in the late delivery of equipment, in providing him with bad specifications and so forth.

Chairman PROXMIRE. Could that explain this enormous discrepancy, though? This isn't just a matter of a slight difference; after all, they claimed a delay of 7½ months; there was no delay at all.

Mr. GUTMANN. No, sir; that does not explain that and I am unable to explain it.

Chairman PROXMIRE. Do you think the contractor intentionally misrepresented the facts in his claim? Doesn't it make you suspicious to see such large disparities?

Mr. GUTMANN. Well, I would not think it is pertinent for me to try to speculate on the contractor's intentions.

REFERRAL TO ARMED SERVICES BOARD OF CONTRACT APPEALS

Chairman PROXMIRE. What I am getting at is this: When the Government learns that it cannot rely on the information submitted by a contractor in support of his claim, why shouldn't negotiations for an out-of-court settlement be terminated and the matter referred to the Armed Services Board of Contract Appeals. When you have this kind of discrepancy, it is not a matter of investigation or negotiations; it seems to me you have to find the facts and let the court determine it.

Mr. GUTMANN. I think, Mr. Chairman, that the basic problem with immediately turning these situations over to the Board of Contract Appeals is that it still boils down to a matter of judgment and negotiation. The facts are obscure largely because of deficiencies in the contractor's cost accounting system.

Chairman PROXMIRE. I can't see how you can ever have a settlement that isn't really questionable. If Lockheed can't relate its additional costs, its alleged additional costs, to specific governmental actions, I don't see how you can negotiate a settlement. The claimant has failed to establish the fundamental link of causality that would make the Government liable and for the Government to go ahead and settle anyway seems to me to be completely arbitrary and against the public interest.

As you say in your report, Mr. Staats, and I quote, GAO is "not in a position to express an opinion on the reasonableness of the settlement."

Don't the facts in this case throw a cloud over the settlement? Do you believe it was reasonable?

Mr. STAATS. As Mr. Gutmann has indicated, the basic difficulty here has been that there have not been adequate records kept in many cases at the time the incidents occurred, which would warrant anybody's drawing a conclusion, and this is what we think.

Chairman PROXMIRE. But a conclusion to the extent of making a payment?

Mr. STAATS. And I think the Board of Contract Appeals would be up against the same problem. If you don't have good documentation, then you are operating, as you say, on the basis or arbitrary judgments.

Chairman PROXMIRE. When in doubt, the taxpayer shells out.

Mr. STAATS. I think, to be sure, there are many cases where action by the Government is very difficult to trace in terms of its full costs, what is called in the industry as the "ripple effect," where you get delays in one operation, that may have an effect on other operations in other parts of the construction operation, which no accounting system, at least that we have been able to conceive of today, would fully reflect.

Chairman PROXMIRE. But doesn't the Board have to—the Board has to operate under legal limitations, legal justification; it is not a matter of a private behind-the-scenes negotiation. You have to prove, establish certain facts before this payment can be made. In this case you make the payment absent the establishment of the facts.

REQUIREMENT OF DETERMINATION BY CONTRACTING OFFICER

Mr. KELLER. Perhaps I can help a bit here, Mr. Chairman.

The contracting officer, under the provisions of the contract, is required to make a determination either to allow a claim or not allow it, or perhaps negotiate a settlement.

Now, he, the contracting officer, should have a basis, of course, to make a determination either to allow or disallow a payment. He can't just refuse to make a determination of any type and pass his responsibility along to the Board.

I am not saying what determination he should or should not make; I am saying he has to be in the act, and he has to make a determination.

RULE CLAIMS SURVEILLANCE GROUP

Chairman PROXMIRE. Let me raise another question: One of the strongest advocates, in my view, of the public interest, one of the most careful groups to protect payments which weren't proper, was Gordon Rule and his group. They won the respect of this Senator and many others in the Congress and outside.

Isn't it suspicious that the claims in question, which you describe in your report as five "consolidated" claims, were considered five separate claims for purposes of determining the amounts of the settlements, and that because each of the settlements was for less than $5 million, none of them had to be submitted for review to the claims surveillance group headed by Gordon Rule?

As you know, the Rule group had jurisdiction over all claims settled in excess of $5 million. Isn't it possible the claims were intentionally broken up into five pieces to keep them away from the Rule group and keep them from requiring that you have a full justification?

Mr. STAATS. I have heard that allegation. I am not in position to either corroborate or not corroborate the allegation. But I have read that in the press.

Chairman PROXMIRE. Well, so many of them are just under $5 million. You have one $4.2 millioin, $3.8 million, $4 million, $4.1 million. It seems to me to be rather suspicious.

SHIPBUILDING PRACTICES

On the shipbuilding practices of the major shipbuilders, you point out in your statement that the Government must assure itself that contractors are keeping costs down by: (1) Buying competitively, (2) maintaining appropriate accounting procedures, and (3) maintaining a budgeting system for the timely disclosure of cost overruns. In the GAO study, it seems to me, they are falling down on all three counts; isn't that correct?

Mr. STAATS. We felt that they were deficient and that improvements were needed in all three respects; and we have outlined in this series of reports which you have asked to be included in the record——

Chairman PROXMIRE. That is why I refer to this as to what seems to me to be a distressing mare's nest.

INADEQUACY OF BUDGETARY CONTROL SYSTEMS

But the most distressing disclosure in the reports on Newport News and Litton is the inadequacy of budgetary control systems. In the Newport News report, you state that the "budgeting system is ineffective in promptly pinpointing areas of the ship where overruns can develop and where greater cost control may be needed." You also conclude in that study that "the current budget and cost system of the contractor does not effectively insure proper control of costs on Navy ships."

What were the reactions when you brought this to the attention of the Navy and the contractor?

NAVY'S SPECIAL STUDY OF THE PROBLEM

Mr. GUTMANN. Well, both the Navy and shipbuilding contractors generally are much concerned with this matter of detailed cost controls, especially as they are necessary for subsequent settling of claims. The Navy has started a special study of this problem, obtaining——

Chairman PROXMIRE. Of course, these people have been building ships for a long, long time, since the Revolutionary War.

Mr. GUTMANN. Yes, sir.

Chairman PROXMIRE. I am concerned about this, too. Go ahead.

Mr. GUTMANN. The Navy project engages several different firms from private industry, public accounting firms, to look at the problem of establishing cost systems with sufficient detail to provide an adequate basis for settling subsequent claims when they arise. Contractors, too, are concerned with it, and Litton is, as we have stated, making efforts to improve their system.

Chairman PROXMIRE. My time is up. Let me just say it seems to me when you have a contract, payment under the contract is one thing, but when a claim is made above that contract, the burden of proof certainly ought to be on the claimant, and if they cannot establish, because they don't have the records, they don't have the basis for making the claim, then under no circumstances should any part of the claim be paid. The record which I think you gentlemen have revealed by your investigation is that unsubstantiated claims are being paid.

I will be back later. I will yield to Senator Percy.

Efficiency of Federal Agencies

Senator Percy. Mr. Staats, I didn't have an introductory statement at these hearings, but I would like to tell you of a question a businessman in a public forum asked me. He asked, "Name just one single Federal agency that is an efficient, effective agency that is worth its budget," and I said to the fellow who asked it, "I think I can answer that without dispute, 'Internal Revenue Service.' "

Chairman Proxmire. How about the General Accounting Office?

Senator Percy. I don't dispute it. If he had asked for two I would have added "General Accounting Office" as the agency which has over the years proved its integrity in the courageous and fearless way in which it wades into disputes. I do want you to know that both the chairman and the minority very much appreciate the extraordinary effort that was put into this request. Our staffs and the Senators on the committee will make full use of it not only in the particular instances pointed out but also in a generalized way to see whether or not enabling and improved legislation is not required to prevent some of the abuses that you have pointed out.

So we are just really beginning then the process of digesting this voluminous material which you have put together for us. I have not adequately inspected the staff study and the testimony of Mr. Durham with respect to the practices of Lockheed-Georgia company.

I would like to ask one basic question on that, though.

Lockheed-Georgia Concurrency Problem

Prior to the exhaustive study of it, you mentioned on the first page in that report that there was a concurrent development and production program for the C–5A.

Could you comment on the nature of the crisis that was involved and the need for the delivery of that aircraft that required what I consider to be a very dangerous, risky program where you are producing at the same time you are developing? Anyone would know that is the most costly and wasteful way to conduct a contract. Were there extenuating circumstances, in your judgment, that warranted such a type of crash program—a program which we would know ahead of time was very difficult to control in cost and delivery schedules? Many times, in my own experiences, generally, you waste time trying to combine development and production.

World War II was the only time I ever knew we had the justification for doing it. And many times when we did it then it set us back rather than moved us ahead when we hadn't completed a developmental program before we went into production.

Mr. Staats. I will respond to your question, Senator Percy, and if my colleagues here would like to add to what I say, they are welcome to do that.

SINGLE-PACKAGE PROCUREMENT

The C–5 contract was let at a time when the Department of Defense was attempting to negotiate contracts on what they called a single package basis, single package procurements they were called. The theory behind the concept was that they hold the contractor completely responsible from a statement of speculations of performance to an end product at the end of the assembly line. The F–14 with Grumman

was substantially the same kind of package Grumman entered into at about the same time.

This, on the basis of experience, turned out to have been a highly erroneous concept, and we think—and I think most people agree, a great mistake.

There was too much of a concept that you could turn over a set of speculations to a contractor and then walk away from it and then hold him accountable.

On the side of the contractor, I think, it should be stated on their behalf that they felt that their prior experience in aircraft production and development would see them through the development of what now turns out to have been a more radical change in the technology than may have appeared at the time the contract was let; but I don't know of anyone in our office or in the Pentagon today who would urge that we go back to that system of contracting. The Defense Department's policy under Deputy Secretary Packard and Secretary Laird has been changed and, we think, for the better.

Mr. GUTMANN. That appears to me to be a very complete statement of the situation, bringing it right up to date. I am not—I wouldn't attempt to defend the military departments for their actions in the past, but it is fair to state that they have recognized that the concurrent development and production that they practiced extensively in the past has been changed, at least the policy has been stated that in the future there will be more of the fly-before-you-buy approach so everyone is satisfied they have a viable product before moving into extensive production.

FITZHUGH REPORT RECOMMENDATIONS

Chairman PROXMIRE. Would the Senator yield at this point for just a quick observation?

That is the recommendation of the Fitzhugh report, all of the reports, that you should fly before you buy and get out the bugs in research completely before you go into production; but the Defense Department is not doing it. They are not doing it. They are not doing it with the ABM or any number of other weapon systems. They should be doing it. I am not complaining about you but I think your observation is wrong. There is no evidence they have gone ahead this way. They have converted this into a cost plus which is not much of an improvement, but there is no evidence that they have insisted that they are going to complete the research and the prototype development, and then determine what they have before they go into production. They should but they are not doing it.

Mr. GUTMANN. You are quite right, sir. In some programs that were in rather advanced stages before the policy was enunciated and they have gone ahead.

On the other hand, there are some cases where they have decided to parallel prototype, in the case of the A–X aircraft and the MK–48 torpedo, for example.

Chairman PROXMIRE. Just one more interruption and I apologize to Senator Percy; this shouldn't be on his time.

Senator PERCY. No apology as long as it comes out of your time.

PROXMIRE AMENDMENT REGARDING "FLY BEFORE YOU BUY"

Chairman PROXMIRE. I put in an amendment on the floor of the Senate that anytime they departed from "fly before you buy" they notify the Congress. They resisted this and I lost on the floor because they were able to carry a sufficient majority of the Senators of that view. But if this were their intention, why shouldn't they let us know in advance? I don't think they really have any intention of departing from these inefficient practices that they follow. I wish they did.

Mr. GUTMANN. We agree with that 100 percent and, in fact, in some earlier reports the Comptroller General specifically recommended to the Congress that it consider requiring the Secretary of Defense to justify concurrent development and production in every case that he thinks it is necessary to proceed in that manner.

Chairman PROXMIRE. Thank you.

NECESSITY OF LOCKHEED'S CONCURRENT DEVELOPMENT AND PRODUCTION

Senator PERCY. One further question on why it was necessary for Lockheed to go into a program of concurrent development and production, which is so wasteful.

Have you concluded that it was the result of the delivery schedule they accepted or had to accept in order to get the contract?

Mr. STAATS. To the best of my knowledge, that was not the reason. To the best of my knowledge, the reason was that the concept that you could take and hold the contractor completely responsible for development, testing and production——

Senator PERCY. So it was the decision of the contractor, then, to do this, to undertake it in this way, concurrent development and production?

Mr. STAATS. He had to agree or there would have been no contract.

Senator PERCY. He had the reponsibility and he had the ability to do that.

Mr. STAATS. I am not able to answer that to what extent he did it under, you might say, duress or coercion or whether it was his idea perhaps, but in any event he had to agree to it or there would have been no contract.

LOCKHEED $250 MILLION LOAN

Senator PERCY. On a general question that may be beyond your province or scope of inquiry, but I think the chairman would be interested in also—we both concluded quite independently that the $250 million loan to Lockheed was not a good investment for the taxpayers. I was opposed to it and voted against it.

What agency of Government is now watching to see and is responsible for reporting to the Congress and to the American people as to what kind of condition Lockheed is in, whether the $250 million is adequate, whether it is going to see them through, and also whether or not there are other ways being deployed to help keep them going and bailing them out beyond the outright guarantee that we provided in the $250 million which is subject to public scrutiny?

Treasury Department's Lack of Cooperation

Mr. Staats. The Congress in enacting the Emergency Loan Guarantee Act included in it a provision requiring our office to audit the program. We are in the process of making such a review at the present time. We expect to be making our report in June, our first report. Our responsibility on this goes as long as there are any loans made or guaranteed under that act. We have had quite good cooperation from the contractor in terms of access to information. I regret to say we have not had similar cooperation from the Treasury Department, which has refused to give us any records pertaining to the Board's operation.

Senator Percy. And you consider these records necessary in order to fully implement the intent of the law?

Mr. Staats. Yes, we do.

Congressional Responsibility Under Emergency Loan Guarantee Act

Senator Percy. I would consider it our responsibility in Congress when you appraise us of this inability of the General Accounting Office to obtain such information, to use every force and power we can to see that you get that information. I think we should be kept currently appraised of the condition and situation so we are not faced with another crisis on the floor of the Senate and told the payments are not adequate——

Mr. Staats. Sir, I have notified the Banking and Currency Committees of both the House and the Senate of this situation.

Senator Percy. I can assure you I will take a deep interest in this as a past member of the Senate Banking Committee.

Mr. Staats. I would appreciate it.

Senator Percy. I will take a deep interest in seeing to it this is brought to the Secretary's attention then, and I am certain he would not want to stand in the way of your fulfilling an obligation imposed upon your office by the Congress.

GAO June report under the act

Mr. Staats. We will make a report irrespective of whether we do or do not have access to the Treasury reports in June, but all I would like to point out for the record is that we would not be able to make a complete evaluation without those records.

Senate Banking Committee Investigation

Chairman Proxmire. If the Senator would yield, I am the ranking member of the Senate Banking Committee. There is just no question you have an absolute right, and equal right, to the books of any governmental agency, do you not? Aren't they violating the law—Treasury violating the law by refusing to cooperate with you in giving you this information?

Mr. Staats. This authority stems from our basic statute, Mr. Chairman. We believe that the Treasury Department is relying upon the fact that there is nothing specifically in the language of this statute which states that we have access to their records.

Chairman Proxmire. But the general statutes certainly ought to predominate there.

Mr. STAATS. We believe this is true with most statutes. Where we are asked to make audits of programs, Congress relies upon our basic statutory authority and obviously does not have to repeat that access to records provision in every statute.

Chairman PROXMIRE. Exactly. I think you brought out here something this morning in which our committee, and I will certainly ask Chairman John Sparkman to hold hearings on this and to investigate it.

I think it is just disgraceful that the Treasury Department, on something as big as this, as controversial as this, with the enormous liability that could hit the American people, is refusing to cooperate with our investigative arm, GAO.

Thank you very much.

CONGRESSIONAL RIGHT TO KNOW

Senator PERCY. I should certainly think this is the kind of information on the progress a company is making that any bank would normally want. Inasmuch as the taxpayers of this country are now in the role of a banker in advancing $250 million to the company on its guaranty, we have an absolute right to know at least as much as the other banks know about what progress the company is making and whether or not it is going to make it.

It would appear that my time is up. I would be happy to yield and come back to some more basic questions later.

COMMERCIAL ACTIVITY AT LITTON'S WEST YARD

Mr. STAATS. We have the answer to your question, Senator Percy, that you asked during the course of my statement.

Mr. Gutmann will respond to it.

Mr. GUTMANN. The commercial activity at the West Yard is approximately 80 percent of the total activity.

Senator PERCY. Could you repeat that again?

Mr. GUTMANN. The commercial activity at the West Yard at Litton is approximately 80 percent of the total.

Senator PERCY. So that any absorption by the Government of overhead that should be properly chargeable to the commercial business would enable them to underbid others on the commercial side by having those costs absorbed by the Government?

Mr. GUTMANN. That is correct.

Senator PERCY. So I think that this is an aspect of your inquiry that we will want to look into very carefully. It is, I might say, a not uncommon practice by industry as I have seen it.

DURHAM INVESTIGATION

Chairman PROXMIRE. I want to get back into this shipbuilding claims a little later. Now I want to get into the Durham matter.

I wonder if you, Mr. Staats, or the individual who directed the study on the field matter, could fill in the details that I left out in my rough draft in my opening statement?

GAO BRIEF SUMMARY

Mr. STAATS. Mr. Chairman, in my telephone conversation with you, I said we might make an effort to prepare a brief summary for the record today. At that time I was not certain that we could do it, but we have prepared a brief summary which we would be happy to put into the record.

Chairman PROXMIRE. How long a summary is it?

Mr. STAATS. It is about three and a half pages, double spaced.

Chairman PROXMIRE. Would you like to read it?

Mr. STAATS. I would be happy to read it if you would like.

Chairman PROXMIRE. Is it a departure from anything you have given here?

Mr. STAATS. Pardon?

Chairman PROXMIRE. Does it depart from what I said or what you said in your statement?

Mr. STAATS. Well, of course, I didn't have the benefit of your introductory statement, but I don't know that it is—it is really an attempt to summarize it; that is all this is.

Chairman PROXMIRE. All right. Go right ahead and read it.

Mr. STAATS. Mr. Durham provided a set of 23 exhibits in support of his charges of unsatisfactory management practices in the assembly operations at the Marietta, Ga., plant and in the fabrication plant at Chattanooga.

Our Atlanta regional office conducted interviews with Mr. Durham, Lockheed officials, Air Force officials, and former employees. Pertinent Air Force and Lockheed documents were obtained and studied.

The observations and evidence submitted by Mr. Durham were obtained while he served as general department manager in charge of production control activities beginning in July 1969. His observations continued until May 1970, when he took a layoff. The principal problems cited by Mr. Durham were:

(1) Assembly records were inaccurate. As a result, C–5 airplanes were moved to the flight line with numerous missing parts and assemblies.

(2) Parts had been installed out of sequence, had been removed without authorization and had been scrapped by mistake.

(3) Inventory controls of valuable small parts and kits were inadequate.

CHATTANOOGA OPERATIONS

Mr. Durham was employed at the Chattanooga Plant as a section supervisor beginning in August 1970, and continuing until 1971. His principal charges regarding operations at this plant were:

(1) Management had not adequately controlled the procurement or use of raw materials, tools and miscellaneous small parts.

(2) Items which were available through the Lockheed-Marietta storeroom at less cost had been purchased locally.

(3) Items had been lost or pilfered because there was not an adequate inventory control system.

(4) Large amounts of excess materials had been allowed to accumulate.

In both cases, Mr. Durham contended that costs had been increased significantly by reason of these practices.

Now I turn to the findings of the staff study made by our Atlanta office, which, as I have indicated, we have not had a chance to review here.

The Atlanta office staff study summarizes the data which we were able to obtain in documentation of each of these charges. While the Atlanta staff was unable to verify all of the examples cited by Mr. Durham due to the passage of time, or the absence of records, Atlanta found that each of the principal problems cited above had occurred, but the staff was unable to assess their cost implications from the records available.

Lockheed Audit Reports

The staff study revealed that in connection with the problems at the Marietta plant, management at the highest levels was aware of and attempting to solve these matters. There were in fact, a number of reports by Lockheed's own internal auditors documenting these problems and tracking the progress being made in their correction.

The Atlanta staff examined Lockheed audit reports dated December 1969; February, March, and May 1970, and May 1971. These reports confirmed the inaccuracies in assembly records and particularly the problem of missing parts; however, the audit did not attempt to evaluate the timeliness or effectiveness of management's actions, nor did it assess whether these actions were apparent to the contractor's organization.

As section supervisor at the Chattanooga plant, Mr. Durham was responsible for correcting many of the adverse conditions on which he reported and which were acknowledged to our staff by plant officials. For example, he revealed that outside purchases were being made at higher prices than material available from Lockheed's Marietta storeroom. This was contrary to Lockheed's own internal instructions.

Waste or Loss of Tools at Chattanooga

On the matter of waste or loss of tools and equipment, the Chattanooga plant manager recognized that he had inadequate security and in May of 1970 he proposed a program to correct this problem. Mr. Durham's proposals in connection with improved inventory controls of materials such as sheet metal, aluminum and bar steel were approved by the plant manager in March 1971. Mr. Durham also helped establish an improved storage system, with the plant manager's approval.

The concluding exhibit submitted by Mr. Durham contained charges that the Lockheed internal auditing system was ineffective, and that Air Force personnel were negligent in allowing conditions to prevail.

Our staff study concluded that Lockheed internal auditors were aware of the major problems in Marietta and had reported them to management together with their recommendations. Their reports were widely distributed to corporate officers and followup audits were made. Chattanooga plant operations, however, were not audited frequently enough. The staff study agreed with Mr. Durham that Air Force personnel did not satisfactorily demonstrate that they were aware of the problems cited, or that they had reported the problems to higher commands.

That concludes the summary of the statement.

Chairman PROXMIRE. Mr. Staats, is the Atlanta man here?

Mr. STAATS. No, sir. As I have indicated to you, Mr. Chairman, we are really not prepared to discuss the substance of this report today.

EXCESS PROGRESS PAYMENTS

Chairman PROXMIRE. Let me read just the one short half page paragraph of the summary he gave us—you didn't mention in what you gave us:

In summary, we found the allegation that Lockheed had received excess progress payments regardless of condition or schedule was correct. Lockheed did receive excess progress payment of about $400 million excess due to understating the value of the work completed and overstating the value of the work in progress. We also found the Air Force was aware of the excess progress payment situation but failed to act on it. In fact, the Air Force made an additional $705 million available for progress payments to Lockheed.

Lack of Air Force/DCAA Action

"We also noted,"—this is your staff, your report—"We also noted the same situation of excess progress payments may have existed with respect to major subcontractors but neither the DCCA nor the Air Force took action to examine into the matter."

Now, do you have any reaction to that?

Mr. STAATS. Quite obviously, Mr. Chairman, this would be one of the matters which we would want to go into further and do additional work because I have had a chance last evening to read through this report pretty carefully. There are many unanswered questions relating to that point. We are not able to give you any assessment at the moment as to the accuracy of that or what the situation is with respect to how this happened. So I would prefer, really, not to get into that matter until I have had a chance to review it a little further.

Chairman PROXMIRE. Well, the reason is because—I will read from exhibit 1 the following:

Our review confirms that Lockheed did have significant financial incentives to move aircraft on schedule—in terms of avoiding up to $11 million in liquidated damages and received over $75 million in additional payments representing reimbursements of costs incurred for achieving certain schedule milestones. In addition, the original contract clause limiting progress payments was not enforced and as a result Lockheed was paid about $400 million in advance of contractural requirements, according to a February 1970, DCAA report of the overpayment. Although the DCAA estimated that these overpayments would increase, the Air Force did not reduce the progress payments as a result of the DCAA report because it was not considered in the best interests of the Air Force. In contrast, the Air Force subsequently made an additional $705 million available through May 31, 1971, for progress payments to Lockheed.

What about the $11 million in liquidated damages for late delivery? Did Lockheed avoid having to forefeit that amount?

Mr. STAATS. Mr. Chairman, again I am sorry that we are going to have to withhold comment on this until we have a chance to review the matter further.

Chairman PROXMIRE. What about the $75 million in payments for achieving certain scheduled milestones; do you know whether they did achieve those milestones and did it obtain the $75 million referred to?

Mr. STAATS. We can't talk about it.

Chairman PROXMIRE. Should we not be talking about $475 million in overpayments rather than $400 million?

Mr. STAATS. I am not really able to comment, Mr. Chairman. Further, I think you understood that when you asked us here today.

Chairman PROXMIRE. You cannot comment on whether the additional $705 million constituted an additional overpayment?

Mr. STAATS. No.

Conversion to Cost-Plus Contract

Chairman PROXMIRE. Let me ask if the contract had not been converted to cost plus, would Lockheed have had to return any of the overpayments? Do you have any views on that?

Mr. STAATS. No.

Chairman PROXMIRE. If Lockheed had to borrow the amount of money it was paid in overpayments it would have had substantial interest costs, obviously. You haven't calculated or have you calculated how much it benefited by what was, at the very least, an interest-free loan up until the contract was converted to cost plus?

Do you know whether the Air Force or the other services commonly make excess progress payments of this magnitude to other contractors or whether overpayments have been made to Lockheed on other contracts? If you do know, can you give it? If you do not know, can you get us this information? This is something different.

Mr. STAATS. Mr. Chairman, as you already noted, this matter of progress payments was not something developed by Mr. Durham but through our own staff work. This is a serious matter and I do not wish to speculate about it without the facts, so that I am afraid I will have to be excused from answering it.

LOCKHEED DELINQUENCY NOTICE

Chairman PROXMIRE. I am referring to the Durham comments summarized by your own exhibit here. Let me ask you this:

The staff report mentions a notice of delinquency issued to Lockheed. Can you tell us about it and can you supply us with a copy of the notice?

Mr. STAATS. Of the delinquency notice?

Chairman PROXMIRE. Yes, sir.

Mr. STAATS. Yes, sir; I am certain we can get a copy of that.

(The following information was subsequently supplied for the record:)

DEPARTMENT OF THE AIR FORCE,
HEADQUARTERS AERONAUTICAL SYSTEMS DIVISION (AFSC),
Wright-Patterson Air Force Base, Ohio, January 30, 1969.

Subject: Delinquency Notice, Contract AF33(657)-15053
To: AFPRO (CMRIKA)
In turn: Lockheed-Georgia Company

1. You are hereby notified that you have failed to comply with the delivery or performance schedule of Contract No. AF33(657)-15053. As a result of your failure to perform you are delinquent and no excusable delay exists.

2. Based upon the latest production information available and the Government's urgent need for the supplies/services, the Government, at this time, is withholding

invoking its rights under the "Default" clause and any other provisions of the contract until further notice to you.

3. The fact that the Government is refraining from asserting its contractual rights as this time shall in no way be construed as a waiver of those rights. All rights which the Government now has, or which will inure to the Government, because of your delinquency, are hereby expressly reserved by the Government.

LUCILLE S. HARRIS,
Contracting Officer.

Chairman PROXMIRE. Can you provide us with copies of all other correspondence and reports mentioned in the staff study discussion of the excess progress payments?

Mr. STAATS. To the extent that documentation is available. I do not know of any reason why it would not be appropriate. We have suggested at the conclusion of our statement, Mr. Chairman, that we are quite agreeable to having the staff who worked on this sit down with the staff of your committee and answer any questions on it. We were quite agreeable to furnishing you a copy of this staff report.

Chairman PROXMIRE. I will tell you our problem here.

I can understand your problem, Mr. Staats, and I don't mean at all to be disrespectful; you are a wonderful public servant and I have the greatest admiration for you; but it is my understanding we are going to have this hearing and we did tell you we wanted to have this man here today. We did think he would be here today; that was my understanding and not until my phone call——

Mr. STAATS. Yes; I explained this to you in our telephone call and I have had a few other things to concern me down in our office, and so have the rest of us. For one thing Congress gave us the responsibility for administering the Federal Election Campaign Act on which we issued our regulations only on Friday.

We have had a great deal of work with the Procurement Commission, which involves the whole division concerned with this subject of the Durham report. We have had many other activities and I would simply like to point out to you, Mr. Chairman, that while we are very happy to assist this committee, we also do work for 23 other committees of the Congress.

SPECIFIC QUESTIONS REGARDING GAO STAFF STUDY

Chairman PROXMIRE. Yes, and I don't mean to be, as I say, critical of you at all. As you can understand, I am very anxious to get answers to this.

Let me read the other questions and then you can interrupt me if you can answer any of them now, and then I would like to know when you can bring this official up who made this study and respond to the committee on these questions in public.

Mr. STAATS. Well, as long as you understand, of course, that he cannot really speak for the office.

Chairman PROXMIRE. I understand; he can answer questions as to the details.

Mr. STAATS. He can supply information to your staff; I am quite agreeable to that.

Chairman PROXMIRE. I would only ask him to appear with you.

Mr. STAATS. I am not prepared to have him at this point in time come and answer the kind of questions that you have. After all, it is my responsibility and not his to speak for the office.

Chairman PROXMIRE. All right.

Well, let me just give you the questions then that I wish you could answer for us.

The staff study says Lockheed deviated from the regulations on progress payments without proper authorization. I would like to know whether you are also saying Lockheed used phoney or inaccurate figures in its requests for progress payments.

No. 2, I notice that the Air Force at one point admonished Lockheed to review its subcontracts providing progress payments and to make certain adjustments. I want to know whether or not Lockheed overpaid or underpaid its subcontractors.

No. 3, I would like you to read the two paragraphs on page 16 of the staff study summarizing the findings on the matter of the progress payments and give us your reactions.

And then, I would also like to know when did GAO first learn of the possibility or the fact that excess progress payments had been made in this case.

And, finally, if GAO had known about the overpayments prior to the conversion or restructuring of the contract, would you have had sufficient statutory authority to disallow further payments or to require that corrective action be taken. Maybe you can answer that last question?

Mr. STAATS. Sir, I just cannot go into this matter; I am sorry. I must say, though, Mr. Chairman, that we will take note of all of these questions, but you have to recognize that we cannot give you a considered judgment about them unless we have the views of the contractor and the Department of Defense, and I am not prepared to go beyond the staff study unless there is an understanding on that point.

Chairman PROXMIRE. You didn't do that this morning with the study you gave us on the shipbuilding claims?

Mr. STAATS. Yes, I am afraid we did; I beg your pardon.

LOCKHEED'S SPECIAL STATUS

Chairman PROXMIRE. On this Lockheed situation we have had trouble ever since the beginning. I remember back in 1969 your office had great trouble getting access to the books of Lockheed and this committee did our best to try to encourage you to do that and you were resisted both by the Defense Department and the contractor. This seems to me to be an especially stubborn kind of situation. Lockheed is in a class by itself; it seems to be able to resist action by the Congress, by GAO and committees. It enjoys a special status.

Mr. STAATS. I have just checked with Mr. Gutmann here and I am not aware of any access to records problem that we have had at Lockheed, Mr. Chairman.

Chairman PROXMIRE. Well, these reports that you have here did not contain contractor comments or DOD comments—these reports?

Mr. GUTMANN. These matters were discussed though, informally with the local officials.

Chairman PROXMIRE. Didn't you also informally discuss this with Lockheed, informally with the Lockheed people?

Mr. GUTMANN. Our staff may have.

Mr. STAATS. We don't know at what level, Mr. Chairman.

Senator PERCY. Is it your intention—may I ask this question—is it your intention and desire that the reports which have been made available to us not be made public until such time as contractors have had an opportunity to comment on them?

Mr. STAATS. That is correct. We have a firm policy, Senator Percy, with respect to any report we make on our own initiative, that we, if we name a contractor in a report, we give him an opportunity to comment on that.

Senator PERCY. Yes.

Mr. STAATS. And we include his comments in the report, and, similarly——

Chairman PROXMIRE. This report was not made on your initiative but on our requests. We did not request contractor comments on it. Doesn't that differentiate it?

Mr. STAATS. If you would let me finish, Mr. Chairman——

Chairman PROXMIRE. I beg your pardon.

Mr. STAATS. When we make these reports on our own initiative we allow the agencies also to review the report and to give us their reactions, and if we are in disagreement with respect to the facts or findings or conclusions or recommendations, those are set forth in the report that comes to the Congress. Now, these reports which are initiated by the General Accounting Office are invariably made public at the time they are transmitted to Congress unless they are classified for national security reasons.

Now, with respect to the work we do at the request of the committees of Congress, we urge in each case that we be allowed to do that in the interest of accuracy of facts and in the interest of having both points of view reflected in our reports; we think this is the better way to do it and in all cases we urge that this be done. But we recognize when we agree to take on an assignment from a committee of Congress that it is a committee product, and if there are errors in the report or if there are misleading conclusions or erroneous recommendations, then it is the responsibility of the committee and not of our office, you see. There is the basic difference.

Senator PERCY. I just want to be certain that even in quoting certain sections of this report I was not violating your policy because I believe in being utterly fair to the contractor. What I do not know is whether or not the Atlanta office before coming to these conclusions had already discussed the study with the contractor. Was there time for rebuttal by them at the time the conculsion was reached?

Mr. STAATS. No; there has been no opportunity.

Senator PERCY. There has been no opportunity for that? But certain parts of this information must have been gotten through consultation with the contractor.

Mr. STAATS. Could I just add though, Senator Percy, just to be sure we are clear as to the ground rules under which we were working on this case, the letter from the committee said:

I am requesting that a report of the investigation not be circulated in draft form to either the Defense Department, the contractor or any other person outside the General Accounting Office.

Now, unfortunately, our staff in Atlanta misunderstood the understanding that we had with the committee and Mr. Durham was furnished a copy of this report and we had it for some time. We have not furnished a copy of this draft to the contractor or the Defense Department. Now, that is exactly what the status of it is.

Senator Percy's Support of Subsequent Hearings

Senator Percy. I would feel it perfectly appropriate to indicate that I would fully support subsequent hearings after that kind of evaluation has been made and the contractor has had an opportunity to comment. We should have the contractor's representatives, Mr. Durham, your representatives, and the Department of Defense here at the same time to testify after giving us adequate time to analyze and appraise all of the responses.

Chairman Proxmire. Let me say, as chairman of the committee, I would be delighted to do that, and we will go ahead and do it.

Missing Aircraft Parts

Senator Percy. But these hearings will not be the full answer to the material which we have just received for analysis. It would seem likely, on the face of it, as Mr. Durham's testimony stated, that Lockheed moved assemblies and aircraft on a prescribed schedule and put them on line when there were thousands of missing parts. That seems to be borne out by the audits that you have made internally.

Mr. Staats. I don't think there is any doubt that there were many problems.

Senator Percy. There seemed to be very great incentive for them to say they were on schedule. They had a shell there which had thousands of missing parts, many of which had not even been delivered to the contractors. Yet they had it out there on line so they could get progress payments and avoid the penalties which the contractor had specifically established. I think this seems to be beyond refutation although I would want the contractor to have every opportunity to so state that that is not true. I presume there are some representatives right in the room today. Let them step forward if they feel that is an inaccurate conclusion. But at least we have gone that far to indicate that there have been very serious violations someplace along the line with the contractor and with the Air Force and that aspect of Mr. Durham's testimony seems to hold water.

Chairman Proxmire. Would the Senator yield at that point?

I think what I have been saying is not an allegation by this Senator, not an allegation by Mr. Durham, not an allegation by anybody at all on the congressional side of it but by the Defense Contract Audit Agency. What did they say? I quote:

> Based on a further analysis of the contractor's progress payment requests, the attached report indicates that current overpayments on Contract No. AF 33(657)-15053 amount to about $400,000,000.

That is signed by Frederick Neuman, Deputy for Audit Management in 1970. It is something, as I say, we are not saying that you allege it, but we are saying that this is something that the Defense Contract Audit Agency found.

Senator Percy. I haven't started on my basic questions yet.

Litton Overhead Expenses

Chairman Proxmire. Let me ask, to get back on shipbuilding having departed from that a little while ago, that both the Defense Contract Audit Agency and GAO concluded from 1969 through 1971, Litton had loaded down the contracts for the LHA and the DD–963 with about $7 million of overhead expenses which should have been charged to Litton's commercial work.

Isn't this plainly a dishonest practice? Shouldn't Litton be required to give the money back to the Navy? Why doesn't the Navy act?

Mr. Gutmann. Well, Mr. Chairman, we are unable to say why the Navy has not acted yet, but they do have this matter under consideration. Now, with respect to the statement that it is clearly improper——

Chairman Proxmire. Dishonest, illegal, it seems to me.

Mr. Gutmann. Dishonest and illegal, if you will, matters of allocation of overhead and methods of allocating overhead certainly are subject to differences of opinion. There may be some mitigating circumstances in this particular situation. DCAA reported it as being improper; the contractor apparently now tends to feel that it was incorrect, and they are considering changing their accounting system.

The Navy has now under advisement the question of whether or not they have any basis for recovering the $7 million from the contractor.

Chairman Proxmire. This seems to me, and again I am not asking for a conclusion from you. You fellows are factfinders; but it seems to me honestly when you come to this kind of a conclusion and not going any further, $7 million is improperly charged, you say with the Defense Contract Audit Agency finding it, and then we say well, there may be mitigating circumstances, $7 million of the taxpayers' money given to a private corporation that seems to me they have no business having—what do we do about it?

Mr. Gutmann. Well, as I say——

Chairman Proxmire. What recourse do we have?

Mr. Gutmann (continuing). The Navy is taking action. They have it under consideration now; they may well collect the entire $7 million.

Mr. Staats. I believe you have Navy appearing as a witness tomorrow.

Chairman Proxmire. Yes; we do.

Mr. Staats. Perhaps they can answer it.

Chairman Proxmire. Senator Percy?

Todd Shipyard Claims

Senator Percy. Mr. Staats, in your statement in the discussion regarding the Todd Shipyard claims, you state that the contractor was willing to assume responsibility for 10 percent of the additional labor hours incurred. On what basis did the contractor arrive at this percentage so far as you are able to determine?

Mr. Gutmann. As far as we are able to determine, it was an arbitrary judgment on his part that this was a measure of his own inefficiency.

Senator Percy. No substantial data to back that up?

Mr. Gutmann. Not to my knowledge. I might check with our site supervisor. He states there was no data.

Senator PERCY. Just pulled out of the air? Why not 50–50, 25–75, maybe the 90–10 matching formula of the highway trust fund?

Chairman PROXMIRE. If the Senator would yield, it is obvious he wants the 10 percent; that is all he wants.

Senator PERCY. There was no record of insisting on 90 percent. When the additional labor hours were increased by 5.6 million hours on what basis did the contractor refuse to assume responsibility for any of the increase in the additional hours?

Mr. GUTMANN. We are unaware of the basis he had in this instance, too.

Senator PERCY. When the claim was settled for $96.5 million or about 60 percent of the total contract price, what was the strength of the justification for the settlement of it so far as you could determine?

Mr. GUTMANN. Here, again, sir, it was simply a matter of negotiating and judgment upon the part of the Navy in dealing with the contractor, in evaluating their chances of doing better in the courts.

PERCENTAGE OF CLAIMS SETTLEMENTS VERSUS ORIGINAL CONTRACT PRICE

Senator PERCY. In your statement you referred to a Lockheed claim which was settled for $46.3 million which added more than 50 percent to the original contract price of $83 million.

You also state that your most recent review of claims showed the claims settlement were averaging 37 percent of total contract prices as they stood before the settlements.

Will you tell us what the range of these claims is, that is, do some of these claims amount to as much as 75 or 100 percent above the original contract prices? What average percentage of the claim are these additional claims being settled at? In other words, if the overall is 37 percent, are some of them as much as 75 or 100 percent over?

Mr. GUTMANN. We have a range here of 25 percent to about 65 percent. On the four major claims that have been settled, this is in accordance with our report on February 20, 1970, to the Congress, where we said the four settled claims, one is Todd Shipyard Corp., the claim was $114.3 million; that was settled for $96.5 million; Lockheed Shipbuilding & Construction, as we have stated, was $46.3 million; it was settled for $17.9 million; General Dynamics Corp., Electric Boat Division, claim was $8.1 million; it was settled for $6.7 million. Tacoma Boat Building Co., Inc., the claim was $6.1 million, settled for $3.4 million.

PERCENTAGE OF CLAIMS SETTLEMENTS VERSUS TOTAL CLAIM

Senator PERCY. Another aspect of what I would like to get on the record are—claims which over all are a very high percentage of the contract price as such, when the claims are actually made, does the Government settle on the high side or the low side of the claim? Do contractors pretty much get what they ask for in those claims or are they bargained and negotiated out so they can't always count on getting it?

Mr. GUTMANN. Senator, I am afraid I am not in a position to generalize on that. I think it could vary quite a bit from case to case.

POSSIBILITY OF UNDERBIDDING

Senator PERCY. Do we have any knowledge that would lead us to believe that is a common practice in this field for competitive purposes, if competition is severe enough, for a contractor to knowingly underbid, bid close to actual cost, and then just tend to make up for it in claims that are later filed and settled on a negotiated basis once they get the contract knowing the Government is powerless to really move the contract over to someone else?

Mr. STAATS. What we are saying in our testimony today, Senator Percy, is that the limited competition in the shipbuilding field is such that this is a great danger. Now, when you get down to specific cases, it is very difficult to prove it. But the danger is there and we conclude from that that it is all the more important for the Defense Department to closely monitor these contracts, so as to minimize the cases where this has happened or could happen.

Senator PERCY. We are debating this year a $1 billion carrier. We are now getting up to the kind of figures where 37 percent overruns can be $370 million. That is a pretty sizable amount of money and general procedure is something that we are going to have to look at very, very carefully in considering the original request for appropriations.

Mr. STAATS. We fully share the committee's concern in this area and I believe that Senator Proxmire will recall that the requests that we received from the committee grew out of work that our office did in this field 2 or 3 years back and reported in our testimony before the committee.

I think everything we have developed since that time has corroborated the judgment of the committee that this is an important area for GAO to look at.

ACCOUNTING BACKUP FOR CLAIMS

Senator PERCY. Did GAO evaluate the accounting backup for the $97.5 million settlement and, if so, how complete were the records?

Mr. GUTMANN. Here is Mr. Rutherford, supervisory auditor from our Seattle regional office, who will answer your questions.

Mr. RUTHERFORD. The Lockheed, or, rather, the Todd settlement was not predicated on detailed cost records. Basically the claim that Todd filed represented its cost of doing business up to that point in time, plus the projected costs to finish the contract, and they came up with an adjusted total. They said 10 percent of this we feel is our responsibility and we would like to have you then pick up the tab for the difference.

It was negotiated to $96 million and exactly how or why they evaluated it to $96 million; I cannot say.

Senator PERCY. If you were assigned to negotiate this on behalf of the Government or if you were a private contractor negotiating with a subcontractor request for additional payments, would you have felt that the records you reviewed would have been adequate to have

justified your coming to a decision that a $96.5 million overrun was justified?

Mr. RUTHERFORD. It is difficult to say. We could not arrive at that conclusion that it was or was not justified because the records just aren't there. We do know there was provocation. There were late plans, late delivery of material.

There were many provocations by the Government. We absolutely could not put a price tag on it.

LACK OF COMPETITION IN SHIPBUILDING INDUSTRY

Senator PERCY. In your statement, Mr. Staats, you state that Newport News and Electric Boat Division of General Dynamics are the only private shipyards which can construct missile submarines and these two shipyards, along with the Ingals Shipbuiding Division of Litton, are the only private shipyards which can construct nuclear submarines.

Is it accurate to say that the number of competitors who are capable of constructing other kinds of ships are equally small?

Mr. STAATS. Are you speaking of naval vessels now?

Senator PERCY. Do we have any knowledge as to how this situation arose? What is the background for that or should we ask the Navy that question?

Mr. STAATS. We are inclined to think this is a Navy question.

Senator PERCY. Does this go back to World War II experience when there were relatively few companies in the field?

Mr. STAATS. It is the same situation, Senator Percy, as I see it. The question is always present: How much business is there to sustain a contractor? I am a member of the Commission on Government Procurement, and this is one of the very tough issues that that commission is wrestling with, and I hope we will be able to make some constructive recommendations on this issue. But it is a problem in acute form in the shipbuilding industry; it is also a problem in the aircraft industry, the whole aerospace industry. We are not dealing with something that is unique, but it is a matter of degree, I think, and it takes its sharpest form in the shipbuilding industry.

Senator PERCY. I would like to say that having served 3 years in the Navy I have always had a soft spot in my heart for the Navy. I have looked upon it as one of the more efficient branches of service and I have found many things to be proud of in the Navy. But I would like to find out, if I can, whether it is a result of Navy practices now that limit competition or whether it is just an outgrowth of the fact that in World War II so much was poured into a limited number of shipyards that by now no one with private capital can really ever compete? The Navy is simply stuck with a very, very few number of competitors and opportunities for alternate bidding. This then permits sloppy practices and procedures to grow up which normal competition should remove. Any insight you can provide as to the background, I would be most interested in, but perhaps it would be more appropriate to question the Navy at some time on that?

Mr. STAATS. I think you will have the opportunity tomorrow, but it is a very difficult subject.

Senator PERCY. All right. I will yield, Mr. Chairman.

SUPSHIPS RESPONSIBILITIES AND SURVEILLANCE

One last question: In your statement you referred to SupShips and its responsibilities. Based on your testimony, it appears that SupShips is not fulfilling these responsibilities. Is it fair to state that failure is based both on inadequate enforcement of procedures and inadequate surveillance?

CHANGE ORDERS

Mr. GUTMANN. I think, sir, that the basic failure is inadequate surveillance and beyond that their job is made quite difficult through the problems that we have enumerated in the past in the Comptroller General's statement and in the reports we have issued with respect to the specifications, the changes that come along after construction has started.

One of the things that cause the changes is the rapid advancement of technology and when a vessel is under construction for 3 to 5 years, as many of them are, a lot of things happen; there are new developments in radar, in various other kinds of communications equipment, and the Navy is anxious to have the most modern vessel that they can get. So they initiate changes. This causes a disruption and delay in the contractor's work.

Now, I believe that to some extent we have in the Navy shipbuilding business concurrent development and production and under such circumstances, it might not be appropriate for the Navy to continue to award firm fixed-price contracts on what is considered by some to be a competitive basis. We have pointed out to this committee that competition really does not exist for a significant portion of Navy ship procurement either initially or through the negotiation of changes and claims subsequently. So, I think it may be necessary for someone to face up to the fact they have to revert to some sort of flexible price contracting, perhaps a cost plus incentive fee arrangement, with even closer surveillance then over the contractor's activities and his cost controls, his subcontracting practices, et cetera.

NAVY PROCUREMENT REGULATIONS AND TRUTH-IN-NEGOTIATIONS ACT

Senator PERCY. The charge seems to be clearly made by your testimony that certain contractors have either refused to comply with Navy procurement regulations or the Truth-in-Negotiations Act. What steps can be taken to get compliance and assure compliance? What practical penalties can be imposed if there isn't compliance?

Mr. GUTMANN. Well, I cannot speak to the penalties for failure to comply. Certainly the SupShips as well as DCAA who have responsibility for maintaining surveillance over the contractors' activities and their application of the Truth-in-Negotiations Act in dealing with subcontractors can take action.

COMPETITION IN SUBCONTRACTING

Senator PERCY. Lastly, in the area of subcontracting, I think your own investigations speak pretty much for themselves of a need for improving competitive practices here.

Do you have any suggestions as to what can be done to get more competitive procurement in these areas where normal market forces simply do not seem to be operating?

Mr. STAATS. Well, as you indicated, we have outlined a number of suggestions; some of them are in our testimony here. In our report to the Congress, we have outlined still further ideas that we think would further this objective. We are inclined to think a lot more can be done in this respect.

Senator PERCY. I think that can be, Mr. Chairman, one of the most important aspects of these hearings which will apply certainly to many other claims as well as the Navy itself.

SOLE-SOURCE PROCUREMENT

Chairman PROXMIRE. I agree wholeheartedly; we do have a question in procurement, problems in procurement, whenever we have a big system and where, as you pointed out, we only have one or two or three companies capable of handling it because of capital requirement and because of special technology required; but where you have subcontracting it doesn't make any sense that they can only get a sole source or in some cases I can understand that there may be a few specialized kinds of products where they could only go to one firm. By and large, however, I would think this would be the great exception, that 99 percent of the time you could either get competition or catalog buying or something of the kind.

Your documentation this morning, I think, shows that, in one way or another, subcontracting competition is being avoided.

FEDERAL GOVERNMENT TAKEOVER OF DEFENSE OPERATIONS

One of the overall remedies I have heard that I have resisted very much, Mr. Galbraith and others have suggested, is that the Federal Government should take over defense operations, and manage work with subcontractors, perhaps manage the whole operation. If you can't get competition with subcontractors at this low level, it seems to me, that there may be economical reasons why that wouldn't work very well.

Senator PERCY. I would like to comment on that.

Whatever abuses there may be within our present system, I think that the recommendation of Mr. Galbraith would be one of the most destructive goals that we could move toward. If the Government did the defense work, then the same people who are supposed to regulate the work are doing it.

Chairman PROXMIRE. I agree with you, but unless we can eliminate some of these abuses we would be pushed in that direction and I would resist it every bit as much as you do.

POSSIBLE CORRUPTION

Senator PERCY. Mr. Chairman, I would like to ask a question which is a delicate and tender one but I ask it with some concern.

There is right on the Hill here, everyone knows, sometimes a rather cozy relationship that develops between staff and an agency or institutions that that staff is really supposed to be regulating and a cozy relationship that sometimes exists between Members of the Congress and the very agencies or industries that are supposed to be regulated. When you have such a small number of contractors, when you have such tremendous power, discretion in these negotiations that involve

hundreds of millions of dollars, is there any evidence that you can determine through expense accounts submitted, through personal relationships that develop, that there is the ability of a contractor to put a Government employee under obligation to him through entertainment, through lavishing attention on them or whatever it may be, that you would in any way consider improper? I ask the question simply because it does exist in private industry; it exists in Government and when we are dealing with large amounts of money like this, and settlements that appear to be unreasonable, I think I would be negligent if I didn't even ask the question.

Has the thought ever arisen that those arrangements exist and there is not due diligence existing or firmness in negotiations for and on behalf of the taxpayers when we have such large amounts involved?

Mr. STAATS. Well, again, I would like to ask my colleagues here, who have been involved in the field work and the review of these findings, but, to the best of my knowledge we have not found enough—no, we have not found any, I should say, direct evidence that would lead to this conclusion. If I am incorrect I would welcome any of our people to comment.

But there is this concern when there is so much at stake, when whole companies are at stake, literally, in the outcome of negotiations.

THE DURHAMS AND THE FITZGERALDS

Chairman PROXMIRE. Let me say, Mr. Staats, that the problem is partly what Senator Percy alluded to, and we all know that there is corruption; there are weak, corrupt, greedy people on both sides who take advantage of the situation.

But I think that a much more serious problem is the problem of the Henry Durhams, the few people who have the guts to speak up and help spotlight these weaknesses and when they do they are driven out of their jobs; they are virtually exiled in their communities; they are destroyed.

Senator PERCY. When I studied the Fitzgerald question and went to the highest authority to find out why he was not acceptable any longer, the worst charge that could be made against him was that he wasn't a team player, and I wonder what that really means.

He was unwilling to go along with the system and he spoke out. I know the same charge has been made against me by members of this administration that I am not a team player because I didn't go down the line for every single thing that was asked for. I don't consider that my responsibility. I think speaking out in these cases is justified if it will save the taxpayers hundreds of millions of dollars if not billions of dollars eventually by revealing practices that ought to have been revealed.

INTEGRITY IN THE PROCUREMENT PROCESS AND PUBLIC CONFIDENCE

Mr. STAATS. I am not sure I fully answered Senator Percy's question which is slightly different from the one you have just asked, Senator Proxmire. But the whole question of integrity in the procurement process is one where I think more than just dollars and cents are involved, in terms of the savings or waste that might exist in the procurement. There is also the question of public confidence, whether

everyone is getting a fair break in the procurement process. It is one of the reasons why we think the subcontracting area is so important, because here you are dealing not with the big primes; you are talking about a prime who is in turn related to a whole series of concerns. And one of the things that the Procurement Commission is looking at very hard is how can you get more competition into the subcontracting field, because bigness is a fact of life; it is not only true among defense contractors, it is true of the whole economy and we shouldn't be surprised at bigness among defense contractors. But the real question is whether or not in the negotiating with primes there is adequate attention also given to the subcontracting area and there are many statutes on the books with respect to integrity of the Government's relationship to the prime. I think that the Truth-in-Negotiation Act which had its genesis in a series of GAO reports before I became a part of GAO is a very important one. But there are many others, including the one that you alluded to earlier which is the extent to which the contracting agency really is on top of the procurement process not only before but after the contracts are let.

Chairman PROXMIRE. The questions opened up by Senator Percy have been extremely useful.

QUESTIONS TO BE ASKED OF NAVY REGARDING CONTRACTING

Senator PERCY. I would like to say, Mr. Chairman, I think it would be only fair to advise the Navy that in their testimony tomorrow I will be asking the question, What is being done to educate the American business community to the business opportunities that are available for contracting being placed by the Navy? What is the Navy doing to spread the subcontracting potential in a country that has 25 percent of its plant capacity idle and 6 million people out of work? I don't think there ought to be a lack of competition. Sometimes maybe it is because specifications are such that only items, heavily tooled up for by an existing contractor, can be used?

But on other items, specifications should be broad enough that others could bid on them. There may be many procurement practices that could be used in increasing the competition in this field which, in the end, will do what I know the Navy wants to do—get as much bang for its buck as possible, and make certain they don't themselves run into these terrible overrun conditions and be at the mercy of very few contractors with whom they can actually place business. So I think it is in our mutual interest to explore this aspect, and I appreciate very much your opening up this whole area for us, which I think will be very valuable.

CONCLUSION

Chairman PROXMIRE. Let me just conclude the hearing by saying it is too bad we have representatives, the people who are responsible for the staff reports in each of the cases except the case of the Lockheed-Durham situation. You explained that to me on the telephone.

Mr. STAATS. I don't think that is a quite fair implication, Mr. Chairman, if I may say so. In all the other cases, the reports were reviewed and were then transmitted to the committee over my signature, so you have quite a different situation.

Chairman PROXMIRE. I understand.

Mr. Staats, let me conclude by saying at the end of your statement you make some suggestions about where attention ought to be given to follow up the staff study and complete the investigation. I think those are excellent suggestions, and I would hope your office would act on them promptly and report back to the subcommittee.

Can you give us an idea how long it will take?

Mr. STAATS. No, sir; I cannot. I would like also to say we would be glad to do this, but in order to be able to do it, we must have an understanding with you that this report and the same draft report that has been made available to Mr. Durham will also be made available to the contractors and the Defense Department.

Chairman PROXMIRE. By all means.

Thank you again. This has been a most helpful hearing.

The subcommittee will reconvene its hearing tomorrow morning at 10 o'clock in this room.

(Whereupon, at 12:20 p.m., the subcommittee recessed, to reconvene at 10 a.m., Tuesday, March 28, 1972.)

(The following information was subsequently supplied for the record by Chairman Proxmire:)

U.S. GENERAL ACCOUNTING OFFICE,
Washington, D.C., March 24, 1972.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee, Subcommittee on Priorities and Economy in Government, U.S. Congress.

DEAR MR. CHAIRMAN: Mr. Kaufman of your staff has requested a copy of the draft of our proposed response to your letter of October 12 in which you requested the GAO to investigate charges and verify the evidence presented to your Committee by Mr. Henry M. Durham, a former employee of the Lockheed Corporation, concerning alleged unsatisfactory management practices of the Lockheed-Georgia Company.

We had hoped that a response to your letter could be completed in advance of the hearings scheduled to be held on Monday, March 27 (dealing with shipbuilders' claims and the allegations made by Mr. Durham. While we have received a staff study from our Atlanta office, it appears that additional field work may be required. Moreover, there has not been an opportunity for a review in the normal manner within the GAO which would be required to fully evaluate the study before rendering it as a GAO report to your Committee.

The Comptroller General advises me that transmittal of the Atlanta staff study to your staff is in accord with your wishes with the view to having it in your hands prior to the hearings on Monday. Because of other high priority matters, the Comptroller General has not been able to review the materials but will be able to advise you Monday as to the status of the GAO report.

If for any reason you should wish to make the Atlanta staff study available publicly, we would appreciate your releasing a copy of this letter with it.

Sincerely,

R. W. GUTMANN, *Director.*

Enclosure.

[Staff Study on testimony by Mr. Henry M. Durham, concerning allegations of unsatisfactory management practices at the Lockheed-Georgia Co. Atlanta regional office]

EXHIBIT 1

ERRONEOUS AIRPLANE ASSEMBLY RECORDS CAUSED OUT-OF-STATION INSTALLATION OF PARTS AND GENERATED ERRONEOUS PARTS REQUIREMENTS

Mr. Durham testified that C–5 airplanes were moved to the flight line with thousands of missing parts and assemblies—although assembly records showed them to be complete except for a few engineering changes and other installations normally planned at the flight line. He stated further that (1) assembly records

erroneously showed that other parts had not been installed, when in fact they had been, (2) substantial additional costs were incurred to identify, procure, and transport the missing parts as their need became apparent, (3) parts had been improperly removed without authorization after inspection, and (4) Lockheed maintained the subterfuge to appear to be on schedule and to receive progress payments from the Air Force, which allowed the unsatisfactory conditions to prevail.

Regarding the missing parts problems, Lockheed advised the Joint Economic Committee on October 7, 1971, that:

* * * * * * *

"Parts shortages, missing parts, and out-of-station work (installed later on in the production process) are an inherent product of the environment of a concurrent development and production program in its early stages.

"These problems were recognized and acted upon by management independently of Mr. Durham and prior to any suggestions by him. All of the conditions, relating to parts problems, were well known to Lockheed top management. Coordination meetings were held weekly for the purpose of reviewing production schedules, changes, and parts availability to ensure that parts shortages were handled properly. Bimonthly meetings were held between officials of the Lockheed-Georgia Company and Corporate officials to bring additional management attention to these conditions. In 1968, 1969, and 1970 a series of special Saturday and Sunday C–5 Program Review meetings, between Lockheed-Georgia and Corporate Management, were held specifically to review the status of missing parts and out-of-station work. Internal audits reflect continuing improvement in this area resulting from constant management attention to the problem."

* * * * * * *

Except for Lockheed's indications that adequate corrective action was taken in a timely manner, our review confirmed that the testimony and comments by both parties were substantially correct and were supported by several memorandums from Mr. Durham and other Lockheed personnel, minutes of special corporate meetings, internal audit reports, and replies from management to internal auditors. The records provided to us by Lockheed officials do show management's awareness of the problems and necessarily demonstrate that significant problems existed—largely as a result of inaccurate assembly records.

In our opinion, the reasons for inaccurate assembly records cannot be associated with other problems which may have been caused by the concurrent C–5 development and production program. Although Lockheed internal auditors recommended corrective action in December 1969, about the time when airplane serial 0014 was being moved to the flight line, the problems continued in March 1970, when airplane serial 0023 was in final assembly. An audit report of May 1970 identified unsatisfactory conditions on airplane serial 0019, but the next scheduled audit covered airplane 0045 and the report of May 1971 stated that adequate controls had been provided and performance was considered satisfactory.

Although these problems were apparently of concern to management and were considered inherent in the concurrent development and production program, none of the records provided to us—including internal audit reports—indicates that the resulting cost impact was ever measured. We doubt that the true cost impact of the missing parts problems can now, in retrospect, be isolated because assembly records were erroneous and because a great number of engineering changes occurred. However, we will consider cost impact to the extent possible in our continuing review as discussed under exhibit 4. We will also consider whether corrective actions taken by Lockheed are currently effective.

Concerning Mr. Durham professionally, Lockheed officials told us that he was competent and knowledgeable in regard to production control procedures and had a good record of steady progress within the company. The officials cautioned us that none of their statements should be construed as indicating that Mr. Durham was a disgruntled ex-employee. They provided us file copies of most of Mr. Durham's reports—thus showing that reports which he had submitted to the Joint Economic Committee on missing parts were valid documents prepared in the ordinary course of his employment.

We noted that neither the Air Force nor the Defense Contract Audit Agency (DCAA) specifically investigated by Mr. Durham's charges on the missing parts problems. Air Force officials told us that the quality Assurance Division of the

Air Force Plant Representative's office tested Lockheed's records and reported their findings, but did not retain records beyond one year. The DCAA had not reviewed the accuracy of assembly records or conditions of missing parts—even though Lockheed's internal audit reports were distributed to the audit agency.

In the testimony, Mr. Durham cited conditions of missing parts and inaccurate assembly records in exhibits 1, 2, 4, 13, 14, 15, and 19—showing for example that:

10,000 parts were delivered for airplane, serial 0008, but 4,000 parts were later returned as not needed.

15,291 missing parts and 5,294 rejected parts were identified on airplanes—serials 0009 through 0014—after their arrival at the flight line.

Assembly records indicated only 30 missing parts on airplane—serial 0023, but an audit on its arrival at the flight line showed that 1,080 parts were missing.

On October 13, 1969, Mr. Durham reported to the Production Control Division Manager that about 1,000 missing parts requirements had been received against airplane serial 0009 and were attributable to the following:

Condition:	*Number of parts*
Missing from aircraft—reported installed	675
Missing and reported as missing	163
Removed/not reinstalled—no record	82
Not missing but reported as missing	55
Not valid engineering requirements	25
Total	1,000

As a result of a special corporate meeting held on October 25, 1969, to resolve the continuing problems of missing parts and out-of-station installations, Mr. D. J. Haughton, Chairman of the Board of Lockheed Aircraft Corporation, directed the establishment of a flight line data control center to coordinate and reconcile aircraft assembly records and establish accurate parts requirements. On November 17, 1969, Mr. Durham recognized that the control center was functional.

On December 31, 1969, Lockheed internal auditors reported that an unusually large number of parts were missing from C–5 airplanes delivered to the flight line, which had been reported as installed. The auditors recognized that procedures did not require reconciliation of the various assembly records and visual verification that operations were in fact performed. They concluded that there was no assurance that all required parts would be installed according to the manufacturing plan and that records would accurately show the work done.

In reply to the audit, Lockheed officials stated that the need to determine the reasons for differences in the status of installed parts between the records and the airplanes had been recognized, but because the assembly line had not become stabilized, it had not been practical to start corrective actions until airplane, serial 0014, reached the flight line on December 18, 1969. In addition, the Project Inspector stated that additional personnel would be assigned to take corrective action and that audits of records would be increased.

A subsequent internal audit report of February 16, 1970, covering airplane, serial 0013, identified that:

Parts shown as installed on production and inspection records had been removed without authorization.

Parts were missing from the airplane but were recorded as installed. Some had been verified by an inspector.

Parts were missing from some feeder plant and subcontractor assemblies but were not reported as missing on assembly records.

Parts reported as missing were found to be installed.

The February audit report stated that the quality, schedule, and cost of the C–5 assembly operations were significantly affected because of inadequate administrative controls over assembly work. In reply, the Director of Manufacturing Operations stated that corrective action would be taken, with periodic audits, to assure accurate documentation of work performed and feedback on deficiencies noted.

During a special review meeting on February 21, 1970, the Director of Manufacturing Control identified parts requirements, including missing parts, for airplanes—serials 0009 through 0016—at the flight line as follows:

	Number of parts requirements caused by—			
	Missing parts	Discrepancy reports	Other	Total
Airplane serial:				
0009	4,000	1,500	4,943	10,443
0010	3,750	1,300	4,692	9,742
0011	3,300	1,750	3,915	8,965
0012	3,000	1,300	2,882	7,182
0013	1,750	1,000	2,414	5,164
0014	1,300	500	2,843	4,643
0015	650	450	875	1,975
0016	600	400	875	1,875
Total	18,350	8,200	23,439	49,989

Legend: Missing parts—Represents inconsistencies in the assembly records when reconciled at the flight line—some of which may have been installed as in a test on airplanes, serials 0009 and 0010, wherein 9 percent of the missing parts had been installed or were not needed. Discrepancy reports—Represents damaged or unsuitable parts replaced at the flight line. Other—Represents parts that were available but not installed, manufacturing change notices, and parts shortages.

An internal audit report of March 13, 1970, reemphasized the earlier findings that procedures did not require reconciliation of assembly records or visual verification of work performed. Other Lockheed reports showed that the missing parts problems continued as follows:

During the period from March 6, 1970, to April 6, 1970, 893 missing parts were reported for airplane, serial 0020; 1,038 for airplane, serial 0021; and 1,120 for airplane, serial 0022 at the final assemply area.

A report of March 16, 1970, showed that 1,084 parts were reported missing from airplane, serial 0023, but had not been included on shortage lists.

A report of April 27, 1970, showed that a daily average of 257 parts requirements were processed as a direct result of missing parts in the final assembly area.

An internal audit report of May 28, 1970, stated that an investigation of airplane, serial 0019, showed that the unsatisfactory conditions previously found on airplane, serial 0013, still existed and continued to significantly effect the quality, cost, and schedule of C–5 assembly operations. The Director of Manufacturing Operations outlined corrective actions similar to those he had proposed earlier in reply to the February 16, 1970, audit report. He explained that airplane, serial 0019, was almost complete before the earlier corrective action had been implemented and that there had not been sufficient time to experience improvements.

As noted above, reports in March and April 1970 showed numerous missing parts for airplanes—serials 0020, 0021, 0022, and 0023. However, the next internal audit was not made until over a year later, This audit covered airplane, serial 0045, and the report, dated May 25, 1971, stated that adequate administrative controls had been provided for maintaining production and inspection records and that performance was satisfactory.

IMPROPER REMOVAL OF PARTS CONTRIBUTED TO THE MISSING PARTS PROBLEMS

Mr. Durham testified that thousands of parts were improperly removed after being installed and inspected. He said parts were removed without proper authorization and were installed on other airplanes.

Our review confirmed that Mr. Durham's testimony was substantially accurate. However, we were unable to determine the cost impact of improperly removed parts. In addition to the documentation provided by Mr. Durham, which we believe supports his testimony, we obtained other Lockheed reports showing that unauthorized removal of parts was a significant problem which was reported to management.

Mr. Durham provided a statement, written by a former Lockheed official, citing Lockheed's inability to control the cannibalization of C–5 landing gear parts and other large assemblies during the flight test program. The official said hundreds of parts were removed from new landing gears for installation on other airplanes and that no records were kept of the items removed.

Mr. Durham provided an example wherein another Lockheed official reported in April 1970 that, as a result of an audit to determine if parts had been improperly removed from main landing gear assemblies for airplanes—serials 0033 through 0036—26 parts had been removed.

We noted that Lockheed management was made aware of unauthorized removals by internal audit reports and other memorandums on the status of investigations of missing parts. Results of these investigations are as follows:

Date of report	Airplane serials	Number of missing parts investigated	Number of parts improperly removed	Percentage
Oct. 13, 1969	0009 and 0010	160	13	8.7
Dec. 19, 1969	0012	160	12	7.5
Feb. 16, 1970	0013	124	12	9.7
May 28, 1970	0019	63	31	49.2

AIR FORCE PROGRESS PAYMENTS TO LOCKHEED WERE EXCESSIVE BECAUSE WORK WAS INCOMPLETE AND WORK-IN-PROCESS OVERSTATED

Mr. Durham testified that Lockheed moved assemblies and aircraft on a prescribed schedule, regardless of the state of completion, to receive credit and progress payments for being on schedule.

Mr. Poore, Executive Vice-President, Lockheed-Georgia Company testified that (1) payments to Lockheed were based on a percentage of costs incurred, (2) the Air Force withheld funds from these payments for shortages of parts and/or work on delivered aircraft, and (3) payments to Lockheed were carefully controlled and audited by the Air Force Plant Representative (AFPRO) and the Defense Contract Audit Agency (DCAA).

Our review confirmed that Lockheed did have significant financial incentives to move aircraft on schedule—in terms of avoiding up to $11 million in liquidated damages and receiving over $75 million in additional payments representing reimbursements of costs incurred for achieving certain schedule milestones. In addition, the original contract clause limiting progress payments was not enforced, and as a result, Lockheed was paid about $400 million in advance of contractual requirements, according to a February 1970 DCAA report of the overpayment. Although the DCAA estimated that these overpayments would increase the Air Force did not reduce progress payments as a result of the DCAA report because it was not considered in the best interests of the Air Force. In contrast, the Air Force subsequently made an additional $705 million available through May 31, 1971, for progress payments to Lockheed. This was part of a financial plan approved by the Secretary of the Air Force and the DOD Contract Finance Committee to legally fund Lockheed, pending execution of the proposed restructured contract.

The original contract provided for liquidated damages of $12,000 a day, up to $11 million, for late delivery of the first 16 airplanes. Although Lockheed was issued a notice of delinquency, the liquidated damages clause was not applied and was deleted in converting the contract.

The original contract provided additional payments for achieving specific milestones associated with initial tooling and completing certain steps of the test program including making the first five aircraft available for the test program. Although the contract provided for regular progress payments to Lockheed primarily based on 90 percent of costs incurred, the additional payments of $75 million were for the net difference between (1) the proposed target billing price for the milestone events and (2) the amount assumed to have been paid to date in progress payments for the events—as determined by liquidation rates specified in the contract.

For example, Lockheed received an additional payment of $18 million for initial tooling when the first C–5 reached a certain assembly line position. Because the target billing price specified for initial tooling was $99.3 million and the contractual liquidation rate was 81.8 percent, it was assumed that Lockheed had already been paid 81.8 percent of $99.3 million. Thus, the additional payment represented 18.2 percent of $99.3 million or $18 million.

Questions regarding the possibility or need of reducing progress payments had been a matter of concern to the AFPRO since 1968. An AFPRO letter of November 26, 1968, requested advice of the PCO on whether the contemplated action to reduce the rate of progress payments should be pursued—taking into consideration Lockheed's production and quality control difficulties, whether the resulting demands for increased working capital could endanger Lockheed's ability to continue performance, and whether the contemplated action would be improper or tantamount to breach of contract. The C–5 System Program Office (SPO) replied in December 1968 that reducing the rate of progress payments would not be in the best interests of the Air Force at that time—but Lockheed could be requested to provide information about adjustments to subcontractor's progress payments rates.

On February 3, 1969, the AFPRO advised Lockheed that:

1. Consideration was being given to suspending progress payments and increasing the liquidation rate to 100 percent.

2. Cost and schedule studies lead to the conclusion that Lockheed has so failed to make progress as to endanger performance of subject contract, the unliquidated progress payments exceed the fair value of the work accomplished on the undelivered portion of the contract, and Lockheed was realizing less profit than the estimated profit used for establishing the liquidation rate.

The AFPRO position was reiterated to Lockheed by letter of May 27, 1969, in which he also requested financial data on credit and projected cash requirements—for assessing in accordance with ASPR the effect of reducing progress payments. Lockheed replied on June 18, 1969, that total performance would be substantially in accordance with contractural requirements and that no change in the progress payment was justified. On June 27, 1969, the AFPRO advised ASD of Lockheed's position and requested ASD's review and guidance on the matter. And on October 21, 1969, the Air Force Systems Command advised ASD that when current negotiations were completed, the SPO and the AFPRO would jointly establish the proper adjustment to progress payment and liquidation rates—timely action would be taken to increase liquidation rates to assure that unliquidated progress payments do not exceed the fair value of work accomplished on the undelivered portion of the contract.

On January 21, 1970, the AFPRO advised the C–5 SPO that the Resident DCAA Auditor was in the process of taking formal exception to the methods used by Lockheed in developing costs applicable to items delivered, invoiced, and accepted for purposes of progress payments because Lockheed was not utilizing cost estimates in consonance with its records and other reports and therefore was deviating from the ASPR and progress payment instructions without proper authorization. The AFPRO requested guidance as to whether Lockheed should be permitted to continue using its methods.

On March 10, 1970, the DCAA advised the Controller of the Air Force that:

* * * * * * *

"Based on a further analysis of the contractor's progress payment requests, the attached report indicates that current overpayments on Contract No. AF 33(657)–15053 amount to about $400,000,000. This exceeds the entire net worth of the Lockheed Aircraft Corporation as of December 29, 1968, as shown on its published report to the stockholders. The overpayment condition results from cost overruns attributable to delivered items.

The report explains that the contractor has been computing the progress payment limitation by using the contract price of the delivered items rather than the experienced costs of delivered items, thereby inflating the costs eligibile for progress payment.

The subject report reiterates the concern expressed in Report No. 118–10–0–0059 [December 12, 1969] over the contractor's financing problems. It is the auditor's opinion that, even if funds were provided to the contractor to the ceiling price level, there is a strong possibility that financing problems would preclude the contractor from delivering the total number of airplanes ordered."

AFPRO officials told us that:

1. Questions of excess progress payments had not been finalized.

2. Neither Headquarters ASD nor the AFPRO have any record of receiving formal responses from higher headquarters to our inquiries and/or advice as to action deemed appropriate in connection with the audit reports.

3. Because of terms under the converted contract, it appears that the auditor's questions are academic and no action appears necessary, appropriate, or permissable.

Thus, the Air Force did not reduce progress payments to Lockheed as a result of the DCAA report of overpayments. We found that the Air Force, subsequent to the report, made available through May 31, 1971, an additional $705 million for progress payments to Lockheed. As stated above, this was part of a plan approved by the Secretary of the Air Force and the DOD Contract Finance Committee to legally fund Lockheed pending execution of the proposal restructured contract. Effective May 31, 1971, the contract was converted to cost reimbursement type and the limitation on payments clause was deleted.

These funds were made available by the following means:

	Millions
Increased contract ceiling price due to interim repricing adjustments because of the exercise of run B option	$300
Increased allowable incurred costs from 90 percent to 100 percent of the ceiling price	148
Increased ceiling price for provisionally ordered items. (spares and age)	82
Ceiling price adjustments for abnormal flucuations in the economy	143
Ceiling price adjustment for undefinitized change orders	32
Total made available for progress payments from Feb. 21, 1970, to May 31, 1971	705

We also noted that the AFPRO by letter dated January 26, 1970, admonished Lockheed to review those subcontracts providing progress payments and to effect adjustments when required to bring unliquidated payments in line with the current positions of the subcontracts. AFPRO personnel stated that an audit was not requested from DCAA concerning unliquidated payments to subcontractors and no further follow-up was made by the AFPRO after the January letter to Lockheed.

The DCAA Resident Auditor stated that an audit of the subcontractors' unliquidated progress payments in comparison with the value of the work in process was not made because it would be a waste of audit effort since the Air Force had not taken any action concerning overpayments to Lockheed on the prime contract.

In summary, we found that the allegation that Lockheed had received excess progress payments, regardless of condition or schedule, to be correct. Lockheed did receive excess progress payments of about $400 million due to understating the value of the work completed and overstating the value of work in process.

We also found that the Air Force was aware of the excess progress payment situation, but failed to act on it. In fact the Air Force made an additional $705 million available for progress payments to Lockheed. We also noted that the same situation of excess progress payments may have existed with respect to major subcontractors, but neither the DCAA nor the Air Force took action to examine into the matter.

EXHIBIT 2

AIRCRAFT CONDITION REPORT ON MISSING PARTS

Mr. Durham provided a report dated March 16, 1970, which describes the inaccuracies of records of parts installed on airplanes being built and the number of parts missing from airplanes upon their arrival at the final assembly area.

We believe that the report is valid and provides an accurate description of conditions. Lockheed officials provided us a copy of the same report. Our discussion of these conditions and problems is presented under exhibit 1.

EXHIBIT 3

OVERPROCUREMENT AND MISUSE OF VALUABLE SMALL PARTS

Concerning valuable small parts (VSP), bolt-like fasteners made mostly of titanium, Mr. Durham testified that:

"Report shows that as of May 1, 1970, the Company was facing a $30,000,000 cost overrun on VSP due to over-procurement resulting from failure to control parts in production areas and cribs—mostly production areas. The report shows

that VSP cost per aircraft [should be] approximately $560,000. However, the [actual] cost was exceeding $1,000,000 per ship.

This information was verified by the Company Industrial Engineer assigned to * * * straighten out the mess * * *.

* * * * * * *

This was money straight down the drain, impossible to be recovered. The best the Company could ever hope to do would be to bring the cost per aircraft back down to what it was supposed to be ($560,000) at some point.

At the time I checked, Ships 0025 and 0026 were in final assembly and had therefore received most of the VSP since 95 percent or more is installed above—(or earlier than Final Assembly). For the sake of even figures, a $500,000 overrun on 26 aircraft would be * * * $13,000,000.

* * * * * * *

VSP was scattered on floors, tables, in boxes, heaps—all over the place. It was being swept up and dumped. Finally, somebody caught on and started sending it to the Lockheed Ventura Company to be sorted out at 6 cents per item.

The cost of VSP averaged 16 cents to $37.50 each according to [the industrial engineer].

No one knew what or how much had been disbursed out to the shops.

Basically the reason for the over-run was not due to cost but to misuse and failure to establish and maintain an adequate inventory accountability system."

Our review confirmed that Mr. Durham's testimony is substantially accurate. Beginning early in 1968, Lockheed officials recognized that serious problems of inventory and production control were causing overprocurement and high surplus and scrappage rates for valuable small parts (VSP) consisting almost entirely of titanium fasteners. However, controls had not proved effective and in February 1970 the company projected a $25 million overrun which was used to justify a new data processing control system. In July 1970 the company determined that additional controls would save about $3.8 million.

At August 1970, after establishing the new control system, an overrun of about $21.3 million was indicated based on total planned procurement of about $67 million—at an average cost of about $807,000 for each airplane. In contrast, the planned bill of materials cost of VSP for each airplane was $550,000. Lockheed recognized that for airplanes produced initially, VSP costs totaled about $1.9 million each, due in part to design changes, but had decreased to about $350,000 for the 44th airplane.

We estimated that the current overrun at January 1972 will be about $10.4 million—based on the most recent, available company projection in July 1971 that procurement of titanium fasteners will total about $56 million at an average cost of about $674,800 for 81 airplanes and 2 test articles.

Although we did not verify current costs, we believe that the apparent reduction of the overrun is due to increased inventory and production controls and to significant use of substitute steel and aluminum fasteners which were substantially cheaper. The quantity of titanium fasteners used on each airplane was decreased from about 1,100,000 to 900,000—an 18 percent reduction in quantity and cost.

Earlier in the program, to help reduce aircraft weight, Lockheed had increased it usage of titanium fasteners, at substantially higher costs, to the extent that 1,100,000 of the 2,000,000 fasteners in the aircraft were titanium. Lockheed had been so concerned about weight that it ordered titanium fasteners with length increments of 1/32 inch rather than the standard 1/16 inch. However, according to one Lockheed official, much of the emphasis on weight reduction was curtailed after the Air Force insisted on installing a 300 pound work platform in each C–5A.

We determined that VSP valued at about $1.9 million has been declared surplus as of January 1972. Of this, fasteners valued at $1.3 million were recently sold for $2,800 even though Lockheed had previously advised the Air Force that the fasteners were commercial catalog items. Presumably, if these fasteners were catalog items they could have been returned to the vendors or sold to other users.

According to Lockheed officials, internal audit reports, and other documentation, overprocurement of fasteners was due to the following fatcors:

1. Procurement was initially based on forecasts rather than specific engineering requirements which could not be identified because manufacturing tolerances could not be precisely controlled. As a result, an excessive range of fastener lengths was procured to assure the availability of correct fastener lengths.

An internal audit report of February 1968 stated that because VSP requirements had not been stabilized, some purchases based on advance requirements may not be used and VSP on hand which cost $408,000 was excess. The report also showed that VSP requirements for each airplane had not been reconciled between engineering and manufacturing personnel. However, the auditors concluded that actions which resulted in the above were necessary at the time.

2. According to an internal audit report of September 1969, adequate controls had not been provided over the disbursement, handling, and usage of fasteners. Excess quantities were held by production personnel, mishandling was widespread, and usage appeared too high. Inactive VSP valued at $1.5 million was identified and controls were recommended to assure its use. Excess VSP valued at $500,000 was identified.

3. In reply to the September 1969 audit the Director of Manufacturing Operations stated in August 1970 that initial plans were to control VSP usage based on engineering requirements, but because of the high rate of changes the paperwork could not be processed. He said the then current system based on physical counts involved a considerable amount of record keeping and was difficult to maintain. He said that the failure to process the high rate of changes, coupled with discrepancies in original parts counts, resulted in erroneous requirements data and improper procurement. He said that inventory controls were unsatisfactory because control of VSP was lost after disbursement and that significant amounts of VSP were continually recycled through the system for cleaning and sorting by another company.

The Director advised that $872,000 of the $1,500,000 VSP identified earlier could not be used and would be surplused.

4. An official told us that initially many workers were mechanically inept and wasted VSP. The small fasteners were easily dropped and at times the production floor was covered with them. Because the fasteners cost from $.16 to $35.00 each, they were collected and sent to a subcontractor for cleaning and sorting.

The initial purchase order was issued in July 1968 and provided for this service at $6 a pound. Although this rate was changed and is now $.0575 for each fastener, Lockheed paid about $906,000 through December 1971 for cleaning and sorting 52,410 pounds from which Lockheed recovered 43,667 pounds of VSP; 1,334 pounds of miscellaneous small parts; and 6,047 pounds of scrap.

In reply to the September 1969 audit report, the Director of Manufacturing Operations stated that to avoid a serious loss, a pilot system based on usage was developed. All crib transactions were to be recorded by charge cards and keypunched to accumulate usage and procurement data. However, an internal audit report dated December 1970, showed that inventory reports were erroneous and that excessive procurement was still possible. To correct this deficiency the Director of Manufacturing Operations stated that physical inventories would be made more frequently.

We noted in a report dated January 19, 1970, by the Contract Management Division of the Air Force Systems Command that the Air Force had found significant problems in Lockheed's procurement of titanium fasteners, including possible price fixing. The report concluded that Lockheed and the Air Force Plant Representative should aggressively pursue the problems. Lockheed officials agreed. However, the Air Force Plant Representatives has not determined whether corrective action was taken.

The report questioned (1) whether Lockheed could have considered procurement from unlicensed vendors, holding them harmless from patent infringement liability—since the patents had not been contested and were of doubtful validity and (2) whether Lockheed obtained adequate price competition—since vendor's quotes were sometimes identical to the fifth decimal place for the same quantities and since Lockheed had not established that the fasteners were commercial, catalog items sold in substantial quantities to the general public.

In summary, Lockheed did project overprocurement of VSP—as Mr. Durham testified—due to unsatisfactory inventory and production controls. Moreover, Lockheed's inability to control manufacturing tolerances and to determine specific engineering requirements for VSP led to procurement based on forecasts rather than known needs and ultimately to procurement based on usage rates. Subsequently, inaccurate inventory records and misuse of fasteners by production personnel led to inaccurate usage rates and procurement, which generated surplus quantities of VSP to be sold as scrap.

Although Lockheed internal audits identified many of the problems and the need for corrective action, in our opinion the audit reports were not totally ef-

fective because there was generally no identification of the cost impact or adverse effect of the problems noted. This may have been omitted to avoid embarrassing management.

We also noted that the DCAA had not reviewed Mr. Durham's charges concerning VSP and had not previously reviewed inventory and production controls over VSP—even though the pertinent Lockheed audit reports were distributed to the DCAA.

Air Force Plant Representative offiicals did not investigate Mr. Durham's charges or determine whether corrective action was taken on procurement problems identified by the Air Force report.

EXHIBIT 4

REPORT OF MISSING PARTS, ERRONEOUS ASSEMBLY RECORDS, AND DUPLICATE PARTS ISSUES

Mr. Durham provided reports citing examples of erroneous airplane assembly records and the resulting adverse effects in terms of missing parts and duplicate issues of parts already installed. The reports cite unnecessary reprocurement actions resulting from erroneous parts requirements which were generated by erroneous assembly records.

Our discussion of erroneous assembly records and missing parts is presented under exhibit 1. However, the review of Lockheed's procurement, use, and disposition of parts and part kits is expected to require a major effort to identify the extent of unnecessary, duplicate procurement. Accordingly, we will consider this aspect in our continuing review of the management of parts and parts kits. Portions of Mr. Durham's testimony concerning unnecessary reprocurement, resulting from various causes, are included also under exhibits 5, 6, 14, 17, and 18. Because of their significance, these factors will be considered in greater detail in our continuing review.

EXHIBIT 5

UNNECESSARY, DUPLICATE PROCUREMENT AND MULTIPLE ISSUES OF PARTS CAUSED BY LACK OF PARTS INVENTORY CONTROL

Mr. Durham provided a report showing an example wherein parts to be installed were lost and caused unnecessary, duplicate procurement and delivery of replacement parts. Inventory control over parts was lost. Unnecessary procurement resulted also because duplicate orders were issued for replacement of damaged parts.

Because we expect that a major audit effort is required, review of this aspect of Mr. Durham's testimony will be considered in our continuing review—as discussed under exhibit 4.

EXHIBIT 6

UNNECESSARY SHIPMENT OF PART KITS TO PALMDALE, CALIF.

Mr. Durham testified that because of poor planning, parts were assembled into kits and shipped to the field at great expense but were not needed—or were incomplete and could not be fully utilized. Control over kits and parts in the field was ineffective.

Mr. Durham's testimony is partially substantiated by a Lockheed report of April 28, 1970, provided to us by Lockheed officials. The report shows that numerous part kits were being returned from the Palmdale plant to the Marietta plant for restocking and future use. The report shows that these kits were not part of the C–5A modification program planned at Palmdale and therefore were not used. We did not determine the reasons for their initial shipment to Palmdale. However, we intend to review the utilization of parts and part kits as discussed under exhibit 4.

EXHIBIT 7

PROCUREMENT ABUSES AT THE CHATTANOOGA PLANT

In describing procurement abuses at the Chattanooga plant, Mr. Durham testified that:

* * * * * * *

"I will show examples of exorbitant prices paid to vendors for material when the same material was available in Lockheed stores [at the Marietta plant] for a fraction of the price paid to the vendors.

* * * * * * *

The practice * * * persisted despite repeated complaints on my part. Finally, a strong letter stopped it temporarily."

* * * * * * *

We determined that Mr. Durham's testimony and evidence were substantially accurate and valid. We obtained additional evidence that significant percentages of material and other items were procured from vendors although the items were available at substantially less cost through the Marietta plant stores inventory.

These outside purchases were contrary to Lockheed-Georgia Company instructions issued in April 1970, reemphasized in March 1971, which stated that there was no excuse for ordering material from outside sources and spending company funds when identical assets were available in Lockheed storerooms. We also determined that material was frequently purchased on the basis of one item on each order form, thereby unnecessarily incurring the vendor's minimum charge for each order. Moreover, material and parts were ordered without knowledge of stock on hand at the Chattanooga plant and without knowledge of cost—because neither perpetual inventory records nor price lists were maintained. Consequently, billing prices were not verified—even though this deficiency was disclosed.

Although we could not determine the total adverse effect or dollar impact resulting from these procurement practices, we did expand the review beyond the scope afforded by Mr. Durham's examples to establish that a pattern existed.

A procurement official at Chattanooga verified that examples and documentation provided by Mr. Durham were valid and showed that items purchased from vendors were available at lesser cost from the Marietta storeroom. Our analysis of his 20 examples showed that the vendors charged $1,516 or more than 3 times the cost that would have been incurred if the items had been obtained from Marietta stores.

Our expanded review of purchases from several vendors, during sample periods, showed that about 9 percent of the miscellaneous parts purchased from two vendors were available through the Marietta procurement system at 62 percent savings and 16 percent of material items purchased from another vendor were available at 77 percent savings. For example, vendors were paid $1,633 versus the Marietta cost of $622 for miscellaneous small parts and $500 versus the Marietta cost of $115 for material items.

We determined that during a 3-month sample period in 1971, 217 or 44 percent of 489 orders for material incurred the vendor's minimum order charge of $5 ($4 prior to April 3, 1971) which could have been avoided or minimized by combining the orders and processing fewer order forms. A former procurement official told us that although he began to combine orders, he was forbidden to continue because management said material receipts were more easily controlled if ordered separately.

Considering the confused state of the material, purchased parts, and miscellaneous small parts inventories and the lack of controls, which are discussed in exhibits 10 and 11, it is understandable that material receipts could be controlled better by ordering one line item on one requisition. We noted many examples wherein the same materials with the same dimensions were ordered separately on the same day—sometimes on consecutively numbered forms. Minimum charges were also incurred on some examples cited by Mr. Durham wherein the items were already available in the Marietta storeroom.

The Chattanooga procurement supervisor told us that procurement personnel must not have checked the Marietta stores catalog adequately before ordering parts from vendors. He also told us that Lockheed's costs for cutting material from stores would be so high that the vendor's price would be cheaper because the vendor warehoused, cut, and shipped the material. We believe that this position is clearly unrealistic because it negates the earlier Lockheed instructions; it does not consider the effect of minimum vendor charges, and does not recognize that daily delivery service was provided routinely between the two Lockheed plants. Moreover, because of the lack of catalogs and price lists, the official could not have made adequate cost comparisons. He told us that the vendors wrote in the prices on almost all orders for material and miscellaneous

small parts and that Chattanooga procurement personnel did not verify these prices.

In contrast to our findings, the Air Force Plant Representative and his staff concluded after a 3-hour review in July 1971 that the Chattanooga "procurement system was satisfactory" and that "All items of purchased parts or raw material for manufacture are purchased by the Materiel Branch at Marietta."

UNNECESSARY PROCUREMENT OF MAINTENANCE NUTS AND BOLTS

As an example of procurement abuses at the Chattanooga plant, Mr. Durham testified that:

"A salesman from one company would come to the Plant, look in the bins and supply whatever he thought was needed. The problem is that he supplied far more expensive parts than were needed and as many as he thought he could get in the bins. For example, he sold Lockheed steel high-tensile bolts, plated bolts, etc., when plain old common stove bolts would do. No one in management questioned anything and went right on paying the bill. No bids were taken. A check showed that a * * * regular hardware supply company could supply parts much cheaper. A real peculiar situation developed when this same salesman changed companies. The bolt account went with him. This is highly irregular. Lockheed is supposed to obtain parts by bid from companies—not individuals."

* * * * * * *

Our review confirmed that this charge was substantially accurate. We determined that, for ordinary plant maintenance purposes, Lockheed purchased the highest possible strength nuts and bolts—exceeding high aircraft specifications—at a cost of about $36,000 over a 5-year period from 1966 through 1970. These purchases were made without competition. Although the salesman apparently flimflammed both Lockheed and his employer, by establishing his own company and proceeding to represent both companies simultaneously, Lockheed issued each purchase order and renewed them on the basis that the items were normally available from only one source.

We determined that the company could have saved about $30,400 or 84.5 percent of costs by purchasing lower grade items from other vendors. As a result of a Lockheed study of this matter in December 1970, the company began purchasing its needs from another vendor in 1971. Lockheed also issued this purchase order on the basis that the items were normally available from only one source. However, we determined that about 64 percent of the items included in the study were normally stocked at the Marietta plant and that the new vendor's prices were about 33 percent higher. We noted that Chattanooga plant officials had been directed to maximize use of the cheaper Marietta stock and that delivery trucks provided daily service between the plants.

A Chattanooga official told us that a Marietta plant official initially introduced the salesman as representing the selected company. The officials said that in 1969 the salesman began representing another company. We determined that he was fired in July 1970 by one company for simultaneously representing both companies and that he is currently president of the other company.

Annual purchases from both companies ranged from about $4,700 in 1966 to $9,500 in 1969, but decreased to $1,400 in 1971. Purchases from the new vendor selected in 1971 totaled only about $1,200 during the year. Thus, annual purchases of maintenance items decreased substantially in 1971 because of decreased requirements and lower prices.

Because they had no vendor catalogs or price lists at the Chattanooga plant until early 1971, procurement officials there were unable to determine that the prices were reasonable. Moreover, invoiced unit prices of items received could not be verified. Procurement officials said that they relied on the manager of maintenance and general plant service to order whatever was necessary.

The maintenance manager told us that although he did not have a price list either, he knew the higher grade items were more expensive. He said that he, rather than the salesman, was responsible for ordering maintenance nuts and bolts, including determining the quality and quantity needed. He said that he could not explain why he bought a range of high quality items without adequate cost comparisons.

EXHIBIT 8

WASTE OF TOOLS AND EQUIPMENT AT THE CHATTANOOGA PLANT

Mr. Durham testified that:

"Standard tools of Chattanooga were completely out of control. (Standard tools consist of such items as drills, carbide cutters, bits, etc.) Many are very expensive. Incredible as it seems, there was no checkout control system or any effective controls. No one knew where anything was or who checked it out. The tool engineers in charge of security told me that $250 to $300 a week was being spent to replace pilfered or lost standard tools. He said this was a conservative figure. I found perfectly good tools rusting away in the back yard * * *.

Example: Rusty drills found in an old water-soaked cabinet thrown out in the back yard. They were immersed in water and ice when I found them. Since I had no jurisdiction over tools. I immediately pointed the condition out to the plant manager in person. Six months later, they were still there, along with other costly equipment and material—rusting away.

* * * * * * *

A control system for tools still had not been established by May of this year (1971)."

Our review confirmed that Mr. Durham's testimony is substantially accurate. We found that his evidence—a written statement by a tool engineer and examples of rusty drill bits—are valid. We obtained additional evidence that significant quantities of tools were lost or stolen due to the laxity of general plant security and the absence of specific controls over standard tools.

Although we note that the company spent a monthly average of about $12,000 to replace standard tools, from May 1970 through May 1971, we could not determine the cost of losses as opposed to valid replacements because of the lack of records. There were no systems to control and record the inventory and issues of standard tools—except that there was a check out system for some items such as precision gauges and micrometers. Even so, 111 gauges valued as $3,614 have been lost since 1966.

The only estimate of losses we could obtain was in a written statement provided to Mr. Durham by the engineer responsible for procurement and handling of standard tools and plant security. He stated that:

* * * * * * *

"There was no check out control of cutting tools to the production areas and regularly small but expensive tools have been reported issued and lost in the shop. It is a fair estimate that between $500 and $400 a week would be saved using some sort of locator control issue system. Security is so loose that company equipment can be taken almost at will with the inability of the management to know the amount of loss."

* * * * * * *

In May 1970 the Chattanooga plant manager recognized that equipment and material were being stolen due to the lack of security and recommended installing a closed circuit television system at a cost of about $4,400, completing the surrounding fence, and increasing effectiveness of the guards. Except for the fence, his plan was not approved.

Plant officials and former employees told us that some of the items stolen were an air compressor, electric motor, power saw, several paint spray guns, socket wrenches, tires intended for C–5A ground support equipment, a micro-wave oven, a dollar bill change machine, and a 200-pound tool box.

In May 1970 the plant manager recognized the need to regain a favorable standard tool budget position and eliminate accumulation of tools in stock—including drill bits in need of grinding. He directed taking a complete inventory to better control and use tools in stock and monitoring the budget and procurement actions.

In October 1970 the tool engineer recognized that costs of supplying standard tools and related equipment was rising. He proposed an inexpensive system to control issues of standard tools based primarily on use of numbered tags to identify the workers charged. In July 1971 the tool engineer again stressed the need for a complete inventory of standard tools as an essential task to identify and remove obsolete tools.

We determined in January 1972 that there were no systems to control and record the inventory and issues of standard tools nor were there any records of

losses. Plant officials told us that issue controls had not been established because the costs of controls would exceed the cost of lost tools. However, the tool engineer told us that the costs of controls would be minor and that only the cost of identification tags for each worker need be considered.

We believe that as a result of the lack of inventory and issue controls, obsolete and excess standard tools were generated. An Air Force report of August 1971 showed that tools on hand were excess to reasonable requirements and that a large quantity of tools from another Lockheed company had been put in stock, but some had not been used. The tool engineer told us that as a result of the Air Force review about 2 tons of standard tools were scrapped.

In regard to Mr. Durham's exhibit of drill bits which he found rusting in the plant yard, Lockheed officials told us and the subcommittee that only about half a shoe box of drills was found. They said the drills were in a cabinet of a fixture transferred in from another Lockheed company and stored in the back yard. However, an employee and a former employee told us that they observed substantially more drill bits and other cutters. These conflicting statements could not be verified because of the lack of records.

EXHIBIT 9

INADEQUATE CONTROL OVER MATERIAL AT THE CHATTANOOGA PLANT

In describing the lack of control over material, Mr. Durham testified that: "Material (raw stock such as extrusion, bar steel, sheet metal, aluminum stock, etc.) was completely out of control * * *. No one knew where anything was, including expensive castings and forgings. Material * * * [was] being ordered every day when it was actually available if anybody had known it or knew where it was. Old scrapped material, new material, old rusty pipes, maintenance equipment, rubber goods, dirt, wood, trash, and other debris were all heaped together. Expensive castings and forgings were piled in old, rusty, water-filled barrels or buried in the muck.

* * * * * * *

* * * I did manage to get this [scrap] cleaned up by dumping 42½ tons (a matter of record) of old material which had rusted and corroded beyond recognition. This enabled us to sort out what was left and get it under control. I established a catalog control system and set it into motion."

* * * * * * *

Our review confirmed that Mr. Durham's testimony is substantially accurate and his evidence valid. We obtained additional evidence that a substantial but indeterminate amount of surplus and scrap raw material, finished parts, tools, equipment, and miscellaneous small parts had been accumulated as a result of production waste, canceled Air Force orders, transfers from another Lockheed plant to the Chattanooga plant without a foreseeable need, and ineffective management controls. However, we were unable to determine the amount attributable to ineffective management because there were no perpetual inventory records of regular stock and no inventory records or other descriptive records of the surplus and scrap on hand at the time.

In a memorandum for distribution dated September 1970, the Chattanooga plant manager stated that the accountability and handling of material was out of control. He stated that there were plans underway to install control systems and directed that in the meantime the indiscriminate ordering of material must cease. According to Mr. Durham's memorandum of March 22, 1971, approved by the plant manager, the purging and sorting of raw stock material was in process to provide an accurate determination of available material and a basis for inventory control and material handling.

As a result of Mr. Durham's efforts, much of the surplus and scrap was sorted, identified, and sold as scrap or stored properly in 32 large plywood boxes which he had built. About 603,500 pounds of material, equipment, and other items were sold as scrap for about $37,400 between June 1, 1970, and July 14, 1971. Other material and parts valued at about $77,000 were set aside for transfer to the Department of Health, Education, and Welfare. About 1,200 line items of miscellaneous small parts were transferred to the Marietta plant. Mr. Durham initiated a system to control and locate the stored surplus and another system to eliminate the practice by which production personnel could easily and without

proper authorizing documents obtain replacements for material and parts lost in the shops or damaged.

Plant officials told us that excess parts and material had been accumulated inside the plant and in the yard. Several officials, employees, and former employees confirmed that the plant yard had been substantially covered with surplus and scrap items, much of which was unidentifiable.

One former employee told us that it was difficult to drive a forklift in the yard because it was so completely filled with junk, excess raw materials, titanium stock, test fixtures, electric motors, caster wheels, castings, forgings, lathes, and other miscellaneous items. He said the rain and weather had corroded or damaged some of the items, including partial frames for C–5 Aerial Delivery System Trailers, which had collected water and burst in freezing weather. An Air Force inspection in July 1971 showed that a considerable number of these frames were still stored outside and unprotected. However, we observed in January 1972 that they had been moved inside the plant.

Another former employee generally confirmed the condition of surplus/excess material and told us that titanium stock valued at about $30,000 could not be used because the related certification papers were not available. The Manufacturing Services Department Manager told us that the titanium was scrapped because it was excess due to engineering changes and its content could not be determined due to lack of certification papers.

Although there were no records describing the 42½ tons cited by Mr. Durham, plant officials told us that the sale included unidentifiable raw materials, tools, and production scrap. On October 7, 1971, Lockheed advised the subcommittee that as a result of closing a facility in Atlanta, Georgia, considerable stock and equipment was transferred to the Chattanooga plant including a large 8-ton test fixture, a structural monorail, scrap steel, several metal cabinets, and metal work benches. Lockheed stated that these items could not be used at Chattanooga and were stored outside. Lockheed stated that the 42½ tons of scrap were sold in May 1971 for $1,159.

We observed and photographed the excess parts and material stored in plywood boxes and in the yard. The excess included miscellaneous small parts; purchased parts for production of missile dollies; frames and tires for C–5 Aerial Delivery System Trailers; extrusions, raw stock, finished parts, castings, and forgings for C–5 loading docks; casters for C–5 engine maintenance platforms; and various forgings, castings, standard tools, project tools, and shop aids for producing C–5 and other aircraft parts and ground support equipment.

Because of the lack of records, we could not determine the adverse effect or dollar impact of inadequate control over this material and other items, in terms of deterioration of the items on hand and unnecessary, duplicate procurement of items already available. Neither could Lockheed management. Moreover, since acquisition of the Chattanooga plant in February 1966, the plant operations were internally audited only once. The internal audit report of May 9, 1967, disclosed no major deficiencies. It stated that there was no accumulation of excess material and that controls were adequate over material and parts inventories, tools, procurement, and production control.

We believe that significant losses occurred unnecessarily during ensuing operations because, as recognized by the Chattanooga plant manager, management lost control over the procurement, accountability, and handling of material. New materials were ordered indiscriminately according to the plant manager. Materials and parts were ordered without regard to stock on hand according to the procurement supervisor. A former procurement official confirmed this and told us that material and parts were routinely ordered to cover material lost in the shops and to replace mutilated material. One former production worker told us that workers could easily obtain replacement parts and material by getting it from the open-crib storage areas or having it ordered by procurement officials without having to furnish documentation.

Mr. Durham helped establish a closed-crib storage system and issued instructions with the plant manager's approval to provide documentation and control over replacement for lost and damaged material. However, management did not establish inventory control over raw stock and purchased parts.

As a result of Mr. Durham's charges, the Air Force Plant Representative and his staff reviewed some operations at the plant. However, we believe that the effort was incomplete and the report somewhat misleading because the scope and depth of review were limited. The report states that a small group of personnel visited the plant during the afternoon of July 27, 1971, to review plant operations, especially purchasing, inventory control, and actions regarding mate-

rial discrepancy reports. Review of procurement was limited to about 3 hours and, in our opinion, erroneously led the team to conclude that the procurement system was satisfactory. Although no specific corrective actions were recommended, the report confirmed or stated that:

1. In February 1971, Mr. Durham demonstrated that only 813 line items of miscellaneous small parts were needed although 4,894 line items had been accumulated, but then current policy did not require reporting these to the Marietta plant for possible use. Subsequently, about 1,200 line items were sent to Marietta. The excess items were due to AGE cancellations and transfer of inventory from Lockheed Industrial Products Company.
2. Due to canceled orders, only half of the parts currently stocked were needed.
3. A considerable number of trailer chassis were excess due to canceled orders, but they were stored unprotected.
4. Nearly all material, castings, and forgings stored outside were left over from canceled Air Force orders.
5. Because entire lots of parts were produced with the same defects in each part, it is obvious that first-piece inspections were inadequate to assure correct machine set-ups.
6. Tools were on hand in excess of any reasonable requirement and had not been used in some time.

As of August 1971, Lockheed planned corrective action to identify, use, or dispose of the excesses, however, much of this material, parts, and other items remained at the plant as of January 1972, as discussed earlier. During our review Lockheed announced plans to sell the Chattanooga plant. No details were disclosed concerning disposition of excess materials and parts.

EXHIBIT 10

QUESTIONABLE PROCUREMENT PRACTICES DUE TO LACK OF PARTS CONTROL AT THE CHATTANOOGA PLANT

Mr. Durham testified that ineffective management and control over purchased parts and miscellaneous small parts resulted in unnecessary, duplicate procurement because the availability of parts on hand was not determined or controlled. He also cited in this exhibit examples of small parts purchased at excessive prices, which we discussed in exhibit 7.

Our review confirmed that Mr. Durham's testimony is substantially accurate. We obtained evidence that parts and material were ordered at the Chattanooga plant without knowledge of their cost, quantities in inventory, and justifiable need. Physical counts of inventories, to support procurement action, would have been difficult in our opinion because there were no inventory records, the stockrooms were open-cribs with parts and material scattered about, and usable parts were not cross-referenced to part number changes and substitute part numbers. Additionally, the carelessness of production workers resulted in unnecessary losses of and damages to parts and material being worked in process. Inadequate inspections resulted in entire lots of parts produced with the same defect as the result of incorrect machine settings. Procurement of replacements, without documenting losses and damages, was routine. These factors are discussed in greater detail in exhibits 7, 9, and 11.

Although we could not determine the extent of unnecessary procurement—because of the absence of controls and inventory records—plant officials and former employees told us that unnecessary procurements resulted from the factors cited above. The Manufacturing Services Department manager told us that one of Mr. Durham's best achievements was to provide for proper cross-referencing of part number changes. The department manager also said that Mr. Durham established separate, closed-crib storerooms for purchased parts and miscellaneous small parts in numerical part number sequence.

EXHIBIT 11

UNNECESSARY PROCUREMENT OF MISCELLANEOUS SMALL PARTS DUE TO LACK OF INVENTORY CONTROL AT THE CHATTANOOGA PLANT

Mr. Durham testified that unnecessary procurement of miscellaneous small parts resulted at both the Chattanooga and Marietta plants because the Chattanooga inventories were overstocked and out of control. He said that as a result of poor management, including purchasing without checking available stock, and

the closure of another Lockheed plant in Atlanta, Georgia, about 4,894 line items of miscellaneous small parts had been accumulated at the Chattanooga plant—although a review of engineering requirements showed that only 813 line items were needed.

Our review confirmed that Mr. Durham's testimony is substantially accurate. Both the Air Force Plant Representative at the Marietta plant and Lockheed officials at the Chattanooga plant confirmed that excesses had been accumulated.

The Air Force Plant Representative's report of August 2, 1971, states that in February 1971, Mr. Durham inventoried the miscellaneous small parts on hand, reviewed engineering requirements, and found that only 813 of the 4,894 line items were needed for the approximately 1,100 related assembly orders then in process. The report states that it was plant policy at the time to hold the excess parts for future orders rather than to report them to Marietta management for screening and disposition purposes. The report also states that the large count was due mainly to heavy workloads during 4 years which peaked at about 2,500 assembly orders for aerospace ground equipment in the summer of 1970.

The report states also that (1) large quantities of the parts were accumulated as a result of orders cancelled by the Air Force in the fall of 1970 and Lockheed's closure of another plant and (2) about 1,200 line items were later sent to the Marietta plant for use.

The Manufacturing Services Department manager generally agreed that Mr. Durham identified the excesses, but he stated that more than 900 parts were needed—rather than 813. He told us that Mr. Durham had organized the parts crib, obtained storage bins, and identified needed parts. He told us also that at January 1972 about 3,000 excess miscellaneous small parts were still on hand.

A former employee told us that the parts crib inventory had been completely out of control, parts were scattered about, and production personnel had to spend unnecessary time looking for needed parts. He said that a substantial amount of these parts were included in the surplus material found outside in the yard.

Our discussion under exhibits 7 and 10 further demonstrates that inventories were not controlled, perpetual inventories were not maintained, and that procurement action was taken without knowledge of available stock on hand.

EXHIBIT 12

INEFFECTIVE WORK SCHEDULING RESULTED IN UNNECESSARY PERSONNEL LAYOFF AND REHIRE COSTS AT THE CHATTANOOGA PLANT

Mr. Durham testified that effective work scheduling and proper planning could have prevented a break in the work load which caused the layoff of production personnel and subsequent rehire, almost immediately, at great expense.

Our review confirmed that a significant layoff occurred in March 1971. However, we could not fully substantiate Mr. Durham's testimony because the personnel did not receive severance pay. Of 74 employees laid off, 24 were rehired. The extra expense comprised administrative costs. The workload associated with the rehire was transferred to the Chattanooga plant from the Marietta plant. The plant manager told us that, before the layoff, he was not aware that the work would be transferred.

EXHIBIT 13

INCOMPLETE AIRPLANE AT ROLL-OUT

In describing how airplanes were moved to the flight line with a substantial number of missing parts—although parts installation records indicated they were complete, Mr. Durham testified that:

"As previously mentioned, the subterfuge began on Saturday, March 12, 1968, with the roll-out of Ship 0001, and continued. It rolled out with slave landing gears, false leading edges, dummy visor (nose of aircraft) and other faked components."

Mr. H. Lee Poore, Executive Vice-President of Lockheed-Georgia Company testified that:

* * * * * * *

"The nose cap, terminology referred to by Mr. Durham, is not recognizable, but he is most likely referring to the visor. At roll-out, the visor was functional on airplane 0001. In fact, the visor was raised during ceremonies and selected

dignitaries walked-through the aircraft. It is true that certain systems of the aircraft were not functional, nor were they required for the roll-out ceremony.

More important, it should be mentioned that while airplane 0001 rolled-out on March 2, 1968—on schedule—its first flight was scheduled and accomplished four months later, on June 30, 1968. The roll-out ceremony was a mere formality and there was certainly no intention to deceive anyone."

* * * * * * *

We noted that on July 23, 1971, the Air Force Plant Representative advised the Air Force Systems Command that Lockheed's statement concerning the visor was not completely accurate because operation of the visor was restricted. The Representative stated:

* * * * * * *

"* * * It is also true that some panels, etc., were units installed in place of parts which were short, and in other cases, installed parts required additional work before being suitable for flight. This is a common practice at 'roll-outs'."

Based on the above, we believe that Mr. Durham's testimony was generally accurate and that neither Lockheed nor the Air Force substantially disagreed—except that Lockheed denied the subterfuge. (See also the discussion on the missing parts problems of Exhibit 1.)

ASSEMBLY RECORDS ON AIRPLANE, SERIAL 0008, WERE INACCURATE

Mr. Dunham testified that airplanes were incomplete on arrival at the flight line although assembly records indicated they were complete. As an example, he cited a memorandum showing that more than 10,000 parts were delivered for airplane, serial 0008, but 4,000 were returned as not needed due to inaccurate assembly records.

Although we were unable to verify this example concerning airplane, serial 0008, we believe that Mr. Durham's testimony concerning inaccurate assembly records is valid. Additional information on these factors is discussed under exhibit 1.

EXHIBIT 14

PRODUCTION COSTS WERE UNNECESSARILY INCREASED BY USING DISTANT FEEDER PLANTS FOR PARTS ASSEMBLY

Mr. Dunham testified that production costs were unnecessarily increased by shipping parts and equipment to distant feeder plans for assembly of components to be returned to the Marietta plant. He also said that thousands of parts were missing from the feeder plant assemblies on arrival at the Marietta plant due to poor planning and workmanship and the need to meet schedules.

A GAO review in 1967 of the establishment of Lockheed subassembly plants and the cost of assembly operations associated primarily with C–130 and C–141 subassemblies showed that total aircraft costs were not increased because of the use of subassembly plants. We found that after learning was substantially complete, subassembly plant costs were slightly less than at the main plant primarily because lower labor costs more than offset the additional transportation and other costs incurred.

Lockheed established six subassembly plants in depressed labor areas to supplement assembly operations at the main plant. Most of these plants supported the C–5A program. The plants were located as follows: Clarksburg, W. Va.; Charleston, S.C.; Logan, Ohio; Shelbyville, Tenn.; Uniontown, Penn.; and Martinsburg, W. Va.

We noted that the Shelbyville plant has been closed and that the Logan, Uniontown, and Martinsburg plants are to be closed in March through May 1972.

Regarding incomplete feeder plant assemblies, Mr. Durham provided a report, dated October 13, 1969, showing that an investigation of 160 parts on airplanes, serials 0009 and 0010, disclosed that 108 or 67.5 percent were missing. Of these missing parts, 56 were components of feeder plant and subcontracted assemblies. We believe the report is valid; however, we did not verify the number of parts specifically attributable to feeder plant operations. This aspect will be considered in our continuing review.

EXHIBIT 15

THE SHORTAGE LIST AND CONDITION REPORT ON AIRPLANE, SERIAL 0023, WERE ERRONEOUS

Mr. Durham testified that although the shortage list and condition report for airplane, serial 0023, showed only 30 open items (parts not installed) it actually had 1,084 open items on arrival at the final assembly area on March 11, 1970. Mr. Durham provided a report to substantiate these conditions and to rebut Lockheed's contention that such problems existed only on the first few airplanes.

We believe that Mr. Durham's statement concerning the open items on airplane, serial 0023, was accurate and the report valid. The information was substantiated in a report dated March 16, 1970, prepared by Mr. Durham and provided to us by Lockheed officials. Additional information on the inaccuracies of assembly records and missing parts is discussed under exhibit 1.

EXHIBIT 16

REWORKABLE PARTS WERE ERRONEOUSLY SCRAPPED

Mr. Durham testified that millions of dollars worth of reworkable purchased parts were scrapped because of erroneous disposition instructions generated as follows:

"Frequently due to engineering changes, parts must be removed from aircraft and replaced with later or higher configurations. Where possible, planning calls for purchased type parts to be removed and returned to vendors for updating * * * at factories. Small fabricated-type parts which cannot be reworked are dispositioned [in the] shop. The problem was that the planning paper called for thousands upon thousands of parts to be scrapped, which should have been returned to vendors for rework. A company auditor trying to find out what was causing over-procurement and re-purchasing activities discovered the problem. * * * causing over-procurement and re-purchasing activities discovered the problem. * * *

In my opinion, the Planning Division faced with a voluminous backlog of paperwork resulting from engineering changes, was unable to process work package on schedule. Under great pressure, bordering on panic to reduce the number of behind schedule engineering packages, they took the easy way out and coded the paperwork scrap rather than taking time to perform the necessary research and call for paper dispositions. Usually the name of the game in any situation was to make schedule, regardless of the price. * * *"

Mr. Durham also referred to his letter of April 17, 1970, to the President of Lockheed-Georgia Company, in which he stated that scrappage was due to mishandling and tagging of parts by Production, Quality Control, and Production Control divisions and to erroneous instructions on planning documents, such as the Manufacturing Change Notice (MCN) and the Liaison Drawing Change Notice (LDCN). The letter also shows that procedures required the production departments to tag parts according to instructions, the quality control departments to verify and stamp the tags, and the production control department to route the parts.

Our review has confirmed that expensive purchased and subcontracted parts, which could have been salvaged, were erroneously discarded. However, we were unable to determine the total adverse effect—the value of the discarded items.

Lockheed records demonstrate that the problem existed. One such record by Mr. Durham in November 1969 emphasized the need to properly tag parts planned for rework, with reference to the MCN or LDCN.

Planning officials reported on April 14, 1970, that investigation had shown that expensive salvageable parts and assemblies had been erroneously discarded for various reasons. The report recommended corrective procedures for subcontract and vendor parts and assemblies and also in-plant manufactured items, with the intent to require tool planners to specify attachment of proper, color-coded tags to parts removed by MCN and LDCN documents. Previously, colored tags had been attached by Production personnel based on their interpretation of information shown on the MCN and LDCN documents.

Another inter-office memorandum, dated April 29, 1970, states that quantities of C–5 purchased and subcontracted parts were found improperly tagged in scrap gondolas which supposedly contained only material which could not be reworked.

The report advised that Production Control would establish a screening crib to assure proper tagging. Flight line activities were requested to send scrap gondolas to the new crib for review.

A comprehensive Lockheed internal audit covering scrap controls in fabrication divisions was reported in October 1970 and showed that (1) controls over the scrapping of fabricated parts through the use of Discrepancy Reports and other documents were inadequate to a significant degree and (2) performance under the controls was unsatisfactory. The report showed that correction of deficiencies would require extensive revisions to manufacturing procedures regarding Discrepancy Reports and documentation. The report states that manufacturing and quality control procedures were revised and that this corrective action was satisfactory. Lack of control was evidenced by the following:

1. Practices of physically disposing of scrap were not in accordance with control procedures in that scrap yard personnel did not identify parts of supporting disposition instructions. Instead, and undocumented in-process and completed parts were received, accepted, and loaded in scrap trailers without screening. Performance with respect to control requirements was almost totally nonexistent.
2. Controls were inadequate to ensure that Discrepancy Reports and other disposition instruction forms were properly processed for replacement and statistical purposes. Accordingly, performance has been unsatisfactory.
3. Controls were unsatisfactory to ensure that scrap dispositions were properly documented and approved on prescribed forms. One form, which is not a scrap authorizing document and should have been used to submit parts to inspection for possible rework, was instead used to support scrapping actions. Controls had not been provided to assure that production and inspection supervisors' stamps and signatures were provided to show required approvals.
4. Controls were not completely satisfactory to ensure prompt and effective corrective or preventive action through analysis of Discrepancy Reports and shop disposition forms.

EXHIBIT 17

INCOMPLETE PARTS KITS SENT TO EGLIN AIR FORCE BASE

Mr. Durham testified that parts kits sent to Eglin Air Force Base, Florida, to provide for engineering changes were found to be incomplete due to omission of needed parts on related parts lists. He cited an earlier report, which he submitted in November 1969, advising the production control department that kits were incomplete due to incomplete parts lists, kits were not being controlled after receipt, and parts were scattered about.

Our review confirmed that Mr. Durham's testimony was substantially accurate. In discussing Mr. Durham's report, the Director of Manufacturing Control validated the report by giving us a copy and stating that, initially, planning papers and parts lists were incomplete because field installation was not provided for. Kits did not include miscellaneous small parts, fasteners, and other items which were available in the main plant but not at other bases. He said there were problems initially, but they have been corrected.

Because our review was limited, we could not determine the cost impact of incomplete parts kits and the lack of inventory control over parts kits. However, these factors will be considered in our continuing review.

EXHIBIT 18

NUMEROUS DISCREPANCY REPORTS WERE WRITTEN AT THE FLIGHT LINE FOR DAMAGED PARTS WHICH HAD BEEN IGNORED BY QUALITY CONTROL

Mr. Durham testified that numerous damaged parts which had been ignored by the Quality Control Department were identified at the flight line. This resulted in replacement of parts from vendors at premium prices, shipped air express, with thousands of hours of overtime. He provided a report showing that 6,746 parts were rejected on airplanes—serials 009 through 0013—after their arrival at the flight line.

Although we have not determined the adverse effect or cost impact of the problem, we believe that Mr. Durham's testimony is correct in describing the

magnitude of rejected parts identified at the flight line. This is substantiated by another Lockheed report dated February 21, 1970, which shows that about 50,000 parts were required for airplanes—serials 0009 through 0016—after their arrival at the flight line, including 8,200 parts required to replace damaged and unsuitable parts. The causes of damaged parts and resulting replacement activities will be considered in our continuing review as discussed under exhibit 4.

EXHIBIT 19

REPORT OF PARTS DELIVERED FOR AIRPLANES AFTER THEIR ARRIVAL AT FLIGHT LINE AND FLIGHT TEST AREAS

Mr. Durham provided a report showing that as of January 23, 1970, about 45,439 parts had been delivered to airplanes—serials 0009 through 0014—after they arrived at the flight line and flight test areas. The report shows that 15,291 of these were missing parts and 5,294 were replacements for rejected parts.

Additional information on missing parts and the accuracy of airplane assembly records is discussed under exhibit 1. However, we believe that this example is substantially correct and demonstrates the magnitude of parts requirements and problems at the flight line. It is supported by a report of February 21, 1970, provided by Lockheed officials which shows that almost 50,000 parts were delivered of which 18,350 were missing parts and 8,200 were replacements for damaged or unsuitable parts.

EXHIBIT 20

LACK OF CONTROL OVER THE STOCKROOM AT THE CHATTANOOGA PLANT

Mr. Durham testified that there were no controls over parts and the stockroom at the Chattanooga plant.

Our review confirmed that Mr. Durham's testimony is substantially accurate. The lack of controls is discussed under exhibits 9, 10, and 11.

EXHIBIT 21

CONTROL PROCEDURES NEEDED AT THE CHATTANOOGA PLANT

This exhibit consists of a letter which Mr. Durham wrote to the Chattanooga plant manager in May 1971 to emphasize the need to follow control procedures which he had initiated and to establish controls over standard tools. The letter also contains a summary of conditions which existed during Mr. Durham's employment at the plant.

These conditions and need for controls were discussed under exhibits 7, 8, 9, 10, and 11, which confirm that Mr. Durham's testimony was substantially accurate. We also specifically discussed the letter with the Manufacturing Services Department manager who told us that the charges were valid—although the extent of losses and waste was probably not as great as Mr. Durham indicated. In summary, the charges were as follows:

1. Raw material was purchased although quantities were available in stock.
2. Miscellaneous small parts were purchased without determining quantities on hand.
3. Raw stock, purchased parts, and miscellaneous small parts were purchased from vendors rather than ordering it from the Marietta plant stockroom at lesser cost.
4. There were no controls over the stockroom and inventories.
5. Shop orders were not assigned for production on a first-in, first-out basis.
6. Of about 4,800 line items of miscellaneous small parts on hand only 813 were needed.
7. The Planning Department would change part numbers on parts lists without notifying the Production Control Department.

8. The matching of material and parts with related shop orders was not controlled.

9. Material lost or damaged in production could be replaced easily by telephoning procurement personnel so that waste would be concealed.

10. Material and parts listings were not kept current as to part number changes.

11. Loss of control over standard tools resulted in replacement costs of $250 to $300 weekly.

12. Supervision was lax.

13. In some instances, standard hours would be credited to the cost centers before the shop orders and work could be inspected.

EXHIBIT 22

OVERDESIGN OF AEROSPACE GROUND EQUIPMENT AND USE OF AIRCRAFT SPECIFICATIONS IN ITS MANUFACTURE UNNECESSARILY INCREASED COSTS

Mr. Durham testified that the cost of aerospace ground equipment was unnecessarily increased because the parts and equipment were overdesigned and unnecessarily made to aircraft specifications. He said this was done to decrease competition and increaase profits ot Lockheed and the aerospace industry. Much of the equipment was manufactured in the Chattanooga plant wherein management did not maintain cost control procedures over purchasing—parts used were more expensive than commercial hardware because of the close tolerances and other specifications usde.

Accordingly, Mr. Durham recomended investigation of the design concept and cost of aerospace ground equipment. Although we have obtained some photographs and other preliminary information at Lockheed and the San Antonio Air Materiel Area regarding design and cost, we anticipate that a major effort will be required to resolve the charges. This matter will be included in our continuing review.

EXHIBIT 23

LOCKHEED AND AIR FORCE AUDITS WERE INEFFECTIVE

Mr. Durham testified that Lockheed's internal auditing system was obviously ineffective or restrained. He indicated that advance notices of audits provided management the opportunity to conceal problems. He stated also that Air Force personnel were negligent in allowing unsatisfactory conditions to prevail.

We believe that Lockheed internal auditors were aware of the major problems cited by Mr. Durham and reported them to management together with recommendations for corrective action. These reports were given wide distribution and were sent to corporate officers. Follow-up audits were made to evaluate corrective actions. However, we noted that audit reports generally did not identify the cost impact or the effect of deficiencies noted and therefore, in our opinion, did not adequately demonstrate the need for corrective action. In addition, we believe that Chattanooga plant operations were not audited frequently enough. We were told that only one audit was made.

In our opinion, Air Force personnel have been unable to satisfactorily demonstrate that they were aware of the problems cited by Mr. Durham or that they had reported the problems to higher commands. Both the Chief of the Contract Administration Division and the Chief of the Production Administration Division, Air Force Plant Representative's Office, told us that the Air Force had not actively participated in managing the C–5 program prior to March or April 1970. The Chief of the Contract Administration Division stated further that Mr. Durham's charges had not been reviewed. The Air Force Plant Representative told us that although the charges had not been reviewed, except for a 1-day review of the Chattanooga operations, he and his staff had been aware of the problems cited and had reported them to higher command. However, these officials were unable to provide us with meaningful information and reports on most of the charges.

MEMO ROUTING SLIP	NOT FOR USE FOR APPROVALS, DISAPPROVALS, CONCURRENCES, OR SIMILAR ACTIONS	ACTION
1 TO M. Krantz The Lockheed-California Company 2555 N. Hollywood Way Bldg. 62A1	INITIALS	CIRCULATE
	DATE	COORDINATION
2 PO Box 551 Burbank, California 91503		FILE
		INFORMATION
3		NOTE AND RETURN
		PER CONVERSATION
4		SEE ME
		SIGNATURE

REMARKS

Attached is copy of Report on Review of C-5A Progress Payment Cost Limitation, Audit Report No. 118-10-0-0074, (Assignment No. 33-70-E-3) Please treat this with the same care as you did the December report.

FROM Andrew J. Stennett, Jr.
ANDREW J. STENNETT, JR.
Resident Auditor

DATE 3-6-70

PHONE 424-3027

DD FORM 1 OCT 60 95 REPLACES PREVIOUS EDITION

GPO 16-76572-1

DEFENSE CONTRACT AUDIT AGENCY,
CAMERON STATION,
Alexandria, Va., March 10, 1970.

MEMORANDUM FOR COMPTROLLER OF THE AIR FORCE

Attention: Assistant for contract financing pricing.
Subject: Report on review of C–5A progress payment cost limitation, Lockheed-Georgia Co., Marietta, Ga.

A copy of the subject report is forwarded for your review and appropriate action. As requested by your office, a copy is also provided for the Chief, Acquisition System Division, USAF Auditor General.

On January 13, 1970, we forwarded Audit Report No. 118–10–0–0059 to advise that the contractor had received excess progress payments resulting from the contract amendment reducing the number of aircraft ordered. Concern was also expressed as to the contractor's ability to finance performance through Run A.

Based on a further analysis of the contractor's progress payment requests, the attached report indicates that current overpayments on Contract No. AF 33 (657)–15053 amount to about $400,000,000. This exceeds the entire net worth of the Lockheed Aircraft Corporation as of December 29, 1968. as shown on its published report to the stockholders. The overpayment condition results from cost overruns attributable to delivered items. The report explains that the contractor has been computing the progress payment limitation by using the contract price of the delivered items rather than the experienced costs of delivered items, thereby inflating the costs eligible for progress payment.

The subject report reiterates the concern expressed in Report No. 118–10–0–0059 over the contractor's financing problems. It is the auditor's opinion that, even if funds were provided to the contractor to the ceiling price level, there is a strong possibility that financing problems would preclude the contractor from delivering the total number of airplanes ordered.

For the Director:

(Signed) FREDERICK NEUMAN,
Deputy for Audit Management.

Enclosure Considered to be for official use only.

LOCKHEED-GEORGIA CO.,
Marietta, Ga., February 20, 1970.

MEMORANDUM FOR THE REGIONAL MANAGER, ATLANTA REGION, DCAA

Attention: CAR–1/AA.
Subject: C–5A progress payment cost limitation.

Forwarded herewith are three copies of Audit Report No. 118–10–0–0074 dated February 20, 1970. This report discloses materially adverse findings as set forth in CAM 9–301.7b. Under that provision, with your concurrence, two of the attached copies should be transmitted to Headquarters, DCAA, for distribution to the Comptroller of the Air Force. A separate copy is being forwarded to the local finance office.

ANDREW J. STENNETT, Jr.,
Resident Auditor.

—

LOCKHEED-GEORGIA CO.,
Marietta, Ga., February 24, 1970.

MEMORANDUM FOR AIR FORCE PLANT REPRESENTATIVE, LOCKHEED-GEORGIA COMPANY

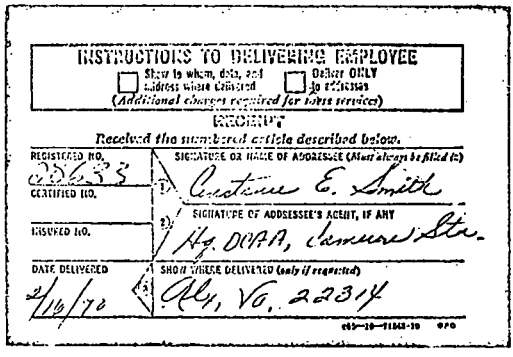
Attention: Finance officer (CMRIC).
Subject: Report on review of C–5A progress payments.

A copy of Audit Report No. 118–10–0–0074 dated February 20, 1970, is furnished for your information and any necessary action concerning C–5A progress payments.

For the regional manager.

ANDREW J. STENNETT, Jr.,
Resident Auditor.

LOCKHEED-GEORGIA COMPANY
MARIETTA, GEORGIA
REPORT ON REVIEW OF
C-5A PROGRESS PAYMENT COST LIMITATION



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DATE DELIVERED 2/16/70
SIGNATURE OR NAME OF ADDRESSEE (Must always be filled in)
1) Constance E. Smith
SIGNATURE OF ADDRESSEE'S AGENT, IF ANY
2) Hq. DCAA, Samuel Stein
SHOW WHERE DELIVERED (only if requested)
3) Ally, Va. 22314

Defense Contract Audit Agency
Atlanta Region
Lockheed-Georgia Company Resident Office
Air Force Plant #6
Marietta, Georgia 30060

Date of Report: February 20, 1970

Audit Report No. 118-10-0-0074
(Assignment No. 33-70-E-3)

FOR OFFICIAL USE ONLY

LOCKHEED-GEORGIA CO.,
Marietta, Ga., February 20, 1970.

Subject: Report on review of C-5A progress payment cost limitation, Lockheed-Georgia Co., Marietta, Ga., Audit Report No. 118-10-0-0074 (Assignment No. 33-70-E-3).

To: Air Force Plant Representative, Attention: Administrative Contracting Officer—C-5A (CMRIKA/Murphy/4419), Lockheed-Georgia Co., Marietta, Ga

1. PURPOSE OF AUDIT

In accordance with policies and procedures of the Defense Contract Audit Agency, we initiated a review of progress payment cost limitations for the C-5A program under Contract AF 33(657)-15053.

Although the comments concerning ceiling price limitations contained in paragraph 7a. of our previous Audit Report No. 118-10-0-0059, dated December 12, 1969, have been temporarily negated by Air Force action taken to provisionally increase ceiling prices, the condition therein remains sensitive in light of the significant program overrun commented upon in paragraph 6 of this report.

Since our earlier report was prepared, further analysis of the contractor's reported costs indicating a significant overpayment based on progress payment cost limitations. We are therefore providing comments on this condition.

The Defense Contract Audit Agency has no objection to the release of this report, at the discretion of the contracting officer, to the Lockheed-Georgia Company.

2. SCOPE OF AUDIT

We confined our review to the cost limitation shown on the contractor's progress payment requests, DD Form 1195. Activation of the cost limitation became apparent upon receipt of contractor cost reports subsequent to preparation of our previous audit report of December 12, 1969. We compared the contractor's progress payment cost limitation with the results that would have been obtained using two of the contractor's Limitation on Payments reports and his Contract Status Analysis Report (CSAR) all at the end of September 1969. We have also computed an approximation of the contractor's current overpayment condition using later information to demonstrate the impact on the contractor's financial condition if progress payments were restricted to contract limitations. Further comments are provided on the overpayment condition under results of audit, with more detailed comparative computations contained in Exhibit A and supporting Schedule A–1.

Comments on the contractor's projected cost excess over current firm contract ceiling prices as related to his financial ability to perform through the balance of Run A are contained in paragraph 6.

Our review was limited to an analysis of contractor prepared reports and data which are also available within Air Force channels. We did not attempt to audit the accuracy of the contractor's reports and data as the results of a detailed audit would be academic in light of the overpayment condition's magnitude.

3. RESULTS OF AUDIT

The contractor has submitted limitation on payments reports required by paragraph 42.f. of the contract which conflict with the progress payment requests concerning costs applicable to delivered items. Use of the data from these reports in computing the progress payment cost limitation indicates that excess progress payments have been paid the contractor. Use of the contractor's Cost Status Analysis Report (CSAR) results in an even more significant overpayment. A comparison of the above data follows:

Source	Cost of delivered items		Amount of current invoice progress payment, line 23	Overpayment including progress payment No. 204
	As of date	Amount		
Progress payment No. 204 (line 14)	Sept. 26, 1969	$453,565,322	$11,987,308	NA
Limit on payment report (original submission)	Sept. 28, 1969	763,726,208	(265,048,367)	277,035,675
Limit on payment report (revised Jan. 19, 1969)	do	560,500,000	(82,144,780)	94,132,088
Contractor's CSAR	do	811,842,644	(308,353,160)	320,340,468

The data on page 2 is further discussed in succeeding paragraphs and on Exhibit A and Schedule A–1. We have compared the data from a later CSAR with progress payment request number 220 dated January 20, 1970, concluding that the current overpayment is about $400,000,000 which exceeds the entire net worth of the Lockheed Aircraft Corporation as of December 29, 1968, as shown on its published report to the stockholders.

4. DISCUSSION OF FINDINGS

Paragraph 7a. of the above referenced report addressed itself to the ceiling price limitation on the progress payment DD Form 1195. Although the Air Force has since taken action to increase total ceiling price on 'provisional' or 'interim' bases, such action does not effect the cost limitation on the DD Form 1195.

Based upon the contractor's submission pursuant to the Limitation on Payments subparagraph f. of Incentive Clause 42 under Contract AF 33(657)-15053, and his reported estimated costs at completion per the Contract Status Analysis Report (CSAR), the contractor was significantly overpaid as of September 26, 1969, under the progress payment cost limitation for undelivered items. This overpayment condition results from cost overruns attributable to delivered items.

The contractor has been completing the progress payment limitation computation based on a formula applied to billing price. Since this formula establishes a cost of delivered items more closely associated with original contract target values than experienced cost levels, the contractor's progress payment requests have been unrealistic in not disclosing an overpayment condition (Exhibit A).

In response to our request dated December 29, 1969, the Administrative Contracting Officer furnished a copy of the contractor's Limitation on Payments Report under clause 42f. on January 14, 1970. This report as of September 28, 1969, reflected costs of $763,726,208 allocable to delivered items. When inserted into the DD Form 1195 limitation of payments computation, this cost amount indicates an overpayment condition as of September 26, 1969, of $265,048,367 (Exhibit A) prior to the payment of that progress payment. After discussion of this condition with the ACO and contractor, the contractor presented an unofficial 'advance copy' of a revised Limitation on Payments Report on January 19, 1970, also as of September 28, 1969. When the contractor's revised cost of delivered items of $560,500,000 was inserted into the limitation of payments computation, this revised cost amount indicated an overpayment condition as of September 26, 1969, of $82,144,780 (Exhibit A) prior to the payment of that progress payment. The contractor's next regular submission under the limitation on payments clause is due 45 days after the close of the quarter ending December 1969.

Neither of the above referenced contractor's limitation on payments submissions as of September 28, 1969, were audited. At our suggestion, the ACO requested that the contractor furnish a Limitation on Payments Report signed by an officer of the company to provide a clear indication that the statement represents the official company position. The contractor did on January 22, 1970, officially submit his above mentioned revised Limitation on Payments Report containing his estimated cost of delivered items at $560,500,000; however, it was not signed by an officer of the company. Since the contractor's own reports indicate an overpayment condition, we consider an audit to support that fact to be unnecessary. However, we consider the contractor's estimated costs of delivered items to be understated based on our review of other contractor reports which are commented on below.

For comparative purposes, we have conservatively computed the cost of delivered items through September 1969 consistent with other contractor reported data. Our computations were based upon an allocation of the contractor's CSAR total estimated costs at completion as of September 28, 1969, to delivered items. This cost of delivered items in the amount of $811,842,644 as developed on Schedule A-1 results in excess progress payments of $308,353,160 (Exhibit A), when included in the cost limitation calculation of Progress Payment Number 204 as of September 26, 1969, prior to payment of that request.

The cost of delivered items we have calculated is conservatively stated as the contractor's estimated costs at completion we have used are currently being overrun as indicated in paragraph 6.

To illustrate the increasing severity of the overpayment condition as costs are incurred and more contract items are delivered, we have prepared an approximation of the cost of delivered items for items shown as delivered on the contractor's Progress Payment Request No. 220 dated January 20, 1970. Al-

though later data was used and is not presented here in schedule form, our computation methods were consistent with those at the end of September 1969, as indicated in Exhibit A and supporting Schedule A–1. Our computations were based upon an allocation of the contractor's CSAR total estimated costs at completion reported at November 30, 1969, which was the latest report available. That report reflected only insignificant changes from the September report, because the contractor had only revised his CSAR total estimated costs at completion for minor changes in work scope. The increased overpayment condition results from allocation of that total estimated cost at completion to the additional delivered items applicable to the later progress payment request. Based on the above indicated contractor data, the cost of delivered items approximates $1,100,000,000 which would result in an excess progress payment of about $400,000,000 after payment of the January 20, 1970 request. Our computation of the cost of delivered items above is conservative as our purpose is to demonstrate the current overpayment condition rather than to arrive at any precise estimate of the amount of overpayment.

In view of the significant overruns commented upon in paragraph 6, we believe that it would be prudent to compute the cost of delivered items for the purpose of progress payment limitations utilizing actual costs or related estimates to the maximum extent feasible. This would preclude the expenditure of Government funds for aircraft in a situation where the contractor may not be able to finance his overruns and make delivery.

We again reiterate the recommendation made in our earlier Audit Report No. 118–10–0–0059 dated December 12, 1969, paragraph 7b., that the contractor be required to demonstrate by convincing evidence his ability to finance performance through DDT&E and Run A under present contractual terms as a prerequisite to the payment of any further progress payments.

5. BASIS OF PREPARATION OF THE CONTRACTOR'S SUBMISSION

The contractor has been completing Section III of his progress payment requests based on a formula applied to billing price, which establishes a cost of delivered items more closely associated with target values than experienced cost levels. The contractor's method of computing cost of delivered items for the Section III cost limitation computation is the least preferrable method, as indicated by the instruction for completion of Item 14 on the reverse of the progress payment request DD Form 1195, July 1, 1968, quoted as follows:

"Item 14—Of the costs reported in Item 7g, compute and enter only costs which are applicable to items delivered, invoiced and accepted to the applicable date. In order of preference, these costs are to be computed on the basis of one of the following: (a) the actual unit cost of items delivered, giving proper consideration to the deferment of the starting load costs; (b) projected unit costs (based on experienced costs, plus estimated costs to complete the contract), where the contractor maintains cost data which will clearly establish the reliability of such estimates; and (c) the total contract price of items delivered."

Although the contractor has been computing costs of delivered items generally in accordance with provision (c) above, the contractor does maintain sufficient cost data which could be utilized to comply with the preferred provision (b) above.

The general intent of the ASPR that progress payments be used to finance undelivered rather than delivered items is apparent from ASPR, E–521, which is quoted in part as follows:

". . . Also, the unliquidated progress payments should not be permitted to exceed the percentage specified in the contract, of the costs forming the base for progress payments, applicable only to the partially finished undelivered portion of the contract."

It is also apparent that the cost of delivered items per the contractor's Limitation on Payments Report is intended to be consistent with his progress payment submissions to permit disclosure of such an excessive financing condition. The pertinent ASPR provision is quoted as follows:

"E–523.1 *Quarterly Statements on Price Revision Contracts.*—Quarterly statements submitted by contractors pursuant to the Limitation on Payments provisions of price revision contracts (7–108, 7–109) should be compared from time to time with the Contractor's Request for Progress Payments in order to assure so far as reasonably possible that costs attributed to delivered items on the quarterly statements are excluded from the costs set forth as the basis for unliquidated progress payments on the DD Form 1195. If there is apparently disparity, request for the completion of Section III of the DD Form 1195 (E–519) would be appropriate."

6. CONTRACTOR'S ABILITY TO PERFORM

Audit Report No. 118–10–0–0059 dated December 12, 1969, paragraph 7b. contained comments on the contractor's ability to perform which are summarized here since they are related to the subject of this report. Although our computations were based on data then available during November 1969, the contractor's reported overrun condition would not significantly change in relation to priced contract work.

Our review of the contractor's CSAR reports indicates that his projected total cost through completion of DDT&E and Run A exceeds the current contract ceiling price through Run A by about $655 million. The contractor's CSAR also indicates that he has exceeded his planned value (budget) through November 2, 1969, by approximately $51 million or 3.37%. Although the contractor's CSAR indicates that total projected cost at completion of DDT&E and Run A will match budget, failure to recover the $51 million excess and continuance of the 3.37% budget overrun would increase the projected loss by approximately $78 million.

The magnitude of the contractor's projected loss through completion of DDT&E and Run A raises serious doubt as to his ability to finance performance through Run A. The Air Force has taken action to adjust ceiling prices to negate an earlier overpayment in excess of the ceiling price limitation on progress payments and permit continuance of payment. Such action does not affect the cost limitation which is the basic subject of this report. Modification Number 545 mailed December 12, 1969, established a "provisional" ceiling price for funded but unpriced spare parts. This action provided only temporary financial relief as eventually these funds will be needed to finance spares production which is not included in the above projected excess cost over ceiling price of $655 million. Modification Number 579 mailed January 9, 1970, increased the contract ceiling price by $100 million as an "interim adjustment" in anticipation of the authorized repricing action to occur after completion of Run A. We also have not eliminated this amount from the contractor's projected excess over ceiling price of $655 million. Even if an amount equal to the ceiling price of Run B ($275 million) were made available as an "interim" ceiling price adjustment for the anticipated repricing action, the projected loss through Run A is of such a greater magnitude that the contractor's ability to finance delivery of all the aircraft through Run A appears questionable.

The contractor's financing problems became especially acute when the Air Force restricted in December, 1969, the total ordered quantity to 81 aircraft instead of the contractor's contemplated 115 aircraft. This immediately activated the ceiling price limitation on the contractor's progress payments. Since the contract repricing formula does not provide for recovery of overrun until after delivery of Run A aircraft, the contractor has a severe interim financing problem during the Run A production period. The restriction of the Run B quantity to 23 aircraft also reduced the contractor's base for application of the repricing formula. This will restrict the amount of overrun the contractor can recover and could probably result in a net loss contract. We therefore advise that the current financing problems be reviewed considering the possible ultimate outcome of the C–5A program. The repricing formula being applicable to only 23 airplanes in Run B will not allow the contractor to reach a break-even point

(recovery of Run A overruns). Our opinion is that even if funds were provided the contractor to ceiling price level, there is a strong possibility that financing problems would preclude the contractor from deliverying 81 airplanes.

There are many other unknown factors which we are unable to adequately assess at this time such as economic adjustments including the outcome of the contractor's current CY 68 request of $28 million, effect of Run B repricing formula, cost of performing the FY 70 portion of Run B, and production of spares not yet priced. Undoubtedly such factors will have an impact on contract financing and should be considered in reviewing the total program.

7. CONCLUDING REMARKS

a. The results of this audit were not discussed formally with contractor personnel.

b. This office will provide additional audit assistance upon request.

c. Information contained in this report should not be used for purposes other than that immediately intended without prior consultation with this office regarding its applicability.

d. Please advise this office of action taken as a result of findings in this report.

Defense Contract Audit Agency Original Signed by Andrew J. Stennett, Jr.

ANDREW J. STENNETT, Jr.,
Resident Auditor.

SCHEDULE A-1

LOCKHEED-GEORGIA CO., MARIETTA, GA., CONTRACT AF 33(657)-15053

ALLOCATION OF CONTRACT STATUS ANALYSIS REPORT (CSAR) ESTIMATED COSTS AT COMPLETION TO DELIVERED ITEMS—PROGRESS PAYMENT NO. 204

	Billing price of delivered items [1]	Target cost			Estimated cost at completion from CSAR as of September 28, 1969 [3]	Percent delivered items to total [4] (percent)	Estimated cost at completion for delivered items [5]
		Delivered items [2]	Undelivered items [2]	Total [2]			
D.D.T. & E.:							
MPC:							
1010					$456,567,367		
1060					37,566,272		
1070					21,722,348		
Subtotal	$331,476,102	$301,341,376	$6,149,824	$307,491,200	515,855,987	98.0	$505,538,867
MPC:							
1020			2,294,504	2,294,504	9,151,120	0	0
1040	6,701,802	6,092,464	6,092,465	12,184,929	19,334,145	50.0	9,667,073
1050	55,484,467	49,320,458	96,123,763	145,444,221	210,862,207	33.9	71,482,288
Subtotal D.D.T. & E.	55,484,467	49,320,458	96,123,763	145,444,221	210,862,207	33.9	71,482,288
General and administrative expense					40,876,447	76.3	31,188,729
Spares handling expense					3,413,000	76.3	2,604,119
Total, D.D.T. & E.	393,662,371	356,754,298	110,660,556	467,414,854	799,492,906		620,481,076

Run A:							
Fiscal year 1967:							
MPC:							
1010					507, 883, 101		
1060					3, 711, 751		
1070					5, 873, 143		
Subtotal	104, 549, 000	95, 044, 000	173, 040, 426	268, 084, 426	517, 467, 995	35. 5	183, 701, 138
MPC:							
1020	390, 472	354, 735	13, 143, 923	13, 498, 658	16, 782, 137	2. 6	436, 336
1040	0	0	5, 373, 101	5, 373, 101	13, 839, 033	0	0
Subtotal, fiscal year 1967	104, 939, 472	95, 398, 735	191, 557, 450	286, 956, 185	548, 089, 165		184, 137, 474
General and administrative expense					20, 699, 320	33. 2	6, 872, 174
Spares handling expense					1, 060, 000	33. 2	351, 920
Total, fiscal year 1967	104, 939, 472	95, 398, 735	191, 557, 450	286, 956, 185	569, 848, 485		191, 361, 568
Fiscal year 1968	0	0	244, 472, 414	244, 472, 414	433, 101, 737		
Fiscal year 1969	0	0	277, 403, 673	277, 403, 673	511, 810, 080		
Total run A	104, 939, 472	95, 398, 735	713, 433, 537	808, 832, 272	1, 514, 760, 302		191, 361, 568
Total D.D.T. & E. and run A	498, 601, 843	452, 153, 033	824, 094, 093	1, 276, 247, 126	2, 314, 253, 208		811, 842, 644
Total run B (target cost)	0			492, 619, 000			
Target profit erroneously included by contractor				176, 982, 764			
Unreconciled difference (target cost)	0			761, 317			
Total D.D.T. & E. run A, and run B per progress payment No. 204	498, 601, 843			1, 946, 610, 207			

[1] Contractor's progress payment. The contractor's progress payment figures are taken from his progress payment request No. 204 as of Sept. 26, 1969, as the contract price of delivered items agrees with the contractor's limitation on payment report as of Sept. 28, 1969.

[2] Items related to limits computation. We have presented only the items from the contractor's progress payment request which affect the limits computation in items 14 through 23 of DD form 1195. No audit adjustments have been made as our intent is to show only the overpayment indicated by the contractor's data.

[3] Contract price of items to be delivered. We have not updated this item for provisional ceiling price increases or made adjustment for the reduction from 115 to 81 aircraft, as experienced overruns would activate the cost limitation of item 22a prior to reaching the ceiling limitation of item 22b.

[4] Costs applicable to items delivered. The contractor's cost of delivered items shown in the 1st col. was computed by applying a formula to the billing price of items delivered. The resulting amount of $453,565,322 approximates the target cost of delivered items. Costs shown in the 2d and 3d cols. were taken from the contractor's indicated limitation on payments reports. Costs shown in the 4th col. were developed by the auditor based on the contractor's CSAR (see schedule A–1). The limitation on payments reports and CSAR were not audited because the intent here is simply to illustrate the overpayment condition by using the contractor's own reports.

[5] Amount of current invoice for progress payment. The comparative overpayment amounts do not include the then current requested amount of $11,987,308. This amount would have to be added to arrive at the overpayment after payment of the then current request.

COMPUTATION OF LIMITS FOR OUTSTANDING PROGRESS PAYMENTS AS OF SEPT. 26, 1969, PROGRESS PAYMENT NO. 204

Progress payment request item No. and description	Contractor's progress payment [1]	Comparative basis using: Contractor's limitation, clause 42f. report — Original submission	Comparative basis using: Contractor's limitation, clause 42f. report — Revision, Jan. 19, 1970	Comparative basis using: Contractor's CSAR
Items related to limits computation: [2]				
3b Contract price of items to be delivered, accepted and invoiced [3]	$1,801,865,238	$1,801,865,238	$1,801,865,238	$1,801,865,238
7g Total of costs eligible under progress payments clause	1,618,155,623	1,618,155,623	1,618,155,623	1,618,155,623
10 Subcontract progress payments and billings	195,142,911	195,142,911	195,142,911	195,142,911
12 Total amount of previous progress payments	1,639,495,664	1,639,495,664	1,639,495,664	1,639,495,664
13 Maximum balance eligible for pregress payments	11,987,308	11,987,308	11,987,308	11,987,308
Limits computation:				
14 Costs included in item 7g applicable to items delivered, invoiced, and accepted [4]	453,565,322	763,726,208	560,500,000	811,842,644
15 Costs eligible for progress payments, applicable to undelivered items and to delivered items not invoiced and accepted (item 7g less 14)	1,164,590,301	854,429,415	1,057,655,623	806,312,979
16 Percentage (90 percent) applied to item 15 limiting progress payments and dollar amount	1,048,131,271	768,986,474	951,890,061	725,681,681
17 Contract price of items delivered, accepted and invoiced	498,601,843	498,601,843	498,601,843	498,601,843
18 Amount of advance payments outstanding	0	0	0	0
19 Net balance of contract price of items not delivered, accepted and invoiced (item 3b less 18)	1,801,865,238	1,801,865,238	1,801,865,238	1,801,865,238
20 Total amount applied and to be applied to reduce progress payments	410,317,912	410,317,912	410,317,912	410,317,912
21 Unliquidated progress payments (item 12 less 20)	1,229,177,752	1,229,177,752	1,229,177,752	1,229,177,752
22 Maximum permissible unliquidated progress payments:				
22a Item 16 plus item 10	1,243,274,182	964,129,385	1,147,032,972	920,824,592
22b Percentage (90 percent) applied to item 19 and dollar amount	1,621,678,714	1,621,678,714	1,621,678,714	1,621,678,714
22c Lesser of item 22a or item 22b	1,243,274,182	964,129,385	1,147,032,972	920,824,592
23 Amount of current invoice for progress payment [5] (item 22c less item 21 ,or item 13, whichever is the smaller) (overpayment)	11,987,308	(265,048,367)	(82,144,780)	(308,353,160)

[1] Contractor's progress payment. The contractor's progress payment figures are taken from his progress payment request No. 204 as of Sept. 26, 1969, as the contract price of delivered items agrees with the contractor's limitation on payment report as of Sept. 28, 1969.

[2] Items related to limits computation. We have presented only the items from the contractor's progress payment request which affect the limits computation in items 14 through 23 of DD form 1195. No audit adjustments have been made as our intent is to show only the overpayment indicated by the contractor's data.

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[5] Amount of current invoice for progress payment. The comparative overpayment amounts do not include the then current requested amount of $11,987,308. This amount would have to be added to arrive at the overpayment after payment of the then current request.

THE ACQUISITION OF WEAPONS SYSTEMS

TUESDAY, MARCH 28, 1972

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON PRIORITIES AND
ECONOMY IN GOVERNMENT OF THE
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10 a.m., in room 1202, New Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senators Proxmire and Percy.

Also present: John R. Stark, executive director; Loughlin F. McHugh, senior economist; Richard F. Kaufman, economist; Walter B. Laessig, minority counsel; Leslie J. Bander, minority economist; and E. A. Fitzgerald, consultant.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The subcommittee will come to order.

The Subcommittee on Priorities and Economy in Government began studying shipbuilding, claims against the Navy, and shipbuilding practices in 1969. The claims problem has grown worse since that time, and some of the disturbing aspects of the shipbuilding industry have also been aggravated.

The claims problem became critical when, for the first time, the dollar volume of claims pending and about to be filed neared the $1 billion mark. Never in our history had the volume of shipbuilder claims been so high.

In 1969, the Navy "settled" a claim with the Todd Shipyards Corp. for $96.5 million, representing about 90 percent of the face value of the original claim.

This subcommittee asked the General Accounting Office to investigate the Todd settlement, and GAO's findings confirmed our worst fears.

GAO reported that the claim had not been adequately substantiated and that the contractor had not been able to establish a relationship between the costs claimed and the specific actions by the Navy which the contractor alleged caused the costs to be incurred.

On the heels of the Todd fiasco, the Navy in 1969 established a civilian claims review group under the chairmanship of Gordon W. Rule. The purpose of the Rule group was to review proposed settlements of claims in cases where the settlements entered into were $5 million or higher.

The Rule group had a limited function. It could not expedite claims or settle them itself. Its primary responsibility was to see to it that the claims were well supported by the facts so that proposed settlements were reasonable and fair to the Navy.

If the group concluded that a proposed settlement could not be substantiated, it could reject it. The effect of a rejection would be to cause the claim to be sent back to the system command from whence it came for further review and negotiations.

In 1970, the Navy settled a consolidated group of five claims with the Lockheed Shipbuilding and Construction Co., for $17.9 million. Because each of the individual settlements was for less than $5 million, it was not forwarded to the Rule group for review.

We asked the GAO to investigate the Lockheed settlement, and the results of that investigation were reported to us and released to the public a few days ago.

Again we find the Navy entering into a very questionable settlement. GAO found in its report that the contractor's alleged delays were either exaggerated or nonexistent in at least two important instances. Lockheed could not relate its additional costs to specific Government actions and GAO concluded that "we are not in a position to express an opinion on the reasonableness of the settlement."

In 1971 the Navy entered into a tentative settlement agreement with another shipbuilder, Avondale Shipyards, Inc., on one of the largest claims then pending. The proposed settlement was for $73.5 million, and it was forwarded to the Rule group for review.

The Rule group unanimously rejected the claim for a number of reasons, among them the fact that the claim lacked substantiation.

Following that action, some funny things happened to Mr. Rule and the claims review group. First, Mr. Rule, who just a year ago received the highest civilian award given by the Navy, "resigned" from his post as chairman of the Contract Claims Control and Surveillance Group. Then the group itself was abolished, and a general board composed of flag officers was established in its place. Finally, Avondale was given a "provisional" settlement of its claim in the amount of $25 million. The circumstances surrounding these actions constitute a major reason for this hearing.

Another and perhaps overriding reason for our inquiry goes back to the subcommittee's longstanding concern for economy in Government. Earlier this month, former Deputy Secretary of Defense David Packard, delivered a speech on receiving the Forrestal Award and in that speech, he made some points that go to the heart of the defense procurement problem. Mr. Packard, it will be recalled, said on another occasion not too long ago that defense procurement was a "mess."

In his more recent speech, Mr. Packard talked about the tendency of contractors to buy into contracts and the way they are bailed out after getting into difficulties. He went on to say: "We are going to have to stop this problem of people playing games with each other; games that will destroy us, if we do not bring them to a halt."

The games that disturb me most are the games that bureaucrats play with the taxpayers' money, particularly the games of spending dollars that do not need to be spent. It is perfectly clear to me that the Department of Defense spends too much, too fast, and there is evidence that getting rid of funds appropriated to it is a Pentagon policy.

Our witnesses this morning are Adm. I. C. Kidd, Chief, Naval Material Command, and Gordon W. Rule, Director, Procurement Control and Clearance Division, Naval Material Command.

Admiral Kidd commissioned and commanded the Navy's first all-missile squadron, Destroyer Squadron 18. He subsequently served for over 4 years as executive assistant and senior aide to the Chief of Naval Operations; as Chief of Logistics at NATO Headquarters in Naples, Italy; commanded Cruiser Destroyer Flotilla 12 and the 1st Fleet; and commanded the 6th Fleet from August 28, 1970, to October 1, 1971.

Admiral Kidd's decorations include the Distinguished Service Medal with Gold Stars in lieu of Second Award, Legion of Merit with two gold stars in lieu of Second and Third Awards, and Bronze Star.

Gordon Rule has testified before this subcommittee on several occasions, and we are glad to have him appear before us once again.

Admiral Kidd, you may proceed with your statement.

STATEMENT OF ADM. ISAAC C. KIDD, CHIEF, NAVAL MATERIAL COMMAND, ACCOMPANIED BY GORDON W. RULE, DIRECTOR, PROCUREMENT CONTROL AND CLEARANCE DIVISION, NAVAL MATERIAL COMMAND; REAR ADM. R. G. FREEMAN III, DEPUTY FOR PROCUREMENT AND PRODUCTION; AND HART T. MANKIN, GENERAL COUNSEL

Shipbuilding Claims and Related Matters

Admiral Kidd. Thank you very much, Mr. Chairman. I appreciate very much indeed your invitation to appear before your committee today, sir, and respond to questions on shipbuilding claims and related shipbuilding matters. Accompanying me this morning in addition to Mr. Rule is Rear Admiral Freeman, the Navy's Deputy for Procurement and Production.

Because your topic is broad, I will keep my formal remarks brief.

I do not plan to cover the specific actions that have been taken in the claims prevention area—I believe Rear Admiral Sonenshein covered these for you in his testimony before your committee last September. The GAO has recently examined this area and concluded that those aspects of the ship construction improvement program (SCIP) that relate to claims hold considerable promise for managing our overall claims problem. If you or members of your committee have questions on these actions I will be pleased to try to respond to them.

Let me assure you that since assuming command of the Naval Materiel Command 4 months ago, I have devoted a great deal of time to our problems in shipbuilding and more specifically, sir, claims.

When I took over, there were several things in this general area that appeared obvious.

Magnitude of Outstanding Claims

First, roughly a billion dollars in outstanding claims, some outstanding for several years is, in and of itself, a problem of tremendous magnitude. There were more claims in the offing, in my judgment.

It was equally apparent that these claims were probably contributing to a feeling of some tension between the Navy and some of our contractors. Moreover, this situation was contributing nothing to our credibility with the Congress and with the American public. This matter requires prompt action—at a time when we need—need desperately—to modernize our fleet. To do this we need a strong and cooperative industry, and, of course, a great deal of congressional and public support. Having been privileged to command our 6th Fleet in the Mediterranean just prior to coming to Washington this time, where we witnessed daily and at first hand the growing Russian naval capability, let me assure you that our naval capabilities are very much at stake here. The Russians are building fine ships and manning them with competent personnel—men that evidence a very complete knowledge of the ways of the sea.

RELATIONSHIP BETWEEN GOVERNMENT AND INDUSTRY

Of concurrent concern to me—and I am being very candid now—was the fact that reflections of this relationship between industry and Government were becoming evident within the Navy. I found a wide divergence of views on how some of our claims problems should be handled—experienced and dedicated men, civilians and military, exceptionally knowledgeable individuals, brilliant men, professionals, in every sense of the word—each with strong feeling. One of my first tasks was to address this matter. As the Chief of Naval Material that was my job. It was not a question of deciding which one of these gentlemen was correct—they were all right because they wanted this enormous claims problem resolved. It was simply a matter of how best to proceed, considering the many ramifications of the overall problem, and keeping the best interests of the Government uppermost in mind at all times.

ACTIONS TAKEN REGARDING CLAIMS PROBLEMS

There seems to be a certain amount of misunderstanding about the actions taken, however. If I may, I would like to describe them to you.

Navy Material Command General Board

One of the first actions was to establish the Naval Material Command General Board. Its purpose is to provide me with the assistance and advice I need in managing all areas of my responsibility. It helps me in turn to keep the Chief of Naval Operations, Admiral Zumwalt, advised on matters involving weapon systems development, acquisition and, of course, fleet support.

You might compare the General Board to the board of directors of a very large corporation. The Naval Material Command General Board has 14 permanent members. They include myself, the Vice Chief of Naval Material, two of my principal deputies, my six system commanders, and to insure that we keep abreast of the operational side of the Navy, the Deputy Chiefs of Naval Operations for Logistics, Submarines, Surface, and Air also attend. Others, civilian and military, attend General Board meetings and participate when their particular area of expertise or knowledge is required.

I did not establish the General Board to deal with claims, in fact, it was not established to deal with any specific problem. It was estab-

lished to deal with all matters of policy and common interest. It is the way I have chosen to manage a very complex command—a command that is responsible for spending approximately 60 percent of the Navy's total budget and employs roughly two-thirds of its total civilian work force.

In short, the General Board was established as a forum to provide discussion and advice. Again, let me say it was not established to solve any particular problem but rather to address any and all subjects. Parenthetically, the Navy had a General Board long before World War II for just this purpose to serve the CNO. I have used a general board to run both the 1st and 6th Fleets.

Establishment of Claims Board

Now to speak a moment about the new Claims Board established this past January. It was in fact in the planning stage prior to my becoming the Chief of Naval Material. The Claims Board is composed of five of the most experienced civilian procurement officials we have in the Navy. It is assisted by an exceptionally well-qualified representative from our Office of General Counsel. The Chairman of the Claims Board is my Assistant Deputy for Procurement. The other procurement members are the most senior civilian procurement officials at our four hardware systems commands.

Their principal function is to review major proposed claim settlements. When their review is completed, the Chairman, or his representative, makes a presentation to the General Board. Then, based on this combined expert advice, the final decision will be made on the merits of the claim. The decision will then be briefed to the Assistant Secretary of the Navy (Installation and Logistics).

Responsibility of Claims Board for claims prevention

An additional responsibility of the Claims Board lies in the area of claims prevention. This Board has overall responsibility for procurement policy and procedural recommendations designed to prevent or minimize claim generating situations. It seemed only logical to me, Mr. Chairman, that when we got this aggregation of talent together that it address itself to preventing claims. Settling claims is only a part of my objective. Preventing new ones is equally important, if not more so.

That, in summary, highlights procedural changes made in the claim settlement area. I consider that our procedures are sound and hopefully should provide the assurance needed to be certain that these claims are being settled properly and promptly.

Personnel Increases in Claims Staffs

You might be interested in an example of increases in staffing now being applied to claims in the Naval Ship Systems Command. Subsequent to July 1971, we initiated action to increase the number of headquarters civilian and military personnel working on claims settlement some fourfold. These people are also receiving increased support on a part-time basis by a large number of legal, technical, and contracting personnel from within the Naval Ship Systems Command as well as additional part-time and full-time support by field personnel.

Senator, that concludes my statement. I will try to answer any questions you may have at this time.

Chairman PROXMIRE. Thank you.

Mr. Rule, do you have any observation you would like to make? I know you do not have a statement.

Mr. RULE. On that statement?

Chairman PROXMIRE. On anything at all you would like to speak on, that statement or anything in connection with it.

TODD SHIPYARD CLAIMS SETTLEMENT

Mr. RULE. First, I do not want to get into a you-know-what contest with you because of a statement you read in your opening statement, but I take strong issue with you, Senator, on how you characterized the Todd settlement. You said it was a fiasco.

I personally approved the Todd settlement and after I approved it, I was given the job by the then CNM, Admiral Gallatin, of making a study regarding the causes of the Todd claim and I think your committee has seen a copy of that study, and the study indicated only too clearly where the Navy was at fault and why this claim of $96 million had been approved.

You, in your characterization, Senator, went far beyond what the GAO said in their comment when they looked at the Todd claim and I just want to say you and I usually get off on a friendly basis but we sure are not getting off today on that basis because you ought not characterize that settlement as a fiasco.

I say that very respectfully.

Chairman PROXMIRE. Well, I know you do, Mr. Rule. You know I have great respect for you. We just disagree on that.

Mr. RULE. And sincerely.

Chairman PROXMIRE. I thought it was a fiasco. People have different views of what constitutes a fiasco. I cannot characterize it as a heinous scandal in which corruption was obvious. I just said it was a fiasco.

Mr. RULE. Senator, I would just like to make this suggestion. The engineer in that case that negotiated and the contracting officer are still around. The people in my office recommended they scrub—recommended approval to me. I scrubbed it. I would like to get those people together in front of you and GAO and go through the motions and show exactly how we evaluated that claim from the bottom up and let you draw your own conclusions.

If we made as lousy a deal as you say we did, I ought to be fired because I believe in accountability.

Chairman PROXMIRE. Mr. Rule, you know I do not want to fire you. Other people seem to have different views on that but I certainly do not.

Mr. RULE. But I would like to go over exactly the mechanizations if at some time you would like that.

Chairman PROXMIRE. Fine. I would like to do it, first at least on a staff level. You obviously are thoroughly familiar with this but I would like to see if we could proceed on that basis first and then maybe we can——

Mr. RULE. OK. Having gotten that off my chest, good morning, Senator. [Laughter.]

Chairman PROXMIRE. Thank you, sir. Any further observations?

Mr. RULE. Only that——

Chairman PROXMIRE. It is a good morning, I agree.

Mr. RULE. Yes, sir. It is nice, and I appreciate your asking me back. It is a privilege and I want to say that the gentleman on my left, Admiral Kidd, is the fourth Chief of Naval Material with whom I have had the pleasure of serving and I am very confident that he is going to be an outstanding Chief of Naval Material when he gets through his shakedown cruise which he is on right now.

NEW CLAIMS BOARD UNDER ADMIRAL KIDD

Chairman PROXMIRE. Admiral Kidd, in your statement you describe what you did to handle the job Mr. Rule's group had handled before. You said that the board that you had is not a claims board primarily. It can take action in this respect but it has many other things it has to do. You said you have a new Claims Board.

That new Claims Board, as I understand it, has no decision capacity. It is simply an advisory group, unlike the Rule group which was—it is unable to send back a claim. All it can do is advise you on it, is that correct?

Admiral KIDD. That is my understanding of the way it will operate, Mr. Chairman, yes, sir. The Flag Officer Board and the additional civilians on the regular General Board. That is, the flag officers, not the General Board, and the Chief Counsel.

Chairman PROXMIRE. You can understand, I think, Admiral Kidd, why the views up here in Congress may be a little bit different than the views that you and the administration may hold. We are concerned that a process which seemed to be very loose and which seemed to represent a potential serious threat to the taxpayers' money and to involve large expenditures might be getting more out of control. I had great respect for Mr. Rule and the job they did, even though we differ on that Todd claim, and with that, with the abolition of the power which that group had and with the abolition—with the shifting of authority from that group to another, and with the principal authority now given to flag officers rather than a civilian lawyer with Mr. Rule's background, we are very fearful that the whole process is weakening.

Admiral KIDD. And were I you, not understanding and knowing the details, I think I would probably share your concern, but I would most earnestly disabuse you of any need for concern because in the first place, the earlier claims review group which Mr. Rule chaired drew its authority from the Chief of Naval Material. When Mr. Rule resigned, and I was told that he had resigned when I arrived in Washington, and that the responsibility was mine, would be mine soon, I asked many questions from many gentlemen in and around Washington who had experience in this area, including Mr. Rule himself, for their advice as to how best to proceed.

One of the first gentlemen that I went to and asked was Admiral Rickover, a gentleman whom I have known ever since I was a youngster, and taking all of this advice and putting it together I found that since the final responsibility was mine, I would be well-advised to learn and know as much about it before I had to make the decisions on these claims as possible, and it would be prudent to bring together the very best brains in the business, gentlemen experienced in handling claims, gentlemen of the law, experienced in the legal side.

I went to see the General Counsel of the Department of the Navy,

sought his advice, invited him to sit with the General Board as I learned of the contributing facets in the matter of claims.

BOARD PARTICIPATION BY VARIOUS SYSTEMS COMMANDS

It then became evident that it would be very wise to insure that all claims were shared with the various systems commands before a final decision was made so that each of the various systems commands, each having a responsibility for reviewing claims of its own, would have an opportunity to see what the other systems commands were doing by way of new legal approaches, new technical approaches.

It seemed only wise to be sure that if System Command A had had difficulty in a particular type of claim, that Command B, C, D, and E could be forewarned, and I decided to use this forum of the General Board which we already had established as a forum to bring all of this expertise and competence together.

ZUMWALT MEMORANDUM OF FEBRUARY 7, 1972

Chairman PROXMIRE. Let me zero in on just why I am disturbed about this. I mentioned the game that bureaucrats play with the taxpayers' money. Let me give you an illustration.

On February 7 of this year, Admiral Zumwalt, Chief of Naval Operations, sent you a memorandum on the subject of fiscal year 1972 outlay targets. Are you familiar with this memorandum?

Admiral KIDD. I believe, yes, sir.

Chairman PROXMIRE. Let me read the first paragraph of this memorandum. It seems to me that Admiral Zumwalt is telling you and the others who were sent copies of the outlay target—let me first read it:

Fiscal year 1972 outlay targets promulgated by reference A as part of the President's budget for fiscal year 1973 are over $400 million above target in the earlier fiscal year 1972 budget for the OPN, SCN, PAMN, and MILCON appropriations. Difficulty of achieving these targets during the remaining months of fiscal year 1972 fully appreciated but importance of avoiding shortfall in meeting newly established fiscal year 1972 targets to avoid resultant adverse effects on anticipated fiscal year 1973 outlay ceilings dictated need for top management attention. Anticipate any shortfall in fiscal year 1972 outlay target could be translated into program loss under fiscal year 1973 outlay ceiling.

2. In order to prepare recommendations indicated in paragraph 4–D, Reference A, request your position on the following areas which appear to offer the best potential for meeting fiscal year 1972 and fiscal year 1973 outlay targets.

(The full text of Admiral Zumwalt's memorandum follows:)

ADMIRAL ZUMWALT MEMORANDUM

FEBRUARY 7, 1972.

From: CNO.
To: CHNAVMAT, MSC.
Infor: NAVAIRSYSCOM, NAVELECSYSCOM, NAVFACENGCOM, NAVORDSYSCOM, NAVSHIPSYSCOM, NACSUPSYSCOM, DIR SSPO, WASH DC, NAVCOMPT, ONR.

FY 1972 OUTLAY TARGETS

A. SECNAVNOTE 7040 of 4 1972

1. FY 72 outlay targets promulgated by REF A as part of the President's budget for FY 1973 are over $400M above targets in the earlier FY 72 budget for the OPN, SCN, PAMN and MILCON appropriations. Difficulty of achieving these targets during the remaining months of FY 72 fully appreciated but im-

portance of avoiding shortfall in meeting newly established FY 72 targets to avoid resultant adverse effects on anticipated FY 1973 outlay ceilings dictate need for top management attention. Anticipate any shortfall in FY 72 outlay target could be translated into program loss under FY 73 outlay ceiling.

2. In order to prepare recommendations indicated in Para 4D, Ref A request your position on the following areas which appear to offer the best potential for meeting FY 72 and FY 73 outlay targets:

A. Settlement of claims in FY 72 vice FY 73.

B. Expedite provisional payments on claims and unadjudicated change orders.

C. Accelerate contract close-outs and subsequent payment of withheld funds.

D. Accelerate shipping and transportation billing process where services have been rendered but remain unbilled.

E. Increase use of unpriced purchase orders and fast pay procedures.

F. Increase source inspection and acceptance of material at receiving activities. Apply prompt processing procedures for materials received for inventory.

G. Increase in amount, timeliness and coverage of progress payments to contractors from direct appropriations and working capital funds.

H. Increasing NIF and stock fund expenditures. Investigate advance procurement of shortlead time material where firm NIF and stock fund orders are anticipated in FY 1973. Also suggest investigate advance payments for stock fund procurements scheduled for FY 73 delivery.

I. Forward procurement of ammunition/components from sources outside the Navy in anticipation of FY 1973 inventory objectives.

J. Acceleration of military construction payments to contractors in FY 1972 through a special one-time effort of NAVFAC taking extraordinary action in processing payment vouchers in FY 1972.

K. Increase military construction payments to contractors in FY 1972 through a one-time effort by NAVFAC reducing retention of funds held for performance surety under present construction contracts.

3. Separate action underway to reprogram $33M into ship overhaul and $20M into transportation programs. This action presumes program accomplishment during FY 1972 and is contingent upon easement of current overtime restrictions. As a related matter maximum effort is required to minimize NIF work carry-over into FY 1973. Accordingly, request your evaluation of the use of unlimited overtime during remainder of FY 1972.

4. Comments on the above and any other recommendations to assist in reaching the assigned objectives requested.

Chairman PROXMIRE. Now, let me once again say that this is Admiral Zumwalt telling you how he wants you to move ahead and spend the money that is available.

That is, the amounts that are supposed to be spent during fiscal year 1972 have been increased by more than $400 million for various appropriations including appropriations for other procurements, Navy OPN, ship construction, Navy SCN, procurement of aircraft and missiles, Navy PAMN, and military construction. Although it may be difficult to spend enough to reach the new targets in the remaining months of the year, it is important to avoid a shortfall so there will be no adverse effects on the anticipated fiscal year 1973 outlay ceilings. This dictates a need, as the memo says, for top management attention because it is anticipated if the current outlay target is not reached, next year's outlay ceiling may be lowered.

In other words, we have to spend up to the hilt this year so we can have more funds to spend next year.

How do you interpret this paragraph?

INTERPRETATION OF ZUMWALT MEMO

Admiral KIDD. I had to study that memo long and hard before I thoroughly understood it, Mr. Chairman, and in a nutshell it is the same type of memorandum, going back through the history books, I found has been written in years gone by.

When we get final approval of our budget and the money actually is in hand so late in the fiscal year, it very, very seriously complicates the ability of the systems commands to get proper contracts drawn and to get that money actually spent. In other words, we end up so frequently having 6 months to do what normally a year would be provided to do, fiscal year to fiscal year.

There is nothing in that memorandum that has affected the thoroughness with which we have gone after contract preparation and the attention to detail necessary to insure that as the money is spent, that it is spent properly and technically correctly.

Chairman PROXMIRE. All right, sir. Let me proceed now. The second paragraph says that your position is requested on a number of areas which appear to offer the best potential for meeting the fiscal year 1972 and fiscal year 1973 outlay targets and lists the following, and that is why—so pertinent to claims:

(*a*) Settlement of the claims fiscal year 1972 vice fiscal year 1973.

(*b*) Expedite provisional payments on claims and unadjudicated change orders.

(*c*) Accelerate contract closeouts and subsequent payment of withheld funds.

(*d*) Accelerate shipping and transportation billing process where services have been rendered but remain unbilled.

(*e*) Increase use of unpriced purchase orders and fast pay procedures.

(*f*) Increase source inspection and acceptance of material at receiving activities. Apply prompt processing procedures for materials received for inventory.

(*g*) Increase in amount, timeliness, and coverage of progress payments to contractors from direct appropriations and working capital funds.

(*h*) Increasing NIF and stock funds expenditures. Investigate advance procurement of short leadtime material where firm NIF and stock fund orders are anticipated, and so forth.

ZUMWALT HIGH PRIORITY ON CLAIMS SETTLEMENTS

You see, the pressure on you, I do not mean to criticize you but Admiral Zumwalt is indicating they want the highest priorities in settling these claims in a hurry. That is what seems so shocking and so difficult for us to accept in view of the fact that these claims in the past have been so controversial, sometimes not legally supported. The only way you can settle them in a hurry is with a shortcut procedure that is very likely to result in a very substantial loss of taxpayers' money and an unjustified payment.

Admiral KIDD. This might be a conclusion drawn, but I would certainly reassure you incorrectly drawn. The haste which you speak to—I just do not move in a hurry when I am spending the taxpayers' money.

Chairman PROXMIRE. Yes, but you follow the orders of your superior, I am sure.

Admiral KIDD. Within the law, Mr. Chairman.

Chairman PROXMIRE. Well, let me just proceed to say that the Chief of Naval Operations is identifying areas he says you ought to look into in order to achieve new outlay targets. You ought to see if you can settle claims this year instead of next year—accelerate contract closeouts, increase use of unpriced purchase orders and fast pay procedures, increase amount, timeliness and coverage of progress payments, increase military construction payments, and so on.

You are also asked to evaluate the use of unlimited overtime during the remainder of the fiscal year. In other words, spend, spend, spend, or do you have another interpretation?

Admiral KIDD. Oh, no. You read the words. And now I just mention in passing rather than increasing the overtime, I have cut it by two-thirds.

Chairman PROXMIRE. How about the other areas?

Admiral KIDD. Where I had to cut them, I have.

Chairman PROXMIRE. Can you give us any examples of what you have done in cutting provisional payments or——

Admiral KIDD. Well, in the case of——

Chairman PROXMIRE (continuing). Settling claims?

Admiral KIDD. Let us take one of the claims. One of the claimants having one of the largest claims has been in to see me, oh, several times urging accelerated settlement. I have told him absolutely not. I would not touch him with a 10-foot pole.

ADMIRAL KIDD'S RECOMMENDATIONS TO ADMIRAL ZUMWALT

Chairman PROXMIRE. Admiral Kidd, I want to follow up on that. You have been a line officer and you are a man with a marvelous military record we are all proud of and all grateful for. In the final paragraph you are asked to comment on the recommendations that I have just read and to make other recommendations.

Did you comment? Did you make other recommendations?

Admiral KIDD. They have been verbal so far, Mr. Chairman, and I have told the Chief where it would be possible to practically conform and comply and in areas where it would not be because you just cannot get stampeded into this type of thing without reaping grievous difficulties.

Chairman PROXMIRE. Can you be more specific? Can you tell us what recommendations you made?

Admiral KIDD. I would be more comfortable if I could provide those specifics for the record, Mr. Chairman, rather than trading on a hazy memory.

Chairman PROXMIRE. Can I ask you the Systems Commanders, NAVAIR, NAVELECSYS, NAVFAC, NAVORD, et cetera, NAV SHIP, NAVSUPSYS, if they made recommendations?

Admiral KIDD. Oh, yes, indeed. To me.

Chairman PROXMIRE. Yes, to you or Admiral Zumwalt.

Admiral KIDD. Yes, to me, and we take them under consideration each week when the Board meets.

Chairman PROXMIRE. Can you make those available—can you tell us in general, summarize them and let the committee know for the record at least, what they were?

Admiral KIDD. I will, indeed.

Chairman PROXMIRE. We would like copies of the original recommendations if we could have them.

(The following information was subsequently supplied for the record:)

The Chief of Naval Material response to the Chief of Naval Operations message (CNO message 100128Z February 1972) considered the recommendation made by the Naval Air Systems Command, Naval Electronic Systems Command, Naval Facilities Engineering Command, Naval Ordnance Systems Command, Naval Ship Systems Command and Naval Supply Systems Command. The CNM response is summarized as follows:

Claim settlement procedures and provisional payment policy have been reviewed.

Naval Material Command teams are reviewing reasons for delays in payment of withheld funds attributable to contract close-out. Resolutions may require actions by higher authority.

Progress payment policy controlled by OSD.

Naval Facilities Engineering Command field divisions and Resident Inspectors of Construction will expedite payment vouchers.

Increased use of overtime is authorized to meet Fleet schedules. We have reduced general overtime in Naval Shipyards to 6 percent.

JUSTIFICATION FOR ACCELERATING OUTLAYS

Chairman PROXMIRE. By the way, Admiral, I did not notice any mention of the Russian naval fleet or any military requirements whatsoever in Admiral Zumwalt's memo. It was not a matter of our having to do this for the national defense. There was no justification for accelerating the outlays except to reach some preconceived spending goal. How do you explain that?

Admiral KIDD. Very easily, Mr. Chairman. Everything that the chief writes, the responsibility to you and to me as taxpayers to protect us with a proper Navy, this is implicit in anything he puts on paper.

In this regard, if we are not able to expand the funds which you gentlemen appropriate for the things that we have asked for, that we need, with which to defend this country, in time, that is, by the end of the fiscal year, it is my understanding that we could stand to lose that money if we do not spend it within the prescribed amount of time. So, we must—and if I were he, I would write the same memorandum—we must do our best to insure that we commit those funds within the prescribed period in order not to be put in a position of disadvantage later on by someone being able to say, well, you asked for the money, but you did not spend it, so we are going to take it away or cut your budget next year.

Chairman PROXMIRE. From the standpoint of the national interest, I would be inclined to disagree. I think the general taxpayer would certainly go along in the overwhelming majority of cases that any money should be spent that is necessary or essential to defend our country or strengthen our Navy so it can perform its functions, but to spend the money just because you may lose it next year seems to me is something you cannot justify, whether it is the Department of Agriculture, Department of Commerce, or the Department of Defense.

Admiral KIDD. In principle, I have no quarrel with what you ob-

serve, none whatsoever. And I do not think that anyone would have. The simple facts of the matter here in Washington are that you ask for so much. That amount is usually cut several times along the line before final approval and appropriation. So you get X when you ask for perhaps three or four X. And here we come to the point earlier made, that you only have half the time needed in which to go through the ponderous mechanisms of effectuating contract arrangements.

Chairman PROXMIRE. Well, why would it be such a disaster if you spent only as much as you can fully justify and not a nickel more? Then if you lose that, then you can come back, and it seems to me you can make a much more effective appeal to people like me.

I am on the Appropriations Committee, and others who are on the Appropriations Committee—that this is the policy you are now following. This notion of getting rid of money at the end of the year in order that you will not lapse the amount and then be cut in a subsequent year, it seems to me, is playing, as I say, a game with the taxpayer and a game with the Congress that is most unfortunate.

Admiral KIDD. Well, sir, I just cannot agree with you on that in the way in which you put it, getting rid of the money. Heaven knows, we are not getting rid of it. We are doing our level best to get contracts written, and it does not come easily nor in short periods of time. We are trying to get contracts written and get that money properly committed, not wasted, not gotten rid of, properly committed.

FEBRUARY 1972 MEMO REGARDING ACCELERATED SPENDING—R.D.T. & E. AND PROCUREMENT APPROPRIATIONS

Chairman PROXMIRE. I would like to ask you about another memo to see if you can throw light on it.

On February 18, 1972, a memo was sent from the Commander, Naval Ships Systems Command, to all offices reporting directly to COMNAVSHIPS, on the subject of "accelerated expenditures goals." The purpose of the memo, which was signed by K. P. Chesky, Acting Deputy Commander for Plans, Programs, and Financial Management Comptroller, was "to accelerate expenditures in the R.D.T. & E. and procurement appropriations." The third paragraph is entitled "Action," and it states the following:

> Addresses are requested to initiate a review of procedures closely related to the actual expenditure of funds including:
>
> (*a*) Contract closeout and subsequent payment of withheld funds.
>
> (*b*) Processing of payment vouchers, including progress payments.
>
> (*c*) Prompt processing and certification of DD–250's to paying activities.
>
> (*d*) Utilization of "fast pay" procedures.
>
> This review should encompass the above areas and others that can lead to expenditure acceleration.

Now, this appears to be a memo implementing the note sent by Admiral Zumwalt to you and the Systems Command, is that correct?

Admiral KIDD. I am not familiar with that memorandum that you hold, Mr. Chairman. I am not familiar with that memorandum at this moment, sir. I could provide a response for the record on that, or perhaps—you spoke there as I recall, of contract closeouts. Admiral

Freeman here can speak to that. This is within his area of responsibility, if you wish.

Chairman PROXMIRE. Would you like to speak on that, Admiral?

Admiral FREEMAN. Yes, sir. One of the areas in which we have quite a difficult problem is contract closeouts, particularly on research and development contracts, the reason being this is the final voucher. It requires an audit by the DCAA, and some rather complex procedures, including such things as determination of patent rights, final equipment deliveries, that all items under the contract are satisfactory and a portion of the contract withheld until these procedures are in fact successfully accomplished.

Since it is the windup of a contract, it tends to take a low priority of the other things which are among the jobs of the DCAA, Defense Contract Audit Agency, and Defense Contract Administration organizations.

Hence, there are residual dollars in these areas that are properly expended, but because we have not gone through the legal and procedural requirements to close it out, the money sits there unexpended.

Chairman PROXMIRE. Well, now, the Chesky memo refers to two documents, Second NAVMSG R202120Z/02 January 1972 and NAVMAT, and the other numbers. I can identify them if you wish.

Can you briefly tell us what these memos say?

Admiral KIDD. No, sir; I cannot at this time, Mr. Chairman.

Chairman PROXMIRE. We just gave you a copy.

Admiral KIDD. Yes, sir; I have the notice. The references I do not have with me.

Chairman PROXMIRE. Can you provide us with copies of the two memos?

Admiral KIDD. I will look into that as soon as I get back, Mr. Chairman.

Chairman PROXMIRE. When you look into it, will you give us the copies of that, provide those copies?

Admiral KIDD. When I get back to the office, yes, sir, I will look at it.

Chairman PROXMIRE. Thank you.

(The following information was subsequently supplied for the record:)

January 2, 1972.

From: SECNAV.
To: ALNAVY.

Fiscal year 1972 Department of the Navy financial status:

1. In order to obtain more complete and timely data for overall sound fiscal management, both obligation control and expenditure control are essential. These controls are being used at highest levels in appraising budget execution/performance. Accordingly all cognizant Navy offices shall establish definitive procedures to insure that processing of documents essential for payment of invoices is accomplished expeditiously and submitted to paying offices. Additionally, suppliers should be requested to submit their bills for services and materials promptly in accordance with billing instructions in the purchase document.

2. Payment of invoices by paying offices without related prompt posting of data by authorized accounting activities creates large balances of undistributed disbursements. These undistributed disbursements reflect adversely on the validity of gross obligations of the Navy and obscure the current fiscal status of high priority programs; accordingly, authorized accounting activities shall take timely action to record paid invoices to allotment and operating budget ledgers to insure credibility of program costs.

CHNAVMAT
COMNAVAIRSYSCOM
COMNAVELECSYSCOM
COMNAVFACENGCOM
COMNAVORDSYSCOM
COMNAVSHIPSYSCOM
COMNAVSUPSYSCOM
DIRSSPO, Washington, D.C.
INFO, SUPSHIP, Bath
SUPSHIP, Bath SPA
SUPSHIP, Boston
SUPSHIP, Brooklyn
SUPSHIP, Charleston
SUPSHIP, Fort Amador
SUPSHIP, Groton
SUPSHIP, Jacksonville
SUPSHIP, New Orleans
SUPSHIP, Newport News
SUPSHIP, Pascagoula
SUPSHIP, Pearl Harbor
SUPSHIP, Philadelphia
SUPSHIP, Portsmouth
SUPSHIP, Quincy
SUPSHIP, San Diego
SUPSHIP, San Francisco
SUPSHIP, San Juan
SUPSHIP, Seattle
SUPSHIP, Sturgeon
NAVPRO, Baltimore
NAVPRO, Bethpage
NAVPRO, Burbank
NAVPRO, Columbus
NAVPRO, Dallas
NAVPRO, Dothan
NAVPRO, East Hartford
NAVPRO, Long Beach
NAVPRO, Philadelphia
NAVPRO, Stratford
NAVPRO, Akron
NAVPRO, Great Neck
NAVPRO, Pittsfield
NAVPRO, Pomona
NAVPRO, Silver Spring
NAVPRO, Sunnyvale
NAVCOMPT
NAVACCTGFINCEN
DEFENSE Contract Audit Agency
DEFENSE Contract Administration Services
CMC
CHNAVPERS
BUMED
ONR
CNO
NAVMATCOMSUPPACT

ACCELERATION OF EXPENDITURES

A. CNM LTR MAT 0123/23:CDL of 3 DEC 1971 [NOTAL]

1. Reference A requested assistance in meeting accelerated obligation and expenditure goals for Navy R.D.T. & E. and procurement appropriations.

2. Additional emphasis is required to accelerate expenditures. Therefore, addressees are requested to initiate a review of procedures closely related to the actual expenditure of funds. The following areas are suggested:

A. Contract close-out and subsequent payment of withheld funds.
B. Processing of payment vouchers—including progress payments.
C. Prompt processing and certification of DD 250's to paying activities.
D. Utilization of fast-pay procedures.

3. This review should encompass the above areas and others that can lead to expenditure acceleration.

4. Fully appreciate this is a workload related effort and that short-term acceleration of expenditures is difficult. Our vigorous and continued support of this effort is essential. (Kidd)

FISCAL YEAR 1972 OUTLAY TARGETS

Chairman PROXMIRE. What are the current outlay targets for fiscal year 1972?

Admiral KIDD. Will you repeat that, sir?

Chairman PROXMIRE. What are the current outlay targets for fiscal year 1972?

Admiral KIDD. I do not have those at my fingertips, Mr. Chairman. I will have to provide that for the record.

Chairman PROXMIRE. Can you tell us how those targets were arrived at? You do not have the figures, but can you tell us how you went about determining what those targets should be?

I know that you moved into this position since that was done, but I am sure you are familiar with how it was done.

Admiral KIDD. As I recall and understand, those targets were arrived at taking the amounts of money that were appropriated for a particular period of time, fiscal year, and then going back to see when—on what calendar date those moneys had to be spent by, and adding up those sums of moneys that had to be spent, let us say, by July 1, 1972.

Chairman PROXMIRE. When you review your remarks, could you expand on that for the record?

Admiral KIDD. Yes. sir.

(The following information was subsequently supplied for the record:)

The Navy's FY 1972 outlay (expenditure) target as published in the FY 1973 Presidential Budget Document is $22.5 billion. This figure represents the anticipated Navy expenditures against FY 1972 and prior year appropriations. This estimate was derived largely through the application of various statistical techniques and judgmental factors to historical experience. The estimating process considers anticipated new obligational authority, actual expenditures in prior fiscal years, anticipated schedule delays and escalation in major programs, and any other known factors that will impact expenditures.

The Navy's acceleration effort is intended to compress the period of time between when an expenditure can be legally effected and when it is actually accomplished and recorded on the Navy's accounting records. These are expenditures the Navy is required to make under the terms and conditions of its contracts and other agreements. In short, the expenditure acceleration effort is directed primarily at those areas of administrative delay that tend to hinder the legitimate expenditures of Navy funds.

IMPLEMENTATION OF ADMIRAL ZUMWALT'S INSTRUCTIONS

Chairman PROXMIRE. What have you done to implement Admiral Zumwalt's instructions as reflected in the memorandum which I read earlier?

Admiral KIDD. We have been meeting—the Board meets weekly, and this matter is taken up routinely at each weekly session, and the systems commanders make a report periodically of how well they are doing, and we are not doing too well.

Chairman PROXMIRE. What action has been taken to—what actions have been taken to implement the admiral's orders?

Admiral KIDD. Each of the systems commanders has received a copy. Each of the systems commanders has gone into means available to him to address each of the areas identified by the CNO.

Chairman PROXMIRE. Can you cite specific actions which the systems commanders and you have decided on taking?

Admiral KIDD. Yes. For example, we have gone with teams of competent contract people from Washington to outlying field activities to look over their books with them, their contracts with them, to see in what areas there is susceptibility to improved capability to commit funds. There has been absolutely not one bit of pressure, not one bit, to, as you earlier said, just get rid of money. I do not do business that way.

Chairman PROXMIRE. Well, if you were in their position and you were visited by your admiral under these circumstances, would you not consider that to be pretty powerful pressure to get rid of that money, spend it?

Admiral KIDD. No, I would not, Mr. Chairman. There is a vast difference between pressure and groups coming out to help and to advise.

COST TO TAXPAYERS OF ACCELERATED SPENDING

Chairman PROXMIRE. Can you give me the additional cost to the taxpayer for the acceleration of spending that has been ordered by Admiral Zumwalt?

Admiral KIDD. Additional cost? No.

Chairman PROXMIRE. Yes. Supposing that order had never been issued. Would there be any difference at all in the amount expended?

Admiral KIDD. None, no, sir. Well, now, wait, you asked two questions. I will go back to the first one. Additional cost to the taxpayer by accelerating the commitment of funds? None.

Chairman PROXMIRE. Well, then, you are telling me that this money would have been spent anyway, so Admiral Zumwalt's order is just useless. It means nothing.

Admiral KIDD. No. No. His memorandum was an urging to insure that we took all available and proper means to commit appropriated funds in appropriate fashion and within the rules.

Chairman PROXMIRE. And absent that memo, presumably some of those moneys would have lapsed and the taxpayers would save something.

Admiral KIDD. No. The taxpayer would have lost. The taxpayer would have lost, Mr. Chairman, because we would have had to come back again for money for the same things, and the way the cost indexes are going up now, we would have had to pay more for it.

Chairman PROXMIRE. Then, what you are telling me is that it is perfectly consistent for the Navy to spend money much faster than it instinctively would in order to use up the funds that are available, because that serves the taxpayer as well as the national interest. This is a very hard response for me to accept, very hard. If it is true in the case of the Navy, it must be true in the case of all other Departments.

Admiral KIDD. If we have the money in hand at the beginning of the fiscal year, we have the people on board in our contracting offices to do a proper job of writing the contracts and committing the moneys within the fiscal year involved.

Now, getting the money as late as normally is the case, we are regularly faced with the proposition of going at forced draft and at a high rate of speed to get these funds committed. So that that memorandum from the chief is nothing more than a recurring emphasis on the need to use the limited time available to commit the funds appropriated.

Chairman PROXMIRE. Admiral, that is a peculiar kind of economic effect. I have never seen it operate elsewhere.

Senator Percy has another engagement. He is in between engagements and I am delighted he is able to come even for a short time. I will yield to him for so long as he would like to question.

NAVY COMMENDATION FOR SPENDING MONEY FAST

Senator PERCY. Thank you, Mr. Chairman.

I have been very interested, Admiral, in the tail end of the conversation I just got in on. I was a naval procurement officer 29 years ago in Washington. I do not think I will ever get over the effect it had on me to see that big chart we had up in the Aviation Fire Control Department, where we had a goal to spend money by June 30 of that

year. We got a letter from the Chief of Naval Operations, Bureau of Ordnance, I guess it was, commending us for spending more money faster than any other department.

Chairman PROXMIRE. That was in the war.

Senator PERCY. That was in the war, and coming out of business, I just could not help but feel there was something wrong with a system that speeded up that process that way and caused us to spend money so quickly. For example, why buy spare parts for the next 3 or 4 years when there may be changes that would make those parts obsolete? I never wasted more money faster in my life than I did then and I have been working hard ever since to make it up to the U.S. Government. But I did it under orders.

CONGRESSIONAL RESPONSIBILITY FOR THE SYSTEM

Now, the Congress must share some responsibility in this respect in the system and the procedure. You would think in 29 years we would be able to improve it. I am somewhat shocked to find that the same incentive system has gone on, and probably the same commendation letters will go out when the money is expended.

Can you as the top Navy officer in these areas of procurement, help us devise a way so that we in the Congress can remove this necessity for what must be wasteful expenditure under pressure of time? This really would not be done by men of good judgment if they were not under such deadlines and if they would not "lose" the money at the June 30 fiscal year-ending unless they did obligate it and spend it. If you would like to comment on it now, I would appreciate it very much. If you can take some time and consider it so that we can take a look at possibilities for legislation that would enable us to rectify what seems to be a built-in disincentive for efficiency.

Admiral KIDD. I can give a very short answer, Senator Percy. I agree with you. Yes, sir, it can be improved upon with your help, you gentlemen up here on the Hill, by not enacting that legislation which was further, as I understand the problems, aggravated by obliging us to lose money at the end of a given period of time, because going around with the contracting officers and looking at the young ladies and gentlemen who are trying to put the words on paper that will permit the expenditure of funds, they are going four bells and a toot and when we get the money late, it is 7 days a week. So this costs you and me as taxpayers more money for overtime for these youngsters.

When you are faced with a proposition of losing funds which you have fought hard to get and to justify, by George, the incentive is high to get them committed. There is no question about it. And when you do things in a hurry, you make an abundance of mistakes. There is no question about that, either. If you want it bad, you get it bad.

Senator PERCY. Well, I am the ranking minority member on the Government Operations Committee of the Senate and I will discuss this with the chairman, Senator McClellan, and cooperatively with the Armed Services Committee whether this is not an area that one committee or the other ought not to take a good look at because it is wasteful. I appreciate your candor on it, and I can understand the human factors involved.

Limited Sources of Supply

I am sure you were advised of my inquiries yesterday about subcontracting, and the sources of supply available to the Navy. Obviously, you are limited if you do not have adequate sources of supply for major components as well as subcontracts and the economic system does not work as well when you are somewhat limited.

I wonder if you could comment on what role the Navy has played and can play if you feel that your sources of supply are too limited? Can you expand those sources of supply in the economy? There is 25 percent idle plant capacity and 5 to 6 million unemployed people.

Admiral Kidd. I agree with your point, Senator. I think that we must get as much business as possible into the small subcontractors. I would parenthetically observe here that with some of the contracts that we have of comparatively recent vintage where we deal only with the prime, that our license to get into the subcontractor area is rather constrained. But as a matter of principle, there is no question but what we should stimulate interest on the part of subcontractors.

I feel a personal obligation to them. I have been told by some primes that that is none of my business but I still feel a personal obligation to them.

I have been disappointed in some of the contracts that we have, finding that in my judgment perhaps too few subcontractors have been looked at for possible help. We can do more and I have a task force within the Materiel Command going after this particular problem at this time.

I am not going to promise you any remarkable results because I just do not know how much success we are going to have.

Disposal of Surplus Material, Equipment, and Lands

Senator Percy. There is one other area that relates to my first question, and I do hope that you can give us some suggestions for what might get us out of this dilemma. Is it a possibility that in the area of disposing of surplus material, equipment, lands, and this ranges from acreage to ships, that there again is no incentive on the part of the military services to dispose of these things?

Now, perhaps a system could be devised where if you got rid of a ship or you were able to get rid of a shipyard and sell it to private industry or see that it goes into the public domain for open space lands, that you would get credit for those sales? Then you would be taking unused assets and moving them over into an area where you can liquefy those assets and use them for something else.

Do you think this would cause the military services to do a lot of housecleaning, look around for things that are not needed or necessary, that cost money to maintain right now, but there is no incentive to dispose of them? Can we be helpful in devising such laws as to provide the incentives for you?

Admiral Kidd. I applaud your thought. Of course, the law does not work that way now. We dispose of things and there is no concurring credit back. Would that it were so.

You ran through quite a shopping list there of things—retired ships, and, of course, you know, we are string savers like the next fel-

low, looking against that rainy day when you might need them and need them quickly.

This in essence is the principle behind our Reserve fleet and it has served us well when we needed it, both the Reserve fleet and Active Reserve fleet.

Real estate the same way. It goes, but when it goes, the Navy or whatever the Government service involved is, enjoys no return for that which they have given up.

This would certainly be a very attractive proposition, sir.

Senator PERCY. Particularly when you see very crucial items that you are neglecting now. We know because of the Vietnam expenditures in recent years that critical expenditures have not been made, for example, to even maintain the Navy in first-class condition. If you had the ability to move accounts around, then if you could not get appropriated funds, you could get funds by disposing of certain things. I think this would be a terrific incentive and furnish an ability to fulfill needs that right now you know should be met that simply are not because of lack of funds.

LOCKHEED EXCESS PRODUCTION MAN-HOURS AND LATE DELIVERY OF GFE

If I could turn to yesterday's testimony, Comptroller Staats testified yesterday about a Lockheed claim with regard to certain contractors for destroyers, destroyer escorts, hydrofoils, oilers, and ammunition ships. In this case Lockheed claimed in excess of 243,000 additional production man-hours attributable to late delivery of Government-furnished boilers for the construction of the two destroyer escorts. Lockheed contended that delivery of the boilers for one of the ships had been delayed 14 months and for the other ship 7½ months.

The Navy found installation of the boilers in one escort had been delayed 48 working days and the installation of the boilers in the other ship had not been delayed at all. The Navy also estimated the delay in delivery resulted in approximately 25,000 man-hours of delay compared to Lockheed's estimate of more than 243,000.

Could you tell us how estimates could differ by as much as a factor of 10 as was the case here?

Admiral KIDD. No, sir; I cannot. I do not know where those Lockheed numbers came from. I know our auditors disclosed during the claim review that this disparity existed and it was on the basis of identifying this disparity and others that the claim settlement was markedly reduced from the claimed figure in its initial form.

I just would have no comment on why the corporation would come in with numbers of that size.

FREQUENCY OF EXCESS MAN-HOUR CHARGES IN CLAIMS

Senator PERCY. I wonder if Mr. Rule could tell us whether differences of this kind exist in the area of claims frequently or is this a very isolated case of a difference of fact of this magnitude?

Mr. RULE. Senator Percy, it is very typical. It is not unusual at all. The Lockheed case is a very unusual case in that the claim as filed involved nine new construction contracts that Lockheed had from the

Navy. On all nine, the only nine contracts they ever had from the Navy, they lost money. The total claim——

Senator PERCY. Well, at least they were consistent.

Mr. RULE. Yes, sir, and I asked the President once if that did not tell him something, that maybe they ought not be building ships, he agreed.

The claim of approximately $180 million was exactly the difference between the total of all the contract prices that they had bid—and all these contracts were advertised procurement—it was exactly the difference between that total and what they said it was going to cost them to build the ships. That was the total claim. It was just that simple.

Senator PERCY. Is it possible that the frequency of these differentials simply comes about as a result of rather lax followup on this and that they really felt they could get by? There is slippage some place obviously. There is an error some place, estimating, bidding, whatever it may be. They incurred extra costs for some reasons but here they suddenly blame the Government, which is easy to do. Is it possible when they do blame the Government that these claims have been allowed in the past with such a frequency that they felt they could get by with it again in this kind of a case where the facts are so contradictory and so easily ascertainable? That is the ludicrous part of it. There is just blatant fraud of some sort here.

AVERAGE PERCENT SETTLEMENT OF CLAIMS

Mr. RULE. Mr. Staats testified yesterday that their records showed that the average of the claims that have been settled were settled at, I believe he said 37 percent of the amount claimed, and this ought to tell you something. This ought to tell you that the claims were almost fraudulent in the first place. Even if they were settled at 37 percent, which seems to me a little high, but even of that is the right figure, to be able to knock off of a claim 63 percent—if we had that sort of overstatement in proposals for new procurement, if people were coming in on new contract proposals and giving us amounts of money that we would reduce that much, we would yell fraud, believe me.

When we reduce a contractor's proposal by 10 or 15 percent, that is high. But when these people come in with these claims and we can settle them at 37 percent, you have to ask yourself where was the rest, and so far as I am concerned it is just padding and this is why I take a hard-nosed view of claims. Some people do not. This is why I have gotten the American Bar Association, the claims lawyers and everybody else, p.o.'ed at me but I do not care.

CLAIMS SHOULD NOT BE NEGOTIATED

I know these things are not correct. I know that they are taking us to the cleaners. And this is why I agree with Admiral Rickover, the claims should not be a negotiation. These people file these big claims and the thing they want to do quickly is sit down and negotiate. I say that they ought not be negotiated. I agree with Admiral Rickover. We ought to look at them carefully, discuss them carefully with the claimant, go over and find the facts, discuss endlessly almost, to be fair, but then we ought to make up our minds what that claim is worth and say this is it. No negotiation.

Senator PERCY. One final question. This may go beyond your province but I do not know where else to ask it.

POSSIBILITY OF CORRECTION OF MANAGERIAL PROCEDURES

What has to happen to get a change of management when you have such flagrant violations of managerial procedures, as in this case by the Government constantly bailing out the company in one way or another? We are finding all sorts of ways the Government is doing this, and using taxpayers' money to do it, but we see no change in management. This does not occur any place else. In one company we have had major changes in management in the last few days in a situation that was intolerable from the standpoint of losses the company was incurring. This occurs every single day in the normal course of procedure except in the largest Government contractor we have got where public money is being used all over the lot for almost everything being done there, every salary being met, and yet no change occurs in management.

Errors, mistakes, gross mistakes in judgment, misleading statements put in, no change in management. It just keeps going on.

What has to happen? How do we bring about change, then? And that is, of course, what those of us who were so strongly opposed to the Government coming in and guaranteeing loans to Lockheed wanted—a change in management. But there is no change. The same old team runs things in the same old way, it seems.

INDUSTRY-SERVICES "GAME PLAYING"

Mr. RULE. I could not agree more and I testified against the Lockheed loan because I thought it was a dangerous precedent, but I would just like to quote to you as one suggestion what Mr. Packard said just a couple of weeks ago when he got the Forrestal Award. He said: "What is the solution"—after describing the game playing that goes on between industry and the services—"what is the solution? We are going to have to stop this problem of people playing games with each other, games that will destroy us if we do not bring them to a halt." And here is the point I want to make.

"Let us take the case of the F–14. The only sensible course is to hold the contractor to his contract." And he never was more right in his life. And it is going to be interesting to see if we do.

Senator PERCY. Well, we are certainly going to be interested in a bipartisan sense.

I want to thank you very much indeed, and I apologize for the executive committee meeting that I must go to now but I very much appreciate your being with us this morning.

UNION STRIKES

Chairman PROXMIRE. I agree with so much that has been brought out by Senator Percy in his questioning, not only on what goes on this morning but that we are never going to break our inflationary cycle unless we let the unions strike. Let them strike. This is a free country and it is the only way we can possibly resolve this situation. But we permit wages to go up as we have done with the Wage Board, the same way Lockheed said they are going to go under if we do not bail them

out. Let them go. We have got to let free enterprise work, either that or we are going to have to expect to settle for a grossly inefficient operation.

I want to get into some questions with you, Mr. Rule, because I want to pursue what Senator Percy was talking about, but I would like to get back just for one more question with Admiral Kidd before I proceed to some other things.

Spending Constraints Versus Spend-Spend-Spend

Admiral, you talk about you being string savers. There is ample evidence to me that there are few if any string savers left in the Navy. If so, they get a short trip out or are taken off their assignments or resign or something of the kind. At least in the Air Force as well as the Navy. We have been working for 5 years on this committee to save money, hold back, constrain spending in one way or another, and hammering away with amendments on the floor and with everything we can do in hearings, and so forth, to call it to the attention of the military. Now we find with Admiral Zumwalt's memo that they are on the other side, they are doing their best to spend, spend, spend. You are sending teams out as you testified here this morning, to implement that memo and to make sure the funds are spent. You can see the terrific frustration we have here. We seem to be working completely at cross purposes and there is no question as to who is the most effective. Just take a look at our deficit of $38 billion. You are obviously winning this battle.

Do you have any reaction to that?

Admiral Kidd. Yes, sir. I would go back one step and underline the fact that the Congress appropriated the money in the first place which is being spent, appropriated it for purposes that we justify the need for in the case of the military, and here the Navy, for pieces of hardware that we must have, so I can see no cause for concern when we take steps to insure that we are able to buy that which we need and for which you gentlemen have appropriated the funds.

Chairman Proxmire. Well, I have no objection to that and I do not know how anybody else could possibly object that you be sure that you can buy what you need. The question is do you have to have at the very highest level this kind of express order to go even beyond the spending tendencies which have been demonstrated in such a superior way in the past? I am informed this decision on military spending has been made at the very highest level of our Government, for the Army and Air Force as well as for the Navy. Can you tell us whether similar efforts have been launched in the other services? Have you ever spoken to the Secretary of Navy on this matter?

Admiral Kidd. I could not speak for the other services.

Chairman Proxmire. Did you ever discuss it with Secretary Laird?

Admiral Kidd. No, sir; I have not.

Chairman Proxmire. Or with the White House, or anyone from the White House?

Admiral Kidd. No, sir.

Chairman Proxmire. Do you know whether the White House initiated the order to accelerate payment to defense contractors?

Admiral Kidd. No, sir.

Chairman Proxmire. All right.

Mr. Rule, have you seen any instructions to accelerate payments to defense contractors or to take steps to achieve fiscal year 1972 outlay targets?

Mr. RULE. I have seen that letter or wire or whatever it is you read. I have seen that.

SPENDING DIRECTIVE EFFECT ON AVONDALE CLAIM

Chairman PROXMIRE. Do you think that instructions of that kind have had anything to do with the recent actions on the Avondale claim?

Mr. RULE. No, sir; I do not think there is any connection at all.

Chairman PROXMIRE. Well, comment on that Avondale settlement. What was your reaction?

Mr. RULE. Maybe we ought to stick to that letter.

Chairman PROXMIRE. All right. Comment on the Zumwalt letter. It would be very helpful to have that.

Mr. RULE. Well, the Zumwalt letter, so-called, if that is what it is—as I recall it, it is a wire.

Chairman PROXMIRE. All right.

Mr. RULE. TWX.

I understand what they are trying to do and I certainly understand Admiral Kidd's explanation. We used to in the Navy have a policy when the Congress would give us our appropriations timely, we used to have a policy that we had to make sure that we spent one-fourth of that money in each quarter, that we could not slack off in our procurement, you see, down through the year. You remember this, Admiral Freeman.

We had to spend it prudently by quarter and not let it pile up at the end of the year.

This is not a new phenomenon, despite the fact that we now get our appropriations later. They always used to let it pile up and the directive to spend it by quarter was an effort to stop this. We used to always end up—Admiral Freeman knows this—with money at the end of the year and we would issue letter contracts pell-mell just to obligate this. This is nothing new.

Chairman PROXMIRE. Though it is not new, what do you think of it? You have been in the Navy now and had tremendous experience in handling these matters.

ZUMWALT DIRECTIVE ERRED IN ITEMIZATION

Mr. RULE. Well, the only thing really new is the itemization there, I think, of areas to look at.

Chairman PROXMIRE. In other words, they are doing it more efficiently now than before. They have got it organized.

Mr. RULE. I am not sure that is more efficient.

Chairman PROXMIRE. They are wasting money more efficiently.

Mr. RULE. I am not sure it is wasting money but if Admiral Zumwalt had just sent a wire, now, look, do all you can to obligate money prudently by the end of the fiscal year, that would have been enough, but when you go into detail and say let us issue more unpriced purchase orders, the very thing we fight all year before this comes down not to do, when he says let us think about——

Chairman PROXMIRE. That is what concerns us.

Mr. RULE (continuing). Let us think about unlimited overtime when we just put out a directive to knock off overtime unless it is really authorized, some of these things are a little antithetic to our normal procurement practices.

RULE RESIGNATION FROM CLAIMS GROUP

Chairman PROXMIRE. Let me ask you now about the claims problem. First, I would like you to tell us why you tendered your resignation from the contract claims control and surveillance group, whether you believe the group's action in rejecting the Avondale claim had anything to do with its abolition. Were you "pressured" to resign?

Mr. RULE. Oh, no; not at all.

Chairman PROXMIRE. Why did you resign?

AVONDALE CLAIM REJECTION

Mr. RULE. The Avondale claim was rejected and I would like the record to show it was not rejected by Gordon Rule alone. It was rejected unanimously by the entire group, including the representative from the Office of General Counsel. It was rejected with the recommendation that a contracting officer's decision be made, not with the recommendation that we spend 8 or 10 months or another year trying to make the contractor's claim for him.

It was rejected on the 23d of July. On the 4th of August I was called into a meeting with the then CNM, and Admiral Freeman, this was just a couple of weeks later, and told they were going to reorganize the claims group. The pitch was that they thought it would be best to have it headed by a lawyer. They were thinking in terms of a lawyer from the Office of General Counsel.

Well, I happen to be a lawyer but I was on notice at that time that they were going to reorganize and as Admiral Kidd said, this all took place before he came aboard.

I did not do anything at that time. I rocked along and on November 8, the Assistant Secretary sent a memorandum to the Chief of Naval Material saying he wanted a plan for a new organization to speed up the review of claims.

It was at that time that I was sure that the change was going to be made and I am just not built in such a way that I am going to hang around until I get kicked out, so I resigned.

Chairman PROXMIRE. So it was obvious that you—as we used to say in the old days, when I was 10 years old, first, I got hired, then I got fired, and then, by God, I quit. Does that describe it?

Mr. RULE. No; I do not get that analogy at all.

Chairman PROXMIRE. Well, do you feel—if you had——

Mr. RULE. That is another one of your patented analogies. [Laughter.]

Chairman PROXMIRE. Well, you have just told us that you could see the handwriting on the wall. Maybe I misinterpreted what you said. Do you feel if you had not taken that action you would still be holding that position and you still would have the same authority over claims that you had before?

Mr. RULE. Oh, that is by no means sure because——

Chairman PROXMIRE. You can say that again.

CONNECTION BETWEEN AVONDALE REJECTION AND REORGANIZATION OF CLAIMS GROUP

Mr. RULE (continuing). There is the authority to reorganize in any way that Chief of Naval Material wants. The only point on which I am satisfied is if the Avondale claim had been approved instead of disapproved, nobody would ever have thought of reorganizing a damn thing.

Chairman PROXMIRE. Good. Well, that is the——

Mr. RULE. That is the way I feel.

Chairman PROXMIRE. That is fine. If you had approved Avondale you would be in the same position you had been in. You would not have resigned.

Mr. RULE. I do not know. I am not saying how long I would have lasted but they would not have thought of reorganization at that point.

COMPARISON OF CLAIMS REVIEW PROCEDURES

Chairman PROXMIRE. You heard Admiral Kidd describe a new system for reviewing claims. Could you explain how the present procedure differs from the one it replaced?

Mr. RULE. There is not any reason why this new organization that has been set up will not be very effective. It will not be as effective as the group I headed because I headed the first team. They got the second team in now. But if they want to run it with the second team, that is all right. But they will do a good job.

Chairman PROXMIRE. You say the procedures are not changed then, that it is just a matter of the quality and experience of the personnel.

Mr. RULE. I do not think the procedures really make that much difference. It has been said that the people have very great procurement experience. They do have. But again, I go back to Admiral Rickover's memorandum and that is not the kind of experience that is necessarily good in settling claims.

MILITARY DISCIPLINE

Chairman PROXMIRE. By and large—I am sure there are many exceptions but by and large, is it not a fair observation that service people, that is, those who are in uniform, those who are in the service, are much more subject to discipline than those who are not?

Mr. RULE. Well——

Chairman PROXMIRE. Would that not make a difference in the makeup of these groups?

Mr. RULE. On that point I would like to say that this is one of the very refreshing things that Admiral Kidd as the new CNM has brought to this office. It is something that has been needed for a long time. I have talked to him and I know that he believes in accountability and discipline on the materiel side of this Navy. We have needed that for a long time and I am just delighted as hell that this refreshing individual comes along with these views because they happen to coincide with mine.

I feel a lot of kindred things about us. I think we both have the basic philosophy that "I may be in error but I am never in doubt."

Chairman PROXMIRE. I can tell you that is an awfully good philosophy.

STATUS OF LEGAL ADVISERS TO CLAIMS GROUP

In 1969 the Navy seemed determined to do something about the claims problem, something other than simply paying the contractors for unsubstantiated claims. The Office of the General Counsel of the Navy was directly involved in claims reviews at that time. We have a memo from the then Acting General Counsel, Albert Stein, to the Vice Chief of Naval Operations, Admiral Clarey, stating:

"We intend to put the claims through a legal wringer to assist in squeezing the water out of any that are not solid."

Of course, your group was set up to help with the reviews.

Now, under the new system, the legal counsel is pretty far out of the picture and your group has been abolished, so the two major steps taken trying to bring the claims problem under control have been done away with.

Mr. RULE. No, sir; that is not correct.

Chairman PROXMIRE. Not a fair statement? Why not?

Mr. RULE. Because Mr. Stein was legal adviser to the CCCSG that I headed and occupies exactly the same position to the new group. No change. He was not a member of the group that I headed.

Chairman PROXMIRE. Was not there a man from legal counsel's office on your group?

Mr. RULE. Only Mr. Stein. He was not on the group, Senator. And the reason he was not on the group, the reason that the Office of General Counsel insists upon being advisers, is because they do not want the head of any group, my group or the new group, to be telling counsel as members what to do, you see. They have got to maintain this legal nicety. Advisers, not participants.

CONTRACTOR SHOULD BEAR BURDEN OF CLAIMS PROOF

Chairman PROXMIRE. The trouble I have is that it seems to me that a contract is a contract, we should live up to the contract. You go over the contract only when there is overwhelming clear evidence that one party owes more. In other words, if a contractor claims that the contract should be—more should be paid than was, then the burden ought to be clearly on him. He ought to be able to make a completely convincing case. The facts ought to be just irresistible, it would seem to me, or no payment should be made. That does not seem to have been what has happened in the past. It happened much more with you in charge. We fear that it is not going to happen in the future.

Shipbuilding claims seem to follow a definite pattern. The contractor incurs large cost overruns and submits voluminous claims to recoup his potential losses. The Navy gets bogged down for months or years trying to figure how much, if anything, it owes. It cannot figure this out to any reasonable degree because the contractor fails to keep records which would substantiate the claim. The shipbuilder makes an issue with Defense and congressional officials about the delay and threatens to hold the ship hostage until the Navy pays the claim. The Navy eventually caves in, releases money through a provisional settlement or makes an overall settlement without ever getting to the bottom of the claim to see how much the Navy actually impacted the

contractor. The first time a major claim is rejected by the Navy civilian review group, the group is abolished.

Possibility of Improvements Under New Claims Group

Admiral Kidd, how will your new Claims Board organization be able to handle these problems any better than they have been handled in the past?

Admiral Kidd. I make no promise they will, Mr. Chairman. All I can do is try.

Chairman Proxmire. How would you reply to my question?

Admiral Kidd. You have made a couple of points there that I think are deserving of a bit of clarification. Admiral Rickover's position has been cited. Mr. Rule has well articulated his views in relation to the importance of lawyers. I fully share both.

As I understand and see the claims situation, there are two parts to it. Those parts which can be easily identified as responsible, where the Government is responsible, and for those portions I believe that we must pay our bills and should pay them promptly.

For those parts of the claim which are legal matters, then those are properly the responsibility of the law.

As far as where the lawyers are, sir, we have lawyers now, and have had for some time, at the contracting officers level in the Systems Command, at the claims team level. The team chief is a gentleman of the law. He has two hats. He works for the General Counsel of the Navy and he works for the Systems Command. So the law is well represented right from the outset.

Now, how are we going to insure that we do better? I make no promises in this regard. More people are obviously needed. These people are being hired, acquired, put on to the claims review problems as they come up.

Here we are at great disadvantage because, if I may continue for a moment, because we are seeing industry equip themselves with large numbers of gentlemen dedicated to the proposition of just addressing claims, trying to find ways in which claims can be developed.

Disneyland Claims Presentation Course

Let me have that thing from Disneyland. I could not believe this yesterday. You might just be interested.

Here is a very nice brochure from Disneyland East, "Government Contract Claims April 17 to 21, 1972, Walt Disney World, Florida, a practical course in the techniques of presenting claims to the Government."

Chairman Proxmire. Disneyland.

Admiral Kidd. Now, you pay——

Chairman Proxmire. Will you submit that for the record? [Laughter.]

Admiral Kidd. In the back here, you pay $350 to take this course.

Chairman Proxmire. Does the Navy pay directly or indirectly for a seminar like that?

Admiral Kidd. Good heavens, no.

Chairman Proxmire. Will you check that out?

Admiral Kidd. I have. We asked if we could go, perhaps send a man free. We were told no.

Chairman PROXMIRE. Who conducts the seminar?

Admiral KIDD. This is George Washington University and Federal Publications, Inc., sponsoring. We volunteered——

Chairman PROXMIRE. I am sure we would find that the taxpayer is paying for it one way or another.

Admiral KIDD. Well, I do not know. We volunteered to send one of our gentlemen down to talk with them, give our side. No.

May I read for a moment—this is how the industry sees it, apparently, or at least the legal branch supporting the industry's views:

Claims volume has risen dramatically, for a number of reasons, contractors' desire (because of reduced work) to maximize returns from existing contracts; the coming-home-to-roost of problems generated by sophisticated procurements; the bold realism that Government contracting is not a honeymoon.

That gives you an insight into what we are up against on the Government side with a very modest group of lawyers having to face up to this type of quite formidable array apparently dedicated to the proposition of seeing how well they can do this job.

(The brochure from Disneyland follows:)

GOVERNMENT CONTRACT CLAIMS—APRIL 17-21, 1972, WALT DISNEY WORLD, FLA.

A PRACTICAL COURSE IN THE TECHNIQUES OF PRESENTING AND DEFENDING CLAIMS ARISING OUT OF GOVERNMENT CONTRACTS

A carefully planned—meticulously structured—Course in the techniques of preparing, presenting, and defending claims which arise out of Government contracts. Concentrated learning—35 full hours.

The need

Claims volume has risen dramatically, for a number of reasons: contractors' desires (because of reduced work) to maximize returns from existing contracts; the coming-home-to-roost of problems generated by sophisticated procurements; the bald realism that Govt contracting is not a honeymoon—a certain number of disagreements are bound to occur. *The result:* a need for practical training in claims management.

Our answer

Government Contract Claims—a *new* one-week Course—*35 hours* of intensive training. Over 450 professionals attended prior three-day sessions of the Course, and their objective verdicts (some are printed elsewhere in this brochure) amply attest to its value. Now—to further increase its worth—we have *expanded* the Course to *five days*, updated the original content, and added *topics never before covered.* So the Course is new . . . it's fresh. Even if you attended an earlier session, joining us again to share in the *additional* learning will be beneficial.

Approach

Our approach is *balanced:* dealing with contractors claims against the Govt, and Govt claims against contractors. Each side (contractor and Govt) is shown how to *recognize, prepare and present* claims; and how to *defend* claims made against it. And it's a *broad-gauged* approach: for *lawyers* who bear the brunt of the battle/for *non*-lawyers (administrators, engineers, accountants, technical personnel), who must be able to spot potential claims, be sure those claims are timely filed, and provide the essential backup information, expertise and testimony for the lawyer.

Teaching method

Our teaching method is based on the *practical experience* of recognized professionals—men who have been involved in thousands of procurement claims. They will lead you through the entire claims process, from initial recognition of a claim to final resolution, explaining not only the principles involved but how best to *apply* them in real-life situations. And you'll learn things that you can't find in books—things that only experience can teach. Most significantly: a *sample case* will be utilized as the common thread for the Course (it will be sent to you in advance) and instruction will generally be related to that case. Finally, (1) Special Clinic Sessions are scheduled, at which the lecturers, plus additional

experts, will consider your *particular questions;* and (2) a Live Hearing Demonstration will conclude the Course, graphically illustrating for you the real-world claims arena.

Claims manual

The Faculty has prepared a completely new Claims Manual (well over 600 pages) containing original text, forms and specimen documentation. All Course attendees will receive a copy of this unique working-reference book—available nowhere else.

Certificate

A special *Certificate of Completion* will be issued by the University to those who faithfully complete the Course.

CURRICULUM AND FACULTY

Course directors

Henry B. Keiser, President, Federal Publications Inc.; Prof. John Cibinic, Director, Government Contracts Program, George Washington University.

Dates

April 17–21, 1972.

Location

Continental Room; Contemporary Resort Hotel, Walt Disney World, Florida.

Daily schedule

Morning Lectures 9:00–12:00.
Afternoon Lectures 1:30–4:30.
Special Clinic 4:45–6:45.
Refreshments 10:30–10:45—3:00–3:15.
Reception/Wednesday 7:00–8:00.
Course Ends/Friday 12:00 Noon.

MONDAY, APRIL 17

8:00 Registration

8:50 Opening ceremonies

9:00 Recognizing the claim and where to take it

How facts, contract provisions and law are blended and analyzed to identify areas of potential cost recovery or other relief. A detailed study of the many possible claims which may arise in contract situations. Where to take those claims—the available forums, their authority to grant relief, steps in the claims process, and (most importantly) guidelines to follow in determining *which* of the relief routes should be pursued for different types of claims. (Eldon H. Crowell, Partner, Reavis, Pogue, Neal & Rose)

1:30 Preparing and defending the claim

How claims should be prepared for submission to the Govt—and how the Govt should prepare to defend them. Techniques of investigation, research, analysis, fact-gathering, fact-organization, use of independent experts, documentation, etc. Form and content of the claim proposal and of the Govt response. The role and use of the claims "team" (lawyer, administrator, engineer, accountant, inspector, technical personnel, etc.). (Overton A. Currie, Partner, Smith, Currie & Hancock; George T. Malley, Chief Counsel, NASA Langley Research Center)

4:45 Clinic

Ralph C. Nash, Associate Dean, National Law Center, George Washington University.
Harold F. Blasky, Partner, Greenberg, Trayman, Harris, Cantor, Reiss & Blasky.

7:00 Reception

Hosted by the sponsors—for the faculty, the Course registrants, and their wives—from 7:00–8:00 in the Hemisphere Lounge of the Contemporary Resort Hotel.

TUESDAY, APRIL 18

9:00 Obtaining information/discovery and subpoena

Use of discovery and subpoena processes to obtain critical information (necessary for contractor claims prosecution or Govt defense) which is in the hands of

the *other* party. The legal and *practical* aspects of these tools. Distinctions between contract appeal Board and Court procedures. Alternative means of obtaining information and evidence, including the Freedom of Information Act. (Walter F. Pettit, Partner, Miller, Groezinger, Pettit & Evers; Irving Jaffe, Deputy Asst. Attorney General, Civil Division, Department of Justice)

1:30 Presenting the claim

To The Contracting Officer And Contracting Appeals Board. How claims—for which relief may be granted under the specific terms of the contract—should be presented (a) to the Contracting Officer (C.O.) and (b) to a contract appeals Board if the C.O. denies relief. Techniques of presentation, Board rules and proceduces, the Complaint and Answer documents, evidence, exhibits, conduct of conferences and hearings, examination and cross-examination of witnesses, trial strategy, briefs. (Jack Paul, Partner, Paul & Gordon)

4:45 Clinic

Prof. Gilbert J. Ginsburg, Assistant Director, Govt Contracts Program, George Washington University.

Gerson B. Kramer, Chairman, Department of Transportation Contract Appeals Board.

WEDNESDAY, APRIL 19

9:00 Presenting the claim

To the Court. Appeals to the Court from contract appeal Board decisions; and Court trials of breach of contract claims over which Boards have no jurisdiction. Rules and procedures, pleadings, motions, conferences, Commissioners' hearings, evidence and witnesses, argument before the full Court, briefs, tactics, types of relief, Wunderlich Act problems, etc. (Max E. Greenberg, Partner, Greenberg, Trayman, Harris, Cantor, Reiss & Blasky)

To the Comptroller General. General Accounting Office review of contract appeal Board decisions; and GAO relief in special areas where Boards have no authority. The standards of review and relief; how GAO action is sought; Govt and contractor presentations and documentation; conferences with GAO; miscellaneous procedures and considerations. (Paul A. Shnitzer, Assistant General Counsel, General Accounting Office)

1:30 Presenting the claim

To A Contract Adjustment Board. The grounds for special *equitable* relief (under P.L. 85–804) when no *legal* right or recovery exists under the contract. Presenting equitable relief claims to the deciding Contract Adjustment Board—procedures of the Board, what the claim request should contain, supporting documentation, possible tactical approaches, etc. (Marshall J. Doke, Partner, Rain, Harrell, Emery, Young & Doke)

Injunctions against the Government

When can (a) bidders and (b) *non*-bidding parties (e.g., labor unions, public interest groups, etc.) obtain—from the Courts—injunctions *preventing* the Govt from making a contract award or proceeding with contract performance. Distinctions between temporary restraining orders (TRO's), temporary injunctions and permanent injunctions. The techniques involved in applying for, arguing for, and defending against, TRO's and injunctions. What to do *after* they are obtained. The possibility of a Court ordering the Govt to *award* a contract to a *particular* bidder. A realistic appraisal of the current status and *practical value* of the injunction remedy. (Gilbert A. Cuneo, Partner, Sellers, Conner & Cuneo)

4:45 Clinic

Professor Cibinic; S. Neil Hosenball, Deputy General Counsel, NASA, Chairman, Claims Committee, Administrative Conference of the U.S.

THURSDAY, APRIL 20

9:00 Government claims against contractors

The circumstances under which the Govt can recover *money damages* from contractors. Rules, limitations and dollar-measurements relating to Govt recovery of: (a) excess costs incurred (following contractor's default) in reprocuring contract items or completing contract performance; (b) actual damages caused by contractor's delay; (c) liquidated damages; (d) consequential damages; (e) damages resulting from latent defects after acceptance; (f) damages due to breach of an express contract warranty. Current Govt policy, and future possi-

bilities, regarding warranties and consequential damages. (Harold Gold, Counsel, Naval Facilities Engineering Command)

1:30 Government collection techniques

Various methods and techniques used by the Govt to *collect*, from contractors, sums owed as a result of Govt claims: Reduction of the contract price. Withholding payment on *unrelated* contracts. Setoffs. Counterclaims. Suits in Federal District Courts (and *contractor* counterclaims against the Govt). (John S. Pachter, Associate, vom Baur, Coburn, Simmons & Turtle)

Debarment, suspension and blacklisting

Debarment and suspension of a contractor from doing business with the Govt: Justification. Applicable regulations and procedures. Contractor's right to a hearing. Methods of defending against, combating, and seeking reversal of, debarments and suspensions. Time limits. / "Informal" barriers—experience lists and blacklisting: Authority for their use. Legality. Procedures. Contractor counterattacks. / Other possible "pressures" on contractors. (Paul G. Dembling, General Counsel, General Accounting Office)

4:45 Clinic

Dean Nash; Professor Cibinic; Professor Ginsburg.

FRIDAY, APRIL 21

9:00 "Live" hearing demonstration

How a claim is presented and defended before a contract appeals Board—a true to life step-by-step hearing before a distinguished appeals Board Chairman. Based on the sample case, it illustrates trial procedures, strategies and tactics. You will see; opening and closing arguments by attorneys for contractor and the Govt; testimony of witnesses; how documents are handled; the use of experts; cross-examination techniques; rulings on evidence and the practical problems of proof. *Special feature:* Periodic commentary, by the Board Chairman, explaining the meaning and significance of developments at the hearing.

Demonstration Director, Elmer Mostow, Esquire.

Board Chairman, Richard C. Solibakke, Chairman, Armed Services Board of Contract Appeals.

Contractor's Attorney, Gilbert A. Cuneo.

Government's Attorney, George T. Malley.

Witnesses, A realistic "cast."

GENERAL INFORMATION

Registration

Fee for the Course, including all instruction materials, is *$350* ($375 *after* April 3, 1972). To register, detach and mail the accompanying application form to the *exact address stated* thereon, along with a check payable to *Contract Claims Course*. Registrations will be accepted in the order of receipt, are limited by the capacity of available facilities, and may not be cancelled after April 3, 1972.

Accommodations

A block of rooms—at special rates—has been reserved for use of Course registrants at Walt Disney World's Contemporary Resort Hotel. Following receipt of your registration for the Course, a reservation form will be sent to you for use in obtaining such rooms. (The Course registration fee does not include accommodations.)

Mail and messages

Registrants should make arrangements to have all mail and telephone messages directed to their hotel rooms. There are no facilities for delivering messages to the registrants during the Course sessions, and the sessions cannot be interrupted for that purpose.

Further information

If additional information is desired, contact:

J. K. Van Wycks, Seminar Division
Federal Publications, Inc.
1725 K Street NW, Wash, D.C. 20006 Area Code 202/337-8200

Registration Application: detach and mail this application to
Contract Claims Course, Suite 500, 1725 K Street NW., Washington, D.C. 20006

Enclosed please find my $350 check ($375 after April 3, 1972) covering registration for your Government Contract Claims Course. [Please make check payable to "Contract Claims Course."] I understand that this registration may not be cancelled after April 3, 1972.

A receipt for this registration will be sent to me along with a form for my use in making room reservations at Walt Disney World's Contemporary Resort Hotel.

Please Print

Name _____

_____

Organization _____

_____

Street Address_____

_____

City—State—Zip _____

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Important. Please be sure to send this Application to the exact address noted above.

VERDICTS

By far the most comprehensive, complete and finest presentation of any of the many Government contracts seminars I've attended. *Horace G. Booth, General Dynamics Corp.*

Comprehensive, in depth review of the contract claims field, sorely needed and long overdue—excellent. *Joseph P. Marcotullio, Atomic Energy Commission*

The best organized and presented course ever attended. Course Manual is better than any other text material in the field. *Robert L. Nash, Lockheed Missiles & Space Co.*

Excellent in format, content and presentation. I recommend it for all involved in Government contracts. *Terry H. White, U.S. Navy.*

High powered—effective—very well communicated to the lay person. I will recommend it. *George L. McGuire, Sr., Arvin Industries*

Course will assist me to train Government personnel in how best to defend against contract claims. *William H. Waikart, General Services Administration*

Written materials are excellent and worth the price of the Course. Information for both the neophyte and the expert. *Robert H. Robinson, ESB Inc.*

The best of your courses. I will recommend it to all Contracting Officers and engineers. *Leland H. Barrineau, Department of Interior*

A "must" for anyone involved in Government contracting—both private and Government personnel. *Clarence E. Butz, Butz Engineering Corp.*

Should be mandatory for all Contracting Officers and legal personnel. *Anthony J. Samaritan, Federal Aviation Administration*

Excellent—presented so that even a person with limited knowledge of the subject can learn. *James E. Killebrew, Couch Construction Co.*

Federal Publications' courses are the best short courses I attend—so worthwhile! *C. A. Bennetch, Atomic Energy Commission*

One of the best yet. Superb written materials. *Gordon H. Clarke, United Aircraft Corp.*

Inadequate Contractor Records

Chairman Proxmire. Well, why will not the Navy require its contractors to keep proper books and records, to maintain adequate budget and cost control systems, and to segregate the cost of changes so that claims can be fully investigated and substantiated? It seems to me the claims are now being settled on the basis of subjective judgments, not objective facts.

Admiral Kidd. Too often.

Chairman Proxmire. The GAO has repeatedly advised us that contractors are not able to relate alleged cost increases to specific Government actions. Why will not the Navy act?

Admiral KIDD. We have been and are in the following ways. Increasing greatly the numbers of the gentlemen that we have in residence at the shipyards, at the factories of all types, not just shipyards, legal gentlemen in some isolated cases because we do not have too many lawyers, inspectors, and examiners. In one large private contractor, some 400.

Now, you get to a point of diminishing returns here, I am sure. Where that point is I would not presume to say.

Chairman PROXMIRE. Let me interrupt. I think hiring more people, I am not sure that will do it. That is spending more money. What we are getting at is what you can do. Maybe it is difficult for you to do things. I am sure it is. But what you can do is to require the contractor to keep these records.

Admiral KIDD. And this we are doing now. There are several new directives. Mr. Packard, God bless him, he has several things in mind. This 7000.2 is one instrument which is going to be a fine ball bat when everybody gets in line. It is not something that can be done overnight.

Chairman PROXMIRE. Well, I can think of one very effective way to act, and that is just not to pay unsubstantiated claims. Do not pay them.

Admiral KIDD. I agree with you fully.

Chairman PROXMIRE. That is the incentive.

Admiral KIDD. Fully.

Chairman PROXMIRE. I am delighted to get that response. That is very helpful.

REFERRAL TO ASBCA

The Navy seems to be avoiding the Armed Services Board of Contract Appeals and the litigation routes. How many claims has the Navy actually litigated, and would you identify the cases and the amounts involved where the Navy has litigated claims?

Admiral KIDD. It will take about 30 seconds, if you want to go on to another question.

LITIGATION VERSUS NEGOTIATION

Chairman PROXMIRE. The reason I stress this, maybe I am attributing to Mr. Rule improperly, but I thought he said something about how we should have less negotiation and more litigation, more going to court, more settling it on the basis of legal determination and not on the basis of negotiation where the other side has really nothing to negotiate.

Admiral KIDD. That is Mr. Rule's view, Admiral Rickover's view, and it is a view I, too, share. I think that we must go after these claims, identify the things that are proper charges on which there is no question, a change that the Government has initiated and for which we owe.

Where you get into some of these nebulous areas, the ripple effect, such things as that, I have told several contractors absolutely not. I am not going to get into that, and if they choose to go that route, they must go to the courts.

Chairman PROXMIRE. Can you give us the data?

Admiral KIDD. Yes, sir. Would you like us to submit it for the record?

Chairman PROXMIRE. Unless you have it available right there.

Admiral KIDD. I have it right here.

Chairman PROXMIRE. Why do you not give it to us right now; that is, the number that have been litigated?

Admiral FREEMAN. These are pending cases we have before the Armed Services Board of Contract Appeals at the present time.

Chairman PROXMIRE. Very good. Give us that for the record, that is fine. You have several pages.

Admiral FREEMAN. Yes, sir.

Chairman PROXMIRE. All right.

(The information referred to follows:)

The following tabulation contains Navy claims before the Armed Services Board of Contract Appeals as of December 1, 1971:

ARMED SERVICES BOARD OF CONTRACT APPEALS

Contractor	Contract No.	ASBCA No.	Amount
CASES OVER $5,000,000			
Edo Corp	NObsr-95188	15,968	$16,701,798
General Dynamics Corp. (Quincy Division)	NObs-4509, 4583	13,885	25,551,075
Merritt-Chapman & Scott Corp. (formerly New York Shipbuilding).	NObs-4581	15,443	19,950,926
Newport News Shipbuilding & Dry Dock Co	NObs-3557	6,565	7,284,084
CASES UNDER $5,000,000			
Al Larson Boat Shop, Inc	J.O. No. 401-68 MSR N626672-67-C-007.	14,134	$101,842
Nethlehem Steel Corp	NObs-3556, 3648	10,316	3,812,221
Do	NObs-4998	13,341	100,080
Detyens Shipyards, Inc	MSR N62673-67-C-0002	15,412	3,380
Do	NObs-4408	16,485	80,479
Dillingham Corp	N652C2-68-C	16,347	2,897
General Dynamics	NObs-77(A)	16,330	61,328
Do	NObs-77(A)	16,568	7,608
Do	NObs-77(A)	16,680	5,043
Do	NObs-77(A)	16,681	1,206
Do	NObs-4914	16,748	723
Do	NObs-4914	16,749	328
Do	NObs-77(A)	16,750	238
Do	NObs-77(A)	16,751	503
General Electric Co	NObs-88325	13,018	564,000
Grafton Boat Co	N00034-68-C-0323	15,969	141,017
Gulfstream Industries, Inc	N00024-67-C-0310		848,500
Ingalls Nuclear Shipbuilding	NObs-4582	16,370	(1)
Litton Systems-Ingalls Shipbuilding Division	N00024-69-C-0283	16,573	(2)
Do	N00024-69-C-0283	16574	1,876,121
Lockheed Shipbuilding & Construction Co	NObs-4780	16494	216,423
Main Ship Repair Corp	NObs-41260(MSR)	12790	1,652,525
Merritt-Chapman & Scott Corp. (Formerly N.Y. Shipbuilding)	NObs-3920	16164	3,761,696
Munro Drydock, Inc	N62665-67-C-0014	15258	16,280
New York Shipbuilding Corp	NObs-4581	11186	42,972
Northwest Marine Iron Works	N00024-70-C-0224	16350	100,000
PACECO, Division of Fruehauf Corp	N00024-67-C-0379	16066	915,865
Do	N00024-67-C-0263	16458	63,171
Radiatronics, Inc	NObsr-91010	15133	316,945
Rondout Marine, Inc	N00024-67-C-0370	14458	95,024
R. R. Allen, Inc	N62678-70-C-0001	16716	27,860
Sea Sled Industries	NObs-4604, 4677	10311	131,022
Do	NObs-4604, 4677	10966	85,980
Space Avionics, Inc	NObsr-94135	13410	20,111
Sperry Rand Corp	N00024-67-C-5401	14852	207,000
Susquehanna Corp., Atlantic Research Division	N00024-69-C-0286	16246	225,000
Teledyne Sewart Seacraft	N00024-67-C-2047	16397	3,799
Do	N00024-67-C-0201	16398	2,768
The American Shipbuilding Co	N00024-67-C-0214	16526	1,143,974
Todd Shipyards Corp	NObs-4415	14409	48,370
Do	NObs-41256	15374	157,546
Do	NObs-3958	15747	39,748
Do	N00024-69-C-0256	15845	2,880,000
Todd Shipyards Corp., Los Angeles	MSR-N62672-67-C-0011	16455	32,745
Video Research Corp	N00161-68-C-0157	14402	23,250
Willamette Iron & Steel Co	N62683-67-C-0014	16242	36,360

[1] To be determined.
[2] Involves 10 percent withholding by prime interest.

Provisional Payments on Claims—Avondale

Chairman Proxmire. Last year Admiral Sonenshein testified that the practice of making provisional payments on claims pending a final legal determination of entitlement and amount had been suspended and the inference I made was that it would not be resumed. A few weeks ago we learned that the Navy made yet another provisional payment to Avondale of $25 million. This is the claim that was unanimously rejected by the Rule group just a few months ago because it could not be substantiated.

I am informed that the provisional payments were made despite objections from the Navy's General Counsel and NAVSHIPS Deputy for Contracts. Is that right?

Admiral Kidd. Despite objection?

Chairman Proxmire. Yes, sir.

Admiral Kidd. No, sir. It was the other way around, Mr. Chairman. This——

Chairman Proxmire. Well, am I correct in saying that this was—this claim would have been unanimously rejected by the Rule group?

Admiral Kidd. Absolutely.

Chairman Proxmire. You reversed it.

Admiral Kidd. No. I did not reverse it. No. It was rejected by Mr. Rule and I have gone over the documentation wherein he rejected it and I think he was right.

Mr. Rule. Rejected.

Chairman Proxmire. I am also informed that payments were made without a report and evaluation by the claims team as to how much the Navy might owe on the claim. Is that correct?

Admiral Kidd. Run that by again, please, sir? No. no.

Chairman Proxmire. The rejection was made without a report and evaluation by the claims team as to how much the Navy might owe.

Admiral Kidd. We have had a claim team down there, Mr. Chairman, since last year.

Chairman Proxmire. Did they make a report on that?

Admiral Kidd. Last summer. They have been reporting continuously as they have identified parts thereof for which there was no question.

Modification Agreement for Avondale Provisional Payment

Chairman Proxmire. I am informed that Admiral Woodfin, the Deputy for Contracts, refused to sign the modification agreement for the provisional payment. Is that true?

Admiral Kidd. Well, I do not recall that. I've just been informed he was home with the flu.

Chairman Proxmire. If he did not sign it, who did sign it?

Admiral Kidd. What is this we are talking about now, sir?

Chairman Proxmire. The modification agreement for the provisional payment.

Admiral Kidd. That was signed by the Vice Chief, Bureau of Ships.

Chairman Proxmire. Why did not Admiral Woodfin sign?

Admiral Kidd. As I say, I believe he was ill at the time.

Chairman Proxmire. He did not refuse to sign. Are you telling us that testimony to that effect——

Admiral KIDD. No, not to my knowledge. We sat right in my office and discussed this.

Chairman PROXMIRE. Did he recommend making the payment—Admiral Woodfin? You say he discussed it. Did he recommend making the payment?

Admiral KIDD. There was no diagreement stated among those at the time the matter was decided. I made the decision.

Chairman PROXMIRE. You say there was no disagreement. Did he recommend it? Did he take positive action and say you should pay this?

Admiral KIDD. No, I do not recall that he did.

Chairman PROXMIRE. Did you object?

Admiral KIDD. No.

TESTIMONY BY NAVY LEGAL COUNSEL

Chairman PROXMIRE. Is the Legal Counsel here in the room?

Admiral KIDD. Sir?

Chairman PROXMIRE. The Navy Legal Counsel, is he here?

Mr. MANKIN. Yes. sir; I am the General Counsel.

Chairman PROXMIRE. Can you testify on this? Will you—did you know about this matter we have been discussing?

Mr. MANKIN. On Avondale?

Chairman PROXMIRE. Admiral Woodfin.

Mr. MANKIN. And Admiral Woodfin. No, sir; I do not.

Chairman PROXMIRE. What about your own recommendations, sir? Will you identify yourself, come forward and identify yourself.

Mr. MANKIN. Senator, I am Hart Mankin, I am the General Counsel for the Department of the Navy.

Chairman PROXMIRE. Yes, sir. Did you recommend this payment, sir?

Mr. MANKIN. Did I recommend the payment? I concurred in this payment, sir.

Chairman PROXMIRE. You did not recommend but you did not object to it. Is that a fair description, or you knew about it but took no action?

Mr. MANKIN. I knew about it and the action I took is that I concurred in it.

Chairman PROXMIRE. Do you think it was a good decision?

Mr. MANKIN. Do I think it was a good decision?

Chairman PROXMIRE. Yes, sir.

Mr. MANKIN. I think it was a valid exercise of the judgment of Admiral Kidd and I think, by and large, it was a good decision, yes, sir.

$25 MILLION AVONDALE PAYMENT

Chairman PROXMIRE. Let me ask you, Admiral Kidd, why did you decide to give Avondale the $25 million?

Admiral KIDD. Two reasons. First, I was satisfied that we owed them the money, but now let me stop right there. You know, this was not a lump sum payment. This money did not change hands all in a bunch. Not by a long shot. This was a provisional payment paid in increments, to be paid in increments.

Chairman PROXMIRE. Let me just interrupt to say did Mr. Rule make any recommendation on this matter?

Admiral KIDD. I do not recall.

Chairman PROXMIRE. Did you ask Mr. Rule?

Admiral KIDD. I did not, no.

RULE POSITION ON PAYMENT

Chairman PROXMIRE. Mr. Rule, did you have any position on this?

Mr. RULE. No, sir. I would like to say I was not consulted. Admiral Kidd——

Chairman PROXMIRE. Your original position was, of course, to reject it; right?

Mr. RULE. Admiral Kidd called me down one evening and was kind enough to fill me in on this payment. The decision had been made. I begged him not to make it. I thought it was a mistake and I begged him not to make it. I would beg him all over again because as I told him, I think really, and this will be my ongoing opinion, we are here to help this man and keep him from making mistakes. He can exercise the final judgment but I thought he was making a mistake and I so advised him.

Admiral KIDD. That is correct.

Chairman PROXMIRE. Fine. Thank you. Why did you think this was wrong, Mr. Rule?

SECRETARY PACKARD'S ATTITUDE ON CONTRACTOR COMPLIANCE

Mr. RULE. Well, I understood and I still understand Admiral Kidd's desire to get the ships. He was trying to do everything he could to get the ships. But basically, as Mr. Packard stated in his speech with respect to holding the contractor in the case of the F–14 to the contract, I was in favor of holding the contractor in this case to the contract. Aside from holding the contractor to the contract, in that connection let me read one more line from Mr. Packard when he says:

Although some companies may be forced to suffer financially because of this concept,

Holding the contractor to the contract—

it will not be a major disaster to the country. It will be a very major disaster to the country if we cannot get the military-industrial complex to play the game straight. Until and unless we can stop this attitude, we are going to continue to waste the taxpayers' dollars, get less defense for the dollars we spend.

Chairman PROXMIRE. I thought very, very highly of Mr. Packard. He and I disagreed on some things but I thought he was a very great servant of our Government.

That entire speech will be printed at this point in the record. I think it is a very fine statement of principle that we ought to abide by.

(Mr. Packard's speech follows:)

DAVID PACKARD ADDRESS AT THE FORRESTAL AWARD DINNER

I am delighted to be here tonight and to be honored with the Forrestal Award. I have a confession to make. During these past three years when I would go back to California I could always begin my remarks there by saying, "It's great to be back among friends". Particularly in the early months of my tour of

duty in Washington, I never dreamed the time would come when I could say the same thing here. I was wrong. I can say in all honesty to you here tonight—and particularly to you at the head table—it's great to be back among friends.

I have given a great deal of consideration to what I might say tonight to this distinguished audience. I must say it has been difficult to think of something you have not already heard many times before.

One subject that I could talk about is the vast build-up of Soviet military power that has taken place during this past decade. But you people in this audience know about that.

Also, this is the season for debate before the Congress on the FY–1973 Defense Budget. Secretary Laird and Chairman Moorer have already made this a strong case before the military committees. If I supported the Secretary and the Chairman on that subject here tonight, Senator Fulbright would certainly accuse me of adding to the over-statement of the case. I would be very troubled if the good Senator should do that.

Or I could extol again all the virtues of the military-industrial complex as I have been doing so often during these past three years.

I could tell you how the defense industries always complete their jobs on time—meet the specs—and control their costs—and with what great accuracy and sympathy Senator Proxmire reports and comments on these matters.

Or, I could talk about the marvelous spirit of cooperation among the Services—how the Army was always willing to give up some more men so the Air Force could have more planes and the Navy more ships.

Or, I could describe how the Navy offered to forgo more nuclear carriers so the Air Force could have more foreign bases—and that I had to twist Admiral Zumwalt's arm very hard to get him to include the CVN–70 in the 1973 budget.

I could even talk about how the bureaucracy all over town including State, Defense and Treasury, fed all those brilliant ideas over to Henry Kissinger month after month from the very beginning of this Administration.

And then, to top it all off, I could tell you what an enjoyable place I found Washington to be.

Instead, let me begin by simply admitting that the three years I spent in the Pentagon must be numbered among the most interesting years of my life. I'm not sure they can be numbered among the most productive. Only time will tell whether anything useful or permanent has been accomplished. In any case, I am delighted to receive this Forrestal Award before time has a chance to apply its ruthless yardstick.

National defense was not in high repute while I was in the Pentagon. A number of factors contributed to this anti-military attitude, particularly the country's disillusionment with the Vietnam War. In many respects these were traumatic years for one who has faith in the future of his country. They were traumatic when some members of Congress, particularly in the Senate, took great delight in seizing on any fact or figure which could be used—generally magnified, distorted, and almost always out of context—to discredit the military and all those who supported the Defense Department.

They were traumatic when scientists used their reputations gained in unrelated fields to influence legislation to stultify national defense programs—particularly the all-important strategic nuclear programs upon which the security, in fact the very survival, of our country depends.

They were traumatic when former friends in distinguished universities supported ideologies contrary to the democratic concepts of this great nation.

They were traumatic when distinguished members of the news media were, in their reporting, sometimes more favorable to Hanoi, to Russia, than to their own country.

This great nation of ours was indeed in a state of shock in 1968 and in the spring of 1969 when I came to Washington. There was rioting and burning in the streets. Some of our great universities were in shambles. Inflation was rampant and had already eaten away at the economic progress of the previous decade. We had 540,000 men and women in Vietnam, and no plan to bring them home—no course to end U.S. involvement in Indochina other than unconditional surrender at the negotiating table in Paris.

Now that I have returned to private life and have had the opportunity to reflect on those three years and what they may portray for the future, it has become evident to me there is nothing so unusual about this period if it is viewed in the long course of history. Our great country had, to a large degree,

lost its commitment to a common goal—to a unifying purpose that is so necessary to keep people working together, whether it be in small organizations within the society, or whether it be as a nation.

But this lost commitment was not a new phenomenon in the course of human affairs. People had been here before in the millenium that has brought man from the jungle to what we call civilization.

Organizations of people are born and develop when people are bonded together with a common objective—a common goal. Their talents, their energies become fully attuned to their aspirations—and working together they can surmount unbelievable obstacles. This has been the history of these United States. It has, in fact, been the history of all great nations, as well as all of the institutions large and small within each nation.

But, just as there is a common characteristic associated with the birth and growth of human institutions, including nations—there is also a common characteristic associated with the deterioration and eventual death of human enterprises, including nations.

The characteristic required for birth, growth, and sustained vitality is an enthusiastic commitment to a common goal. Decline, decay, and eventual death starts with the loss of that commitment.

If this is a proper premise, and I believe that it is, then the United States in 1968 and the spring of 1969 was teetering on the brink of a decline from the greatest nation in the history of civilization, to a second rate power. It makes no difference that we were the wealthiest nation in history. It makes no difference that we had the most powerful military establishment in the history of the world. It makes no difference that we had the largest and most efficient research and development capability. It is not what a nation is, but what it wants to be that determines its future.

What troubles me most as I have observed the Washington scene during these past three years is the divisive nature of the debate. There has been not only a lack of agreement on what our future goals should be, but a more serious lack of understanding of what kind of goals will sustain the vitality of our country in the future. Senator Fulbright is pushing for a fortress Arkansas policy for our future foreign policy. Senator Church would prefer that it be fortress Idaho. I can think of no better way to assure the demise of America to the status of a second rate world power by the decade of the 1980s than to follow this line of thinking.

Fortunately, new and exciting goals for America have been established during these past three years under the leadership of President Nixon. I am very proud to have had at least some small part in helping to develop this new and exciting course for our future foreign policy. This new direction has already excited the imagination of the American people, and set the stage for the commitment and purpose which is so necessary if our country is to maintain its position of world leadership into the decade of the 1980s and beyond. It is a positive policy and a realistic policy—matched to our legitimate interests and to our resources, as any realistic policy must be.

There is no need to defend the President's leadership during these three years. Just look at the facts. Peaceful and legal protest has largely replaced rioting and burning in the streets. The great universities and colleges are back in the business of education. More than 400,000 of our servicemen and women have been brought home from Vietnam. U.S. casualties have been reduced nearly a hundred-fold. Our military units that remain are all but out of ground combat, and substantial reductions have been made in air combat activity. The South Vietnamese are now able to defend their country from the Communist invaders, and North Vietnam has no hope whatever of a military victory.

Bold measures have been taken to bring inflation under control, and wishful thinking has been taken out of international monetary policy, and international trade.

American self confidence at home and American leadership abroad are again on a rising course.

Whether America will move forward to the challenge of leadership in the decades ahead will depend on what the people of our great nation perceive their role to be. This role will be reflected with some degree of clarity by the attitudes of the elected members of the Congress, and by the attitudes of those in the executive branch. But regardless, it is well to remember that the desires and commitments of the American people, and the institutions to which they belong, will determine the eventual course and outline of history.

The attitude of the nation, of course, directly affects the Defense Department as one of the largest and most important public institutions in the nation. The Defense Department will be strong, and efficient, and effective, to the extent every individual in that Department is devoted to a common aim, and is working toward the achievement of that objective. It is difficult, if not impossible, for the Department to be strong and effective if the country is not united in its goals—and if the Department is not in tune with these goals.

When we came to the Department in 1969, people were not working together effectively. James Forrestal, when he became the first secretary of defense tackled a momentous job. He had the great vision that our military strength would be enhanced under a unified Department.

However, unification is easier said than done. There are strong diverse forces in and around the Department of Defense. It is hard work to keep them headed in a common direction in times of peace. When Secretary Laird and I took on this job in 1969, that was our most important goal. I believe we succeeded to some degree in bringing these diverse forces more nearly together.

As I worked with the men and women in the Defense Department over these past three years, I became greatly impressed with the high caliber of people who serve their nation in Defense. I worked closely with the Joint Chiefs and other top officers in each Service, and I had many occasions to visit men and women in units large and small all over the world. This country can be proud of the military people who provide its security. It has been especially disturbing to me to witness the bitter, often vicious, criticism of the military in the press, on TV, in many of our more liberal universities, and even by some elected public officials—who, of all people, should know better. I can understand disillusionment with Vietnam policy going back to 1966 or so, but the military does not deserve criticism for the policy—it was dictated and completely directed from the very beginning by the civilians in the Administration and in the Department at that time. The officers and other servicemen and women in the Army, the Navy, the Air Force and the Marines simply did what they were asked to do. They were asked to do an almost impossible job, and they did it well.

As we move ahead to address the formidable problems of the nation, the factors which will make America equal to the challenges of the future are the same factors which will make the Defense Department strong and able to defend and support the country's commitment to the future. The Department's first and foremost commitment is to the security, the strength, and the world leadership of the United States. This commitment comes before any well-intentioned individual loyalty to the Army, the Navy, the Air Force, or the Marines.

With this broad commitment in the forefront at all times, the day-to-day problems can and will be resolved. And with this commitment from the Armed Forces of this country, the President can address the all-important challenges of world leadership.

As I indicated earlier, while some progress has been made, there are still those—both in the Defense Department, and in industry—who have not accepted the larger commitment.

Within the Defense Department, for example, there continues to be a degree of competition between the Services—and frequently between parts of a Service—that is unacceptable because it is inconsistent with the common commitment. Some competition is healthy, but not when it begins to affect such major matters as funding, missions, and roles. Jealousies and in-fighting will only serve to drain our nation's energies.

In the same vein, I am not much impressed by what I have seen in the attitudes of some of our great corporations in the so-called military industrial complex. You are, of course, aware of the problems we have had with the C–5A, the Mark 48, and other programs which have had much publicity. In many ways, the problems are deeper than they appear to be.

I visited one plant last year that was running a year behind its project schedule. After a couple of hours it was apparent the company knew it would be at least a year off schedule on the day the contract was signed. I asked the manager why he offered to do the job in one year less than was possible. The essence of his reply was—yes, we know we could not meet the terms of the contract, but there was no way to get the contract if we told the truth.

One serious impediment to good defense management is that defense contractors can appeal directly to the Congress. On one occasion, about two years ago, a company tried to reverse a decision I had made by appealing to one of our Congressional committees. The company's recommendation was purely one

of self-interest and it was wrong. The company knew it, and I knew it, and so I called the management of the company and told them so.

What is the solution? We are going to have to stop this problem of people playing games with each other. Games that will destroy us, if we do not bring them to a halt.

Let's take the case of the F–14. The only sensible course is to hold the contractor to his contract. Although some companies may be forced to suffer financially because of this concept, it will not be a major disaster to the country. It will be a very major disaster to the country if we cannot get the military-industrial complex to play the game straight. Until and unless we can stop this attitude, we are going to continue to waste the taxpayer's dollars—get less defense for the dollars we spend.

Quite simply, it means the Army, the Navy, the Air Force and the Marines must put the welfare of America ahead of the welfare of their respective Service, in peacetime as well as in war. It means the great industrial corporations that forge the seams of our military strength must put the long term gains of America ahead of the short term gains of their respective organizations. It means that Congress should address America's security policy, stay out of day-to-day administrative problems, and discourage game-playing between the Services and the business community.

If we want to remain a powerful nation, we can do so.

And if we are powerful, we can influence the course of history in a positive way.

The critics will say—yes, we agree, but power does not necessarily mean military power. There is economic power, the power of moral persuasion, the power of ideas—power beyond that which comes from the barrel of a gun.

We all want to believe this, but the record is not all that persuasive. If there is a case to be made, it is that a united commitment, is the most commanding factor available to influence the course of human events.

Only if all of us—in the Congress, in the Administration, and in the private sector—rise above our personal biases and our personal interests, will the future course of America and the well-being of the world be secure.

Only if all of us—particularly those who are charged with, or who have the opportunity for leadership—wipe this blurring film of self-interest from our eyes, will we be able to see the sharply-defined images of opportunity and accomplishment that await us in the future.

I have had the opportunity to get acquainted with many fine people in both the Services and in the Department during my three years in Washington. I know from first-hand experience that you who shoulder the responsibility for the defense of our country have the desire and the ability to do the best possible job.

I know that you will carry on with your efforts of working together. As you do, you demonstrate convincingly to the critics that you have the welfare of the country as your first priority—and that you deserve their wholehearted support and confidence.

It has been a great privilege for me to be with you tonight and a great honor to receive the Forrestal Award. Thank you very much.

Chairman PROXMIRE. Let me ask you a little further——

OGDEN CORP. RESPONSIBILITY

Mr. RULE. I would like to make one more point in answer to your question why I advised Admiral Kidd not to sign this provisional payment. Avondale is a division of the Ogden Corp., a conglomerate with a lot of money. If they had simply said we are turning off the spigot, we are not going to finance Avondale any more, I think we should have gone after Ogden and made them put up the money rather than let them off the hook.

Chairman PROXMIRE. Thank you very much. That is most helpful.

Admiral KIDD. Would you like me to continue on that subject, Mr. Chairman?

FACTORS INFLUENCING DECISION

Chairman PROXMIRE. All right. Maybe if I ask a couple of further questions you can include those in your response. I wonder if your

decision was influenced by the instruction you received to accelerate payments to contractors from your superior.

Admiral KIDD. Absolutely not.

AVONDALE THREAT

Chairman PROXMIRE. And also whether your decision was influenced by Avondale's threat to stop work?

Admiral KIDD. Oh, they had already stopped.

Chairman PROXMIRE. Threat not to continue, then, not to proceed.

Admiral KIDD. In answer to the first question——

Chairman PROXMIRE. Holding the ship hostage, not letting you have the ship.

Admiral KIDD. In answer to the first question, absolutely not.

Chairman PROXMIRE. That did not influence your decision.

Admiral KIDD. Admiral Zumwalt's memo?

Chairman PROXMIRE. No. You have answered that. I am talking about holding the ship hostage, whether or not that was an important element in your decision.

Admiral KIDD. It was, indeed.

Chairman PROXMIRE. It was. That was the crucial factor?

Admiral KIDD. Well, no. No. I will not say the—the crucial factor was the pressing need for those platforms. The fleet needed those.

Chairman PROXMIRE. That is what I mean.

Admiral KIDD. The fleet needs them badly. The team had been down there since last summer, going through, revalidating the figures which Mr. Rule had not approved, and that team was reporting regularly their findings and I, in checking with the team, found what they had validated as proper charges to the United States for changes and for things that were our responsibility, and I decided that I would pay that bill. And the proper name for that bill I see here is a provisional price increase paid incrementally as they performed.

AVONDALE REQUEST FOR CONTRACTOR MODIFICATION

Avondale was very strong in their objection. They preferred to have what they called a maximum modification to the contract which I rejected out of hand. I said no, I would not stand still for that because implicit in that if I agreed to that would be that we owed them the money that Mr. Rule said we did not owe them and I said I do not think we owe you that much money.

PREVIOUS PAYMENT OF $23½ MILLION TO AVONDALE

Chairman PROXMIRE. Is it not true that the Navy had already provided $23½ million to Avondale?

Admiral KIDD. That is exactly correct.

Chairman PROXMIRE. So this $25 million meant that you were paying about two-thirds of what the original claim was?

Admiral KIDD. Quite right. That is correct. And the first $23 million was made up of increments at that time of validated charges as the 25 provisional price increase was made up of elements of validated proper charges, too.

Chairman PROXMIRE. Does not the Navy when it makes this much of a payment gives up its bargaining position? You will never get that back, will you?

Admiral KIDD. Well, I was advised on that score——

Chairman PROXMIRE. I am sure.

Admiral KIDD. I was advised on that score and I made a judgment. I could have been wrong. It would not be the first time I have made a wrong judgment, but I wanted those ships, having just come from a fleet where we needed them badly, and this was a validated bill that I was led to understand by the experts in whom I have proper confidence, that it was money owed by the United States and I decided to pay the bill.

POSSIBLE EXTORTION

Chairman PROXMIRE. Well, another way of looking at it is that this is extortion, that they were extorting funds from you on the grounds that otherwise you would not get your ship, you would not get what the Navy needed and you collapse and give in under this claim and it establishes a precedent which Mr. Packard and Mr. Rule are warning against here.

Admiral KIDD. I thought about that, too, very carefully, and extorting—perhaps. But their price asked, demanded, was ever so much higher, somewhere around $74, $76, somewhere around there, $73 million, and I——

Admiral FREEMAN. $75 million.

Chairman PROXMIRE. This is $48½. This would be $48½ million of that $75 million.

Admiral KIDD. Yes. And that difference has been the part in question right along.

The ripple effect, and so on, things that are rather nebulous, hard to get a handle on, and I said absolutely not, I will not touch it.

ADMIRAL RICKOVER'S MEMO TO ADMIRAL KIDD ON NEW CLAIMS PROCEDURE

Chairman PROXMIRE. Now, on February 11, Admiral Rickover sent a memo to Admiral Kidd strongly objecting to the new procedure for handling claims. Admiral Rickover said in his memo that claims settlement is principally a legal matter and should not be handled like contract negotiations. He suggests that the Office of Senior Counsel establish a review board composed of legal, accounting, and technical experts to review settlements and eliminate items not clearly substantiated and, among other things, a list be promulgated of contractors who frequently make claims against Government or who submit excessive or unwarranted claims and that procurement agencies give consideration to contractors' claims records in awarding new contracts.

I would like to get your reaction and Mr. Rule's reaction to Admiral Rickover's recommendations. Do you feel they are sound?

Admiral KIDD. Oh, I can answer that very simply. I agree with him. I seek his advice regularly. He calls me up many times a day with advice and I think he is sound.

Chairman PROXMIRE. What have you done to implement that recommendation? What have you done to have legal counsel set up?

Admiral KIDD. I think that the board we have constituted now is going to operate, if I have my way, just about the way he proposes.

Chairman PROXMIRE. That is not under the General Counsel?

Admiral KIDD. No, it is not. However, the legal gentlemen whom we have as I mentioned earlier in the Systems Command and at the claims team level are gentlemen who have double allegiance, allegiance to the General Counsel and to the System Command for whom they work.

Now, when we go after a claim and agree to and pay our proper bills for things that are uncontestable, anything else I am going to say, take it to the court, which is what Admiral Rickover has proposed.

SYSTEMS COMMAND REVIEW AND CONFLICT OF INTEREST

Chairman PROXMIRE. At the present time the claims come up through the Systems Command?

Admiral KIDD. They do, sir.

Chairman PROXMIRE. They get to review them?

Admiral KIDD. Yes, sir; they do.

Chairman PROXMIRE. Isn't there a conflict of interest involved here?

Admiral KIDD. How so?

Chairman PROXMIRE. What I had in mind was at that point an independent group, either Counsel's office or Mr. Rule's office, wouldn't have advice, would they? They would step in maybe later but at that point the decisions would be made by the——

Admiral KIDD. No, no.

Chairman PROXMIRE (continuing). Procurement officials.

Admiral KIDD. I disagree with that, Mr. Chairman, because the team for instance, that I sent down to Avondale were gentlemen picked from rather far and wide. I would say, "No" to the possibility of a conflict of interest there, sir.

LOCKHEED CLAIMS DIVISION

Chairman PROXMIRE. Mr. Rule, yesterday we heard testimony from the Comptroller General about the settlement of Lockheed's claim 2 years ago. I suggested it appeared the claim was divided up into four portions in order to keep it from going to your Review Board. Seventeen million dollars should have gone to your Review Board since the total exceeded $5 million, they divided it into five portions—all of which were under $5 million, so you had no opportunity to see it and no right to under the law.

I also suggested the enormous discrepancies between the alleged delays and the actual delays indicated to me that the contractor may have intentionally misrepresented the facts in his claim.

I wonder if you could comment on the Lockheed claim and the GAO report.

Mr. RULE. Well, sir, as I mentioned earlier, the total claim involved nine contracts——

Chairman PROXMIRE. What is that? I am sorry. I missed it.

Mr. RULE. The total claim from Lockheed involved nine contracts. These five contracts were—they had a total claim value of about $40 million and Admiral Sonenshein did feel that they were worth $17 or

$18 million. However, each one of those five contracts or rather none of those five contracts was he going to settle for at over $5 million and we discussed this—Admiral Sonenshein, Admiral Freeman, myself. We made it perfectly clear that if they were going to be negotiated as a lump sum, all five together, they would have to come to my review group.

We were assured that they would not be negotiated that way, that they would be negotiated separately. I have no reason to believe that they weren't, although it is a little difficult negotiating technique for me to comprehend, but I have no reason to believe that they were not negotiated separately, and in fact, the GAO has checked that point. And they have no reason to believe that they were not negotiated separately, and hence, Admiral Sonenshein lived up to his agreement and they did not and should not have to come to my group.

Rule Recommendations for Claims Settlements

Chairman Proxmire. Mr. Rule, I wonder if you would like to add anything as to how you think claims problems ought to be handled. What should the Navy, what should Congress do? Do you have any recommendations that you would like to make at this point?

Mr. Rule. You realize that you are asking an ex-claim person, but I have thought a lot about it.

Chairman Proxmire. One for whom I have the highest respect and faith.

Mr. Rule. I have thought a lot about claims for various reasons and I do have some recommendations. Bear in mind that my philosophy on claims against the government, unilaterial claims, submitted by—we are talking about shipbuilders now who come in years after—in some instances the ships have delivered—and say, you owe us $50 million, $100 million, I just want to say that I characterize that as an adversary proceeding. I don't think that is just another negotiation. I think that when a contractor comes in like that, unilaterally with five stacks of volumes prepared by so-called experts, I think that is an adversary procedure and I would treat it as such. And it is that feeling that makes me get to the point in my thinking where I say, these things should not be negotiated.

You negotiate new procurement. You do that because, in every new procurement, when a contractor gives you his proposal, there is a big grey area of costs that he wants, and you only sort out those grey areas by sitting at the table and negotiating them and then you determine how much you should pay for what it is you want.

But when a claimant comes in unilaterally for millions of dollars that we are now told are settled for an average of 37 percent of the claim, my philosophy is that the grey area which cannot be substantiated, those grey areas should be left for a board or a court to decide.

Now, there are people who don't feel that way obviously. The lawyers are not very prolitigation. Lawyers like to settle things. This is the one objection to—possible objection to Admiral Rickover's memorandum. I would be all in favor of turning them over to the lawyers if you had a hard-nosed staff of lawyers. If you had a bunch of panty-waists who wanted to settle everything and not go and slug it out at the ASBC and do the hard work, I wouldn't be in favor of that.

I would suggest that we get these claims, we scrub them, we sit down with the contractor and go over all the areas so that he cannot say we have been arbitrary or capricious. We would discuss every possible point in the claim with them and then make our judgment as to what the claim is worth and we have no negotiations. We tell the contractor, here is our evaluation. You can take this and settle right now. If you don't, we will make a CO decision, a contracting officer's decision right now for that amount and you can appeal.

Now, that is—if I had carte blanche I think that is the way I would do it.

RECOMMENDATION FOR GAO COOPERATION IN CLAIMS SETTLEMENT

There is an alternative that I would recommend, and that is that after the Navy has received the claim and after they have done all their factfinding work, that both those packages be turned over to the GAO for decision as to how much we owe this contractor. This would obviously negate any pro or con feeling on the part of Navy personnel. Sometimes they feel anti a contractor and sometimes pro. This would get it into a purely objective forum and I am reminded that the GAO is going down and investigating these claims anyway after they have been settled, and I just would like to get them in with us to help settle them.

Now, I know they said yesterday that they don't want to do this because the contracting officer has to make the decision and they are not contracting officers. Well, that is a detail and I think it could be taken care of in the case of claims, but I really think GAO could help us a great deal more.

Chairman PROXMIRE. We have asked the GAO to do this and they have indicated they couldn't.

Mr. RULE. Well, they did that on the ground that they stated yesterday that a contracting officer has to make a decision. Normally this is true, but I suggest, sir, that in an unusual situation, why can't we cut the cloth just a little differently to suit the situation?

Chairman PROXMIRE. Mr. Rule, those are excellent recommendations.

Mr. RULE. I haven't finished. I haven't gotten to the best part.

Chairman PROXMIRE. I beg your pardon.

TREAT CLAIMS AS ADVERSARY PROCEEDINGS

Mr. RULE. I think, Senator, that claims, I am not talking new procurement, I am talking claims—when this man comes in and files a claim against the government, I think that those claims should have the same stature, and dignity as a case in court. It is an adversary proceeding just like a case in court.

PROHIBIT INTERVENTION IN CLAIMS SETTLEMENTS BY MEMBERS OF CONGRESS, LAWYERS, ETC.

When a case in court is filed or when a case is before a board, Members of Congress, lawyers, Secretaries, they don't call up the judge and they don't lean on anybody and they don't call the clerk of the court, and I think that claims should have that—should have attached that same dignity and people should not be able to call up about

claims. And this applies to lawyers, Members of Congress, and everybody else.

I think there should be a canon of ethics in the Bar Association that should preclude lawyers from running to Congress, calling up the Secretaries, doing a lot of things that they wouldn't do for a case in court, you see. I think that they should do exactly the same things and only those things that they do with a case in court.

I think that there should be a rule in the House and in the Senate of the Congress along the same lines, that it is improper for Members of Congress as they are doing today to call constantly, have meetings, call people up to the Hill, go down and sit with the Secretary, to talk about claims while claims are being adjudicated. I think they ought to—that ought to be an improper practice, and certainly to the extent that they call to expedite a claim which is perfectly natural, you would like to point out how it is all right to expedite, and I agree.

Chairman PROXMIRE. We have been through that once.

Mr. RULE. Yes; we have been through that. But records ought to be made of any call placed by the lawyers, the Members of Congress, on claims and they just don't have that stature today and I think they ought to have it.

RECORDINGS OF CLAIMS MEETING RECOMMENDED

I think that further, my last point is that when claimants and their lawyers, have meetings in the Bureau on the claims, I think those meetings ought to be recorded and a record kept of them for further use.

Those are my recommendations.

PARTICIPATION OF GOVERNMENT EMPLOYEES ON FACULTY OF DISNEYLAND CLAIMS PRESENTATION COURSE

Chairman PROXMIRE. Those are very, very valuable. I am glad you went ahead instead of stopping when I interrupted. And I am glad that you sent up to me the Disneyland faculty showing contractors how they can get money out of the Government. It includes on the faculty, as I suspected, officials of the Federal Government who are being paid by the taxpayers.

For example, preparing and defending the claim. George T. Malley, Chief Counsel, NASA Langley Research Center.

Obtaining information, discovery and subpoena, Irving Jaffe, Deputy Assistant Attorney General, Civil Division, Department of Justice.

Clinic, Gerson B. Kramer, Chairman, Department of Transportation, Contract Appeals Board.

Presenting claim, to the Comptroller General, Paul A. Schnitzer, Assistant General Counsel, General Accounting Office.

Clinic, S. Neil Hosenball, Deputy General Counsel, NASA.

So that I don't see any—wait a minute, oh, yes. Government claims against contractors, Harold Gold, Counsel, Navy Facilities Engineering Command. That is the first Navy personnel I have seen.

Department suspension and blacklisting, Paul G. Dembling, General Counsel, General Accounting Office.

And "live" hearing demonstrations, Board Chairman, Richard C. Solibakke, chairman, Armed Services Board of Contract Appeals.

So, this course is given to tell contractors how to get money out of the taxpayer, I think it is shocking. I am delighted that you called that to my attention. I missed that Disneyland faculty.

Mr. RULE. Senator, there isn't anything new about that except where it is going to be held. Those sessions are being put on throughout the country regularly.

Chairman PROXMIRE. Yes, but my question earlier was whether this was being done by the Federal Government or not? It is not being done directly. It is under the sponsorship I understand of George Washington University, I was told.

The important point I am trying to make is that members of the faculty here, moonlighting, are the people who are on the other side and employed by the Federal Government. I think it is an observation that is worth noting.

SHIPBUILDING COST CONTROL AND PROCUREMENT PRACTICES

Admiral Kidd, I would like to get into shipbuilding practice now. The GAO reviews of cost control and procurement practices at two of your major shipyards, Newport News and Litton, indicate that the Navy still doesn't have effective control over the cost of work for which the Government shares a large part of all cost overruns and underruns. How much business do you estimate you have under contract that is under effective cost control?

Admiral KIDD. Oh, I wouldn't hazard a guess, Mr. Chairman. I am not comfortable with the total adequacy of our cost controls. I am satisfied that the contractors are gradually becoming increasingly aware of the need for much improved cost controls. I am also satisfied that in the majority of cases they are bending quite satisfactorily and promising efforts in this regard.

But it is not going to be an easy thing to solve and it is going to take a long time.

ACTIONS TAKEN TO CORRECT DISCREPANCIES

Chairman PROXMIRE. Well, for the record, to the extent that you could do so, with your staff, will you review what has been done and indicate what actions you are taking to correct deficiencies?

Admiral KIDD. Yes, sir.

(The following information was subsequently supplied for the record:)

The procurement practices and cost control problems in private shipyards are being addressed in a number of ways. Basic to the overall cost control problem is the claim problem. In this regard the Navy has implemented, or plans to implement, actions in the following areas:

(1) To accomplish development and service evaluation of new systems and equipments prior to their inclusion in ships' characteristics. When this is not possible due to the urgency of the requirement, concurrent-development items will be included only after a formal cost and risk evaluation.

(2) To accomplish all advance-planning, including approval of ship characteristics, in a timely manner to ensure the validity of overall costs and feasibility of each SCN Program.

(3) To identify cost estimates by a prescribed classification to indicate the quality of the estimate.

(4) To develop procedures to ensure that an adequate and complete cost-benefit analysis is performed for each proposed specification change prior to its approval.

(5) To improve ship specifications and associated drawings including updating of the ship specifications which have the greatest impact on shipbuilding claims.

(6) To analyze key provisions of shipbuilding contracts for the purposes of developing new clauses of procedures to resolve contract problems.

(7) To develop procedures for early reporting of delays expected in Government-furnished-material and information and more timely information on the status and progress of Government-furnished-equipment.

(8) To include claims identification clauses in selected contracts which require that contractors identify potential claim problems as they arise during performance of the contract, thus permitting their resolution on a current basis.

In addition, one of the major objectives of the Naval Ship Systems Command is to provide each of the Navy's major private shipbuilders with specific guideline and direction for improving those business, financial and managerial operations which have been having an adverse effect on cost, delivery and technical performance. This improvement program includes the following actions:

(1) Ensuring that each shipbuilder has as effective Cost Control System which (1) allocates the total planned cost of each contract to discrete subordinate work elements, i.e., by organizational units and type of cost (direct labor, material, etc.); and (2) relates physical progress and expenditures to planned cost.

(2) Ensuring that each shipbuilder has an effective Management Information Systems which provides periodic and situation reports by planned and actual performance and performance trends at the first level of supervision; and which summarizes by contract and by organization units.

(3) Ensuring that each shipbuilder employs effective internal audit procedures that provide a continuing measure of the validity of charges for direct labor, material, services, and overhead.

(4) Ensuring that each shipbuilder has an effective Material Management System which encompasses make/buy decisions, subcontracting, receipt, inspection, issuance and return of material.

(5) Ensuring that contract administration problems are minimized by improving shipbuilding contracts through the development and utilization of an organized body of standard contract clauses.

(6) Ensuring that the Navy's surveillance capability over the business aspects of the ship acquisition process is strengthened by adding business review groups and legal counsels at Navy Supervisor of Shipbuilding Offices at Groton, Connecticut; Newport News, Virginia and Pascagoula, Mississippi.

LITTON $7 MILLION OVERHEAD IRREGULARITY

Chairman PROXMIRE. Both the Defense Contract Audit Agency and GAO have reported that during the periods 1969 to 1971 Navy contracts were charged about $7 million for overhead expenses applicable to Litton's commercial work carried on at the West Yard. We were shocked by this yesterday. Why hasn't the Navy acted and caused them to refund this money?

Admiral KIDD. Oh, we have, Mr. Chairman.

Chairman PROXMIRE. What else have you done?

Admiral KIDD. Yes, sir. This irregularity, if you will, because as yet we can't prove one way or the other how or why it happened, was first identified by our own Government contract auditors. It was brought to our attention. We went back to the contractor, drawing his attention to this, and asking him why and directing that he change his procedures to insure that this sort of thing would be prevented in the future.

Action To Be Taken by DCAA

He came back to us with a letter acknowledging this error and then enclosed a piece of paper, a legal brief, saying that he would change his bookkeeping procedures henceforth, but that the change in proce-

dures would not be properly, legally made retroactive. We sent this compendium, this file, to the Defense Contract Audit Agency for comment and review. They are to come back to us on April 14, of this year. But I haven't given up on that one.

Chairman PROXMIRE. Well, I am glad to get this report. We missed it yesterday.

LHA PROGRAM COST AND PROGRAM UNIT COST

What are the present estimates for the program cost and the program unit cost of the LHA being built by Litton and how do these costs compare with the original estimates?

LITTON'S LHA CLAIM

Let me ask some other questions in this connection as long as you are getting the data together. I want to know how much is Litton's claim on the LHA and I want it broken down, if possible, the figure by escalation, cancellation, and Navy impact costs.

Admiral KIDD. Those figures are not in our hands, Mr. Chairman, and aren't due in until the end of this month. The reset time.

LHA DELIVERY SLIPPAGE

Chairman PROXMIRE. How about LHA delivery schedule? I understand there has been a slippage of 2 years, 24 months.

Admiral KIDD. The LHA delivery schedule has slipped, Mr. Chairman. Let me see where that stands right now.

Chairman PROXMIRE. Will you give us those other figures when they come in?

Admiral KIDD. Yes, sir.

Chairman PROXMIRE. I know you don't have them now, but send them to us.

What is the reason for the slippage which has occurred on the LHA program?

Admiral KIDD. Well, sir, a combination of many things. From the contractor's point of view they had a hurricane down there which slowed them down. They had a strike of about a month's duration. But when the men struck, they left town. They didn't all come back. So it wasn't a question——

Chairman PROXMIRE. Now, did you agree it was a 24-month slippage? Is that accurate or not?

Admiral KIDD. On the LHA?

Chairman PROXMIRE. Yes.

Admiral KIDD. No. I think that is kind of a soft figure yet.

Chairman PROXMIRE. It is more than 24 months?

Admiral KIDD. No. I would say somewhere between 12 and 24 but it is a little bit early to tell just how much.

Chairman PROXMIRE. I see.

Admiral KIDD. Those are the two things.

Chairman PROXMIRE. It could go higher, I presume?

Admiral KIDD. Yes, it could, I suppose.

IMPACT OF DELIVERY DELAYS

Chairman PROXMIRE. How much will the delivery delays impact on other Navy programs such as the DD 963?

Admiral KIDD. I hope none, but I am from Missouri in this regard and here again the contractor is not far enough along in what he is doing on the 963 to be able to tell you with any degree of assurance just what his delay, if any, is going to be.

LHA OVERRUN

Chairman PROXMIRE. I am told that the overrun on the LHA is $400 million on the five-ship original target costs. Can you confirm or deny that?

Admiral KIDD. No. I think that that—I think that sounds like a figure picked out of the air.

Chairman PROXMIRE. Well, so far we have been—you know, when we make these estimates of overruns, they tell us that we are too high and we are always either on the nose—we were on the C–5A—or too low.

Admiral KIDD. I didn't say it is too high or too low or anything else.

Chairman PROXMIRE. I know. You didn't deny it.

Admiral KIDD. We don't have the figures in hand, sir, from the contractor yet.

Chairman PROXMIRE. Well, when will you have these?

Admiral KIDD. They are due at the end of this month, Mr. Chairman.

Chairman PROXMIRE. Only a few days from now.

Admiral KIDD. Correct. What his cost dollars are going to be, and in that would be included the dollars for the cancellation which is in the contract, when we went from nine down to five, and additional changes in costs.

Chairman PROXMIRE. Can we count on having that by the end of next week?

Admiral KIDD. If he is on time, sir.

LITTON LHA PROFITS

Chairman PROXMIRE. All right. It is my understanding that Litton is proposing that the Navy pay at the same ceiling price for five LHA's as was originally granted for nine LHA's and then in return Litton would accept "low profit of about 8 percent on costs," which would be an enormous profit, of course, on invested capital, and would drop its present claim. Can you confirm or deny this?

Admiral KIDD. I have heard that which you just enunciated but very informally and something on which I have taken no action because it is just about fourth-hand conversation.

EAST BANK VERSUS WEST BANK DD 963 CONSTRUCTION

Chairman PROXMIRE. I am also informed that partly because of the difficulties Litton has experienced at its new yard on the East Bank it is proposing to build the first seven DD 963's at the East Bank, the increased costs to be borne by the Government.

Do you have estimates as to how much it would cost to build the DD 963's at the East Bank?

The Navy has had no estimate as to how much that would cost?

Admiral KIDD. No. We have no such recommendation from the contractor yet, sir.

Chairman PROXMIRE. If some of the DD 963's are built at the West Bank and some at the East Bank, wouldn't this cause the Government to pay twice for startup costs and wasn't this what was supposed to be avoided by giving the entire program to Litton and not giving part of it to the Bath Shipyards in Maine? Wasn't this part of the justification for concentrating the whole program at the new Litton yard? How do you avoid the concentration, if you can?

Admiral KIDD. Good heavens, if that proposal that you have just indicated is apparently about to hit us, comes to pass, that would obviate the advantage of that West Bank yard.

Chairman PROXMIRE. That is our point, gentlemen.

Admiral KIDD. It seems to me.

Chairman PROXMIRE. Will you let us know if they make that proposal and what the terms are?

Admiral KIDD. Indeed.

RESTRUCTURING OF LHA AND DD 963 CONTRACTS

Chairman PROXMIRE. Has Litton asked the Navy formally or informally to restructure either or both the LHA and the DD 963 contracts?

Admiral KIDD. Restructure? No, sir, not to my knowledge.

Chairman PROXMIRE. Does the Navy plan to restructure either contract?

Admiral KIDD. No, sir, not to my knowledge.

May I make an addition here, Mr. Chairman?

Chairman PROXMIRE. Yes.

F–14 CONTRACT

Admiral KIDD. Mr. Rule mentioned earlier, and you indicated we had fudged a little bit on that F–14 contract, this is the same type contract, you know, and in counterpoint to Mr. Rule's observations on holding the contractors feet to the fire, that type of contract is no longer allowed, which I am sure is well known to you; but I think it would be important to introduce it into the record at this time.

Chairman PROXMIRE. Good. I have so many difficulties with the F–14. I know it is dear to the hearts of some of the people in the Navy but, boy, it is a tough one for me to justify in terms of admissions in view of the fantastic per copy cost of, what is it, $16 million now compared to the planes it would replace of about $3 million and the notion that it would enable the aircraft carrier to be able to stand up to—help it to stand up to Russian land planes, and so on. It just seems to me to be something impossibly costly and we have to cut our number of planes that we can possibly afford to have.

PROBLEMS AT LITTON'S NEW SHIPYARD

Has Litton—let me ask this. Isn't it true that the Navy work at Litton's new shipyard so far is suffering from the same problems the Maritime Administration reported for its program, that is, defective structures, costs overruns, schedule delays, and a lack of trained manpower?

Admiral KIDD. Was that first defective structures, sir?
Chairman PROXMIRE. Yes.
Admiral KIDD. No, sir. Not yet as far as——

Cost Overruns

Chairman PROXMIRE. Let's take these one by one. Cost overruns?
Admiral KIDD. That again is going to be a piece of this reset submission from the contractor due at the end of this month.

Schedule Delays

Chairman PROXMIRE. Schedule delays?
Admiral KIDD. The same; yes, sir.

Lack of Trained Manpower

Chairman PROXMIRE. Lack of trained manpower?
Admiral KIDD. This I can confirm; yes, sir.

Litton's Estimated Cost Overruns

Chairman PROXMIRE. Let me go back to the cost overruns. What was your response on that?
Admiral KIDD. This would be again a part of this dollar package that is due at the end of this month. As far as what I can prove to you at this point in time, I am——
Chairman PROXMIRE. We were asking for the——
Admiral KIDD. I am uneasy.
Chairman PROXMIRE (continuing). Asking for the figures, on the original cost and present projected cost. You don't have those?
Admiral KIDD. No. Not in writing.
Chairman PROXMIRE. What can—can you give us what you have, if not in writing, verbally?
Admiral KIDD. No; because you ask five different people, Mr. Chairman, you get five different answers.
Chairman PROXMIRE. They are all estimated overruns but in different amounts.
Admiral KIDD. But they are high, sir, on the high side.

Navy Estimate of Cost Overruns

Chairman PROXMIRE. How about the Navy's estimates? Does the Navy have one of its own or have more than one?
Admiral KIDD. We are tracking what they are telling us and we are tracking what our estimates are.
Chairman PROXMIRE. What does your track show?
Admiral KIDD. As you can well imagine, and I summarize that which I said just a moment ago when I said I am uneasy.
Chairman PROXMIRE. What are the figures?
Admiral KIDD. I don't have those right at my fingertips, Mr. Chairman.
Chairman PROXMIRE. You can get that for the record, I understand.
Admiral KIDD. All right.

(The following information was subsequently supplied for the record:)

The 31 December 1971 Selected Acquisition Report (SAR) estimates the total program cost for the LHA to be $960 million. This is the only official estimate available at this time.

Benefit of the New Yard

Chairman PROXMIRE. Isn't it also true that the anticipated benefits from the new yard have so far not been realized by the Navy?

Admiral KIDD. Here again it is still too early to tell because they are not yet at an identified milestone which they haven't met.

Chairman PROXMIRE. You gave them an LHA contract in 1969. When will you be able to get them? That is 3 years ago.

Delivery Delays

Admiral KIDD. Yes. The first one, memo of agreement, original 1973, memo of agreement, April 1, 1974; 19 months in one case.

Chairman PROXMIRE. Nineteen months in connection with what, sir?

Admiral KIDD. Delay in delivery on the first one.

Chairman PROXMIRE. Will you submit that document for the record? Can that be available to us?

Admiral KIDD. I would be happy to give you a summary of what the schedule shows, Mr. Chairman.

Chairman PROXMIRE. All right.

(The information referred to follows:)

The original contract delivery dates for LHA 1 through 5 were as follows:

LHA-1	March 30, 1973	LHA-4	December 31, 1973
LHA-2	June 29, 1973	LHA-5	April 1, 1974
LHA-3	October 1, 1973		

Revised delivery dates were proposed by Litton for planning purposes, in April 1971. These dates were as follows:

LHA-1	April 1, 1974	LHA-4	February 28, 1975
LHA-2	July 29, 1974	LHA-5	June 2, 1975
LHA-3	December 2, 1974		

It is anticipated that these dates will be modified as a result of the "reset" proposal received on 31 March 1972.

Chairman PROXMIRE. I just have one other area, admiral. You have been most patient and responsive and I am very grateful to you, it wouldn't take us long, I think.

POLARIS POSEIDON PROFITS ON OVERHEAD AND CONVERSION

I want to get into the profits on Polaris Poseidon overhead and conversion. I am sure you are familiar with the correspondence between Admiral Rickover, Admiral Sonenshein, and myself concerning the issue of excess profits made by the Electric Boat Division of General Dynamics?

Admiral KIDD. Yes, sir.

Chairman PROXMIRE. On Polaris Poseidon overhaul and conversion program, some time ago Admiral Rickover testified that a shipyard made more profit than another shipyard for the same work. Admiral Sonenshein later identified the yards as Electric Boat and Newport News Shipbuilding & Drydock Co., a subsidiary of the Tenneco con-

glomerate firm. I asked Admiral Sonenshein about Admiral Rickover's charges and Admiral Sonenshein replied in a letter that the last time they had this problem was in 1970 and since then profits and costs were coming down. I asked Admiral Rickover to give me his reply to this letter and he told me in a lengthy and detailed response that there was no significant change in costs or profits on the submarine involved with the exception of one where Admiral Rickover personally negotiated a lower profit with Electric Boat. Now, in the first place, Admiral Sonenshein has created quite a credibility gap between the two of us. Why shouldn't Members of Congress be able to obtain the unvarnished truth about defense contracts without digging for it like a coal miner?

COMPARABILITY OF PROFITS—ELECTRIC BOAT VERSUS NEWPORT NEWS

Second, do you intend to continue paying Electric Boat more profit than Newport News for comparable work? As you know, Electric Boat Co.'s costs are higher than Newport News' on essentially the same work. This fact is beyond dispute, and so far I have seen nothing to indicate that the Navy is doing anything about it. In fact, I believe the situation is getting worse. Why won't the Navy act?

Admiral KIDD. Well, I would hope your last observation is inaccurate, that we are not doing anything about it. I think we are. I cited earlier the additional number of inspectors, examiners, that we have gotten on scene at both sites. We have made changes there.

Chairman PROXMIRE. Once again, when you cited that I pointed out this is more people, more expenses to the Government, more expenditures but doesn't necessarily mean that you are going to reduce anything——

Admiral KIDD. No, sir.

Chairman PROXMIRE (continuing). In their explicit instructions of a particular kind that are going to be put into effect.

Admiral KIDD. Quite right.

Chairman PROXMIRE. What are they?

Admiral KIDD. Those instructions are to insure an improved and more accurate audit track of material, manpower, labor costs, direct, indirect, and overhead.

Now, we are going to continue to also have cost disparities based upon geographic locations which is a case in point here where the wage rate at one site is higher than the wage rates at the others. There are going to continue to be instances of greater efficiencies which we are seeing here. No question about it. I called Admiral Rickover and thanked him for his intercessions in the instance which he cited in his letter to you. I have been personally in discussions, visited, and talked to the top management of these activities.

Now, one point that has been made to me, and I will be a parrot and report it back to you. We haven't had up until about the last 2 years a direct comparision of work at the two sites where the work packages have been actually identical and thereby lending themselves to precise comparison. This is, nevertheless, sort of a one-time yardstick, but it is a yardstick that makes your point.

Chairman PROXMIRE. Well, I appreciate this very much. It is good to get this confirmation. Admiral Sonenshein denied the problem, and,

of course, contradicted Admiral Rickover. It is good to get your confirmation.

COST PLUS INCENTIVE FEE CONTRACTS

I understand the contracts for this work are cost plus incentive fee.

Admiral KIDD. Correct.

Chairman PROXMIRE. Under such contractor's reimbursement all of his cost plus a profit—my information shows that in nearly every case, where more than 10 contracts are involved, the contractor got higher profits than were initially negotiated for the job. Is that correct?

Admiral KIDD. I don't know, Mr. Chairman.

Chairman PROXMIRE. In nearly every case where more than 10 contracts were involved?

Admiral KIDD. If I may, I would be grateful to be able to provide that for the record.

(The following information was subsequently supplied for the record:)

It is correct that for every Polaris/Poseidon overhaul/conversion Cost Plus Incentive Fee Contract negotiated through October 1970, the respective contractors actual profit exceeded the amount initially negotiated. It should be recognized, however, that such profit increases are direct result of cost reductions achieved by the contractor. His share in such reductions is normally 20–25% with the government realizing the balance. The total cost to the government is therefore less than the negotiated amount for the initial scope of work (i.e. exclusive of change orders). To the extent initial target costs are reasonable and change orders under the contract are properly administered, additional profits earned by the contractor as a result of such reduced costs are entirely appropriate and the results are benefical to the government.

PROFITS ON COSTS VERSUS PROFITS ON INVESTED CAPITAL

Chairman PROXMIRE. Fine. I am also informed that the initial targets were overstated for both shipbuilders to make excessive profits. In one case the profit amounts to 18 percent on costs which of course could be over 100 percent on invested capital. Can you verify that? Can you verify whether it was 18 percent on costs in one case.

Admiral KIDD. We are studying that now. We have two study efforts underway to address that matter, Mr. Chairman. It is not completely done yet, sir.

HIGH PRICES AND PROFITS ON COST-PLUS CONTRACTS

Chairman PROXMIRE. Why does the Navy pay such high prices and high profits on cost-plus contracts?

Admiral KIDD. May Admiral Freeman address that, Mr. Chairman?

Chairman PROXMIRE. Yes, sir, Admiral. Go right ahead.

Admiral FREEMAN. I don't think the statement is basically a true one, that we pay high costs and high profit. It certainly is not the intent.

Chairman PROXMIRE. In this record we are making here, that seems to be true.

Admiral FREEMAN. In an incentive fee contract, the original negotiated profit will increase if he does in fact reduce his costs. That is one of the provisions of that type of a document. In this particular case, as you have been a strong supporter of uniform accounting stand-

ards, so this deals with that kind of a problem in trying to be able to relate exact work packages, exact costs comparison.

Chairman PROXMIRE. But in this case they seem to be increasing their costs. Doesn't that mean that the profit will be reduced?

REDUCTION IN PROFIT NEGOTIATED BY NAVSHIPS

Admiral FREEMAN. Well, the most recent one was a substantial reduction in profit negotiated by the Naval Ships Systems Command for the most recent overhaul.

Chairman PROXMIRE. That is the one Rickover negotiated.

Admiral FREEMAN. I understand he was a participant, yes sir.

Chairman PROXMIRE. Admiral Kidd, you said something about a study that you are making. Will you make that available to us when you have completed it?

Admiral KIDD. When it is completed.

(The following information was subsequently supplied for the record:)

A summary of the Cost Comparison Study (Electric Boat and Newport News) will be forwarded after the Navy has completed its review.

PROFITS AS RETURN ON INVESTMENT

Chairman PROXMIRE. Can you tell us what the profits on these conversions and overhaul contracts represent as return on investment? Is there any evidence on that?

Admiral KIDD. No. And I have talked to the president of one of the two shipbuilders involved and here it is kind of fuzzy, Mr. Chairman, as to what the investment is.

Chairman PROXMIRE. I know it is a difficult concept. We have had difficulty with the GAO on it. I have argued and my staff has argued that the return on the investment is really much more significant. My own business experience and business training tells me that this is what a businessman looks for, whether the costs are high. Whether the profits on costs are high or low is fairly relevant. They will take a very low profit on costs if his return on his capital is high. Return on capital is the vital determining factor and determines the justification, too, of the price being paid.

Admiral KIDD. The thing that I find troublesome is the great difficulty in identifying from the contractor's point of view what is his capital investment. It could be dollars, it could be money spent in new equipment, new machinery, new training techniques.

Chairman PROXMIRE. I realize that. But I think almost any estimate, we get the contractor in a discussion and the dialog, having him give his estimates, the Navy gives its, and then well, at least, have some basis for determining what kind of return they are getting——

Admiral KIDD. Those two contractors strongly objected, of course, to using the return on capital.

Chairman PROXMIRE. They also do because it shows, of course, that they are doing very well.

The study by the GAO overall showed the average return was 50 percent, 50 percent on invested capital. I am informed that last year's Electric Boat division made $28 million on a little over $52 million in

investment and here is another example. You confirm that? If it is true, that is more than 50 percent profit. Can you determine that?

Admiral KIDD. Following your lead of some moments back, Mr. Rule just reminded me here, we have five actions for the selected application of this approach. Magnavox, Texas Instrument, Itek, Hughes, and Librascope, and we are attempting to have Navships and NavElex to participate but that thus far has been unsuccessful.

ELECTRIC BOAT 50 PERCENT RETURN ON INVESTMENT

Chairman PROXMIRE. How about the Electric Boat profit of 50 percent, $28 million return on $52 million in investment?

Admiral KIDD. I can't confirm or refute the $52 million investment figure, Mr. Chairman.

Chairman PROXMIRE. Could Admiral Freeman?

Admiral FREEMAN. No, sir. I am not familiar with that specific contract, sir. I will be glad to provide a comment for the record.

Chairman PROXMIRE. If you will provide that for the record, fine.

(The following was subsequently supplied for the record:)

These figures are comparable to those which the Navy has derived from the contractors unadjusted trial balance records.

GENERAL DYNAMICS' PROFITS

Chairman PROXMIRE. I am also informed that General Dynamics Company-wide profits for the year were about $24 million, less than the profits made by its Electric Boat division. That means except for the Electric Boat the company actually lost money. Wouldn't that seem to follow?

Admiral KIDD. It would.

WHAT IS PROPER PROFIT?

Chairman PROXMIRE. Why is the Navy allowing such high profits? Again, do you intend to do anything to remove excessive profits?

Admiral KIDD. We are trying. I think the matter of allowing profits—in the short time I have been here, I have asked just about every contractor I have seen, how much is enough? What is a proper profit? And fascinatingly I get answers ranging from 2½ percent to 15 and 20. There seems to be no uniformity, and this I don't understand.

Chairman PROXMIRE. Well, if they are talking about return on invested capital, I think 15 or 20 would be quite modest. I would be delighted if they would settle on the average of 15 or 20 percent. But they don't in so many cases.

Admiral KIDD. On the other hand, I had a very prominent contractor in the office yesterday who told me that in his operation, if he could make a profit but a fraction above that which he would get if deposited in the bank, he figured he was doing pretty well.

Chairman PROXMIRE. Well, they are getting 50 percent at Electric Boat. That is a lot better than you can do in any bank savings account.

ELECTRIC BOAT-NEWPORT NEWS DIFFERENTIALS

In the Polaris Poseidon overhaul and conversion situation I described earlier it appears that the Navy has spent $65 million more

at Electric Boat than at Newport News for the same amount of work. Why don't you find out the individuals responsible and hold them accountable?

Admiral KIDD. We are trying and I think those figures are a bit off because the work packages are not identical and this leads to a great difficulty in precisely scoping the problem.

Chairman PROXMIRE. Will you give us a final report on that?

Admiral KIDD. Yes, sir.

Chairman PROXMIRE. At this point I want to insert it in the record.

(The information referred to follows:)

The figures are substantially correct. They are the result of a comparison of differing classes of submarines with varying degrees of comparability. In a recently completed review of the operations of both yards, where six hulls of the same class were selected for comparison, the cost difference per hull was found to be $5.2 million which would result in a total difference for nine ships of approximately $47 million dollars, rather than $65 million. More relevant is the fact that the review itself indicated considerable differences did exist in the amount of work performed and in the effect of labor-management contracts and state law on overhead costs. These differences did not however, account for the total cost differential and a number of actions are being taken to reduce total costs at both yards as well as to reduce the differential itself. Among these actions are several to standardize the work required of each contractor.

Admiral KIDD. In that regard EB just reorganized and replaced certain key people who had been apparently involved in weak material controls but have seen no great improvement yet.

CONCLUSION

Chairman PROXMIRE. All right, Admiral, once again, and Mr. Rule, it has been a most informative and useful hearing. You have made a fine record. I know there has been some controversy but that is one of the things you have to expect in a record that is worth anything. Thank you very, very much.

Tomorrow morning the committee will reconvene in the same room at the same time. We will hear the Honorable Charles L. Ill II, Assistant Secretary, Navy Installations, and Mr. Herbert J. Frank, president of Aerosonic Corp. will be introduced by Senator Chiles.

The subcommittee stands in recess. It will reconvene at 10 o'clock tomorrow morning.

(Whereupon, at 12:25 p.m., the subcommittee recessed, to reconvene at 10 a.m., Wednesday, March 29, 1972.)

(The following information was subsequently supplied for the record by Chairman Proxmire:)

DEPARTMENT OF THE NAVY,
OFFICE OF THE GENERAL COUNSEL,
Washington, D.C., June 26, 1969.

Memorandum: For Mr. Gordon W. Rule, Director, Procurement Control and Clearance Division, MAT 022.

Subject: Provisional Increases in Contract Prices on Account of Claims.

1. In your memorandum of June 4, 1969, you requested our advice as to the legality and propriety of making provisional payments on account of unadjudicated claims.

2. Your inquiry embraces two questions: (a) whether a partial or provisional payment may lawfully be made of a claim before the total amount due has been determined, and (b) assuming that it is within the Navy's discretion to make or not to make such payments, whether it is prudent to do so.

3. It is axiomatic that any payment under a contract must be in discharge of an obligation properly created thereunder. Our contracts impose obligations on the Government to compensate contractors for increases in the cost of contract performance under various circumstances, such as for changes, for late delivery of Government furnished material, etc. There is no legal requirement that these payments be made in one lump sum, although there are obvious practical advantages to making a single payment that is complete and final.

4. Hence, if it is determined (a) that the Government is legally obligated to compensate the contractor in some amount and (b) that the amount of that compensation when finally determined will exceed the amount of the proposed interim payment, there is no legal objection to making a provisional payment on account of the claim. That is not to say that the Government is required to make such payment, but only that it may do so if it chooses.

5. Our contracts do not—and probably could not—define exactly what constitutes an equitable adjustment in contract price. Essentially, it is the right of the contractor to be compensated for the additional costs and burdens it incurs on account of a Government action for which an upward adjustment of the contract price is authorized. The manner of making such adjustment is not specified, except that it is to be equitable, which in substance is whatever is fair, just and reasonable under all the circumstances.

6. There are manifest disadvantages to making partial payments of claims which have not been fully adjudicated. Bargaining leverage is weakened in almost direct proportion to the amount of the claim which is paid without obtaining a total settlement. There is also a possibility that the value of he claim will be overstated and that the provisional payment will exceed the amount ultimately determined to be due. To guard against this possibility, it would be prudent to obtain the contractor's agreement to repay any excess provisional payment with interest. As a practical matter, provisional payments tend to be in amounts well below the true value of the claim, and I am not aware of any case in which a repayment has been necessary.

7. In the *Todd* case to which you referred in your memorandum, we understand that NavShips' contracting personnel determined that the total amount due the contractor would exceed the 55 million dollars which was paid on account of those claims before final adjudication. As you know, the estimate turned out to be conservative.

8. Even though the detrimental impact on negotiation of a total settlement is recognized, there may be cases when provisional payment of unadjudicated claims is proper and practically unavoidable. It is indisputably burdensome, and perhaps inequitable, to require the contractor to carry additional expenses occasioned by Government action for a protracted period of time, particularly if the delay in settling the claim is attributable in whole or in part to the Government. The Government's failure to make available funds to compensate for the costs of Government action may impair the contractor's ability to perform the contract, as, for example, when the contractor is in danger of becoming bankrupt or otherwise financially handicapped, and may give him a possible excuse for nonperformance. Moreover, there is a trend in cases in the Court of Claims and the ASBCA to allow interest as an element of cost in an equitable adjustment where the contractor is required to borrow extra money to finance performance of a change or on account of some other Government action for which an equitable adjustment of the contract price is authorized. To the extent such interest costs would be allowed as a part of an equitable adjustment, the Government avoids the additional cost by making provisional payments before the total amount due is finally determined.

9. In our judgment, it is much preferable that claims be totally adjudicated when this can be done within a reasonable time with confidence in the amount. When it can be determined that the contractor is legally entitled to an equitable adjustment but the amount cannot be determined with certainty within the time that the contractor can, or reasonably should, carry the cost without payment, a partial provisional payment of an amount which is less than the estimated value of the claim may be the lesser evil. For added caution, it would be desirable to obtain the contractor's agreement in such cases to repay any excess payment, preferably with interest.

ALBERT H. STEIN,
Deputy General Counsel.

DEPARTMENT OF THE NAVY,
OFFICE OF THE CHIEF OF NAVAL OPERATIONS,
Washington, D.C., June 28, 1969.

MEMORANDUM FOR THE CHIEF OF NAVAL MATERIAL

Subject: Shipbuilding claims.

1. As you know the 1 May SCA is being held up while detailed review is made of claims submitted or anticipated, estimating their validity and ultimate percent of settlement. This is essential, and provides an opportunity for top level review of the total claims situation.

2. Some general comments appear appropriate in this interim. It is noted that the Todd claim settlement was very nearly full amount, that it applied to the first of some DEs, and that Todd has recently indicated one of their better years in terms of overall profits. Mr. Archie Folden, in talking to Tom Weschler last November, indicated that, with fixed price contracts and the escalating labor and materials market, the only way to make ends meet to look into the claims business. Ebbie Bell notes that Mr. vom Baur was successful for Todd and now is being sought out by Avondale, Lockheed, Newport News and others (Defoe) to press claims for them. Mr. vom Baur's letter to you says as much.

3. (*a*) Certainly the DE picture has changed from the first ships to the later ones with clarification of specifications, waivers, etc., so that the liability of the government for claims is significantly different.

(*b*) In general the claims level previously paid has been well below that of the Todd DE experience.

(*c*) I understand that it is not necessary for the Navy to be satisfied with the findings of the Armed Services Board of Contract Appeals, but may take the case to the Court of Claims if we feel we have good reason and fair likelihood of winning.

(*d*) Ship types other than the DEs probably do not have the same vulnerability to claims on dynamic analysis and shock.

4. Mr. vom Baur, in his letter, suggested improvement in specification writing as one of the keys to curtailing claims, and noted that today's specifications are claim-prone. He indicated ways of accomplishing this.

5. Overall, it appears that this matter of claims has entered a new phase and has become a way of doing business for some of the shipbuilders—perhaps reacting to fixed price contracts in a rapidly rising market—and that the shipbuilders are seeking the most expert talent to make their claims stick. We should be similarly mobilized, in that case, to protect the Government's interests and to throw cold water on this approach.

6. Thoughts that come to mind are:

(*a*) Have we the best legal talent mobilized to combat the claims?

(*b*) Does the legal chain require greater participation or advice from the Navy General Counsel, or the Secretariat, say above some dollar limit on claims settlement or for review of the first claim against a ship type produced in quantity?

(*c*) Is the Court of Claims used fully to support the Navy's case, or to help cool the flow of claims, if such legislative delay does not add unduly to Government costs?

(*d*) Are the engineers assisted in evaluating claims so that their technical judgments are guided by legal opinion and advice?

(*e*) Is there sufficient legal talent available at the working level with individual project managers to help them forestall claims or adjust their actions to make them claim proof?

(*f*) Are current specifications now being written as suggested by Mr. vom Baur, and are existing ones being examined to correct major deficiencies where there is still time to minimize incipient claims?

7. You have the facts and the level of claims close at hand. These thoughts may provide a perspective which is useful. In any event, a response as to what is being done in general—particularly in the legal and claim settling area—will be appreciated, as a supplement to the detailed financial review now in progress.

B. A. CLAREY,
Vice Chief of Naval Operations.

DEPARTMENT OF THE NAVY,
OFFICE OF THE GENERAL COUNSEL,
Washington, D.C., July 22, 1969.

MEMORANDUM FOR THE VICE CHIEF OF NAVAL OPERATIONS

Subject: Shipbuilding claims.

1. Your memorandum for the Chief of Naval Material, dated 28 June 1969, raises timely and pertinent questions regarding claims under shipbuilding contracts. The questions for the most part concern the performance of legal services within the responsibility of the Office of the General Counsel. For this reason, I have requested the opportunity to reply directly.

2. As you have noted, Navy shipbuilding contractors have embarked upon aggressive claims programs. Some contrators have gone so far as to establish departments whose sole or principal function is to develop claims. Even allowing for cost inflation, the resulting claims have exceeded those of previous periods in number and in magnitude. Reasons are not hard to find. The use of competitive fixed price contracts has pared profit margins to a point where contractors cannot absorb additional costs as they once did. At the same time, the increasing complexity and sophistication of ships and their components, aggravated by the concurrent development and production of mutually dependent parts, has multiplied the potential for claims. Not surprisingly, contractors have availed themselves of the opportunity presented.

3. To some extent, claims can be countered by effective legal defenses. To do this, we have gathered an able and effective group of lawyers to work on shipbuilding claims. Additional lawyers are being recruited, and personnel will be assigned from other of our offices to assist if necessary. We intend to put claims through a legal wringer to assist in squeezing the water out of any that are not solid. While this should help, it can only mitigate, it cannot solve the basic problem. The crux of the problem is that our procurement practices have a built-in claims potential which is relatively easy for contractors to exploit. A truly effective counter must be directed to the practices that give rise to the claims.

4. When, for example, Government-furnished material is late or defective, when Government specifications are inconsistent, ambiguous, deficient, or impossible to perform, when the Government imposes additional requirements on the contractor or interferes with its performance, the Government cannot escape the resulting increased cost. These are the root causes of claims. To prevent the claims, it is necessary to attack the causes.

5. Most of the basic causes of claims are not within a lawyer's province to cure. Every change or other action that entitles a contractor to an equitable adjustment of the contract price opens the door to claims, and carries a fixed price contract a step away from the lump sum undertaking it started out to be. We necessarily defer to you and other cognizant administrators to establish the controls over these claim wedges that a proper balance of interests will permit. In another paper that we plan to send to you and other interested persons soon, we will make some specific suggestions we think may be helpful in controlling this problem.

6. To say there is merit in a claim is only a partial answer. Equally if not more important is to determine the amount of the claim. This is an area where we, as lawyers, can make a greater contribution. In some instances in the past, there has been an inclination in the Naval Ship Systems Command to treat the contractor's entitlement to compensation as the only legal question and not to have lawyers participate in determining the amount of the compensation. For example, in the case of the *Todd* claim, counsel determined only that if the specifications were defective, the contractor was entitled to be compensated for the increased costs attributable to those deficiencies. Lawyers did not participate in the determination of the amount that was paid to Todd and were not aware of the amount of the settlement until after it had been agreed upon. There is no sound basis for such dichotomy. There are shadings of legal entitlement and opportunities for trade-offs that lawyers are particularly qualified to exploit in negotiations. For this reason, lawyers have traditionally been active members of negotiating teams in the Navy. We have discussed this with the Director of the Contract Division of the Naval Ship Systems Command, and we are in agreement that our lawyers hereafter will participate fully in all aspects of claim settlements, including the determination of the amount due.

7. With this background, I would like to comment specifically on the points in paragraph 6 of your memorandum that directly relate to this office:

(*a*) *Have we the best legal talent mobilized to combat the claims?* It is clear that a major expansion of the Office of Counsel for the Naval Ship Systems Command is needed to handle the increased work load there. Some time ago, we shifted lawyers from other NavShips legal work in order to concentrate more effort on claims. Since then, we have assigned two experienced lawyers from other offices to NavShips, and we are actively recruiting the additional lawyers required. Without attempting to comment in terms of qualitative absolutes, I believe that the lawyers we now have engaged on ship-building claims, with the additions programmed, will enable us to represent the Government's interests well. Any significant increase in the number of claims will further increase the requirement for lawyers.

(*b*) *Does the legal chain require greater participation or advice from the Navy General Counsel, or the Secretariat?* Arrangements have been made to keep the General Counsel or Deputy General Counsel currently informed regarding major shipbuilding claims. Regular and frequent consultations are being held between the General Counsel or Deputy General Counsel and the lawyers handling these claims. The many legal questions involved are being explored in depth, and those that are particularly significant or controversial are being brought to the attention of the General Counsel or Deputy General Counsel. It would seem desirable that the Secretariat also informed of proposed settlements of large claims. Since major settlements are already subject to an independent business clearance review by the Naval Material Command, a further approval by the Secretariat would not seem necessary.

(*c*) *Is the Court of Claims used fully to support the Navy's case or to help cool the flow of claims?* It would be possible to force claimants to sue in the Court of Claims by refusing to pay awards by the Armed Services Board of Contract Appeals. There has been a reluctance in the Defense Department to do this since it would in effect repudiate the decision of the Board which has been given authority, as the Secretary's representative, to decide appeals as fully and finally as the Secretary. Hence, a refusal to pay pursuant to a Board decision presents the anomaly of the Secretary or a subordinate refusing to respect a decision that purports to be as final as the Secretary can make it. In appropriate cases we nevertheless favor forcing the contractor to go to the Court of Claims under circumstances where the contractor might itself appeal from a Board decision in favor of the Government. As we envision it, this procedure would encompass cases where the Board decision appears to be based on egregious errors of law, where it is clearly unsupported by the evidence, or where it is arbitrary or capricious. There will need to be coordination and approval at OSD levels which in the past have been disinclined to disturb the finality of Board decisions. Even if the necessary approval were obtained, it is not likely that this would significantly "cool the flow of claims," since the Court of Claims is traditionally a forum in which claimants receive most sympathetic consideration.

(*d*) *Are engineers assisted in evaluating claims so that their technical judgments are guided by legal opinion and advice?* In all claims reviewed since the settlement of the *Todd* claim, counsel has participated in establishing the contractor's entitlement with respect to specific amounts and in assuring that such amounts are supported by the record. This has necessitated a close working relationship between counsel and the engineers making the technical evaluations. A lawyer is currently assigned to every team at Navships headquarters performing the technical evaluation of shipbuilding claims and is in constant contact with the engineer members of the team it would not be feasible to provide sufficient lawyers to work in such close juxtaposition with all other technical personnel whose work may involve claims evaluation. However, we are endeavoring to build up our staff in NavShips to make lawyers more readily available to all the engineers who have need of legal guidance, and we have arranged with Commander, NavShips to impress engineering personnel with the importance and desirability of seeking advice of counsel.

(*e*) *Is there sufficient legal talent available at the working level with individual project managers to help them forestall claims or adjust their actions to make them claim proof?* Sufficient lawyers are not presently available to give individual project managers all the legal services required for preventive purposes. The shortage is attributable partly to the increase in number of projects and partly to having transferred lawyers to claims work who would otherwise have been available to counsel project managers. We are undertaking to expand this

area of legal service substantially so that each individual project manager will have a lawyer available who is sufficiently accessible and familiar with the project to handle on-going work and to devote the time needed to minimize or prevent claims from arising.

8. I would like to add two final thoughts in response to your inquiry as to what is being done in the legal and claims settling area. There is ordinarily a considerable period of time between the date of the contract and the date that substantial claims begin to arise under it. Hence in most shipbuilding claims situations, we are concerned with a contract awarded years earlier. During the interval new contract clauses have been developed to avoid the problems that have been encountered, so each new generation of contracts tends to have more legal armor against claims. This whittles away some of the claims potential, subject to occasional set-backs when the Board or Courts open up new bases of liability.

9. We must distinguish between the type of contract provisions that avoid wasteful costs and those that merely transfer the burden of legitimate costs to the other party. In the last analysis, really effective claims control depends upon stopping the cost. Merely to shift the liability to the contractor is not a feasible long-range solution. Contractors must recover their legitimate costs if they are to continue in business. If they cannot recover costs attributable to Government actions or inactions through some form of price adjustment, they must do it through contingencies in their bids. That is why we think the emphasis must be on correcting the practices that create the costs.

10. Finally, it should be observed that the desire for prompt settlements wars with the need to subject each item of each claim to searching analysis. In this business impatience has a price tag. It takes huge effort to review the type of complex claim that major shipbuilding contracts generate. For example, the current Lockheed claims include 84 volumes, comprising 7000 pages. Of this, the DE 1052 claim alone consists of 15 volumes, 18 inches thick, including 740 pages of narrative, 100 figures and illustrations and 352 individual documents and exhibits. The lawyers, engineers and auditors on whom the contracting officer must depend to search out the weaknesses in claims need time to do the job. This may make progress slow at times, but it should save substantial sums in the end.

ALBERT H. STEIN,
Acting General Counsel.

THE LAWYER'S ROLE IN THE SETTLEMENT OF CLAIMS[1]

(By Albert H. Stein[2])

When Merritt put me on this agenda, he did not specify a subject. I was flattered to be included in such distinguished company, but I was not certain how I should take advantage of the opportunity. The more I thought about the various topics that I might discuss the more one subject predominated. In terms of my own work during the past year, current interest of the public, the press, the Hill and sheer dollar magnitude, nothing else with which I was involved equaled the subject of claims in interest or importance. Claims are not new in the Navy. There have been claims as long as I have been around—and even longer—and no doubt there will be long after I have left this office. However, during the past few years claims have reached a crescendo of volume, magnitude and importance they never had before, and that I hope they never will again.

Twenty years ago I was Chairman of an ASPR Subcommittee to develop a uniform master ship repair contract. We drafted the contract and set up meetings at various ship repair centers to test industry reaction. I recall one old gentleman in San Francisco sat patiently through the discussion of warranties and guarantees and third party liabilities and then asked simply and honestly, "What have you done to the changes article? Everyone knows we underbid to get the job and make it up on changes." Some things do not change with the passing years.

The role of the lawyer in the settlement of claims is reminiscent of a sensational murder trial held in a small county seat. Most of the townspeople were

[1] This address was given at the Office of General Counsel Seminar on May 6, 1971.
[2] Deputy General Counsel, Department of the Navy.

in the courtroom when the jury filed in to deliver its verdict. "Your honor", said the foreman, "we want to make this trial as fair and merciful as possible. So before announcing our decision we would like to ask the defendant a single question." "Proceed", said the judge. Turning to the prisoner, the foreman asked politely, "Sir, do you prefer DC or AC current?" Some of our lawyers who have had personal experience in the settlement of claims will have a particular appreciation of the relevance of that story to this subject.

If I am going to talk about claims, we had better start with some definition of what we are talking about. In a strict legal sense every assertion of a legal right is a claim. I am concerned at this time only with a certain type of claim. Because of the special interest at the Secretarial level, in Congress, by GAO and others in major claims, the Secretary has required that "settlement of claims in the amount of $5,000,000 or more be subject to his approval." In addition, a special group known as the Contract Claims Control and Surveillance Group has been established within Headquarters, Naval Material Command to review such major claims. I am the legal advisor to that group. For the purpose of the Secretary's approval and for the purpose of the Contract Claims Control and Surveillance Groups' cognizance, the term claim has been defined to be: ". . . any request for contract adjustment [in the amount of $5,000,000 or more] involving to a significant extent a 'constructive' change order, including those based on late or defective specifications, drawings, data or other administrative action or inaction by the Government, and also includes claims based on defective late Government furnished property. The term 'claim' excludes, however, the pricing or settlement of written change orders, price adjustments under escalation provisions and redetermination provisions and actions under P.L. 85-804."

I learned long ago that lawyers should not expect to be universally loved. The nature of our work militates against it. We might hope, however, that the criticism will be reasonably consistent. In the claims area, as in many others, that has been a forlorn hope. The bricks come from both directions—from those who think the lawyers interfere too much and from those who think the lawyers do not do enough.

That might be taken as an indication that we have struck about the right balance but it would not be safe to count on it.

Within the past couple of months there have been some interesting published statements on the subject. One of the Supervisors of Shipbuildings who has had major responsibility for claim settlements recently gave a presentation on what he called the "philosophy and methodology" of claim settlements. Some of the comments made by him showed something less than a fulsome appreciation of the efforts of counsel. A few quotes taken from that presentation will give you the flavor of it. My purpose in quoting it is to illustrate a point of view. I have reason to believe that some of the Supervisor's facts are not correct, but nonetheless they reflect his thinking. So I would like to talk about what he has said, without arguing the facts and without any intimation that my silence in that respect implies assent. One quote was:

"The concept in Headquarters that personnel in the field are not qualified to determine what constitutes a constructive change is considered erroneous, and the involvement of legal counsel on contract interpretation is much overstressed."

Another paragraph dealt with what was referred to as counsel's involvement during the cost verification phase. In this latter record, the paper stated that: "counsel involvement is superfluous and a duplication of effort in cost and price analysis actions. Prior legal entitlement determinations by counsel on the elements being priced were considered sufficient. Adequately trained and qualified personnel exist in SUPSHIP offices to intelligently evaluate proposals. No attempt is made by SUPSHIP personnel to second guess counsel actions, and, conversely, it is not quite understood why their conclusions have to be reviewed and concurred in by counsel representatives who do not have the technical background and qualifications to do so."

One final interesting and pertinent quote reads:

"Additionally, *any* proposal valued at $5,000,000 or more presently requires a legal review memorandum as part of the business clearance, delving in depth into such matters as whether or not the labor and material position is equitable and whether or not there exists sufficient documentation to support such a position. It is submitted that these items are technical matters and, as such, deserve (and receive) the attention of technical expertise. Therefore, this part of a legal review is not only a duplication of effort but introduces a probability of ill-judged novice conclusions."

There is more of the same, but I think what I have quoted gives you a fair sample of it.

Now that is one side of the coin, and, as full of error as it is, I must say in fairness to the writer of it that there is some support elsewhere in the Navy for the point of view expressed.

On the other hand, there has been concern at high levels that the quantity and quality of legal work may be insufficient to cope with the claims problem. In June 1969 following the settlement of the Todd claim for a record shattering $96,500,000 the then Vice Chief of Naval Operations, Admiral Clarey, expressed concern as follows:

(*a*) Have we the best legal talent mobilized to combat the claims?

(*b*) Does the legal chain require greater participation or advice from the Navy General Counsel or the Secretariat?

(*c*) Is the Court of Claims used fully to support the Navy's case or to help cool the flow of claims?

(*d*) Are engineers assisted in evaluating claims so that their technical judgments are guided by legal opinion and advice?

(*e*) Is there sufficient legal talent available at the working level with individual project managers to help them forestall claims or adjust their actions to make them claim-proof?

Those questions suggest a desire on the part of top management in the Navy that we mobilize our legal talents to combat the rash of claims that has descended upon us. And that is what we have tried to do. There is no doubt that a lot of enterprise has gone into the development of claims on the other side—and it takes a major effort on our part to analyze and evaluate the product. I don't have to tell you that lawyers are ingenuous fellows when it comes to making out bills. I read recently of one lawyer who billed his client as follows: "For crossing the street to confer with you and for recrossing the street on discovering it was not you."

Only last week, Vice Admiral Rickover testified before the Joint Economic Committee of Congress on problems in defense procurement. One of the problems on which the Admiral focused his attention was claims against the Government. He noted that "contractors retain claims lawyers and they train personnel at all levels in how to recognize and report situations that could possibly be used as a basis for claims." He attributed "part of the increase in claims activity over the past few years . . . to Washington claims lawyers, one of whom," he noted, "had served most of the 1950's as General Counsel to one of the military departments."

Admiral Rickover commented with obvious reference to the Todd settlement that "the Navy tends to settle its claims by bargaining." "In one case," he said, "the Navy settled a multi-million dollar claim at nearly the full amount claimed by the contractor without even completing a legal analysis of the case." [That is not correct] "The Navy counsel," he stated, "was not even consulted on the amount of the final settlement arranged by the contracting officer." [That is correct] The Admiral expressed the opinion "that the Navy should not be making payments for claims unless these payments are based on strict legal entitlement and a factual determination of amounts due." "Any claim," he continued, "or any item in a claim that is not solidly grounded in fact or in law should be eliminated from claims settlements."

Whatever our friends in NavShips may say about the particular case to which Admiral Rickover referred, it is clear that the Admiral believes that lawyers should have played a greater role in the evaluation and determination of that matter. And I think he is right. Unfortunately there is a school of thought that holds that the proper role for lawyers is merely to determine whether or not the contractor is legally entitled to additional compensation. These people believe that once a lawyer has determined that there is such legal entitlement, the settlement becomes an administrative matter that does not require the involvement of counsel. That appears to be essentially the thought expressed by the Supervisor of Shipbuilding in the presentation I discussed earlier. I think it is dead wrong.

When Admiral Clarey raised his questions following the Todd settlement, we told him, among other things:

"To say there is merit in a claim is only a partial answer. Equally if not more important is to determine the amount of the claim. This is an area where we, as lawyers, can make a greater contribution. In some instances in the past, there has been an inclination in the Naval Ship Systems Command to treat the contractor's entitlement to compensation as the only legal question and not to have lawyers

participate in determining the amount of the compensation. For example, in the case of the Todd claim, counsel determined only that if the specifications were defective, the contractor was entitled to be compensated for the increased costs attributable to those deficiencies. Lawyers did not participate in the determination of the amount that was paid to Todd and were not aware of the amount of the settlement until after it had been agreed upon. There is no sound basis for such dichotomy. There are shadings of legal entitlement and opportunities for trade-offs that lawyers are particularly qualified to exploit in negotiations. For this reason, lawyers have traditionally been active members of negotiating teams in the Navy. We have discussed this with the Director of the Contract Division of the Naval Ship Systems Command, and we are in agreement that our lawyers hereafter will participate fully in all aspects of claim settlements, including the determination of the amount due."

I wish I could say that that was the happy ending of the story. Unfortunately, that would be a misleading oversimplification. There is not yet full agreement on the proper role of the lawyer in claim settlements. The Supervisor's presentation reflects a contrary point of view that still has a good deal of vitality.

The size of the Todd settlement was certain to attract Congressional interest, and it did. On 13 February 1970, Senator Proxmire wrote to Secretary Chafee as follows:

"I am of course delighted that the Navy has set up a special group to deal with the enormous pending claims. However, I am concerned over whether the Navy will follow through by taking steps to insure that any settlements are made within the terms of the written contracts involved, the facts and legal merits, rather than by the let's-cut-it-down-the-middle kind of horsetrading that goes on around the bargaining table. I urge you to have each claim carefully reviewed by your legal and procurement experts to avoid this possibility. Frankly, on the basis of the claims settlement made in the Todd DE–1052 case, I am somewhat skeptical about the Navy's willingness to insist on full performance under the contract."

At about the same time, Senator Proxmire wrote to the Comptroller General urging the General Accounting Office to actively review the disposition of major shipbuilding claims, and to give particular attention to the effect the settlements might have on future Government contracting.

Congressional interest in large claims being what it is, it was inevitable that the General Accounting Office would accept the invitation to look into the subject. Their first report is ambivalent to say the least. In a study dated 28 April 1971, GAO reported on three unindentified Navy claims, one of which was obviously the Todd settlement. With respect to that settlement they stated:

"In the absence of tangible evidence of the cost of the contractor resulting from acts of the Government, the Navy, in our opinion, could not adequately evaluate the validity of the amounts claimed.

"In our opinion the material submitted in the contractor's proposal did not adequately demonstrate that the amounts claimed were caused entirely by acts of the Government and not possibly caused by the contractor's inefficiencies and/or an unrealistically low bid. It appears to us [they said] that the approach for determining the increased labor hours in the settlement of this claim is not favored by the Court of Claims, and it has been stated by the Court that it may be used only where there is no alternative."

Those critical comments are balanced by the statement that: "We [GAO that is] believe that under the circumstances, the Navy did as well as could be expected in negotiating the claim." That is what might be called putting things in the best light, like the new father who wanted a boy and had a girl. "Oh that's all right" he told the doctor, "if I couldn't have a boy, a girl was my next choice."

I have been asked to comment on the SUPSHIP's presentation. As you have no doubt gathered from what I have already said, I do not agree with it. Yet we need to ask ourselves how so many erroneous conceptions of our functions have gotten about, whether we may have contributed to the misunderstanding, and, in any event, what we can do to clarify our role and to obtain more general acceptance of it.

I do not disagree with everything the Supervisor has said. Certainly, we have no desire to take over responsibilities that properly belong to others or to duplicate the performance of those responsibilities. We would be among the first to recognize that there are technical aspects to claims that we are not qualified to pass upon, and that we have no desire to be responsible for. We don't purport

to be all wise or all-knowing. There are admittedly many matters that are beyond our ken.

It is true that we rarely become involved in the pricing of formal change orders. To this extent, there may be a logical inconsistency in our position. But there are differnces between formal change orders and the type of claims that we have endeavored to review. In the case of formal change orders, the Government is obtaining something more or different than it originally ordered and is paying what it considers the value of that difference. The kind of claims with which we are now mainly concerned . . . the so-called constructive change . . . involve situations where the Government is obtaining substantially the same contract article that it originally ordered, but it is asserted that because of some action or inaction by the Government, the law imposes upon it an obligation to pay more than the original contract price. Only a non-lawyer would consider the identification of constructive changes the relatively simple matter that the Supervisor seemed to find it. As lawyers we know that it is often extremely difficult to identify a constructive change and perhaps even more so to track the damage that a Board or Court would attribute to it.

The Navy has long been committed to the concept of the negotiating team. The legal member of the team occupies a key and sensitive position, since to a large extent he sets the parameters within which the other members must operate.

While we lawyers have individual responsibilities that we cannot and should not abdicate, the very concept of a team connotes a group of persons working in concert for the accomplishment of a common goal. We must do all we can to stress that these are collective actions for a common end. We must try to make our non-legal associates see our work as supporting them and protecting them and not as an obstacle to be overcome.

How do we do that? I have no quick and easy answer. We each have our own style and technique. I can only tell you that we must avoid the impression on the part of our associates that we are the adversary. We don't want to impose our views on our clients. We want them to adopt our views and perhaps even to think of them as their own. That is why we use soft words such as "advise", "recommend", "suggest", "advocate", and avoid hard and offensive words like "direct", "insist", and "dictate."

Three determinations must ordinarily be made with respect to a claim. It must be determined that if certain facts exist, there is a basis for Government liability. Second, it must be determined that those facts exist in the instant case. Finally, the extent of the damage attributable to the Government must be determined. As lawyers, we can claim virtually full responsibility for the first determination. The second two determinations must be made in concert with other members of the negotiating team, and, as to them, we claim only the right to participate in the determination; not the right to make the determination.

Based upon my own experience and observation, it is only fair to acknowledge that our clients rarely, if ever, intrude into the determination of what they recognize to be legal matters. To some of them there apparently seems something inequitable about an arrangement in which they respect our jurisdiction over legal matters but they feel we go beyond legal matters in commenting on their business. That is what was bothering the Supervisor when he protested that they never second guess their lawyers but lawyers second guess them. There is some truth to this charge, and it is best that we recognize it for the sensitive matter that it is.

Lawyers are not scientists or engineers, and we must necessarily defer to the technicians on matters that require technical expertise. But all of our lawyers can read and write and count. And two and two would not make six nor would black be white if the person who said it had a doctors degree.

There are some arguments that you lose even if you win, and I think this may be one of them. The close rapport that lawyers need to have with their clients simply cannot exist if they are bickering among themselves over their respective jurisdictions. So it is not enough for us to prevail in a contest of authority. We must convince our non-legal colleagues that we have a useful contribution to make and that we can help them. We will not succeed by forcing our unwelcome advice on reluctant associates.

The principal friction seems to come in the area of documenting the claim. The documentation may relate to whether the conditions that would give rise to Government liability have in fact occurred, or it may relate to the extent of the damage attributable to that cause. To some, this appears to be a pricing action that non-lawyers are capable of handling as they handle other pricing actions.

But there is a basic difference between pricing claims and pricing contract articles. When we pay this type of claim, we are not buying something, we are paying damages, by whatever name we call them. To do that with reasonable confidence in the results, we must anticipate what a Court or Board would allow the contractor if the matter were adjudicated in a judicial forum. That in turn requires us to have an understanding of the evidence on which the claim depends, both for the determination of legal entitlement and for the determination of the quantum. And evidence is a subject that lawyers ought to know something about.

It was easily predictable that the principal doubts would arise and the principal challenges would come with respect to the adequacy of the evidence. And that is what is happening. You will recall that the GAO criticism of the cases they have evaluated thus far centered on the lack of tangible evidence. They not unreasonably concluded that in the absence of such tangible evidence of the contractor's costs resulting from acts of the Government, the Navy could not adequately evaluate the validity of the amounts claimed. At the hearing last week of the Joint Economic Committee, Senator Proxmire seized upon the GAO report as confirmation of his worst fears and as what he called "concrete proof of a virtual give away by the Navy to its contractors of well over $114,000,000."

Now Senators are not given to understatement and the gentleman from Wisconsin is no exception. The GAO report does not purport to be concrete proof of anything, let alone of a $114,000,000 give away. Nonetheless, we would all feel more comfortable if there had been more tangible evidence to support the Todd settlement.

Under all the circumstances, GAO let us off lightly, but we are all on notice that the evidentiary basis of future settlements will be subjected to more searching scrutiny. I think our clients also have that word, and I am hopeful that they will respond accordingly.

We are not going to win any friends or influence any people by playing the "I told you so" theme, and I don't think it is necessary that we do so to get our point across. We can't look good if our client looks bad. We must both look good or we shall both look bad.

DEPARTMENT OF THE NAVY,
NAVAL SHIP SYSTEMS COMMAND,
Washington, D.C., May 10, 1971.

MEMORANDUM FOR THE GENERAL COUNSEL OF THE NAVY

Subject: Shipbuilder claims.

1. At a meeting on March 23, 1971, we discussed the problem of shipbuilder claims. I stated my concern that these claims had become a way of life in the shipbuilding industry; that shipbuilders are able to turn almost any contract into a cost-plus contract by simply submitting claims for change orders or for extra work beyond the requirements of the contract.

2. Subsequent to this meeting, the Deputy General Counsel sent me a copy of his July 22, 1969 memorandum which he had submitted to the Vice Chief of Naval Operations. In this memorandum he explained the position of the Office of General Counsel on shipbuilder claims. Also, I have reviewed General Accounting Office report of April 28, 1971, which criticized the Navy for not obtaining specific evidence to support shipbuilding claims settlements.

3. It is my opinion that neither the Navy nor the General Accounting Office has fully faced up to the claims problem, and that the Navy is not taking adequate or appropriate steps to exercise fiscal responsibility and to protect the government.

4. Here is the situation we face today as I see it:

(*a*) Most of our major shipbuilding contracts are awarded sole-source or with only limited competition. Even in the recent SSN 688 class procurement where there was a fair degree of competition, the Navy is using incentive type contracts under which the Government assumes the major portion of the risk of cost overruns. In sum, there is little or no competition to keep prices down.

(*b*) For many years shipbuilders have been operating on what is, in effect, a noncompetitive basis. There is, and has long been, no compulsion, no requirement for them to develop effective cost controls, procurement practices, or concern about the efficiency of their operations. Generally, the attitude in these shipyards is that costs cannot be controlled and they will end up to be whatever

they turn out to be. Wasteful subcontracting practices, inadequate cost controls, loafing, and production errors mean little to these contractors. They will make their profits whether the product is good or bad; whether the price is fair or whether it is higher than it should be; whether delivery is on time or late. Shipbuilders can let costs come out were they will and count on getting relief through changes and claims, relaxation of procurement regulations and laws, government loans, follow-on sole-source contracts, and other escape mechanisms. It necessarily follows that there is considerable inefficiency and waste in shipbuilding. In fact, current Department of Defense profit policies actually *reward higher costs with higher profits* and punish greater efficiency with lower profits.

(*c*) Under current shipbuilding contracts the Government is highly vulnerable to claims. These contracts are built around detailed technical specifications which are necessary to assure essential military features. For various reasons, the Government itself furnishes many of the components and equipments which the shipbuilder is to install. The work extends over a long period of time, four to five years or more. Under these circumstances, changes are inevitable. Inevitably too, shipbuilders can find ambiguities or minor faults with specifications; the Government may be late in furnishing some of the components. A shipbuilder can always find some reason for increasing the price of the contract. Regardless of his inefficiency and no matter how high his costs, the shipbuilder can protect his profit by claims against the Government. In actual practice, the contract is binding on the Government alone, not on the shipbuilder.

(*d*) Today many of our shipbuilders devote considerable efforts to establishing, early in their contracts, a basis for large claims to be submitted later. Some shipbuilders have set up sizeable permanent organizations whose sole purpose it is to develop claims against the Government. Every Government action is carefully screened to discover any possible basis for a claim. In some cases shipbuilders delay pricing of individual change orders in order to force negotiation of an overall settlement of several changes to which can be added large amounts of unsubstantiated costs for delay, disruption or other claims.

(*e*) In preparing his claim, the shipbuilder assembles a team of experienced lawyers, accountants, and engineers—as many as are needed. The shipbuilder also engages the services of a law firm that specializes in prosecuting claims against the Government. The claims team develops a rationale for the claim and then puts together volumes of documents carefully selected to support the shipbuilder's contentions. The Government pays directly or in overhead as much as 90–98 percent of the shipbuilders' costs and expenses. Thus, the Government has placed itself into the position of paying almost the entire cost to the shipbuilder of making and prosecuting his claim against the Government.

(*f*) In contrast to the shipbuilder's claims organization, the Government usually has but a small number of people knowledgeable in the details of the claim; fewer yet who are competent to defend against it. Government technical personnel can ill afford the time from the work that is required to analyze contractor claims thoroughly, to refute them or to separate valid from invalid claims. As a result most claims are being settled by bargaining, not by factual, legal or accounting determinations. In fact, many shipbuilders have made factual determination impossible, by simply not keeping adequate records. This, I believe, is why shipbuilders are adamant in refusing to maintain adequate accounting records which would show the actual costs of changes and of other work.

(*g*) Once a claim is submitted, the shipbuilder and his claims lawyers press for a quick settlement, using their considerable influence in the Department of Defense, and threatening action before the Armed Services Board of Contract Appeals or the courts. Knowing that legal action to defend itself can consume years of effort by the few Government people available, who must meanwhile continue to handle their normal assignments, the Navy has been forced to resort to lump sum settlements and "handsshake agreements" based on bargaining.

(*h*) Since the shipbuilder knows his claim will be settled by bargaining on a lump sum basis, he is encouraged to exaggerate his claim so as to obtain as high a settlement as possible. As House Ways and Means Committee Chairman Mills once pointed out, industry negotiators sometimes plant a few Easter eggs in their proposals for Government negotiators to find. On finding them the latter score some points, but the farsighted contractor remains, as intended, ahead of the game.

5. To the extent shipbuilders get more than they should in claims settlements, the Navy is subsidizing inefficiency and undermining its own contracts. As long as shipbuilders know that the government will bail them out through changes and

claims, it will be impossible to achieve effective cost control, improved efficiency, or lower costs.

6. Deputy Counsel's July 22, 1969 memorandum to the Vice Chief of Naval Operations stated his intent to put shipbuilder claims through a "legal wringer" to squeeze the water out of any that are not solid. *This is essential.* Any claim or part of a claim not solidly grounded in fact or in law, or not susceptible of factual determination should be disallowed. Items not clearly supported by factual records or not susceptible of factual determination should, if pursued by the shipbuilder, be settled by the *courts*, not by the *Navy*.

7. I realize that your office does not generate shipbuilding claims; that they arise out of actions by others. I also realize that it is not your job, but the job of others to eliminate practices which give rise to unfounded claims. It nevertheless appears to me that it devolves upon you as the Navy's legal officer to see to it that these claims are settled legally and properly, and without setting damaging precedent for the future. In this sense, your clients are the American public and those of us in the Navy who are charged with building ships at minimum cost. There always will be great pressures to settle claims quickly. These pressures militate against thorough review. The Navy, by failing to ensure adequate legal review has already set precedents damaging to future contracts.

8. In view of the above I recommend the following:

(*a*) Government contracts should prohibit payment, directly or indirectly, of any costs associated with preparation or prosecution of claims against the Government. The Armed Services Procurement Regulation should be strengthened as necessary to implement this; and with no room for ambiguity, as is presently the case in many of its provisions.

(*b*) Whenever it is necessary to augment its own resources for legal analysis and defense against claims of shipbuilders, the Office of General Counsel should obtain competent outside help—legal and technical. I understand that outside legal help was used in connection with the subsidence problem at the Long Beach Naval Shipyard. The use of outside legal firms to help the Government defend against claims would ease the burden on the small existing organization. It would serve to expedite the review and settlement process, and would provide for the thorough analysis required to settle claims on their merits.

(*c*) The settlement of claims is principally a legal matter, not a contract negotiation. Therefore, the Office of General Counsel should establish a Review Board composed of qualified legal, accounting and technical experts to carefully review proposed claim settlements and to eliminate from them any items not clearly supported by factual determination of entitlement and amount. The elimination of unsubstantiated items from negotiated settlements would compel shipbuilders to keep proper records.

(*d*) The Office of General Counsel should promulgate a list of contractors who is frequently or repetitively make claims against the Government, or who submit excessive or unwarranted claims. Procuring agencies should give consideration to a contractor's claims record in awarding new contracts. I believe the above steps would help to ensure that current claims are settled properly and that further degradation of the contractual relationship with our shipbuilders is avoided.

9. The Government and members of the shipbuilding industry have become mutually hostile groups in that the one desires a satisfactory product at a reasonable price while the other appears to desire the greatest price the traffic will bear. These antipathies will continue to the detriment of the shipbuilders and of the Government unless there is developed a self-disciplined manner of dealing with one another. What we need between these two hostile groups is the greatest courtesy and consideration. We need a moderation and mutual consideration in their behavior that is not evident today. Such mutual consideration cannot be achieved as long as these shipbuilders make it standard practice to use every possible strategem against their Government: as long as they resort to dubious accounting practices; employ large number of lawyers and accountants whose sole objective is to prosecute claims against their Government; use the monopoly position and superior bargaining power they possess to take advantage of their Government's urgent needs by forcing costs as high as is possible. In short, operating on the basis that by these actions they have nothing to lose and everything to gain.

10. I know of no company that conducts its contracting business as loosely as the Navy does its shipbuilding. This loose way of doing business has now led to a situation where many officials of companies in overall charge of shipbuilding

look on shipbuilding as a financial proposition, pure and simple. These officials hold their positions because of their financial acuity, their political contacts and ability to manipulate government contracts to their own advantage.

11. A degree of self-limitation is essential in all human behavior; a mutual self-limitation which represents tacit agreement on the rules of the game. This is essential to the survival of both business and Government and is within the bounds of practical possibility. This must be achieved as soon as possible.

H. G. RICKOVER.

DEPARTMENT OF THE NAVY,
HEADQUARTERS NAVAL MATERIAL COMMAND,
Washington, D.C., May 11, 1971.

From: Chairman, Contract Claims Control and Surveillance Group.
To: Commander, Naval Ship Systems Command.
Subject: Lockheed and Avondale Shipbuilding Claims.
Reference: (*a*) CNM ltr MAT 022/GWR of 2 Dec 1970 to NAVSHIPS; (*b*) NAMAT 022/GWR ltr of 2 Apr 1972 to NAVSHIPS: (c) NAVMAT 022/GWR ltr of 19 Apr 1971 to NAVSHIPS; (d) COMNAVSHIPS ltr 00:NS: jd of 26 Apr 1971 to CNM.

1. References (*a*), (*b*) and (*c*) requested certain information to be supplied the Contract Claims Control and Surveillance Group (CCCSG) to support subject claim negotiations.

2. Reference (d) furnished some of the requested information but because it declines to comply with two of the most important requests and further because of the distortions and inaccuracies contained therein, it is considered essential that the record be set straight.

3. The GAO, the Congress and Admiral Rickover have quite recently spoken out on the proper and prudent settlement of shipbuilding claims against the Navy and the CCCSG is determined to negate future criticism of the way the Navy settles these claims, either procedurally or substantively.

4. The purpose therefore of this letter is to:

(*a*) Record the concern of the CCCSG regarding the delays in submission of fully documented and supported business clearances covering subject claims.

(*b*) Obtain for the record precise information regarding procedures followed by NAVSHIPS in the negotiation of subject claims settlements.

(*c*) Make clear for the record the refusal by NAVSHIPS to furnish certain requested information pertaining to the Lockheed claim proposed settlement.

(*d*) Record for the record the proper role of the legal member of any claim settlement team, as distinguished from his role in the normal procurement function.

5. *Concern of CCCSG re Delays in Submission of Subject Claims Business Clearances:*

(*a*) The latest NACSHIPS report on the status of shipbuilding claims of $5 million and over, dated 1 May 1971, shows that the Avondale claims for the DE 1052's and DE 1078's were negotiated and agreement reached with the contractor on 2 December 1970. Since that date NAVSHIPS has apparently been attempting to substantiate the agreed upon figure. The fact that as of 6 May 1971 a legal memorandum of entitlement had not been finalized is the cause of considerable concern to the CCCSG.

(*b*) Similarly, the Lockheed DE 1052 and LPD claims were negotiated and agreement reached with the contractor on 29 January 1971. A business clearance was brought to the CCCSG on 25 March 1971 without any legal memorandum of entitlement for the LPD portion of the proposed settlement, which is the major part of the agreed upon figure ($48.4M of the proposed $62M settlement). The fact that as of 6 May 1971, over three months have elapsed with no finalized memorandum of legal entitlement for the LPD's is the cause of considerable concern to the CCCSG.

(*c*) It would appear that something is basically wrong in both of these cases. As a minimum, it seems rather obvious that at the point in time when agreement was reached with both contractors on the proposed settlement figures, no memorandum of legal entitlement for the amounts negotiated, had been finalized by the legal member of the settlement team.

(*d*) When NAVSHIPS forwarded to the CCCSG their revised settlement procedures in mid-1970, it was recognized that these new procedures could make the Commander, NAVSHIPS to establish a pre-negotiation position (Command Decision) without benefit of a final written memorandum of legal entitlement having been prepared and submitted to him. Neither the CCCSG nor the Office

of General Counsel interposed objection to the revised procedures at that time despite the fact that the previous procedures approved by ASN(I&L) and CNM required a memorandum of legal entitlement before the pre-negotiation position was established, because it was never envisaged that this newly minted procedure could also permit *negotiations to be concluded* by the COMNAVSHIPS with a contractor on a claim against the Navy, in the absence of a memorandum of legal entitlement having been finalized for his guidance.

(*c*) Patently, if no memorandum of legal entitlement—draft or final—is in being at the time the Command Position is established, nor at the time of negotiation of a dollar agreement with a contractor, the originally approved NAVSHIPS settlement procedures have been effectively perverted, with the result that the legal memorandum of entitlement is being used to justify, after the negotiation, the dollar figure negotiated, *rather than have this basic document form the basis of what can legally be negotiated and hopefully substituted.*

6. *Information Desired Regarding Procedures Followed by NAVSHIPS in the Negotiation of Subject Claim Settlements:*

(*a*) In order to establish for the record precisely what was done, the following information is requested.

(1) What was the date of the Command Decision for the Lockheed DE 1052 and LPD claim?

(2) What was the amount of that decision?

(3) Was there *any sort* of legal memorandum of entitlement in writing and available to the COMNAVSHIPS on that date? If yes, please provide a copy.

(4) On 29 January 1971 when agreement with Lockheed was reached, was there in being and available to COMNAVSHIPS, a finalized legal memorandum of entitlement covering the DE 1052's and the LPD's? If yes, please provide a copy.

(5) Why has no legal memorandum of entitlement for the LPD portion of the Lockheed proposed settlement been submitted to the CCCSG six weeks after the incomplete business clearance was submitted on 25 March 1971 and three months after negotiations were concluded?

(6) What was the date of the Command Decision for the Avondale claim?

(7) What was the amount of that decision?

(8) Was there any sort of legal memorandum of entitlement in writing and available to the COMNAVSHIPS on that date? If yes, please provide a copy.

(9) On 2 December 1970, when agreement with Avondale was reached, was there in being and available to the COMNAVSHIPS, a finalized legal memorandum of entitlement? If yes, please provide a copy.

(10) Why has no business clearance with legal memorandum of entitlement been forwarded to the CCCSG five months after agreement was reached on 2 December 1970?

(*b*) In connection with the above requested information, paragraph 1.g.(2) of reference (d) states in part as follows:

"2. As stated above, the claims [Lockheed] were processed in accordance with procedures previously furnished to NAVMAT. Under those procedures the pre-negotiation position (Command Position) is determined on the basis of the *facts developed by each member of settlement team.* These findings of fact are, however, *in preliminary draft form* and are not formalized as completed documents at that time." (Italic added)

The lawyer assigned to each claim settlement team by NAVSHIPS is obviously a member of that team within the meaning of the above quote, and if this quoted statement is entirely accurate and not something else, a preliminary draft form of the team lawyer's input was available to the Commander, NAVSHIPS, at the time he decided the Command Position in both the Lockheed and Avondale cases and should be really available as requested.

7. *Refusal by NAVSHIPS to Furnish Certain Requested Information Pertaining to the Lockheed Proposed Settlement:*

(*a*) References (a), (b) and (c) requested that certain additional information relating to the Lockheed proposed settlement be provided. Paragraph 5 of reference (b) states as follows:

"It is appalling that for a sixty-two million dollar proposed claim settlement, NAVSHIPS would permit business clearances of three pages each, to be submitted for review, and clearly indicate that if anyone wants rationale, documentation, etc., go and dig it out yourself from some voluminous exhibit or attachment. This type of business clearance is an insult to any reviewing authority in an ordinary claim case but in the Lockheed case one would think the Com-

mander, Naval Ship Systems Command would insist upon the fullest and most complete discussion and documentation in the business clearance."

In reply, paragraph 1.c. of reference (d), the Commander, NAVSHIPS again tells the CCCSG members to go dig out of the exhibits what they want and that the requested full discussion of the proposed settlement in the business clearance would be redundant. Imagine, if one can, any reviewing court, board or group being denied a brief or similar document, fully outlining and discussing the issues presented for review and the course of action recommended.

(*b*) Paragraph 8 of reference (b) repeated the previously made request for the written views by the cognizant SUPSHIP concerning the proposed settlements. Paragraph 1.e(2) of reference (d) states as follows: "COMNAVSHIPS does not consider the request of reference (a) for the written views of the Supervisor of Shipbuilding to be appropriate."

(*c*) These two requests by the CCCSG and refusals by COMNAVSHIPS in reference (d) place the COMNAVSHIPS in a most untenable position.

(*d*) The Commander, NAVSHIPS, either by reason of his present position and/or his previous positions in NAVSHIPS, is responsible for the existence of subject claims. Additionally, in his present position as COMNAVSHIPS, he is responsible for the revised settlement procedures which we now realize have emasculated the team lawyer's timely role in subject proposed claim settlements. Finally, COMNAVSHIPS personally took the leading part in the negotiations which culminated in the agreements reached with Lockheed and Avondale.

(*e*) Now we find this same COMNAVSHIPS deciding what information he will or will not provide the CNM established claim settlement review group—the CCCSG—for purposes of their review.

(*f*) The refusal to obtain and provide the requested written views of the cognizant SUPSHIP on proposed shipbuilding claim settlements and provide full discussion of the proposed settlements in the business clearance submitted to the CCCSG is indefensible and regrettable. Who, other than the SUPSHIP should know as much about the merits of a claim from a yard under his cognizance? The fact that members of a claim settlement team set up in Washington draw upon the knowledge of the SUPSHIP is not enough, in the opinion of the undersigned.

8. *The Role of the Legal Member of a NAVSHIP Claim Settlement Team:*

(*a*) A careful or casual reading of reference (d) indicates that the well recognized role of the negotiator and contracting officer in the procurement process is not being properly differentiated from their role in the *claim settlement process.* Paragraph 1.d. of reference (d) states in part as follows:

"The TAR, AAR, and even the legal memorandum are a product of long and exhaustive team effort, which has been under active and influential direction of the negotiator and contracting officer. The proposed settlements were possible only through the efforts of the negotiator and contracting officer in their proper decision-making role in the procurement process."

To state that the legal member of a claim settlement team, whose primary function is to determine legal entitlement by the claimant contractor to any or all elements of he claim is "under [the] active and influential direction of the negotiator and the contracting officer" is just plain erroneous and ridiculous. It is the legal member of a claim settlement team who will inform the negotiator and contracting officer what elements of a claim legally can or cannot be negotiated and become part of any settlement.

(*b*) Lawyers normally do not get involved in pricing matters in the procurement process, but when claims are involved, the lawyer is the key person on the team up to the time he decides what is or is not legally compensable. Thereafter, the lawyer must stay in the claim settlement exercise to make sure that the team does not go overboard on the quantum of dollar relief that can be justified and substantiated for those elements of the claim which he has determined legal entitlement.

(*c*) Reference (d) reiterates the role of the negotiator and contracting officer but fails to indicate a realization that claim settlements are vastly different than procurement. It is suggested that this distinction be recognized and understood in the interest of future claim settlements by NAVSHIPS.

9. The information requested in paragraph 6. above will be appreciated.

GORDON W. RULE,
Chairman, Contract Claims Control and Surveillance Group.

DEPARTMENT OF THE NAVY,
HEADQUARTERS NAVAL MATERIAL COMMAND,
Washington, D.C., July 23, 1971.

From: Chairman, Contract Claims Control and Surveillance Group.
To: Commander, Naval Ship Systems Command.
Subject: Avondale Shipyards, Inc. Claims on DE 1052 and 1078 Contracts (NAVSHIPS Clearances SH 10969.1 and SH 10798.1).
Enclosure: (1) Clearance SH 10969.1; (2) Clearance SH 10798.1.

1. Subject proposed claim settlements in the amounts of $25,620,000 and $47,900,000 respectively, were received by the Contract Claims Control and Surveillance Group (CCCSG) on 16 June 1971 for review action. These two claims were negotiated as a single package on 1 December 1970 for a combined total of $73.5 million of which $27.3 million represents unadjudicated changes and $1.6 million for warranty liability of Avondale on the seven ship 1052 contract.

2. Five different claim proposals were filed beginning in January 1969 on the seven-ship DE 1052 contract and three on the twenty ship DE 1078 contract beginning in September 1969. The various proposals add items and dollars, shift the theory of the claims and were prepared by a special claim team composed of the com Baur law firm and accountants from Arthur Anderson and Company, rather than by Avondale's regularly retained counsel and accountants.

3. The basis of the CCCSG review of this proposed settlement has been the contents of the business clearances, the TAR's (Technical Advisory Reports), the AAR's (Advisory Audit Reports), the Memoranda of Legal Entitlement, all documents submitted with the clearances, conferences with the special negotiating team members, the Resident DCAA Auditor, the Project Manager and others.

4. The object of the CCCSG review was not to determine what the claim settlement amount should be—ours is a review function, not a negotiating function—but to determine if the $73.5 million figure negotiated by COMNAVSHIPS has (i) complete substantive merit and (ii) is adequately supported by evidential demonstration. The best interests of the government and the taxpayers so dictate. These tests of substantive merit and adequate evidential demonstration are by design rugged tests to meet, especially when applied to claims against the government that have been ascertained, prepared, brochured and processed by highly paid special claim nurturing legal and accounting combines.

5. Before these two tests can be objectively applied and results evaluated however, it is necessary to ascertain certain basic facts in any claim review. These required facts are as follows:

Question a. What is the objective sought by the claimant?

Answer: Page 16 of Audit Report No. 103-03-0-0634 on the 1052 claim contains the following statement: "Contractor personnel candidly admit that the concept for determining the hours and amounts claimed was based on the premise of repricing the total contract labor by estimating the total hours and costs at completion of the contract less the value of the basic contract plus adjudicated change orders." The object of a claim should be the identification and payment of those additional *costs* incurred, or to be incurred, by the contractor which are demonstrably caused by government action or inaction. Thus, the theory of this contractor's claim is contra to what it should be with consequent difficulty to the ascertainment of reasonable governmental responsibility and liability.

Question b. Is there any evidence of original buy-in on the contracts involved?

Answer: The team engineer has testified there is such evidence.

Question c. Has the claim been prepared in such a manner that merit and specifics are reasonably evident or is it dominated by generalities and vagueness?

Answer: The DCAA reports complain of generalities and estimates with supporting data NOT prepared but in the "brains" of the engineers.

Question d. Have the several areas—not necessarily the amounts—in the original claim stayed relatively constant or have these areas changed with subsequent proposals?

Answer: The basic areas in the 1052 claim stayed relatively constant while the areas in the 1078 claim did not. As one claim theory would get shot down a new proposal would shift to a new theory on the 1078 claim. Indeed the original five volume Avondale 1078 claim proposal for $97,871,956 was characterized by the COMNAVSHIPS in a letter to the contractor dated 9 April 1970 as "not supportable", "erroneous", "no basis in fact for the claim that late GFE had impacted your building schedules", "the claim of damage in such a circumstance appears to be spurious and unwarranted."

Question e. Has the claimant been fully cooperative with the government representatives in their investigation of the claim or claims?

Answer: The claimant has refused to prepare certain manhour breakdowns requested by the engineer and required the DCAA personnel to deal only through the specially retained Arthur Anderson and Company claim accountants.

Question f. Has the claimant fully carried his burden of proof for every item or area in his claim or claims?

Answer: The claimant has definitely not carried the burden of proof of his claimed items, particularly in the areas of alledged ripple effect of government actions relating to the 1052 contract over to the 1078 contract and shock and dynamic analysis.

Question g. Is there any tangible evidence that claimant has attempted to mitigate additional costs to the government?

Answer: None whatsoever. On the contrary, it appears that claimant was building a claim on the 1078 contract long before the claim was submitted in September 1969.

Question h. Has the claimant been responsible for bringing unreasonable outside pressures on the Navy for the settlement of these claims?

Answer: The claimant has not only threatened to do so but has actually done so to such an unreasonable extent that one begins to wonder about merits of the claim.

Question i. Has claimant threatened to stop work?

Answer: Yes, in writing.

Question j. Is there any evidence that government personnel have assisted claimant—in whole or in part—in preparing elements of the claim or claims?

Answer: There is clear evidence that the contractor's claim for alleged ripple effect on the 1078 contract was documented by the team engineer—not the contractor.

6. The factual answers to the above questions recreate the climate in which the claim was prepared, investigated, processed and negotiated. These factual answers also impacted the credibility of the claims which was considered by the CCCSG in reaching a final decision.

7. The negotiated figure of $73.5 million for both claims cannot be approved by the CCCSG if any of the principal elements making up that figure fail the two basic claim tests set out in paragraph 4 above. After removing the unadjudicated change order amounts—which actually should not be a part of this claim settlement proposal—from both the 1052 and 1078 claims and the amount for warranty liability in the 1052 contract from the $73.5 million figure there remains $44.6 million of claim dollars.

8. The largest dollar items that make up this $44.6 million remaining claim figure are approximately as follows:

	Millions
Shock and dynamic analysis on 1052	$3.9
Shock and dynamic analysis on 1078	6.4
Escalation on 1052	3.59
Escalation on 1078	6.541
Profit on 1052	2.09
Profit on 1078	5.78
Ripple Effect on 1078	6.181

9. As the result of individual and collective analysis, discussion, and consideration of all information received in support of the proposed settlement of $73.5 million and pursuant to the charter of the CCCSG, the undersigned Chairman of the CCCSG determines as follows:

(*a*) The amount proposed for payment to Avondale for shock and dynamic analysis on the 1078 contract for twenty ships lacks evidential documentation.

(*b*) The proposed profit allowances on both the 1052 and 1078 claims as computed on DD Form 1547 cannot be justified—especially in view of the poor quality of the 1052 ships.

(*c*) The escalation dollars contained in the proposed settlement result from a theory contrary to the escalation formula contained in the contracts, which different theory is clearly designed to pay the contractor more dollars than the contracts provide and is not supported by evidential documentation as being in the best interests of the Navy.

(*d*) The amount contained in the proposed settlement for so-called ripple effect of government action relating to the 1052 contract, alleged to carry over to the 1078 contract, is entirely without evidential documentation. This particular

element of the contractor's claim is theoretically enticing and interesting but quite specious in actuality, as sought to be made a major element of the 1078 claim. The CCCSG cannot and will not approve payment of many millions of dollars to any contractor on the basis of information presented which does not fully support this element of cost entitlement.

(*e*) The sample concept employed in the 1052 claim, whereby 70 of the 147 claim items were evaluated in-depth, with the resulting percentages of allowance applied to the non-sampled items is not sound claim settlement precedure. Obviously, the sample technique serves to expedite analysis and TAR preparation, but claims against the government and the taxpayer had best suffer prolongation of resolution than fall victims of undue haste and questionable evaluation. The message must be transmitted to all claim-minded contractors and individuals that there is no short cut to their burden to prove every dollar claimed.

10. Accordingly, subject business clearances for the settlement of the Avondale claims against the Navy 1052 and 1078 contracts, in the total amount of $73.5 million, are disapproved and returned to NAVSHIPS with the recommendation that a contracting officer's decision be made which will require the contractor to prove to the satisfaction of the ASBCA or GAO every dollar of entitlement for action or inaction resulting increased costs. alleged to be the responsibiliy of the government under both the 1052 and 1078 DE contractor. The $27.3 million for unadjudicated changes on both contracts may be susceptible of a separate approval by NAVSHIPS.

11. The above determinations and action of the Chairman of the CCCSG are unanimously concurred in by the membership of CCCGS and Counsel to the CCCSG.

12. That some increased cost on the seven ship 1052 contract is the responsibility of the government is not disputed. Likewise some small portion of the claimed increased cost on the 1078 contract. The contractor however—or rather the contractor's professional claims purveyors——have, in their presentations to the Navy, so intermingled these elements of the claims that have merit with those elements which are wholly without merit, that the burden of proof should be placed squarely upon them to prove every dollar to which they feel or contend they are entitled.

GORDON W. RULE,
Chairman, Contract Claims Control and Surveillance Group.

DEPARTMENT OF THE NAVY,
NAVAL SHIP SYSTEMS COMMAND,
Washington, D.C., July 30, 1971.

MEMORANDUM FOR COMMANDER NAVAL SHIP SYSTEMS COMMAND

Subject: Avondale Claim Review.

1. BACKGROUND

As a result of the Contract Claims Control and Surveillance Group's (CCCSG) 23 July 1971 disapproval of NAVSHIPS recommended settlement of Avondale Shipyards Inc. claims for construction of DE–1052 and DE–1078 Class vessels, you directed the formation of a special team to expeditiously review the facts and recommend a course of action. This review team was to be composed of RADM. K. L. Woodfin (SHIPS 02 Team Leader, CAPT. James R. Wilkins, Jr. (SHIPS 051), and Mr. David W. James, Jr. (OGC). CAPT. A. Bodnaruk (SUPSHIPS EIGHT), Mr. W. Murphy (DCAA) and CAPT A. W. Holfield provided part-time consultant services to the team effort as did Messrs. Schemp and Bates of SHIPS O2X staff. The findings, conclusions and recommendations set forth below have the concurrence of the team members.

2. FINDINGS

(*a*) The preponderance of Avondale's asserted claim elements present qualitative descriptions of Government actions and omissions for which the Government is said to be liable to the contractor. But Avondale's claims and subsequent data provided do not describe adequately and quantitatively the changed, added, delay or disrupted work caused by such Government conduct.

(*b*) Avondale's generally qualitative descriptions and back-up information provide only a limited basis for computing and verifying claimed manhours and material costs.

(*c*) Avondale's manhours and material costs are derived from estimates; it made no effort to support those claimed hours and costs by actual cost data.

(*d*) The productive manhours claimed by Avondale and proposed for settlement are inconsistent and insupportable, for example:

DE 1052

	DD 633's	Cost estimate summary ASI form 2823's	Actuals exceeding contract	Navy offer
Hours	2,846,601	3,852,000	2,341,000	2,726,000

DE 1078

	DD 633's	Cost estimate summary ASI form 2823's	Actuals plus contractor estimates to complete	Navy offer
Hours	9,221,081	9,701,000	7,528,000	5,144,610

(*e*) NAVSHIPS has fundamentally sound directives and procedures to obtain meaningful change/claim information and to document changed, delayed and disrupted work. (See SACAM Ss 13–3.3.4; 13–3.18.9; and 18–2.3.3) However, Avondale did not use these techniques to formulate and present its claims.

(*f*) In response to Avondale's inadequate claim submissions, the NAVSHIPS claim team diligently attempted to elicit meaningful information of the sort required by SACAM. But the record contains little documentation of the requested information.

(*g*) The claim analysis does not treat and dispose of possible underpricing of either of both contracts, or state whether the proposed settlements considered underpricing with respect to any of the claim elements.

(*h*) My investigation probed not only the business clearance documentation, but also selected back-up files disclosing Avondale's "Cost Estimates" and "Cost Estimate Summary" forms. These back-up data, however, did not yield specific, factual quantities of changed work susceptible of meaningful evaluation. It is understood that Avondale and Navy engineers orally explored such factual information; but it is not recorded.

3. THE CCCSG'S FIVE GROUNDS FOR REJECTING THE CLEARANCES

(*a*) As found above, not only does Avondale's DE–1078 Shock and Dynamic Analysis claim element lack substantiation, but also most other claim elements are equally deficient.

(*b*) Although Avondale only bid to obtain a 5% profit on these contracts, it is noted that a 13% profit was proposed for settlement of the claim for changed work. Thirteen percent profit appears questionable, particularly in view of the 6 point cost risk factor calculated in the Weighted Guidelines Profit/Fee Objective.

(*c*) With regard to the question of escalation, Avondale can properly claim recovery of its actual labor and material costs for changed work. This result is neither barred by the provisions of the contract escalation clauses nor contrary to them. Their operation is completely independent of the elements of Avondale's proposed equitable adjustment.

(*d*) Just as the DE 1052 claim allocated changed manhours into production and disruption manhours, so too the DE 1078 claim could be re-assessed to identify whether any of the substantive claim elements can similarly be allocated to production and disruption manhours. Such disruptive manhours would theoretically present a valid claim (if properly substantiated) in lieu of the questionable "Ripple Effect" claim element.

(*e*) Although the DE 1052 NAVSHIPS claims team's sampling techniques and the percentages of manhours (82%) and material cost (98%) sampled appear to be essentially sond and reliable, the issue of the sampling plan is rendered most of the initial findings presented above.

4. CONCLUSIONS

(*a*) Avondale failed to use fundamentally sound claim presentation and substantiation procedures such as those set forth in the SACAM. Thus the claims have not been adequately and sufficiently supported.

(*b*) Existing actual cost information now available to the Navy—which was not available at the time Avondale initially submitted its claims—should be used to correct and to corroborate the manhours and material costs claimed. Avondale should provide detailed information explicitly and fully describing:

(1) A clear, detailed and explicit factual statement of changed work attributable to each claim element, subdivided into:

(*a*) Deleted labor hours and material costs;
(*b*) Added labor hours and material costs;
(*c*) Wasted labor hours and materials;
(*d*) Precise time periods of delay for each element;
(*e*) Precise time periods of acceleration for each element;
(*f*) Disrupted work; including (1) how the work was disrupted and disruptive elements, and (2) the time period of disruption.

(2) Avondale's July 1964 and August 1966 breakdowns of engineering and production manhours and material costs, as estimated and allocated to each work element or work package, for the construction of DE–1052 Class and DE–1078 Class vessels respectively.

(3) Current breakdowns of actual engineering and production man-hours and material costs incurred by Avondale for each of those same work packages enumerated for (2) above.

(4) A correlation, wherever and to the maximum extent possible, of the differences between initially estimated and subsequently incurred manhours and material costs to Avondale's specific claim elements.

(*c*) If Avondale appealed a final decision of the Contracting Officer on these claims, Avondale would be required to prove and document its case against the Navy in the manner suggested in the foregoing findings.

5. RECOMMENDATION

(*a*) Regardless of the forum before which its claim may be adjudicated, since actual cost data now exist, the Government must inevitably require the contractor to prove and to document its claim in the manner discussed above to sustain its burden of proof in these Avondale claims (as in all similar claims).

(*b*) Accordingly, it is recommended that the NAVSHIPS Contracting Officer write to Avondale in a form such as that provided herewith, enclosure (1).

(*c*) SUPSHIPS EIGHT has estimated that Avondale will require a minimum of 6 months to furnish meaningful supplementary information, and I estimate that the Navy will need an additional 6 months to review and evaluate such supplemental information and to propose and agree upon a revised claim settlement for both the DE 1052 and DE 1078 contracts. It may be advisable, in this regard, to consider separate handling of the DE 1052 contract where return costs are available, since both the contractor's and the Government's efforts could be accelerated.

(*d*) It is expected to make maximum use of cognizant legal, audit, contract administration offices (SUSHIPS EIGHT) and SHAPM participation in such supplemental review.

K. L. WOODFIN,
Deputy Commander for Contracts.

Enclosure: (1) Draft of Proposed Letter to Avondale Regarding DE 1052 and DE 1078 Claims.

—

Dear Mr. Carter: As you know, on 23 July 1971 the Navy's Contract Claims Control and Surveillance Group disapproved the proposed settlement for $73,500,000 of your consolidated claims submitted under DE 1052 Contract NObs–4784 and DE 1078 Contract NOOO24–67–O–0220. Subsequently, an ad hoc panel of Navy officials was directed to review the substantive merit and adequacy of documentation of your claims.

It has been determined that although the claims documentation is replete with assertions of Government conduct which gave rise to ultimate Government liability to Avondale, most elements lack meaningful, measurable, factual, verifiable information identifying and quantifying the contractual work added, deleted, delayed and disrupted by such Government conduct.

It is neither the intention nor the desire of the Navy to reject Avondale's claims out of hand. The Navy stands ready to receive any supplemental information Avondale may wish to present to sustain its burden of proving its claims.

It would be helpful if any re-submission would include the following sorts of information:

(*a*) A clear, detailed and explicit factual statement of changed work attributable to each claim element, subdivided into:

(1) Deleted labor hours and material costs;
(2) Added labor hours and material costs;
(3) Wasted labor hours and materials;
(4) Precise periods of delay for each element;
(5) Precise periods of acceleration for each element;
(6) Disrupted work; including (1) how the work was disrupted and disruptive elements, and (2) the period of disruption.

(*b*) Avondale's July 1964 and August 1966 breakdowns of engineering and production manhours and material costs as estimated and allocated to each work element or work package, for the construction of DE 1052 and DE 1078 Class vessels, respectively.

(*c*) Current breakdowns of actual engineering and production manhours and material costs incurred by Avondale for each of those same work packages enumerated for (b) above.

(*d*) A correlation, wherever and to the maximum extent possible, of the differences between initially estimated and subsequently incurred manhours and material costs to Avondale's specific claim elements.

The Navy will analyze and evaluate any supplemental information of the sort just described. If such information satisfactorily proves and documents your entitlement to a verifiable sum, the Navy will promptly renew negotiations for the eventual settlement of your claims. Please contact me if you desire any clarification of this matter.

Yours truly.

AUGUST 4, 1971.

MEMORANDUM FOR RADM T. R. MCCLELLAN, COMMANDER, NAVAL AIR SYSTEMS COMMAND; RADM J. E. RICE, COMMANDER, NAVAL ELECTRONIC SYSTEMS COMMAND; RADM W. M. ENGER, COMMANDER, NAVAL FACILITIES ENGINEERING COMMAND; RADM M. W. WOODS, COMMANDER, NAVAL ORDNANCE SYSTEMS COMMAND; RADM N. SONENSHEIN, COMMANDER, NAVAL SHIP SYSTEMS COMMAND; RADM K. R. WHEELER, COMMANDER, NAVAL SUPPLY SYSTEMS COMMAND

Subject: 30 July 1971 Memorandum to all Systems Commanders regarding Claims Guidance.

1. At a meeting this date with Admiral Arnold and Rear Admiral Freeman, I was directed to withdraw subject memorandum because it is considered to be derogatory and improper in tone.

2. Please return the subject memorandum.

GORDON W. RULE,
Chairman, Contract Claims Control and Surveillance Group.

DEPARTMENT OF THE NAVY,
HEADQUARTERS NAVAL MATERIAL COMMAND,
Washington, D.C., July 30, 1971.

MEMORANDUM FOR RADM T. R. MCCLELLAN, COMMANDER, NAVAL AIR SYSTEMS COMMAND; RADM J. E. RICE, COMMANDER, NAVAL ELECTRONIC SYSTEMS COMMAND; RADM W. M. ENGER, COMMANDER, NAVAL FACILITIES ENGINEERING COMMAND; RADM M. W. WOODS, COMMANDER, NAVAL ORDNANCE SYSTEMS COMMAND; RADM N. SONENSHEIN, COMMANDER, NAVAL SHIP SYSTEMS COMMAND; RADM. K. R. WHEELER, COMMANDER, NAVAL SUPPLY SYSTEMS COMMAND

Subject: Claims against the Navy requiring review by the Contract Claims Control and Surveillance Group (CCCSG)—Guidance concerning.
Reference: (a) Charter for CCCSG dated 20 October 1969.
Enclosure: (1) CNM ltr MAT 022/CWR of 23 July 1971 to NAVSHIPS.

1. Paragraph 4(e) and (f) of reference (a) authorize the Chairman of the CCCSG to prescribe the form and scope of pre and post negotiation business clearances on claims and to provide guidance and assistance to the Systems Com-

mand and their delegated representatives in connection with the processing of claims.

2. Pursuant to the authority, enclosure (1) is forwarded for guidance and assistance in the preparation and processing of claims business clearances. Enclosure (1) is the first major claims clearance to be disapproved by the CCCSG and the contents of the disapproval may be helpful to the Systems Commands.

3. Enclosure (1) provides the general format for future action decisions emanating from the CCCSG and special attention is invited to the two basic tests set out in paragraph 4 and some of the collateral facts to be determined, as set out in paragraph 5.

4. The questions posed by paragraph 5(a), (c) and (e) of enclosure (1) are required knowledge by members of a claim team within a Systems Command and also the reviewing activity. For example, with respect to the claims covered by enclosure (1) the file shows that the president of the company involved made the following comments to the Secretary of the Navy on 27 October 1969:

"Mr. Carter complained that the claims review team was asking too many questions and that they did not understand the reason for all the legal and contract personnel involved in the contract and that they were ready to sit down and *negotiate*. Mr. Carter stated that the way to settle the claim was to negotiate on a broad picture judgment rather than trying to assess a monetary value to each event or detail. He stated that this might take as much as a year and that Avondale was not able to show the impact on each event taken individually."

Patently, when faced with this kind of personal and corporate mentality regarding multimillion dollar claims against the Navy, the danger flag is up and extraordinary caution is clearly indicated.

5. It should be noted that the determinations contained in paragraph 9 of enclosure (1), in this particular case, are entirely substantive in nature, as distinguished from procedural. Because of the abundance of substantive deficiency in this case, it was unnecessary to base the negative decision on procedural deficiencies or irregularities.

6. Obviously, review action should be bottomed—if at all possible—on substantive grounds. This is not to say however, that the required procedural aspects of analyzing, negotiating and reviewing claims are not important. Indeed, the failure to follow required procedures can be grounds for disapproval of a claim clearance. For example, in the claims covered by enclosure (1) the ComNavShips personally negotiated the settlement figure without having any written memorandum of legal entitlement, without having a completed technical or audit report and without the DCAA audit people ever having seen the technical report. In short, a figure was negotiated and then it took over six months work attempting to justify that figure with the written legal, technical and audit data that are required to be in existence *prior to negotiations*.

7. This sort of procedural irregularity can be ample grounds for disapproving a claim clearance. Any claim clearance submitted to the CCCSG in the future, where it appears that a negotiation was conducted in advance of and without written complete legal, technical and audit comments, will be returned to the SysCom involved without review. The reason for this position should be clear to anyone with an appreciation of the best interests of the Navy. An unsupported and improperly negotiated claim settlement can only result in GAO and other criticism *of the Navy as a whole*, not the individual responsible.

8. Additionally, in the future the CCCSG will not accept a claim clearance on shipbuilding contracts unless accompanied by a thorough analysis and recommendations from the cognizant SupShip of the claim or claims. The omission of this supporting information on shipbuilding claims will be considered a fatal defect.

9. A further procedural irregularity noted by the CCCSG is that of the contracting officer or others circumscribing the DCAA audit review. This practice will not be tolerated by the CCCSG. Every bit of advice and assistance—without reservation—is required to properly analyze and evaluate a claim and to tell the auditor to confine his review to labor rates and overhead is unacceptable and may lead to delay while the auditor is permitted to perform his normal review of the claim and the technical report.

10. Finally the following guidelines for settlement of delay claims have recently been provided by the GAO:

(1) Claims should be analyzed in light of the type of contract involved, which should aid in defining allowable cost elements.

(2) Documentation in support of subcontractor original estimates should be requested and *received prior to negotiation meeting.*

(3) Analysis of these data should be performed *in advance of any negotiation meetings*. Such an analysis should include a cost per week figure to enable negotiators to perform rapid, supportable computations during negotiation meetings. Any such cost per week figure should recognize the relationship between man-days and time if this is pertinent.

(4) Change orders, strikes, and other non-Government causes of delay should be identified and analyzed *prior to any negotiation meetings*.

(5) Provisions for adjustment should be included in any proposed settlement amount based on wage settlements which are not firm at time of negotiations.

(6) Estimators' mathematical short-cuts should be fully supported by descriptive data.

(7) If production efficiency losses are expected to be a claim element some preliminary analysis should be used to establish a reasonable rate.

(8) A detailed legal analysis concerning the acts, or failures to act, which render the Government liable for breach of contract should be performed and made a part of the record with respect to each claim *prior to any negotiation meetings*.

11. It may be helpful to the Systems Commands to be aware of what the undersigned has written regarding the role of the lawyer in claims.

"A careful or casual reading of reference (d) indicates that the well recognized role of the negotiator and contracting officer in the procurement process is not being properly differentiated from their role in the *claim settlement process*. Paragraph 1.d of reference (d) states in part as follows:

"The TAR, AAR and even the legal memorandum are a product of long and exhaustive team effort, which has been under active and influential direction of the negotiator and contracting officer. The proposed settlements were possible only through the efforts of the negotiator and contracting officer in their proper decision-making role in the procurement process".

To state that the legal member of a claim settlement team, whose primary function is to determine legal entitlement by the claimant contractor to any or all elements of the claim is "under [the] active and influential direction of the negotiator and the contracting officer" is just plan erroneous and ridiculous. It is the legal member of a claim settlement team who will inform the negotiator and the contracting officer what elements of a claim legally can or cannot be negotiated and become part of any settlement.

Lawyers normally do not get involved in pricing matters in the procurement process, but when claims are involved, the lawyer is the key person on the team up to the time he decides what is or is not legally compensable. Thereafter, the lawyer must stay in the claim settlement exercise to make sure that the team does not go overboard on the quantum of dollar relief that can be justified and substantiated for those elements of the claim which he has determined legal entitlement.

Reference (d) reiterates the role of the negotiator and contracting officer but fails to indicate a realization that claim settlements are vastly different than procurement. It is suggested that this distinction be recognized and understood in the interest of future claim settlements by NAVSHIPS.

12. There is clear evidence in the enclosure (1) case, that the Navy strained to find adequate justification for an already negotiated figure. Assisting a claimant in any manner whatsoever to substantiate or document a claim against the Navy should be grounds for disciplinary action. If a claimant cannot carry the burden of proving his own claim, that claim should be returned rejected rather than direct or permit Navy personnel to work full time trying to make the contractor's claim for him.

13. It is hoped the above will be beneficial to the SysComs and please do not hesitate to call upon us for any assistance we can provide.

GORDON W. RULE,
Chairman, Contract Claims Control and Surveillance Group.

FEBRUARY 11, 1972.

MEMORANDUM FOR THE CHIEF OF NAVAL MATERIAL

Subject: Claims procedures.

Reference: (a) NAVMAT NOTICE 4200 dtd 11 Jan 1972 and (b) My memorandum for the General Counsel of the Navy dtd May 10, 1971 subj: Shipbuilder claims.

1. I have just learned of the new procedures established by reference (a) for handling contractor claims against the Navy. I am concerned because these new

procedures appear to be a step in the wrong direction, particularly for the large complex shipbuilding claims we are encountering today.

2. The new procedures provide for settlement of contract claims at the "lowest possible level in the contracting framework." Claims of $10 million or more are subject to review by a General Board consisting of selected senior flag officers in the Naval Material Command and the Office of the Chief of Naval Operations. This General Board is to be assisted by a Claims' Board composed of "procurement executives" designated by COMNAVSHIPS, COMNAVAIR, COMNAVORD and COMNAVELEX. Presumably, assignment to the Claims Board is in addition to each procurement executive's normal full-time job. Reference (a) further provides that a Navy Deputy General Counsel will be an adviser to but not a *member* of the Claims Board.

3. I consider a number of things to be wrong with this approach.

a. First, the new procedures make claims settlements a routine contract matter. Yet these claims, by their very nature, go beyond routine contract actions and therefore should be accorded special handling. Routine settlement of claims as an ordinary contracting matter will encourage more claims and will tend to undermine our contractual relations.

b. These claims usually involve complex questions of fact and of law; to properly resolve these matters requires both special expertise and legal training. My experience over a period of many years is that most Navy contracting officers and procurement executives are not adequately trained or experienced to analyze and settle these large claims. Further, few flag officers possess the training, background, experience and judgment to deal with such claims; even fewer have the time to do so.

c. The settlement of claims, particularly large complex claims against the Government is principally a legal matter, not a contract negotiation. The Navy should not pay any claim or part of a claim that is not solidly grounded in fact or in law. Any claim not susceptible of factual determination should be rejected. Items not clearly supported by factual records or not susceptible of factual determination should, if pressed by contractors, be settled by the courts, not by the Navy.

4. In reference (b) I pointed out that our contractors are exerting considerable effort to establish, early in their contracts, claims against the Government. Some contractors have set up large organizations with experienced lawyers, accountants and engineers—as many as are needed—to develop claims against the Government. Often, they also engage outside claims experts in the legal profession to guide and assist them. The Government has no comparable body of talent to defend itself against these claims.

5. In reference (b) I also pointed out that to the extent contractors get more than they should in claims settlements, the Navy is not only subsidizing inefficiency but also undermining its own contracts. As long as contractors believe that the Government will bail them out through changes and claims, it will not be possible to achieve effective cost control, efficiency, or lower costs.

6. I would like to reiterate my recommendations in reference (b) for handling major claims against the Government:

a. I would assign primary responsibility to the Office of the General Counsel.

b. The Office of General Counsel should establish a Review Board composed of qualified legal, accounting and technical experts to carefully review proposed claim settlements and to eliminate from them any items not clearly supported by factual determination of entitlement and amount. The elimination of unsubstantiated items from negotiated settlements would compel contractors to keep proper records.

c. Whenever it is necessary to augment its own resources for legal analysis and defense against contractor claims, the Office of General Counsel should obtain competent outside help—legal and technical. The use of outside legal firms to help the Government defend against claims would ease the burden on the small existing organizations. It would serve to expedite the review and settlement process, and would provide for the thorough analysis required to settle claims on their merits.

d. Government contracts should prohibit payment, directly or indirectly, of any costs associated with preparation or prosecution of claims against the Government. The Armed Services Procurement Regulation should be strengthened as necessary to implement this; and with no room for ambiguity, as is presently the case in many of its provisions.

e. The Office of General Counsel should promulgate a list of contractors who frequently or repititively make claims against the Government, or who submit

excessive or unwarranted claims. Procurement agencies should give consideration to a contractor's claims record in awarding new contracts.

7. I know of your strong desire to improve Navy procurement. I trust you will give full consideration to my recommendations. We must have procedures that will ensure that all claim settlements are adequately supported, factually and legally.

H. G. RICKOVER.

DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., March 13, 1972.

Hon. WILLIAM PROXMIRE,
U.S. Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: Your letter of February 18, 1972, in which Congressman Aspin joined with you, expressed dissatisfaction with the recent change in the Navy's process for handling contractor claims.

The matter you highlight is, of course, of extreme importance to the Navy, and one about which numerous inquiries have been received. I believe that the enclosed Fact Sheet is fully responsive to the substance of your letter.

A similar reply is being forwarded to Congressman Aspin.

Sincerely yours,

CHARLES L. ILL,
Assistant Secretary of the Navy,
(Installations and Logistics).

FACT SHEET

The Chief of Naval Material has decided to change the process by which contractor claims are handled in the hope of resolving the Navy's blacklog of claims.

The previous process was established in October 1969 when Admiral I. J. Galantin, then Chief of Naval Material, chartered the Contract Claims Control and Surveillance Group to assure adequate review procedures for processing major claims, maintain the status of claims, and give guidance and advice regarding the handling of claims. Gordon W. Rule, Director of the Procurement Control and Clearance Division, was appointed as Chairman of the group and delegated the duty of determining the Naval Material Command's position for disposition or settlement of claims. Final approval was made by the Assistant Secretary of the Navy (Installations and Logistics).

In its two years life span the group arrived at a final disposition of some claims, however, the Navy's backlog of major claims remained approximately the same.

On November 12, 1971, Mr. Rule submitted his resignation as chairman of the group to the previous Chief of Naval Material, Admiral Jackson D. Arnold. In doing so he further declined to serve in any capacity with any reorganized claim review group outside his division. Later in November Admiral Arnold recommended establishment of a claims review board composed of senior civilian contracting personnel. The board was to assume the review functions of the Contract Claims Control and Surveillance Group and report its recommendations to the Chief of Naval Material for approval.

Shortly after relieving Admiral Arnold as Chief of Naval Material, Admiral Isaac C. Kidd, Jr. published a notice establishing the Claims Board. The Board will be chaired by the top civilian procurement official in Admiral Kidd's headquarters, Mr. Joseph C. Cruden, Assistant Deputy Chief of Naval Material for Procurement and Production, and will consist of the senior civilian contracting personnel of the subordinate Systems Commands. The Chairman of the Claims Board will report directly to Admiral Kidd. In addition to assuming the review function of the previous groups, the Claims Board will guide the efforts of working level claim settlement teams in an attempt to improve the process.

The recommendations of the Claims Board and the results of its review on the more significant transactions will be presented to Admiral Kidd for approval in session with his advisory General Board. This group consisting of the Commanders of the Navy's Systems Commands is the forum for reviewing and advising the Admiral on most major decisions involving his command. One of the reasons for making these presentations is to assure that problem areas result-

ing in claims are made known to the Systems Commanders for corrective action as soon as possible.

The new procedure will differ from the old in that the authority to determine the Naval Material Command's disposition of claims will be retained by the Chief of Naval Material whereas under the previous procedure it was delegated to the Claims Control and Surveillance Group.

The new Claims Board will have the additional responsibility for procurement policy and procedural recommendations aimed at preventing or minimizing claims generating problems in the future. It is composed entirely of high rank civilian personnel. The new procedures strengthen the Navy organization and overall approach to claims resolution.

It is noted that the ASN(I&L) will retain final approval authority with regard to claim settlements over $10 million.

Composition of the Claims Board is as follows: *Chairman*: Mr. Joseph C. Cruden, Assistant Deputy Chief of Naval Material (Procurement and Production) Note: Designated by DCNM (P&P), GS–17.

Members: Mr. J. S. Tassin, Executive Director for Procurement Management. Naval Air Systems Command, GS–17; Mr. G. McBride, Executive Director of Contracts, Naval Ship Systems Command, GS–16; Mr. J. W. Frankl, Executive Director for Contracts, Naval Ordnance Systems Command, GS–16; and Mr. B. S. Pyrek, Executive Assistant to the Director of Contracts, Naval Electronic Systems Command, GS–16.

Legal Advisor: Mr. A. H. Stein, Deputy General Counsel, Office of the General Counsel of the Navy, GS–17.

THE ACQUISITION OF WEAPONS SYSTEMS

WEDNESDAY, MARCH 29, 1972

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON PRIORITIES AND
ECONOMY IN GOVERNMENT OF THE
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10 a.m., in room 1202, New Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senators Proxmire and Percy.

Also present: John R. Stark, executive director; Loughlin F. McHugh, senior economist; Richard F. Kaufman, economist; Walter B. Laessig, minority counsel; Leslie J. Bander, minority economist; and E. A. Fitzgerald, consultant.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The subcommittee will come to order.

During the past 2 days, we have been hearing testimony from the General Accounting Office and Navy officials on what can only be described as the unholy mess in military procurement.

The Subcommittee on Priorities and Economy in Government has been studying defense contracting for many years.

I have been chairman of the subcommittee for 5 years, and during that time, we have heard literally thousands of pages of testimony, conducted numerous studies, and issued many publications, including reports, on the subject.

I wish I could say that the problem of waste, mismanagement, and general inefficiency throughout the Department of Defense and the aerospace industry has in any way improved. So far as I can tell, the problem has gotten worse, and I believe that evidence we received yesterday and the day before confirms this observation.

The Department of the Navy has been awarding contracts for the construction of naval vessels for well over 100 years. You would think that the Navy would have acquired the expertise and the ability to perform this function with a reasonable degree of efficiency by now.

Of course, the expertise exists. There are many capable and talented people throughout the Navy and the other services who are willing and able to perform their jobs in a wholly competent and effective manner. There are even courageous and dedicated individuals like Gordon Rule and A. E. Fitzgerald, who sits right here on the platform with us, who are willing to speak out against abuses even at some personal risk.

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The problem, as I see it, comes from a higher level of officialdom and the question that has been raised in my mind this week is whether the people who make policy in the Department of Defense are really interested in cleaning up the procurement mess. I am highly skeptical that they are.

Yesterday, for example, we learned about a telegram from Admiral Elmo R. Zumwalt, the Chief of Naval Operations, to Admiral I. C. Kidd, Chief of the Naval Material Command. In this telegram, the top-ranking military officer instructed his subordinates throughout the Navy to find ways to accelerate and speed up the expenditure of public funds.

No military justification is offered for this decision. The only explanation I can discern is that the Navy (1) has had its outlay target for the current year increased by more than $400 million, and (2) if it does not spend all the money allocated to it, the Navy's outlay target for next year might not be as high as they would like it to be. In other words, spend, spend, spend this year so that next year we can spend, spend, spend even more.

TRANSFERS OF HIGH RANKING NAVY AND MILITARY PERSONNEL

I don't believe this is the way to run a tight ship or an efficient procurement operation. Moreover, I am not impressed with the excuse that is so often offered by high ranking Navy and other military officials to the effect that they are new on the job, that the problems we have identified were created before they got there, and that they intend to correct them in the future.

We hear such protestations year after year, and by the very nature of government service at the highest levels, we can expect that military and civilian Presidential appointees will continue to be rotated at relatively short intervals.

At this rate, the problems will never be solved because Presidential appointees will almost always be able to say that they are, more or less, new on the job, and as soon as they have been around long enough for people to begin holding them responsible, they are replaced.

I believe that it is time for the services to act and to begin doing the hard work required to solve the problems that have been identified.

These problems won't be solved simply by hiring more people and establishing new groups to make endless studies which will be filed and forgotten.

SHIPBUILDERS' CLAIMS

The problem of shipbuilders' claims has badly deteriorated since we began studying this area in 1969. The Navy asserts that it has created new systems and reorganized its claims review procedures in order to more effectively settle and prevent claims. How in the world will the Navy ever be able to prevent new claims from arising when it continuously caves in on the old claims?

How in the world can we succeed in eliminating waste, reducing costs, and becoming more efficient when at the same time we in Congress are urging greater care in the handling of taxpayers' money, the highest ranking military officials in the Pentagon are instructing their subordinates to spend taxpayers' money as fast as they can?

FAVORITISM TOWARD LARGE CONTRACTORS

The policy of favoritism toward the large aerospace contractors and the compulsion to distribute the taxpayers' dollars to them at a breakneck pace seems to be matched only by the discriminatory treatment given to the small defense contractor.

REINFORCEMENT OF COMPETITIVE BIDDING AND SMALL BUSINESS PARTICIPATION

For many years this subcommittee has been urging the DOD to reinforce competitive bidding rather than discouraging it and to employ the resources and the capabilities of the small and medium-sized business communities. Instead procurement policies and practices have been weighted in favor of the large contractors and the percent of contract awards made to small business and the amount of competition in defense procurement has steadily dwindled.

Today's hearing will demonstrate some of the reasons for these unfortunate tendencies.

Our first witness this morning will be Mr. Herbert J. Frank, president, Aerosonic Corp., Clearwater, Fla. Mr. Frank has been involved in the design, development, and manufacturing of aircraft instruments for more than 30 years. His firm, the Aerosonic Corp., has been doing business with the DOD since 1956. His company produces basic flight instruments, such as altimeters, air speed indicators, cabin pressure indicators, and clocks.

Mr. Frank will be introduced by our good friend, the distinguished Senator from Florida, Senator Lawton Chiles. Following Mr. Frank's testimony we will hear from Charles L. Ill II, Assistant Secretary of the Navy (Installations and Logistics).

Mr. Ill was previously an official with Page Communications Engineering, Inc., for 14 years, and has served on the boards of governors of three UHF television stations. In 1969, he was named special assistant to the Secretary of the Navy, and was appointed to his present position in July 1971.

WELCOME TO SENATOR CHILES

Senator PERCY. Mr. Chairman, I simply would like to welcome a native of my own State of Florida, Senator Chiles.

It seems our witness, Mr. Frank, is eminently qualified to answer one question I have asked in these hearings. Why are the number of bidders so limited? Why aren't more bidders interested? If we have more bidding, automatically the marketplace forces will operate.

We certainly welcome you to these hearings and certainly welcome Senator Chiles.

Chairman PROXMIRE. Senator Chiles, take it away.

C–5A OVERRUNS

Senator CHILES. Senator Percy, Mr. Chairman, I am delighted to be here. I want to compliment the committee on the hearings they have been conducting. As a result of your hearings I had a call from one of

my constituents the night before last, an interesting case, with regard to our hearings on the tremendous overpayments on the C–5A.

This particular constituent had heard about it on television that night and told me he was a superintendent for a construction company, earning $16,000 a year. He said, "I am concerned with helping make up the bids in my construction company." He said, "The company does $30 million worth of work a year. It is not a small company." "But," he said, "I know that every time I work on a bid, if I make a mistake or anyone in my company makes a mistake and we underbid a project, we are going out of business. Nobody is going to bail us out. Nobody is going to pay us back. We are just going under."

He said, "I also know that when I start figuring out my tax returns if I make a mistake there the Government is going to bring its full resources to bear to see that I pay every penny I owe, and," he said, "I cannot understand how in the world our Government can give away $400 million to a company that has failed to bid properly or failed to carry out its duty properly," and he wants to know also what Congress was going to do about it.

REQUEST FOR JUSTICE DEPARTMENT INVESTIGATION

Mr. Chairman, I had a hard time trying to answer him, but I do want to congratulate the committee, and as a result of his call I did make a statement yesterday in which I hoped that the Justice Department would certainly look into this and the Air Force also would give an explanation as to what action they have taken in regard to people in the Air Force that should have been conscious and following what went on.

INTRODUCTION OF HERBERT FRANK, AEROSONIC CORP.

It is my pleasure to introduce to you Mr. Herbert J. Frank, the president of Aerosonic Corp., Clearwater. It is my hope his testimony will be beneficial and relevant to the committee's investigation.

Chairman PROXMIRE. Mr. Frank, we are delighted to have you here. You have a prepared statement which I understand you might desire to depart from. The entire prepared statement will be printed in full in the record.

I might say the last two pages will seem to be a little garbled. We will do our best to print the prepared statement.

STATEMENT OF HERBERT J. FRANK, PRESIDENT, AEROSONIC CORP., CLEARWATER, FLA.

LIMITED COMPETITION

Mr. FRANK. I want to thank you for the opportunity. I am going to depart from the statement and I hope I can impress the committee as best I can—certainly you and Senator Percy from Illinois—with some of the basic facts of why the competition is being limited and what is happening to our industrial State as it stands now as far as the military is concerned.

I do want to give some—although the statement is there, maybe for people that don't know about it, we are very proud of the fact that

our corporation was honored in 1966 with the award of the year for employing the handicapped. I also would like you to know that I served on the Senate subcommittee as an adviser on small business procurement during the late 1960's where the small business was being sort of pushed around, and I served as one of the members of this subcommittee on trying to get some sort of legislation to protect the small businessman.

I think, and I am going to depart from the problem, but I think basically speaking I would like to go over some of the things that are occurring in the industry today, tell what is happening, and fortunately for me and maybe for the committee, I am not only going to talk, but I have facts.

In other words, it seems that one of the problems we have is the fact that the military services can justify anything. They can justify whatever they wish to justify because there is nobody to question their justification and some of the things I am going to bring up today will sort of point this way. I have been trying for probably the last 15 years to convince the military services that millions and millions of dollars can be saved by the Government by eliminating what we call tests that are absolutely ridiculous, and specifications, by trying to stop building up requirements of specifications instead of just letting them lie as they are because they do the same thing.

And every time we bring something like this up, we are told no question about it, either stop rocking the boat, or you are getting paid for it, what do you care?

These are the statements that are given and these are the statements that probably get me the sorest of all.

Comparison of Services Procurement Practices

Now, I also would like to bring to your attention the fact that each organization within the service operates differently. Each one has their own rules and their own regulations and in doing business, in negotiating with the Government, I rate the companies just like everybody else in the services. I rate the U.S. Army procurement as the best overall, the U.S. Air Force the second, and the Navy so far down the line they are not even worth talking about.

What I am talking about might be of some interest to you as an example. When it comes time for procurement from the U.S. Army, Senators, they will produce a document to anybody that is interested and state what is going to be procured, well in advance of the procurement, approximately how many parts are going to be procured, what the price of that item was by the last bid, and approximately how many were bought the time before, so it gives a contractor the opportunity to look at a program and decide whether he wants to bid or not.

Sole Source Versus Competitive Army Bidding

I refer specifically to an item that was sole source to the U.S. Government by the U.S. Army prior to this, shall we say, conception being utilized by the U.S. Army. In 1964 the sole source—we will keep names out of this if we can—bid approximately $300 for this specific item. It was a rate of climb indicator that goes on aircraft for the Army.

By the year—then they opened up the bidding, Senators, and by the year 1966 this same bidder who was a sole source now having to compete brought his price down to $139.98 under competitive bidding. Not a different man, the same company. And by the year a little later on—and by the way, you of course know prices are going up—by 1969 this bidder was down to $133.92 in competitive bidding.

When you multiply the savings by the fact that approximately 10,000 of these were bought during this period of time, from sole source initially, to the time it is today, you will see that there was just millions upon millions of dollars saved.

Navy Sole Source Procurement

Now, unfortunately, for the taxpayer, the Navy does not believe in this system. The Navy perpetuates their sole-source supplies and one of the instances I am going to bring up is a specific item that I would like to point to in the service and I brought some of the—usually we say merchandise—to the attention or to the—it is called an altimeter and it is called the 24–A altimeter. This 24–A altimeter up until approximately 3 months ago was a sole-source item being supplied to the U.S. Government from one source of supply. The U.S. Air Force came out with a similar type item which is called the 27–A. The performance requirements of both are as close to identical as possible with the exception that the 27–A which is the Air Force unit, goes to a higher altitude.

Under the sole source——

Chairman Proxmire. Will you take those out of the cellophane and hold them up so we can see them, see what they are?

Navy 24–A Altimeter

Mr. Frank. This is an altimeter, the basic altimeter that is used by the Navy aircraft today. It is called the 24–A altimeter. This tells the pilot his altitude.

Chairman Proxmire. Simply the altitude?

Air Force 27–A Altimeter

Mr. Frank. Just the altitude. This is called the 27–A which is the basic altimeter for the U.S. Air Force at the present time and this also tells altitude.

The basic difference between the two, Senator, is this goes to 38,000 feet and this instrument goes to 50,000 feet. Other than that, the two specifications, as far as anybody wants to say, are identical in performance requirements, et cetera.

Altimeter Price Comparison

Under the bidding of sole source, the last bid that was let by the Navy for this item was approximately $1,700 apiece for this item. Under the Air Force procurement which was an open bid, where there were six bidders, the price went for $565 each. Now, when you multiply that times whatever you wish to multiply it by, you come up with one hell of a lot of money.

Chairman PROXMIRE. So that under sole source it was $1,700. For precisely the same product with competition it was $565.

Mr. FRANK. $565; that is correct.

Chairman PROXMIRE. One-third.

Mr. FRANK. That is right, with six bidders bidding on the item.

COST OF SIMILAR COMMERCIAL ALTIMETER

Chairman PROXMIRE. Can you tell us how much a similar commercial altimeter would cost?

Mr. FRANK. Anywhere from $70 to $300.

JUSTIFICATION FOR DIFFERENCE

Chairman PROXMIRE. What is the reason for this? Is there anything that would possibly justify this enormous difference?

Mr. FRANK. The Government can justify—you have to understand, I am cutting my own throat but that is my way of life. The Government can justify any sort of requirement they want.

TYPES OF SPECIFICATIONS

I would like to explain, if I can, there are three types of specifications. There is the Army specification or the Air Force specification, the Navy specification and along with the others there is what you call a commercial specification, a specification written by the FAA, and I would like to read, if I may, for the record, the first page of the specification from the FAA.

FAA Specification

Now, this is a commercial requirement and I would like to explain to the hearing, if I can, that this is the altimeter that the FAA specifies is the minimum requirement that must be used and as far as the law is concerned, from a 747, which is a $25 million airplane carrying 350 people, the requirements do not have to be any greater than this piece of paper here which is the commercial requirement for altimeters.

Now, this altimeter specification is written, and I would like to quote. This is an FAA industry-cooperation in the development of performance standards and specifications which are adopted by the Administrator as a technical standard order. This means, Senator, that not only do the FAA and the industry and the airline pilots meet and decide what should be the requirements, but they get together and write a specification.

Military Specs

This is not so with the military. The military turn around and they write these specifications and I have some examples that you won't believe in front of me, and put requirements in that are just unbelievable.

ALTIMETER ACCURACIES

I would like to show you one requirement, but getting back to this item here, this is the requirement that the commercial items call for. The commercial item, for instance, says that the accuracies have to be

to a certain standard. The accuracies of these altimeters are approximately the same. There is not that much variation in accuracy. In fact, up until the time this was developed by the Navy they were selling another instrument whose accuracy was so poor—I hate to bring it up, because that is my problem—that theoretically midair collisions could occur because of the accuracy of this instrument but fortunately they did not.

Chairman PROXMIRE. That was a military altimeter?

Mr. FRANK. Which cost three to five times more than the commercial version, with approximately——

Chairman PROXMIRE. Which aircraft?

Mr. FRANK. All Navy aircraft. I mean, mostly the basic aircraft which was the MC–3 and MC–4 altimeter which is the Navy version. So when you say which aircraft, that would be the Navy's version of what they bought to tell altitude.

Now that you have got me on the subject, which is—if you would take the original MC–3, MC–4 specification, and I have it in front of me now, the tolerances added up would come to an error at 50,000 feet. There could be an error as much as 1,150 feet at 50,000 feet. Talking about 1,150——

Chairman PROXMIRE. That was a military procured altimeter which cost, say, $300?

Mr. FRANK. How much?

Chairman PROXMIRE. Did you say $300?

Mr. Frank. No, I said somewhere—that instrument cost somewhere between $700 and $1,000.

Chairman PROXMIRE. And this was subject to an error——

Mr. FRANK. At 35,000 feet you could have an error as high as 1,150 feet. The Air Force at the same time there——

Chairman PROXMIRE. What was the year this was being——

Mr. FRANK. 1962 on.

The Air Force——

Chairman PROXMIRE. Is it still being sold?

Mr. FRANK. It is not being sold, but it is still in Navy aircraft.

Chairman PROXMIRE. The Navy is still using it?

Mr. FRANK. Sure, absolutely.

Chairman PROXMIRE. Is that figure an error, for that enormously expensive altimeter?

Mr. FRANK. Right. Let me go back again. Don't misunderstand. The Navy can justify anything. The U.S. Air Force has the same instrument. When I say the same instrument, I am talking about the basic altimeter that sold for somewhere about $230 that only had an error of 205 feet total error instead of 1,150.

Chairman PROXMIRE. So it sold at about a third of the price and it has about 20 percent of the tolerance, 2 percent of the error.

That is a vastly superior instrument sold at lower price.

Mr. FRANK. The words "vastly superior" can be interpreted any way you want to interpret them. I do not want to get into parameters because basically as a pilot flying an airplane, the only thing I am interested in is how true my altitude is. The Navy can come along and make a statement saying we have little correction cards in front of the altimeter which tell when you are 35,000 feet, what you should really be—in other words, you should be flying at 34,000. Or when you are

at 41,000, you should be at 39,000, but basically speaking when you fly an airplane and are under severe conditions of instrument flying, you do not pay any attention to little cards.

Chairman PROXMIRE. Is there any other quality of an altimeter that is of any interest except for the accuracy of the altitude?

Is anything else of any importance?

Mr. FRANK. You could say this, that there are many versions of how you read an altimeter, Senator. In other words, the Air Force's version, and I have one here, is what they call a three pointer altimeter. This is not the newer version. This is the three pointer altimeter. This is the one that the Air Force——

Chairman PROXMIRE. Hold that up a little higher.

Mr. FRANK. This is the version that the Air Force and commercial aviation have been using since World War—even before World War II. This tells altitude in thousands, hundreds and 20-feet increments. And this is the instrument that sells to the services for somewhere around $200 apiece. It was sold to the service under competitive bidding for approximately $200 apiece. This instrument has an accuracy of approximately 200 feet of error at the same point that the Navy's MC–3 and MC–4 have an error of 1,150 feet.

NAVY JUSTIFICATION

Chairman PROXMIRE. I do not want to distract what you had in mind in presenting it but you said the Navy can justify anything.

They can justify this great discrepancy for an inferior altimeter. What is the justification?

Mr. FRANK. They just write a memo and there is no question about it. Who do you go to?

What do they say? You say they can justify it. They might say the fact that you can read this instrument faster than you can read this instrument is the reason that the cost of the instrument is so high, and I am only saying that. But there is no basic reason why the accuracy of this instrument should not be the same accuracy as this because this was developed after this. So the state-of-the-art as it stood proved that an instrument could be made, manufactured and mass produced commercially by their spec and militarily by the U.S. Air Force spec with an error of 205 feet. There was no question in anybody's minds about that. We have been doing this for the Air Force since 1960, or 1968. So the state-of-the-art was there. But unfortunately as far as the Navy is concerned—I am not picking specifically on the Navy, everybody has their faults, they did not feel this was necessary.

Now, why they did not feel that the taxpayer or the Navy pilot should get the same accuracy in his instrument as the Air Force should get in theirs I do not know, but the state-of-the-art was there to prove that such a tolerance could be met and was met in production and all they would have to have done was take this tolerance, put it into that instrument, and they would have had it.

True, it would have cost them another, I would say, comparatively, $300 to $400 with this system of picking out contractors but that is not here nor there. The state-of-the-art was such that there was no reason for this type of altimeter to be in existence at the time that specification was written, but as far as we are concerned, since we do

not do too much business with the Navy—we are not very well liked by the Navy because of our griping and always calling to their attention these mistakes—it does not do us very much good and this is one of the things we are saying.

So in actuality, this instrument—we are talking about the MC–3, MC–4—has a basic error, could have a basic error of as much as 1,150 feet with the basic error of this as the altitude, the basic error would be only 205 under the same conditions.

You take a pilot flying at 35,000 feet and you have got yourself some problems.

Chairman PROXMIRE. I see. Proceed.

REQUIREMENTS ON RATE OF CLIMB INDICATOR

Mr. FRANK. Now, to show you how ridiculous some of the requirements are, I have two pictures here I would like to show you. This is a requirement that has been in existence since I have been in business which is 30 years. This is called a test on what we call a rate of climb indicator and I do not want to get off the altimeters specifically, but I do want to show you how ridiculous tests are.

The tests call for the fact that you will take this instrument and you will run it at 55° below zero. And immediately at the temperature, after it has soaked there for 3 hours, you will immediately take the instrument out of the chamber at 55° below zero and start reading the instrument.

Well, Senator, I hold up a picture. I do not know whether you can see it, but it is for the file. This is the basic instrument as you can see it. In other words, it is a picture of the instrument at temperature. This is a picture of the instrument after it has been taken from the cold chamber. You cannot read it, there is so much frost on it. For 15 years I have been asking everybody in the U.S. Government why this requirement is in the specification and have never been able to get an answer.

This requirement has cost taxpayers $20 million cold hard cash and there is no reason for this to be in it. You can't read it. So you go up to the Government and say where is there a procedure where a pilot or an aircraft will go from 55° below zero, to room temperature in 10 seconds. There is no answer. They don't even bother with you. They say, look, you are getting paid for it, what do you care. And that is the standard typical answer.

I conservatively estimate as a manufacturer this requirement has been costing the taxpayers $20 million. Now, it is requirements like this that are costing the taxpayers their shirt. Commercially, there is no requirement.

The 747 doesn't have to do this. Nobody has to run this test. Only the military.

And so what you have to do, Senator, is you have got to design into the instrument that quality and it is very funny to read because as you read it, the specification says you read it, you stand there and you chip the ice away, you know, as you are reading the instrument. It is very funny because if you fly an airplane like I fly, you don't have time to chip ice away. You know, you have got 15,000 other things to do.

Now, the funny thing about it is, and I would like to repeat, and

I don't want to overemphasize, that we have on an average 25 other instruments in the panel. This is the only instrument that calls for this. All the other instruments——

Chairman PROXMIRE. The what?

Mr. FRANK. This is the only instrument that calls for this test. None of the other instruments call for the test. They are all going to fog up, ice up, but my problem is we say if you take this piece of equipment out or that test out you are going to save so much money. It falls on deaf ears.

REASON FOR REQUIREMENT

Senator PERCY. Could you expand on your thoughts why you believe this requirement exists. It is not just stupidity, is it?

Mr. FRANK. Uh-huh, Senator, if you can come up and have one person from the U.S. Government explain that test to you, then I will give—there is no explanation. What happened many years ago, and I am sure it did, and hear me out, they used to have open cockpit planes in World War I and I believe their specifications came from—you smile—I have been in this business all my life and this specification came from the fact there was an open cockpit and when the pilot came down from high to low altitudes, there was a possibility this would occur, but I am saying that these specifications stay in and as the next specification is written, they just leave what is in and add. They never take out, just keep on adding, and this specification appears on every single requirement of a rate of climb indicator that the U.S. Government buys since I have been in business and there are, I would say, conservatively 10 specifications that have been written.

It just stays in. It is just there. Who is going to take it out? Why should they take it out? What would happen if somebody yesterday, if they took it out. After all, they are going to retire in a few years. That is the other story I get. Talk to the other guy. I am retiring in 5 years. And basically speaking I honestly would say there is no reason in the world why such a requirement should be in but I can tell you that taxpayers of the United States are spending for this and thousands of other typical types—I have got an answer and it sounds crazy to you. I was going to end my speech with it but I do have an answer for it.

SOLUTIONS TO PROBLEM

If you would take some of these engineers that write these specifications and put these requirements in and give a percentage of the savings back to these people, you would have some multimillionaires as engineers working for the Government and you would——

Chairman PROXMIRE. Saving money?

Senator PERCY. Nevertheless, just the same kind of a suggestion is that a great many of our private companies have; that is correct?

Mr. FRANK. That is correct. Now——

Senator PERCY. There is a lethargy in changing things. As you say, don't rock the boat. But there is nothing else behind it other than an unwillingness to change. Is that right?

Mr. FRANK. Absolutely right.

Chairman PROXMIRE. Mr. Frank, I think you have made this point very well, dramatically.

You give us an indication of the extent to which this is not a completely typical and rare and unusual kind of requirement, that this—that you have run into this in other respects; or have you?

Mr. FRANK. Yes, continuously. You are talking about one instance. You can talk about any specification that you want in the U.S. Government.

Let me give you another instance, if I may.

Chairman PROXMIRE. Before you do that, let me ask if the enormous difference you gave us between commercial altimeter costs and the military costs and the Navy expenditures and the Army expenditures, is a result primarily of specifications of this kind——

Mr. FRANK. Absolutely. No question about it.

Chairman PROXMIRE. They are unnecessary, redundant, should have been disregarded long ago and have never been rationalized year to year, never been considered——

Mr. FRANK. Absolutely, no question about it. I am only talking from 30 years' experience.

Chairman PROXMIRE. Plus an absence of competitive bidding.

Mr. FRANK. That is the great one. I would prefer to bid $3,000 and make my 6 or 10 percent on $3,000 rather than bid on $700 for the same type of instrument. No question about it. That would be the typical thing. You of course, you have brought this up, Senators, and it is very interesting to know there are basically—I say basically—with all the slowing words they speak, they are trying to drive small business out of this field. The reason for trying to drive small business out of this field is they can then just justify the cost of what they are paying.

SMALL BUSINESS BIDS VERSUS LARGE BUSINESS

I have with me, coming back once again, some papers—let me get it because I don't want to get myself all confused—I have brought with me some bids that the Government bid on and this is what we would call bidding on no sole source, Senator. We are just talking about basic bids that the U.S. Government bids. I have with me a series of them. I have the actual physical bid, but let me explain, if I can, something.

AIR SPEED INDICATOR BID

We are talking about three companies bidding on an instrument for the U.S. Navy. Two small, one large. One company bid $37, one company bid $39.

Chairman PROXMIRE. Bidding on what?

Mr. FRANK. On an airspeed indicator, Senator, an instrument for the U.S. Navy.

Chairman PROXMIRE. Airspeed indicator?

Mr. FRANK. One company, small business bid $37. The second small company bid $39, the large company bid $109.

Bid No. 2. Three small—three companies bidding, two small, one large. One company bid $54, one company bid $55. The large company, $109.47.

Another bid on instruments, two small companies, one large company; $52 on one, $67 on the second small business, the large bids, $187.40.

Chairman PROXMIRE. Can you tell us the names of those companies?

Mr. FRANK. Well, the names of the companies—we were one. The Karnish Instrument Co. in Pennsylvania was the second and Kollsman, which is the large corporation, is No. 3.

We have another bid of four companies, $48 on one, $43 on the other, $49 on the third, the large company, $213.

So you can see that as far as the Government is concerned, they cannot really justify giving this company the business. The only thing they can do is if they can sort of eliminate these little men, then you can justify the $213.

SOLE SOURCE PROCUREMENT

Now, in all the bidding that I have done in my industry, I have never ever lost a bid to a large company in competitive bidding. Yet these large companies exist. I am not critical of them. I do not wish to be critical of the large companies. They exist due to the fact that they can get these sole sources requirements and basically bring the price up. I am not arguing that.

Chairman PROXMIRE. You are not making this presentation to say in these cases that you told us about that the big company with the higher bid got the business?

Mr. FRANK. No. Oh, no. No, no. I am only saying that the big company cannot compete for the taxpayer's dollar.

Chairman PROXMIRE. Whenever there is competition they lose it?

Mr. FRANK. Right, and so in order to keep them in business——

Chairman PROXMIRE. They need a sole source?

Mr. FRANK. They need a sole source type of procurement and the only way they get that is by going to some of the agencies and getting these sole sources.

Now, some of the agencies will come up here and tell you that we go out, we try to get companies to bid, we do everything we can to get them to bid. That is a lot of hogwash. And I have some more proof here that will verify this if you are interested. I don't know how much time you have but I am trying my best to do what I can.

Chairman PROXMIRE. Well, I will try not to interrupt you.

Both Senator Percy and I are very interested in this presentation but we would like you to wind it up and we will get into questions as soon as you finish.

ALTITUDE INCODING DEVICE

Mr. FRANK. The U.S. Government recently has had a sole—I don't mean the U.S. Government, I mean the U.S. Navy—has had a sole source requirement with Kollsman to build what they call an altitude incoding device. This, Senator, is a copy, not of theirs, of a standard altimeter that reports altitude to the ground at the same time. This is the new requirement of the FAA and the military. This view, as you have it here, is sold to the U.S. Navy. The last contract was around $9 million to a sole source which comes to approximately $3,000 a piece for this instrument. Commercially you can go out and buy it from a store for approximately $900, which means that if you sold it to a large producer, he would get approximately 50 percent off.

Senator PERCY. Mr. Frank, could you tell us why you feel the Navy wants to maintain sole source procurement when any sophisticated buyer would know he can do better in competitive bidding. What advantages are there to the Navy and why do they persist in a sole source such as this when it can be readily asserted they are paying high prices for the instrument and what stands behind it?

Mr. FRANK. I can't—Senator, I can't answer for the Navy. I know that for many, many years we have honestly attempted to do business with the Navy. I am talking about my corporation. And it seems that for some reason we can never seem to get an instrument passed by the Navy. I would like to repeat——

MILITARY ROTATION AND CIVILIAN ENTRENCHMENT

Senator PERCY. Now, can we define what you mean by the Navy. You have uniformed personnel and you have civilian personnel. The uniformed personnel rotate on a regular basis so that year in and year out you are not dealing with the same people. They are moved about on an average of every 15 months which is ludicrous in itself. So they are rotating. When you are talking about the Navy, are you talking about civilian personnel that stay here in bureaucracies and see politicians and administrations come and go while they persist? Is it a community with the same personnel persisting year after year? Is that what you are talking about when you say the Navy?

Mr. FRANK. Yes, Senator. I have been attempting to do business with the Navy for 20 years. The same exact people that were there 20 years ago are still there today.

Senator PERCY. And would you say then that they are entrenched? While in the Navy I tried to fire a civilian who I considered grossly incompetent here. He said I will stay here as long or longer than you, and I shook his hand and congratulated him when I left the Navy. It is true, he survived me and he was able to thwart my best efforts to introduce changed procedures and efficiency. I don't want to disparage the bureaucracies because without that stability you wouldn't be able to carry out your programs. Is it your feeling that you are really talking about the civilian entrenched bureaucracy when you say the Navy?

Mr. FRANK. Yes, sir.

Senator PERCY. Possibly the uniformed officials either aren't there long enough to find out what is happening or they can't really impose a philosophy which many, many of them want—that of competitive bidding.

Mr. FRANK. I agree with you 5 million percent but you have to understand one thing, Senator, that these people who are the Navy personnel who you say are only there for 15 months, when a man who has been there for 20 years writes a memo to a fellow who has been there 5 months and says that is the way it goes, all the man does is mimic or parrot what the man says.

I want to give you one more case and then you——

Chairman PROXMIRE. Let's do that.

AEROSONIC'S DEFAULT CASE

Mr. FRANK. We are talking about a specific procurement where we were involved in bidding on a tester program in testing for the U.S.

Navy. The program came about due to the fact we bid on a program, we were the low bidder but the Navy did not want us to get it. When I say the Navy I am not talking about military personnel. I am talking about the same group of people. They vehemently protested that we couldn't make the item, didn't have any right to be in the business, and over the protest we got the bid.

The delivery called for was 120 days after the bid was made.

To make a long story short, and I make no bones about it, we were unable to complete the specific item as the bid was. We were unable to make the item in 120 days and the Navy came along, which we knew they were going to do anyway, and said, see, we told you this company couldn't make it.

Now, we are going to go out and get another company that we know can make that item in 120 days.

The cost of the item that we bid was $300,000. The next closest bidder to us was $650,000, which was $350,000 more, and naturally we were, if you will pardon the expression, assessed with the costs. But as you probably know, justice does rule out in many instances and we fought the case all the way up to the ASBCA.

Basically speaking——

Chairman PROXMIRE. What case? You didn't say what this case was.

Mr. FRANK. This default case about the $300,000 assessment.

Chairman PROXMIRE. They placed you in default?

Mr. FRANK. They placed us in default. We didn't argue that. It was legal. We didn't meet the requirement of 120 days. But the contracting officer, and I think it is in my testimony someplace, the contracting officer specified clearly, and I would like to quote this because it is very important—this is the contracting officer of the U.S. Navy: "Well, I think the 120-day requirement as we have said before was considerable and it was considerable principally because the industry from which we contemplated receiving bids, the fact that this industry did and had made testers of either equal, slightly less, or comparative complexity, they"—talking about the contractors—"had experiences as we pointed in the case and certainly Bendix, Garrett, and IDC had reasonable assurances that in themselves they could meet the same requirement within 120 days." So the contract was given to what we consider a preferred contractor with the U.S. Navy. I enjoy this part of the testimony, believe me. Four years later——

Chairman PROXMIRE. Name that contractor.

INTERCONTINENTAL DYNAMICS CORP. CONTRACT AND LATE DELIVERY

Mr. FRANK. IDC. Intercontinental Dynamics Corp. They were given a delivery of 120 days after. Four years later they had still not delivered an acceptable piece of equipment to the U.S. Navy.

I am not talking about 120 days. I am talking about 4 years later, and do you know that from a Mr. Frank Sanders—he wrote me a letter justifying those 4 years. The letter is here. However, as I have said before, and I quote, I would like to quote this now. The Navy said: "The Armed Services Board of Contract Appeals is the authorized representative of the Secretary in this hearing." They are going back and telling me because they couldn't talk to me. They denied me even the fact that I wanted to see them.

Aerosonic's Exoneration

Listen to what the final decision was from the Board of Contract Appeals. "Undoubtedly the close previous relationship between the Navy and IDC in a noncompetitive atmosphere and an eye to acquisition of knowledge and experience for use by IDC on future Government and commercial contracts go far to explain the unusual situations and lack of formality which characterizes the performance of the IDC contracts," and we were exonerated.

But the Navy legitimately wrote us a letter and explained away 4 years on why that contractor was unable to submit this item.

Chairman Proxmire. I would like a copy of that letter for the record.

Mr. Frank. All right. After submittal failed——

Chairman Proxmire. Who wrote that letter?

Mr. Frank. The Assistant Secretary of the Navy.

Chairman Proxmire. Who is it? What is his name?

Mr. Frank. A fellow by the name of Frank Sanders.

Chairman Proxmire. Frank Sanders? Thank you.

Mr. Frank. I would like to end my discussion if I possibly can and stand under whatever questions you want by saying that I sincerely appreciate the opportunity to come before you and explain the problems that we do have and the fact that I feel that I am not against a defense posture. I am a contractor that does. I just believe that there are hundreds and hundreds of millions of dollars that are being squandered and wasted because of the fact that these people that you do business with will not listen. They don't have to listen to you. They know they don't have to listen to you. And they are not responsible to anybody.

Chairman Proxmire. Mr. Frank, Senator Percy will be right back. He had to step out for a few minutes.

Aerosonic's Qualifications

First I would like you to elaborate on your qualifications as an expert in the field of precision aircraft instruments and as a defense contractor. I want to know about your training, your background and experience in your field. You have indicated how long you have been a Government contractor and also what you do—you have indicated what agencies you have done business with, but I would like to know a little bit more about how you are qualified to make these criticisms.

Mr. Frank. I attended three schools, California Institute of Technology, Pennsylvania University, and the University of Cincinnati and at the University of Cincinnati I majored in metallurgy.

I worked for Pioneer Central Corp. which is a manufacturer of aircraft just at the beginning of World War II. I flew for the coastal defense during this time looking for submarines, out in the Atlantic Ocean, in single engine aircrafts. I then went to work for the Lackner Co. who manufacture and design aircraft instruments. For the Lackner Co. I received a job as a research and developing engineer with the Sperry Gyroscope Co. in their research and development section in Great Neck, Long Island. I worked there and in 1951 I returned to the Lackner Co. as an executive and chief engineer where I designed and

developed approximately five or six different types of aircraft instruments for use in the military services.

In 1953 I left the Lackner Corp. and started my own business and I have designed and developed personally, approximately 25 different instruments for the U.S. Government and the commercial aviation market, including all the instruments that you are talking about of various types.

I specifically consider my corporation one of the very few left of the small businesses. I have had trouble with the Government due to the fact that I don't agree with them sometimes and will take them to task which doesn't make me a real popular person with them, but due to the fact that we have a good price and our product is widely accepted, widely used, we consider ourselves to be manufacturers.

Percentage of Commercial Business

Chairman Proxmire. What percentage of your business is commercial?

Mr. Frank. Approximately 30 percent is commercial and 70 military. I might add that——

Chairman Proxmire. You manufacture the same kind of instruments for commercial as you do military?

Mr. Frank. The commercial specifications, that is correct. We sell to such companies as Cessna, Beech, Lockheed—don't smile when I say Lockheed. We sell them commercial instruments, Senator. North American. We sell to companies such as Lufthansa, Swissair, the airlines. We sell to Boeing Air for 727-type aircraft.

Lack of Contract Award Complaint

Chairman Proxmire. Let me interrupt to ask, I want to clarify another point. Are you here to complain about any particular specific decision related to a contract award you did not receive? Is it your objective to come before us to have a contract decision reversed in your favor or obtain any kind of monetary benefits from the Government or Department of Defense?

Mr. Frank. No; I think what you are talking about, as a contractor we have under protest but to be truthful with you, I didn't even mention it at this hearing.

Risks of Testifying

Chairman Proxmire. Do you recognize any risk to your business in testifying in public under these circumstances when one of your big customers is the Defense Department and a great potental customer is the Navy?

Mr. Frank. Well, we don't do business with the Navy. We have learned our lesson with the Navy. They just put you out of business when you start.

Possible Reprisals

Chairman Proxmire. Yes, I know, but after all, the Navy has its sister and brother, the Army and the Air Force. You say you do business with them. Are you afraid of reprisals by the Pentagon?

Mr. FRANK. Yes; in a certain sense, but, Senator, there comes a time in everybody's life and for 15 years I have been fighting and that is why I think it made my, actually, pardon the expression, my life a fact that I could come and testify. I really don't, if you will pardon the expression, I hate to use this type of language, I really don't give a damn what the Government does anymore because somebody has got to put a stop to what is going on. If they want to put me out of business they can. I have a nice golf course that I own, so I can go and play golf the rest of my life. I am not worried about that. But I think the problem is these people are just so intent they don't realize they are putting 300 or 400 families out of business. They are interested in getting one guy, Herb Frank. They don't have to go to the task of explaining why these things are in. I don't worry about it. My whole life has been a series of ups and downs and if the Government decided it want to do so, they can do it.

NATURE OF BUSINESS AND VALUE OF DEFENSE SALES

Chairman PROXMIRE. Tell me more about the nature of your business, how you started it.

Mr. FRANK. We have approximately 250 people. We do approximately $3 million a year.

Chairman PROXMIRE. What do you estimate your annual sales to the Defense Department during each of the past 2 years were?

Mr. FRANK. Somewhere around $2 million.

Chairman PROXMIRE. Has there been any drastic change up or down in your sales volume in the last 2 or 3 years?

Mr. FRANK. No. As long as we keep on being able to competitively bid—hear me out—as long as we can competitively bid we have no trouble staying in business.

Chairman PROXMIRE. You say in your statement your firm has provided the Army and Air Force with about 90 percent of their airspeed indicators and 50 to 70 percent of their rate-of-climb indicators since 1956; is that correct?

Mr. FRANK. That is correct. Altimeters, airspeed indicators.

Chairman PROXMIRE. That is quite a job for a small business.

Mr. FRANK. And when it comes to the Navy, zero, just about.

Chairman PROXMIRE. What aircraft programs have these instruments gone into?

Mr. FRANK. Just about every one—sorry. When the Army and the Air Force buy, they buy for a whole program, so I would say that from the B–52 down to the helicopter, you will find an Aerosonic instrument somewhere on it, either a rate-of-climb or altimeters.

Chairman PROXMIRE. Are there any other instruments you have sold to the services?

Mr. FRANK. Basically no. Unless you want to take clocks and cabin pressure indicators. This is our basic item.

I would like to explain that we make what we call diaphragm instruments. We don't make gyros, don't make too much electronic instruments. We have been supplying most of these needs to the services.

Chairman PROXMIRE. Now, are most of your contracts procured through competitive bidding or sole source?

Mr. FRANK. No; 93 percent of ours is strictly competitive bidding.

Chairman PROXMIRE. And yet you have gotten this large proportion of the market as far as Army and Air Force?

Mr. FRANK. That is correct. That is why we went into business to start with. There was only one source of supply of altimeters in the United States.

Chairman PROXMIRE. What are some of the other firms you compete with?

AEROSONIC COMPETITION WITH OTHER FIRMS

Mr. FRANK. We compete with the Kollsman Corp., we compete with the Bendix Aviation and a little bit with Lear Siegler, a division called Aztec.

Chairman PROXMIRE. How do you account to, that you as a small company can compete with the big firms that have so much more in the way of capital and can hire people of enormous ability, and so on?

Mr. FRANK. Well, I think we have two things going for us. No. 1, we do not have a tremendous overhead that these firms have. We do not have engineers at each base, you know, waiting to service the people that are on the base. And No. 2, we have a philosophy of designing instruments that are simple, more simple than the more expensive and, shall we say, sophisticated instruments that do the same thing, and this is the reason we are in business today.

In one instance, I can tell you we bid on an airspeed indicator—I have the quotations in front of me—we bid $500. The closest competitor to us is a thousand dollars, but the competitor uses three diaphragms. We are able to complete identical functions with two. So basically speaking we simplify and by simplifying you are able to bring your costs down.

We also have a machine shop. We also manufacture all of our own parts within our own facilities, where some of these contractors go out and buy a tremendous amount of parts and must pay the other contractor their percentage, whereas in our plant we manufacture most of the items, probably 90 percent in our plant, and believe it or not, but we believe in modernization, because 50 percent of our machine shops are automated.

REASONABLENESS OF MILITARY REQUIREMENTS

Chairman PROXMIRE. You have a dramatic example. Earlier you pointed out the particular kind of requirements where you had an instrument that was 55° below zero and within 10 seconds came up to room temperature and frosted, and you said this was unrealistic. This was dramatic and impressive. But do you believe you are qualified to judge what are unrealistic or unreasonable military requirements? Isn't this something only the military experts are competent to do?

Of course, there are occasional examples of the kind you gave just on a commonsense basis that are most impressive, but in general, how can you maintain that you are an expert as compared with the Navy knowing their own particular requirements? These are military men who have military experience, understand the military situation as it changes in an enormously rapidly changing technological context.

Mr. FRANK. Senator, I consider myself as good an expert as anybody in the United States on aircraft instruments, in my field. When you say Navy weapons systems, you are talking about something else. We are talking about a basic instrument that flies an airplane and basically speaking, as far as we are concerned, those basic instruments may change a little in sophistication but they still tell the pilot his airspeed, his altitude, and what have you.

When you go up to the U.S. Navy or the U.S. Air Force and ask them why these requirements are in there and they can't give you a logical answer, basically speaking it is about time somebody went to somebody and asked.

Chairman PROXMIRE. Fine. Can you give us other examples besides that one which was most impressive?

Mr. FRANK. Let's go back to the altimeter again. At the present time there is a requirement for running each altimeter under a military requirement at 35° below zero and you run the instrument all the way up the scale and all the way down.

We have argued with the point that this is an unnecessary requirement which costs the taxpayers hundreds of thousands of dollars a year. We want somebody to show us why the instrument has to run 100 percent at 35° below zero. The Government comes along and gives you what you would term a runaround as a reason.

Now, the instrument is up in Alaska some place and we have to have it here and we have to have it there.

Chairman PROXMIRE. I have flown a little bit, not nearly as much as you have, but I have flown commercially some. When you get up in one of these new jets at a very, very high altitude, the pilot will often announce that it is 50° below zero outside.

Mr. FRANK. Outside.

Chairman PROXMIRE. And that temperature apparently does exist when you fly.

Now, do you argue that the altimeter is inside and therefore the outside condition is irrelevant?

Mr. FRANK. Right. I will finish what I said but I don't want—you are right. You really don't think the pilot inside is at 50° below zero, do you?

Chairman PROXMIRE. Of course not.

Mr. FRANK. All right. So if this was such a great requirement in the aircraft, and it must be done, then why aren't all the other instruments on that panel tested at 35° below zero? The man has an airspeed indicator in his plane that isn't tested, has a clock, a gyro. Why aren't these instruments tested at 35° below zero individually? You can look and say they justify as far as we are concerned—they are justified with a piece of paper. But there is no justification.

I go one step further. The jets will fly at 35°, 50°, 60° below zero. There is no requirement by the FAA for such a test individually at 35° below zero. You could take a test alone—I am just talking about that test—and do one of the two things to it.

LIMITING TEST REQUIREMENTS

Limit test points instead of having 100 test points. Limit it to 20 instead of 100 test points, and save 5 to 10 percent of the cost of the

instrument, or eliminate most of the tests and maybe save 20 percent on the cost to the taxpayers. That is what I am getting at.

But you can't go anywhere. The test is there. They say stop rocking the boat. You are getting paid for it.

Padding of Cost of Military Instruments

Chairman Proxmire. You touched briefly on the difference, at the beginning of your testimony, in the commercial and military costs in prices for the same instruments. Could you elaborate on this and tell us why you think the cost of military instruments is padded, if it is, in general?

Mr. Frank. All right.

Chairman Proxmire. That is a dramatic example in this one case.

Mr. Frank. All right. Here is another one. Here is a commercial altimeter that meets the commercial requirements of the SOC 10B. The accuracies at room temperature are the same as the military instruments. The U.S. Government uses this instrument in some airplanes. I don't think they know it.

Chairman Proxmire. That is the commercial instrument?

Mr. Frank. The commercial instrument. This instrument sells to the manufacturers—Cessna, Beech, whatever you want—in the same range as the military for approximately $75.

Chairman Proxmire. $75 for the commercial.

Mr. Frank. Right. $185 to $190 for the military.

Chairman Proxmire. The same instrument really.

Mr. Frank. Basically, except for one thing. The military requires all this additional testing which costs the contractor and the taxpayers money because if you only have to read 50 test points on this instrument and you lose one, you have lost. When you have to read 300 test points on this instrument, and you lose one, you have got to assume that you have to take all these losses into the consideration of manufacture.

Chairman Proxmire. In your judgment, would that account for the difference?

Mr. Frank. This would account for 90 percent of the difference.

Chairman Proxmire. Now, in your judgment, are those tests necessary?

Mr. Frank. No. If they are necessary, they are not necessary to the degree that they make them necessary.

Padding of Sole Source Prices

Chairman Proxmire. Now, what about sole source prices? How are they padded? Give us an example.

Mr. Frank. I don't know. There are five contractors that bid on the 27A which is this item here. The bids range—we were the low bidder, I am very happy to say, but they range from $565, for one $642 from another source, $750 from another source, $895 from another source, and the sole source that supplies this for $1,700, sole source, on the competitive bidding only bid $1,400 on a competitive bid.

Now, I don't know why. It doesn't make any difference to me why. I am saying that if you open this up—now, recently, and I don't want to bring this up too much, the Government did open this up to partial—

this instrument here that was sole source, they did open it up to competitive bidding and they did get some other companies to bid on this item, Senator, and the last bid that was announced, the last bid somewhere $1,000 on competitive bidding, and the sole source for this same item was $1,700.

So at least you can give the Navy a hand for the fact that at least they recognized that competitive bidding is going to knock $700 off each instrument, and there was an award of approximately 3,000 units, so you can add that up and tell me how much that came to.

Chairman PROXMIRE. The competitive bidding is in general a rarity in military procurement.

Mr. FRANK. No.

PERCENT OF COMPETITIVE VERSUS NEGOTIATED BIDDING

Chairman PROXMIRE. Congress has provided that it be the principal method of procurement but the most recent statistics indicate that only 11 percent is competitive bidding and 89 percent negotiated.

You have this enormous discrepancy where you have competitive bidding as compared to sole source bidding. You are testifying there from your experience.

Mr. FRANK. That is correct.

RELUCTANCE OF AIRFORCE PERSONNEL TO FLY

Chairman PROXMIRE. I understand that the project engineer for the Air Force in charge of the procurement of aircraft altimeters refuses or is reluctant to fly in aircraft himself. Do you know whether this is true?

Mr. FRANK. Yes, that is.

Chairman PROXMIRE. And do you know what the individual's official capacity is and the reason he gives for not wanting to fly? He knows too much about how dangerous it is?

Mr. FRANK. Yes. I brought this up. There are a couple of instances. We had a project engineer who was in charge of our total altimeter program called the Ames program and he was the engineer in charge of seeing that these altimeters meet all the requirements and all the specs and all the parameters, and yet he was afraid to fly.

We used to pick him up at the train station when he came in from Dayton, Ohio. We used to put him back on the train when he went back to Dayton, Ohio. I know this sounds odd and funny—a man like this charged with the safety of people in the air. I am sure his capabilities are there but I was going to mention it, but I just don't like to specifically embarrass him, but this man—the only time he has flown, out of approximately 10 visits to us, I have only picked him up at the airport once.

The other times I have put him on the train. While other people are flying in, they have to wait for him at the train station.

Chairman PROXMIRE. You stated that the unreasonable specifications placed on altimeters has cost the taxpayers about $20 million. On what do you base that estimate?

Mr. FRANK. All you have to do is just take the average cost of a commercial altimeter, take the average cost of a military altimeter, and

even just take some of the requirements off of the basic altimeter, and as a manufacturer, I can truthfully tell you that we, as a manufacturer, could reduce our prices anywhere from 10 to 25 percent on an item because the basic guts of this instrument are the same as the basic guts of this instrument.

It is like a wristwatch. It tells the time. And if you have a wristwatch on and you go to Bulova Watch and tell them you want that wristwatch and it costs $89 and it tells time and you are happy with it, if you go back to them and tell them you want it run in cold, hot, thrown against the wall, he will give you a time cost.

Cost of Unreasonable Military Requirements

Chairman Proxmire. Do you have an estimate on any other kind of instruments at all, as to how much the unreasonable specifications might cost?

Mr. Frank. I am only saying this, that if these requirements are put on us, as a manufacturer of one little tiny section of the armed services, you have got to multiply this by the rest of the armed services procurement, and you would come up with hundreds of millions of dollars.

Chairman Proxmire. You testified it is primarily the Navy, or all three services——

Mr. Frank. No.

Chairman Proxmire (continuing). Which have unreasonable specifications?

Mr. Frank. No. I think as far as I am concerned, I think all three have them. I have reiterated that I think the Army does the best job in trying to come together with the contractor on solving some of these problems.

I think the Navy is the one that just won't listen, and the Air Force is fairly close behind. They don't have to listen, and this is the problem that the manufacturer has. And as far as I am concerned, this is what I am coming to you for. What can the manufacturer—what can the taxpayer do about these things to save the Government money?

I am not arguing the fact that the military status must stay as it is, but there is no reason why an aircraft costing a million dollars can't be made to cost $750,000-odd and give the same characteristics.

Contract Default

Chairman Proxmire. Let me ask you something about contract default. You mentioned contract defaults in the course of your testimony. Explain to us what a contract default is and whether you know of specific contracts that have been terminated because of default on the part of the contractor. How is this used?

Mr. Frank. Well, I can only go by my experience and my corporation's experience. We had been supplying instruments to the agencies.

We submitted an instrument to the U.S. Navy for qualification for a specific contract. We bid $89,000. I would like to get the price in, if I can, on the item. And the Navy gave us the contract.

A little while later they wrote us a nice piece of paper saying the instruments that they had run had failed to pass the test. We submitted them again, and once again the Navy wrote us back a letter saying they

had failed to pass the test. We are defaulting you and you are going to be charged to pay the difference to another contractor.

Our price was $89,000. The next contractor—once again we won't mention names—was $205,000. We were defaulted, and when you are under default you know, of course, Senator, you can't bid on any more contracts.

Chairman PROXMIRE. You have to pay the difference between the $89,000 and the $205,000 so the Government is not out.

Mr. FRANK. That is correct. Meanwhile, as you know, you are not permitted to bid with that agency on any contracts because you are in default.

About a year and a half later we get a very nice letter from the U.S. Navy saying, we are advising you we are no longer defaulting you and we are going to convert at the convenience of the contractor and you don't owe us any money. This simple letter comes through—and they don't even say, we are sorry— I don't mean to say that— it just says, After a year and a half we find that there is no termination for default, with no hearings.

I don't mean to say—no hearings, no nothing, just a letter from them saying you are no longer terminated for the convenience of the Government.

Chairman PROXMIRE. It sounds as if you are saying there is a difference in the way contractors are dealt with, whether they are big or small. We have had all kinds of inquiries into the big contractors. I never heard of them doing this with the big ones.

Mr. FRANK. I am sorry you don't have more time. I hate to embarrass them, but there are such things that go on with the services that are just unbelievable. Not only do they pick on the small businessman and make him eat crow every time, but at the same time the man is defaulted he eventually ends up not doing business.

For your information we have been defaulted by the Navy three times. In each case—the first case was on altimeters. We went before the ASBCA and we got a decision in our favor.

The second time was on the rate of climb indicator. They didn't even bother to go. They waited a year and a half, approximately, and then sent us a letter saying, We are terminating for the convenience of the Government.

The third time we were defaulted by the U.S. Navy was on the tester where, after 4 years, we finally got to be heard at the ASBCA and they ruled in our favor.

In all this time we——

Chairman PROXMIRE. You never were defaulted by other services?

Mr. FRANK. No. Just the Navy.

Chairman PROXMIRE. Do you know of any other?

Mr. FRANK. I know of none, Senator. But that doesn't mean there are not others.

Chairman PROXMIRE. Senator Percy.

KOLLSMAN INSTRUMENT CORP. AS NAVY SOLE SOURCE CONTRACTOR

Senator PERCY. In your statement, Mr. Frank, you referred to certain altimeters sold to the Air Force and Navy. From whom did the Navy purchase these altimeters from a sole source at $1,775 apiece?

Mr. FRANK. That bid went to the—let me get it right so I don't mess myself up. That bid went to the Kollsman Instrument Corp., and in the bid—I hate to show—in the bid the award was for 300 units at $532,500. The award was made the 16th of November 1971, and in parenthesis, no formal RFQ. That means they didn't even bother to go through a formality of having a negotiation on it.

This comes to approximately $17,000 per instrument.

Senator PERCY. Well, do the contractors who bid to supply the Air Force have the capability of supplying instruments to the Navy?

Mr. FRANK. Oh, I don't think there is any question in my mind that this is the case.

If I might, and I—I don't know whether you were here or not.

Senator PERCY. I heard your analysis of the differences between them, but it seemed to me, as a layman, that the capacity would be there for any contractor to supply the Navy instruments.

Mr. FRANK. I would like to tell you, for instance, that we are looking—here we go—at the 27A altimeter. The 27A altimeter is as complicated, if not more complicated, than the 24A. On the opening bid of this, the Bendix Corp. bid, Lear Siegler bid, the McLeod Corp. bid, the Aerosonic Corp. bid, Leigh Instruments bid, and Kollsman Corp. bid.

They all bid on this procurement for this item. Yet up through November of this year, whenever it was, there was only one source supplying the U.S. Navy with altimeters.

INTERSERVICE RIVALRY AND UNIFORM PROCUREMENT

Senator PERCY. We did talk about the difference in who the Navy is and who actually has the power and authority, and it is the civilian personnel may times. Is there an element here of interservice rivalry where the Navy just simply wants its own suppliers, and the Air Force wants its own supplier? This is something we thought we had legislated against in theory with a combined Department of Defense, but how persistent is this interservice rivalry where each of the services wants its own particular specifications, and it is just literally impossible to get uniform procurement?

Mr. FRANK. You hit the nail on the head. Unfortunately, you did. But once again these people can justify. At the present time, there is no reason in the world why there should be 16 or 15 outstanding specifications on altimeters in the United States for the military.

The U.S. Government recently got together, the Navy and the Air Force got together on a couple of procurements, but for your information, this instrument, which is a three-pointer altimeter, there are two specifications for this. A Navy specification and an Air Force specification. If you were to put the two specifications together, line for line and word for word, I don't think you would probably find performance-wise any variation whatsoever.

The 24A and the 27A are two requirements that are the same. In fact, I have understood from the Navy that they are now updating their 24A to 50,000 feet so it will be like the 27A.

ADVANTAGES OF QUANTITY BUYING

One of the arguments that we have argued all along is the fact that they ought to have one or two specifications and buy in a quantity

which, in turn, would reduce the overall price. The aircraft that these are flying in are basically the same, either jet fighters or jet trainers, and the performance of one and the other is really not that different as far as flight is concerned.

Maybe one climbs a little faster or one goes a little faster, but as far as instrumentation is concerned, there is no reason why there should be this tremendous amount of instrument specifications in existence at the present time. And I think I would agree with you. But each one wants their name on the specific item, and that is the answer.

Army Versus Navy Bidding

Senator Percy. To your knowledge, the suppliers of the Air Force altimeters were not asked to bid on Navy altimeters?

Mr. Frank. I can only express my personal, shall we say, experience where, at one time we went up to the U.S. Navy in Washington and asked why we were not permitted to bid on this specific item, and the man looked at me, straight in the face, and said, we didn't know you made altimeters.

Well, you turn around and say, but we do, and the man said, next time around we will let you know.

Now, the Navy——

Senator Percy. Has there been a next time around yet?

Mr. Frank. No. You see, there is a big difference, Senator, and I hate to keep on repeating myself, that the Army has a system that sort of tells the contractors who are involved what is going to be bought, when it is going to be bought, how many are going to be bought, and the specifications, so that if a man is interested, he has plenty of time to be able to manufacture that. He knows what the last bid price was. He knows everything about that product, if he wants to get into that business.

Lack of Navy Information to Prospective Bidders

The Navy uses the system, you come to us and if you are around and you happen to glean this information from us, we will tell you.

Now, I have been involved in trying to do business, but it is just physically impossible to do business with an agency because the information you get from them is wrong or they don't give you some of the right facts.

We recently tried to get in on a bid for the contract—a contract that was for $9 million that they awarded. We went to the Navy. I personally did. And we asked them about it and it was a very nice and legitimate answer. We are not going to be purchasing any more of these instruments. We are going to a new model which is this model over here, and here is the specification. This is what you ought to be making.

Four months or 6 months later, they came out and bought up $9 million worth of the old instrument.

Now, why would a manufacturer want to spend $100,000 developing an instrument when somebody just told me they aren't going to buy any more?

Navy Procurement Practices

Senator Percy. In your statement, you refer to a number of ways in which the Navy could, if it chose, keep specific companies out of

Navy procurement. You have given us the example of the IDC case which you described for us already. Could you give us additional specific examples of cases in which the Navy has used these methods for keeping specific companies out of procurement?

Mr. FRANK. Well, let's assume now, and I have to assume just from past experience, that a company would like very much to qualify for an instrument.

In other words, they request that the instrument be tested for inclusion in a listing that commits them.

I can truthfully state, without a question in my mind, that the Navy can control that testing as they see fit. The specification says that you must pass all the tests in order to be qualified. Fortunately for me, I have been able to get hold of some testing documents from the U.S. Navy which—it is not illegal. Supposedly it is partial public information. And it isn't a matter of whether anybody passes the test, or not. I have never seen a document where the contractor has completely passed all the tests. It is the degree that he passes the tests by.

I have seen documents, and I would like to send one to you—I didn't bring it with me—where the Navy has said that the instrument or the item that they are going to buy is acceptable to them, although—I am talking about the test was acceptable—although 20 percent of the test points were out of specification. That means one out of every five test points did not meet the requirement, but the Navy can come back and say, and they have done so, in their opinion there is nothing wrong with this specific item.

Nobody is going to stand there, Senator, and question them. On the other hand, if another contractor comes in and maybe they don't want to do business with him, for some reason, and I don't know some of these reasons, if he falls out on one test point, they will pick up the specification and say, you see this? It has to pass all the tests. Your instrument didn't. It faults here at one point, and here at one point, and thus we are rejecting it.

Now, when it goes to such a point where these people can determine who they want to do business with and who they don't want to do business with, then it is a matter of opinion of the engineers and the specifications of the testing program are null and void, and I have such documentation which shows that the Navy has accepted tests where a minimum of 20 percent of the test points were out of spec and they just made the conclusion—I am not arguing with them—that as far as they are concerned, this is acceptable to them in this specific manner.

If you brought in the same instrument under the same circumstance and for some reason they didn't like Senator Percy's corporation and you fell out at one test point, they could legitimately turn around and say, I am sorry, Senator, you did not pass the test points.

But you see, nobody can get these requirements, nobody can get these test reports. Only the Navy and the guy that is doing the contracting.

DIFFERENCE IN LOW BID VERSUS PREFERRED BID PRICE

Senator PERCY. In the specific cases that you gave to us in the case of the items described in your statement, the low contractor is less

than half what the preferred contractor bid for a difference of more than two to one. Is this kind of spread between competitive and noncompetitive situations and preferred and nonpreferred situations isolated?

Mr. FRANK. No.

Senator PERCY. Or is this a pattern that seems to be developing?

Mr. FRANK. I would say this: In all the experience I have had, you will normally find that the noncompetitive bidding runs anywhere from two to five times the cost of the open competitive bidding. I can make this statement without even a bother, that over the past—I don't care how far you go back, it really doesn't make any difference how far you go back, 3, 4, 5, 10, 15 years. You could take the cost of the Navy's altimeter against the cost of the Army and Air Force altimeter and I can give you my assurance that the cost would be at least three to five times the amount, the instrument bought by the Navy over the Air Force and Army for an altimeter.

TELEDYNE CORP. AS SOLE SOURCE SUPPLIER

Senator PERCY. I would like identification of the contractor. On the last page of your statement you refer to the Government under a sole source procurement purchasing a rate-of-climb indicator and paying approximately $300 apiece from this sole source basis, and then it dropped to $140 after competition came in.

Could you identify that company?

Mr. FRANK. Teledyne.

Senator PERCY. Pardon?

Mr. FRANK. Teledyne.

Senator PERCY. Their headquarters are where?

Mr. FRANK. Los Angeles, I believe.

EFFECT OF INTERSERVICE RIVALRY ON PROCUREMENT

Senator PERCY. Mr. Chairman, I had shades of recollection yesterday which went back 30 years. I am trying to recollect now my shock—it was so great I am sure my recollection is good—at the effect of interservice rivalries on procurement when I was a naval procurement officer here in 1943.

THE NORDEN BOMBSIGHT

We were procuring the Norden bombsight and I am sure the Navy officers in the room will recollect that that was developed over a period of many years by the Navy. The Navy had a great pride in it.

The Norden Co. was sewed up 100 percent turning out Norden bombsights like cookies.

The only difficulty is that the Navy was not doing a lot of high altitude bombing, in fact, not very much at all, and this is a high altitude bombsight. The Air Force was doing the high altitude bombing and needed them desperately, and yet the Norden bombsights kept coming out with the Navy maintaining them and keeping them in the ready and not really using them. When the Air Force tried to get them from the Navy, I can remember my commanding officer saying, "Over my dead body is the Air Force going to get those Norden bombsights after we developed them over a period of 20 years." Unused sights were

sitting in ships and aircraft carriers being maintained and kept in ready condition, and never used.

Chairman PROXMIRE. At that time the war was on, too.

Senator PERCY. We were in the middle of the war and the Air Force had to go in, and instead of procuring them from Norden, they had to set up, as I recall, the Burroughs Corp., and the Victor Adding Machine Co. The Norden Co. gave them all blueprints without some of the change orders in them and there were criminal prosecutions finally brought as a result of this.

So the case is reasonably well known and it became a terrible scandal and heads rolled as a result of that, but that was my first experience, in my first 90 days in the Navy, what happens in interservice rivalries.

NAVY TO BE ASKED TO RESPOND

Now, this kind of scandalous performance I had assumed was now gone as a result of the formation of the Department of Defense. And I have been in procurement. I can only assume what you are telling us is accurate and right. You have no motivation in telling us other than to try to serve the public interest, I presume, and your credentials as supported by Senator Chiles are certainly good on the record. I will be most anxious to have the Navy respond to this very specific testimony, and if your testimony is accurate, and I can only assume it is, otherwise you wouldn't be giving it, I would commend you for having the courage which many, many private contractors do not have. They won't take the time, they won't take the interest, and they haven't got the guts to take a chance that they are going to be put on some sort of a blacklist. I suppose you have given up trying to get business anyway.

You have got nothing maybe to lose, other than the fact that I suppose if someone wants to hit back at you, they can find a way.

I just appreciate very much your coming forward and giving this straightforward testimony, which brings back horrible remembrances in my mind of procurement practices that we simply must eliminate.

SENATOR DOUGLAS' BAGS

I must say in closing I can recall very vividly some of the bags that Senator Douglas carried around Illinois. He would pull out an item that could be purchased in a local hardware store for x dollars and then pull out the item that the military was purchasing, and they were paying three times as much with some silly specifications, but it was still a screwdriver in anybody's mind. The military could still have bought that screwdriver at a less cost. He got elected time after time after time.

Once he didn't, but he got elected time after time on the basis of pointing these things out.

Chairman PROXMIRE. He was finally beaten by a former Navy procurement officer.

Senator PERCY. I admired the tenacity with which he went after this issue. I should think it would be applauded. I assume the vast majority of the men in the military service are utterly loyal, tenacious, and they want to see that these practices are exposed. I assume that that is in the public interest and that of the military, to root

these practices out. But it is our job in this subcommittee, which I consider one of the most important subcommittees in the Senate, to bring these facts to light, and certainly you have helped us and rendered a service in being here.

Mr. FRANK. If you decide to rerun for election, I will be only too happy to lend you some valuable tips.

Chairman PROXMIRE. He flies high.

Mr. Frank, I can only add to what Senator Percy said. I want to say you are unique. We can't get other contractors to testify. You are the only one we could get that had the guts, the courage, the sense of public interest to come up here and appear in public.

We are deeply appreciative. Without your kind of appearance we could not get this story told. We have a few people—Ernie Fitzgerald up here now, Gordon Rule from the military who testified yesterday, who had the courage to speak up—but the contractors have been very, very silent, and to have this story told from the contractor's viewpoint is absolutely invaluable.

ALTIMETER PLATES

Let me ask you about the experience you had designing plates. I understand that you were once asked to design a plate for the installation of an altimeter in an aircraft. Why did this plate have to be designed after the altimeter was ready to be installed?

Mr. FRANK. A funny story. A pathetic story, but it is funny.

It just so happens I have the instrument. The U.S. Government—by the way, in conjunction, this was an all-service system.

The U.S. Government decided that they were going to replace this altimeter with what they call a Servo-driven altimeter which would report altitude and do a lot of sophisticated work, but they found out that they had to put it in a square instrument case instead of a round instrument case. You can see what I am getting at?

So they went to all the manufacturers, including McDonnell-Douglas, who make the F-4, and they told them from a point on, make a square hole in the instrument panel so that you would be able to take that specific instrument.

Lo and behold, the contractors—I am one of them, I do not argue—fell behind in their delivery requirements, and now McDonnell-Douglas came back and said, "What we are going to put in these square holes? We have no altimeters."

So the Government convinced me—I use the word "convinced" in as nice a way as I can—that I should give them free all 800 instruments to replace these ones that hadn't been delivered so that we could put the instruments in the aircraft and the airplane would fly, which we voluntarily did.

Well, McDonnell-Douglas then came back through our project engineer and said, "But we cannot put a round instrument in a square hole. We have to have a little plate made that would cover the hole up, so it would cover the square with a little hole in the middle."

So the Government came back to us through our project engineer and asked us if we would design this.

Well, Senator, we are talking about a little piece of sheet metal that is square, with a round hole in it. And we did it. And I am not

being sarcastic. We figured we were really going to take the Government this time. They needed them desperately. They just took us for 800 instruments at about $250,000 which we just gave, and we were really going to take them, so we came up with a price of $15 apiece to make them.

Well, time goes on and we got hold of the project engineer and we asked the project engineer what happened. After all, we are shipping you the instruments. Who was putting these things in the square holes?

And the project engineer told us, and I am sure we can get his testimony, that the contract was given to somebody else for $230 apiece to make this little piece of metal. And I said to him in a nice way, "With a nail file, a lady's nail file, I could make them cheaper than that."

But basically speaking, that is actually the facts that occurred. The little plates——

Chairman PROXMIRE. Can you give us the date of that and the——

Mr. FRANK. About 1966. The little plate cost more than the instrument.

Chairman PROXMIRE. What was the firm that got the order?

Mr. FRANK. McDonnell-Douglas.

Chairman PROXMIRE. They got the order at $230 apiece?

Mr. FRANK. $238 apiece.

Chairman PROXMIRE. And you said that you had bid $15 and you were ashamed to bid $15?

Mr. FRANK. Absolutely. It was just a $3 stamping plate, but we figured we were going to take the Government.

Chairman PROXMIRE. Can you give us one of the plates?

Mr. FRANK. I don't have one with me. I will be sure that you get one, but I did bring the instrument to show the square instrument going in, and this is the reason.

Chairman PROXMIRE. Mr. Frank, once again thank you. I would like you to submit copies of all your documentation for the record. We will put it in the record at this point.

(The following information was subsequently supplied for the record:)

AEROSONIC CORP.,
Clearwater, Fla., April 5, 1972.

JOINT ECONOMIC COMMITTEE,
Washington, D.C.

GENTLEMEN: I am enclosing the necessary documentation I presented at the hearing last Wednesday, March 29. I hope that this is of some assistance to you. If there is any additional documentation you would like to have, please do not hesitate to call on me.

I have categorized each subject and hope that it is self-explanatory.

Very truly yours,

HERBERT J. FRANK,
President.

Enclosures.

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TESTER PROGRAM

(1) Tester Program, with the following information: The letter from Frank Sanders, Assistant Secretary of the Navy; second, the final decision after 4½ years from ASBCA, with the last page bearing out my quotations in my presentation; third, and I think the most important is the test data showing the results of the tests over a period of four testing periods by their sole source contractor. I am sure you are aware of the fact that 120 days was the requirement, and as

you can see, even though there is one unsatisfactory report after another, they still claim there is nothing wrong with the equipment. I would like to point out two other things which I believe are very important to you and the Committee, which I discussed. When you see the word "satisfactory" on the test this means that the unit passed the requirement as per the specification. When you see the word "acceptable" this means that the instrument did not pass the test as per the requirement, but the Government engineers made a decision that in spite of what the specification said they were going to accept the unit. Further, which certainly would be of the most interest to you, is the fact that the specification of "all three units will be subjected to all the tests". As you will see from Test No. 1 through No. 4, never was this accomplished. In fact, the last test, as you can see, had only 8 tests that passed the full requirement of the specification, 6 that the Government engineers said were acceptable to them but did not pass the requirements of the test, and 10 tests that the unit failed. Yet the Government engineers came up with the conclusion that there was nothing wrong with this unit and production could start.

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DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., January 5, 1970.

Mr. HERBERT J. FRANK,
President, Aerosonic Corp.,
Post Office Box 4627, Clearwater, Fla.

DEAR MR. FRANK: This is in further reference to your letter of October 27, 1969, in connection with contract N383–91995A which was terminated for default.

In your letter you allege unfair treatment of your company because your contract was terminated due to your failure to deliver acceptable preproduction items within the 120 days required under the contract, while the successor contractor has been allowed an extension in time for the delivery of such items. You imply that the repurchase was directed to a "favorite contractor," and allege that the successor contractor cannot meet the specifications. You state that you have been unsuccessful in getting the Navy to attend the Armed Services Board of Contract Appeals (ASBCA) hearing in connection with your appeal of the assessment of the excess costs and that the Legal Department of the Navy in Washington has issued a written report to the effect that the Navy has no case against your firm and that it should be dropped. You request assistance in absolving your firm of liability for excess costs resulting from the repurchase of the equipment.

The record discloses that prior to the award of contract N383–91995A, your firm was queried as to your understanding of the contract requirements as well as to the possibility of error in your bid price. You confirmed your prices but the Contracting Officer, on the basis of a pre-award survey, was unable to make an affirmative determination that your firm could perform successfully if awarded a contract and accordingly rejected your bid for lack of capacity. Your firm then applied to the Small Business Administration for a Certificate of Competency which was granted despite the Contracting Officer's opposition. The preproduction samples submitted by your firm on December 16, 1965, were found to be deficient. It was the judgment of technical personnel at the Aviation Supply Office and the Naval Air Development Center that the poor workmanship demonstrated in these samples evidenced a serious lack of understanding as to the specification requirements. Based on this, it was their further judgment that your firm could not produce an article meeting the specifications. This lead to the termination of your contract.

The repurchase contract was not, as you imply, directed to a "favorite contractor." It was awarded to IDC on May 13, 1966, as a result of formal advertising. The contract with IDC contains specification requirements and terms and conditions identical to those contained in the contract with your firm, including the requirement for submission of preproduction samples. Although the initial samples did not fully meet the specifications, it was the judgment of ASO and NADC technical personnel that IDC could produce a complying article. They have reaffirmed this judgment on the basis of subsequent submissions. Delays in obtaining acceptable product have been aggravated by a shortage of personnel at the Navy testing activity and the priority of other test projects. IDC has now been directed to submit three preproduction samples by January 31, 1970.

The ASBCA in its decision of February 23, 1967 (ASBCA No. 11344), upheld the Navy's action in terminating your contract for default. In its decision the Board noted the Navy's fair treatment of your company ". . . We note that

respondent dealt fairly with appellant and warned it repeatedly of the difficulties it might encounter should it accept this contract . . ." and noted that your firm had indicated in its final brief that it was wholly unaware of the vast complexity of the instrument it had attempted to design and fabricate.

In connection with the pending ASBCA hearing on your appeal of the assessment of excess repurchase costs, it is our understanding that the hearing was deferred by mutual agreement.

No Navy review, by legal or other personnel, has concluded that reprocurement costs should not be charged to your company. The Armed Services Board of Contract Appeals is the authorized representative of the Secretary in hearing, considering and determining appeals by contractors from decisions of contracting officers on disputed questions. Since your appeal is pending before the Board and will be heard at an appropriate time, a meeting to discuss this matter now would not serve a useful purpose.

I trust the above will explain the Navy's position in this matter, and assure you of our continuing desire to be fair and objective in serving the best interests of the Government.

Sincerely yours,

FRANK SANDERS,
Assistant Secretary of the Navy,
(Installations and Logistics)

ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of Aerosonic Corp., under Contract No. N383-91995A.

ASBCA No. 11718

Appearances for the appellant: Norman P. Herr, Esq., Clearwater, Fla.

Appearances for the Government: Peter P. Russial, Jr., Esq., Counsel; Robert D. Barnes, Esq., Assistant Counsel; Navy Aviation Supply Office, Philadelpha, Pa.

OPINION BY MR. RUBERRY

BACKGROUND

This appeal is from an assessment of excess costs in the amount of $306,664.70. This Board previously upheld the Government's termination of the contract for default on the basis that appellant's default was not beyond its control or without its fault or negligence under the standard "Default" clause of the contract. *Aerosonic Corporation*, ASBCA No. 11344, 67-1 BCA par. 6178; *Motion for Reconsideration denied*, 67-1 par. 6272. At the request of both parties, the hearing of this appeal was deferred pending completion of deliveries and final payment under the repurchase contract. However, on 1 May 1970, the appelant filed a "Motion for Avoidance of Assessment and Interest" on the ground that the Government had not shown that any deliveries or payment had been made under the repurchase contract, and requested a hearing on said motion. A hearing was held in due course and both parties have submitted briefs in support of their respective positions. After the hearing the parties stipulated that no deliveries or payment had yet been made under the repurchase contract.

FINDINGS OF FACT

I—The terminated contract

Our earlier decision, cited above, contains detailed findings of fact concerning the procurement history of the contract item, the solicitation and award of the captioned contract, the attempted performance hereof by appellant, and the termination of the contract for default.

Briefly, on June 22, 1965, appellant, a small business firm, was awarded the contract requiring delivery of 113 vacuum pressure test sets manufactured in accordance with interim specification 63/150. The sets were for use in testing the accuracy of various instruments used by aircraft. That award was made on the basis of a certificate of competency, issued by the Small Business Administration, after the contracting officer had determined that appellant lacked sufficient experience and manufacturing know-how successfully to manufacture the test sets.[1] The Navy declined to meet with appellant to discuss appellant's technical

[1] The 113 Test Sets represented the non-set-aside portion of the procurement. The portion set aside for small business firms (112 Test Sets) was never awarded.

question but offered to answer questions by an exchange of letters. The contract required that, within 120 days after date of contract, three pre-production samples be submitted for testing and approval by the Government. After delays, partly attributable to damage in transit to the samples originally submitted in November 1965, the pre-production samples (a second set) were delivered to the Naval Air Development Center (NADC) on December 16, 1965. On December 23, 1965. NADC advised the procurement agency, the aviation supply office (ASO). that the three samples had been tested and were considered unsatisfactory and unacceptable. The test results were described as follows:

"3. Three samples subsequently submitted December 16, 1965. also unsatisfactory. Test set weight excessive. Workmanship poor, pressure hold feature not provided, leakage test capability not incorporated, design detail differences exist between units, adequacy of design for shock and vibration questionable.

"4. Performance checks indicate no samples meet altitude accuracy requirements. Airspeed outputs not available for one unit. oscillated excessively second unit, and inaccurate low airspeed at sea level with only partial output at altitudes for third unit. Static pressure test vacuum not available on unit.

"5. Major redesign considered necessary to meet specification physical requirements. Substantial development and evaluation effort by aerosonic necessary to meet specification requirements for accuracy and function. Test sets P/N 90000-0101 considered unsatisfactory for service use. Acceptance under contract not recommended."

On 29 December 1965, the contracting officer terminated the contract for default. We determined, in the above-cited decision, that: Appellant's preproduction samples did not meet the very difficult and sophisticated contract requirements; the Preproduction Sample clause of the contract did not require the Government to give appellant the opportunity to correct the discrepancies in the samples; and that appellant had not established that its failure to submit acceptable samples was due to causes beyond its control and without its fault or negligence.

The preproduction samples which were submitted and rejected employed a "dry" pump and control panel inclined at a 35–40 degree angle.

On 22 June 1966, the Government made demand upon the appellant for $302,230 as excess costs of repurchase, from which this appeal was taken. This amount was the difference between the awarded amount of the replacement contract ($745,700) and the defaulted contract ($443,470). The assessment was increased to $306,664.70 on 16 September 1966 to reflect a discount. (Rule 4–E.)

On 8 March 1967 appellant entered into a "Deferred Payment Agreement" with the Director of Contract Financing, Office of the Comptroller, Department of the Navy, which provided that the Government would take no action to enforce collection of excess costs pending resolution of this appeal, and that appellant agreed to pay 6% interest accruing from 22 June 1966 on the amount determined to be due.

II—The repurchase contract

On 13 May 1966, the repurchase contract (N484–00001B) for 113 Vacuum Pressure Test Sets at a unit price of $6,500 was awarded to Intercontinental Dynamics Corporation, Englewood, New Jersey. The parties have stipulated as follows:

"1. That repurchase contract N383–00001B with Intercontinental Dynamics Corporation, purporting to be a contract to procure the articles that were covered by defaulted contract N383–91995A with Appellant, was issued in such a time and manner as to satisfy the Government's duty of timely letting a reprocurement contract.

"2. That the solicitation which led to issuance of the repurchase contract was reasonable and of such a scope and manner as to satisfy the Government's duty with respect thereto.

"3. That the written provisions, including the specifications, in or otherwise made applicable to the repurchase contract upon its issuance were so similar in substance to those in or otherwise made applicable to the defaulted contract at time of the default that the differences shall be deemed to be of no consequence to any issue covered by the appeal."

In addition, at the hearing appellant stipulated that a change in the type of connector for the tester, effected by Modification No. 2 to the contract. dated 6 September 1966, was a minor change. (Tr. 337) That change was the only formal revision of the written specifications which were otherwise equally applicable

to both the defaulted and repurchase contracts. The specification (Rule 4, Tab B) provided, in part, as follows:

"3.3. Components—The test set shall consist of but not be limited to a combination or carrying case enclosing a control panel, a motor driven pressure-and-vacuum pump assembly, static and differential pressure control systems, functional displays, sinusoidal modulation, electrical parts, wiring, and accessories as required to satisfy the requirements of this specification.

* * * * * * *

"3.6 Design and Construction—The test set shall be designed for functional operation and used at both flight-line and field-shop levels. Primary function of the test set shall be to provide regulated pitot and static pressures for evaluating performance characteristics of aircraft pneumatic instruments, air data systems, and other auxiliary systems. . . .

* * * * * * *

"3.6.1 General Layout—The test set shall be a single, integral unit, self-contained within its case. The case shall serve to house and protect the complete test set . . . Detailed mechanical and electrical design of the test set shall be accomplished by the contractor in accordance with the requirements herein; these requirements being detailed only to the extent considered necessary to obtain the necessary mechanical and electrical characteristics, performance, and permanence in accuracy of operation . . . Provisions shall be made for operation with the control panel horizontal or vertical unless the control panel . . . is inclined at 45 degrees to allow for viewing either while on a standard bench or on the ground level. . . .

* * * * * * *

"3.8.2 Configuration—. . . The case shall be rectangular in shape with the control panel mounted horizontally, to be viewed from above, and rotated 90 degrees to be viewed from the front, or so inclined as to be viewed from the front of the case with the lid open. If inclined, the inclination shall not exceed 45 degrees from the horizontal."

The specifications also prescribed various performance requirements relating to the operation and capacity of the pump and other components and provided that such performance requirements had to be met when the test set was subjected to specified rigorous conditions of environmental pressure, temperature, sand and dust, humidity, explosion, shock, vibration, fungus, salt atmosphere, power variation, radio interference, and rain.

Intercontinental Dynamics Corporation (hereafter IDC), the repurchase contractor, had supplied the Government with its standard commercial test sets, used by airlines, before the Government developed the interim specification and had furnished the Government complete information as to the operation of its Test Sets during the time the specification was being developed. (Tr. 209) IDC had developed two test set models which it designated VPT–10 and ADG–20, respectively. Both models employed two "wet" pumps (i.e., they required lubrication by oil in operation) and a case with a "typewriter" or 45° angle configuration for the control panel. IDC had intended to follow the basic design of its ADG–20 model in the performance of the repurchase contract, with such modifications and improvements as the performance requirements of the specifications might dictate. (Tr. 213) However, at an informal meeting between IDC and NADC representatives on 4 June 1966, the Government representatives expressed a strong preference for the design approach of IDC's VPT–10 model. That preference was confirmed at the official post-award meeting between such representatives on 21 June 1966, and IDC agreed to follow the VPT–10 approach although it believed that either approach would permit compliance with the specifications. (*Ibid.*) At the earlier meeting, the NADC representatives stated that a "wet" pump which required two different oils (one oil for operation at high temperatures and one oil for operation at low temperatures) did not comply with the specifications. (Tr. 336) IDC took no definite position at that time as to whether it agreed with the Government's interpretation of the specifications, but indicated that it would endeavor to obtain a single oil which would be effective throughout the temperature range. (*Ibid.*) The subject of case or control panel configuration was not discussed at either meeting. At the 21 June meeting, IDC presented two test sets and manually demonstrated their operation and the changes planned therein to meet specification requirements. (Govt. Exh. I.)

The repurchase contract required IDC to submit three production samples within 120 days after the date of the contract, the same period required by appellant's

contract. Delivery of production items was required in increments during the period commencing 450 days after date of contract and ending 600 days after date of contract.

On 12 September 1966, three preproduction samples were submitted to NADC. The test sets were identified as IDC Part No. VPT–30–18100. The samples employed a "wet" pump and the control panel was at a 45 degree or "typewriter" angle. (Govt. Exh. N) IDC provided with the samples one oil for use when the test set was operated at ambient temperatures higher than —15° C and another oil for operation at lower temperatures. However, NADC representatives insisted that the specification permitted the use of only one oil, and, accordingly, the oil reservoirs of the test sets were filled with the "high" temperature oil for the testing. After general operational checks by NADC had revealed that scale errors exceeded specification tolerances at two points, IDC was permitted to replace the altitude and air speed pressure sensors of all the samples. Installation and recalibration of replacement sensors by IDC representatives at NADC were completed on 21 October 1966 and testing of the sets commenced. On 13 December 1966, a meeting was held between IDC and Government representatives. A handwritten preliminary report of discrepancies noted by NADC during the tests was discussed. (Govt. Exhs. L and M) That report noted various deficiencies, the majority of which were considered minor or easily correctable. (Tr. 222–225, 339–341) A problem of scale error in one of the three samples was alleviated after IDC was allowed to replace the altitude servo amplifier and correct a pinched hose condition in the sample. Although the altitude scale error results of all three samples exceeded specification tolerances at some elevations, such results were considered acceptable by NADC. (Govt. Exh. N; Tr. 385) However, major deficiencies were determined to exist with respect to slew rates (the rate at which the pump supplies air to either the vacuum or pressure side of the test set) and the failure of the pump motor to start when the set was placed in a temperature below —40° C. The slew rate deficiency was caused by the inadequate capacity of the pump. A larger pump was necessary to achieve the prescribed slew rates. (Tr. 345) The cause of the failure of the pump motor to start at low temperatures apparently was due to the "high" temperature oil used during the low temperature test. NADC made no attempt to ascertain whether the pump motor would start at such low temperatures if the low temperature oil also provided by IDC for the test were employed. (Tr. 347) The preliminary report also noted, as a general discrepancy, that there was no means of determining the type of oil installed in the pump.

At the 13 December 1966 meeting, IDC was advised that the preproduction samples were defective in seven described areas, the only major deficiencies being the slew rates and low temperature failure. (Govt. Exh. M) In discussing the latter, NADC reiterated its position that the specifications did not permit the use of two oils since it was impracticable and burdensome to require an operator of the test set to change the oil under the varying temperature conditions of indoor and outdoor use. IDC did not agree that two oils were prohibited by the specifications or that changing oil was unduly burdensome. (Tr. 228) However, at NADC's urging, IDC agreed to use a dry pump in the new preproduction samples (hereinafter second samples) which IDC and NADC had arranged for at the meeting. To dispel IDC's fear that a dry pump would fail the longevity requirement of the specifications (par. 4:6.17.2), under which any test set failure due to component wearout during 3,000 hours' continuous operation required rejection, NADC assured IDC that it would be permitted to replace internal parts (such as seals) every 500 hours as "routine maintenance." (Tr. 292–293) NADC engineers also expressed doubts that the "typewriter" configuration of the case was a "combination" case within the meaning of the specifications and whether the case would pass the environmental tests prescribed by the specification. (Tr. 351–352) Such doubts were largely make-weight arguments to persuade IDC to adopt the case configuration desired by the NADC engineers. (Tr. 323) No environmental tests had been performed by NADC because of its decision that the samples were unacceptable on the basis of the other deficiencies discovered. NADC urged IDC to change the design of the case for the second samples to a "bathtub" design in which the control panel would be in a horizontal position easily readable whether the test set was placed on the ground or on a shop table. (Tr. 75) IDC insisted that the "typewriter" configuration of the preproduction samples met the specification requirements, but acceded to NADC's desire that the second samples be a "bathtub" design. There is no indication in the record that a "bathtub" design had ever been utilized previously by any producer. (Tr. 232) A Government techni-

cian testified that the Navy would have allowed IDC to continue to use its wet pump and typewriter configuration if IDC had refused to make such design changes. (Tr. 323–4) But for such changes, an acceptable preproduction sample could have been furnished within an additional 120 day period. (Tr. 245)

We find that IDC's wet pump, employing two oils, and typewriter case configuration were permitted by the specification.

After the meeting it was agreed that the second samples would be submitted by 20 March 1967, and the second samples were delivered to NADC on that date. The Government did not demand consideration for permitting a second submission of samples. (Tr. 158) The second samples employed a combination dry pump and the configuration of the case was a "bathtub" design with the control panel in a horizontal position. (Govt. Exh. P.)

The NADC tests of the second samples revealed that various deficiencies existed, the most serious of which was that all three samples were unsatisfactory with respect to scale errors due to instability of the sensors. It will be recalled that scale errors in the first samples were within acceptable limits. IDC was allowed to install new altitude sensors with heaters for the second samples, but the scale error problem was not corrected. (Govt. Exhs. P and Q). The scale errors continued to be substantially greater than in the first samples and rendered the second samples unacceptable. (Tr. 357). Most of the deficiencies noted in the first samples had been corrected. The scale error problem was due to excessive cooling which resulted from the bathtub design of the cases. (Tr. 360).

At a meeting between IDC and Government representatives on 22 November 1967, IDC informally demonstrated another test set which it had manufactured and detailed corrections which it proposed to make if it was allowed to submit a third set of preproduction samples. The Government representatives were impressed by the innovations and improvements revealed by IDC's demonstration and were of the opinion that IDC had showed progress which promised delivery of acceptable test sets if further modifications were accomplished. (Govt. Exhs. R and S). Accordingly, on 8 December 1967, the parties entered into a supplemental agreement (Modification 3 to the contract), by which, in consideration of a price reduction of $14,125, IDC was permitted to submit a third set of preproduction samples by 29 March 1968, and the delivery dates for production articles were extended to a period beginning December 1968 and ending May 1969. (Govt. Exh. V). The amount of the price reduction resulted from an informal agreement between the parties that a reduction approximating 2% of the contract price would be appropriate. (Tr. 157.)

The third samples were submitted on 29 March 1968. Although Modification 3 provided that the Government would notify IDC of its approval or disapproval of the third samples within 120 days of the date of their submission, testing of the samples apparently was not completed until March 1969. (Govt. Exh. AA). The tests revealed that the major problem of scale error remained. In particular the differences between scale readings at the same altitude, depending on whether an ascending or descending reading was taken, were excessive. (Tr. 266, 359, 388–389). IDC had been allowed to submit a modified altitude sensor indicator after initial failure of the samples. The formal test report (Govt. Exh. Z), dated 22 April 1969, indicated that such modification had improved the altitude accuracy of the samples, but that they remained deficient as to scale errors. The samples were not recommended for acceptance.

By letter of 27 May 1969, IDC advised the contracting officer that it had been conducting tests of the rejected third samples and was confident that changes which it had made to the altitude sensors would result in compliance with the performance requirements of the specifications. (Govt. Exh. AA). On 3 July 1969 cognizant Government officials attended a briefing and demonstration of the changes made in the altitude sensor by IDC. Such changes included modification of the temperature compensator to correct temperature shift, reduction of operating voltage level, and a change in the material for the housing. The Government officials concluded that IDC should submit a fourth set of preproduction samples incorporating the demonstrated changes. (Govt. Exh. CC). Following a meeting at NADC on 6 August 1969, arrangements were made for IDC to submit the fourth samples by 31 January 1970. (Govt. Exh. JJ). By supplemental agreement (Modification 4), the delivery dates for the production articles were further extended to a period beginning October 1970 and ending March 1971 without any change in the contract price. (Govt. Exh. EE.)

Since 31 January 1970 fell on a Saturday, IDC hand carried the fourth samples and test data to NADC on Monday, 2 February 1970. (Govt. Exch. FF). NADC

determined in March 1970 from a preliminary review of test data that the fourth samples were sufficiently close to specification conformance to indicate that, despite failures to meet high temperature and humidity test requirements due to unstable pressure sensors, they could be corrected by return of the pressure sensors to IDC for reworking. (Govt. Exh. HH). Accordingly, the pressure sensors were returned to IDC for stabilization by heat treatment. (Tr. 131). The sensors were heat-treated and returned to NADC on 17 April 1970 (for two samples) and 6 May 1970 (for the third sample). Upon reinstallation of the sensors into the samples, scale error was determined to be satisfactory. NADC considered that further submissions of preproduction samples were not necessary and that necessary corrections such as control of altitude rate, range of pressure modulation, and compliance with humidity tests, could be accomplished by IDC in production on the condition that IDC be required to perform the full range of preproduction tests on the first production unit. (Govt. Exh. II; Tr. 363–367, 395). At the time of the hearing, ASO was considering and evaluating the NADC test data and recommendations. (Tr. 133).

DECISION

The Government has the burden of proving that it incurred a loss as the actual and proximate result of the appellant's default. It may not sustain that burden by the classic device of showing the difference between the contract price and the market price, but must prove an actual repurchase specifically related to appellant's default.[2] The fact of an ultimate, completed purchase of the same or similar items by the Government does not, *ipso facto*, establish that such a repurchase was made. *Williams Industries, Inc.* v. *United States*, 155 Ct. Cl. 360 (1961).

Even if we presume that the Government eventually could establish completion of deliveries of conforming items and final payment under the IDC contract, we think that the Government has failed to prove that the IDC contract continued to be an actual repurchase specifically related to appellant's default after rejection of IDC's first preproduction samples. Certaintly, if IDC and the Government had agreed to a no-cost cancellation of Contract N383–00001B at that point and thereupon negotiated a new contract at the same price under which IDC agreed, irrespective of the contractor's obligation merely to meet the minimum requirements of the specifications and the contractor's general right to make its own design choices under the original production contract, to comply instead with the particular desires of the Government engineers, a loss attributable to appellant's default could not be proved. We believe that the actions of IDC and the Government show a tacit agreement to such a "standard" of performance, and, in effect, were tantamount to a cancellation of the contract and a new undertaking by IDC, constituting essentially a research and development rather than a production effort. Undoubtedly, the close previous relationship between the Navy and IDC in a non-competitive atmosphere and an eye to the acquisition of knowledge and expertise for use by IDC on future Government and commercial contracts, go far to explain the unusual situation and lack of formality which characterized the performance of the IDC contract. In any event, the Government has thereby lost its right to cite the amount which might ultimately be paid to IDC as proof that it sustained a loss attributable to appellant's default.

Accordingly, since no other loss has been shown, the appeal is sustained.

Dated December 23, 1971.

WILLIAM J. RUBERRY,
Member of Division No. 8,
Armed Services Board of Contract Appeals.

I dissent. It should be noted that the facts in the instant appeal highlight the complexities created by, and the consequent problems facing the Board as a result of the failure of cognizant authority to conform the administrative procedures dealing with the assessment and collection of excess costs and of in-

[2] Of course, no other actual damages which might be recoverable under paragraph (f) of the Default clause have been shown here.

terest thereon to the rule laid down more than a decade ago in *Whitlock Corporation* v. *United States*, 141 Ct. Cl. 758, 765–766 (1958); *cert. den.* (1958).

RUDOLPH SOBERNHEIM,
Member of Division No. 8,
Armed Services Board of Contract Appeals.

I concur.

BASIL S. NORRIS, Lt. Col., *USAF,*
Member of Division No. 8,
Armed Services Board of Contract Appeals.

I concur.

RICHARD C. SOLIBAKKE, *Chairman,*
Armed Services Board of Contract Appeals
and Member of Division No. 8.

I concur.

HARRIS J. ANDREWS, Jr., *Vice Chairman,*
Armed Services Board of Contract Appeals
and Member of Division No. 8.

I certify that the foregoing is a true copy of the decision and opinion of the Armed Services Board of Contract Appeals in ASBCA No. 11718, Appeal of Aerosonic Corporation, rendered in conformance with the Board's Charter.
Dated: January 5, 1972.

GEORGE L. HAWKES, *Recorder,*
Armed Services Board of
Contract Appeals.

(1ST SUBMISSION)

TABLE I.—SUMMARY OF TEST RESULTS, IDC VACUUM-PRESSURE TEST SET (VPT-30-18100)

Test	Unit S/N:101	Unit S/N:102	Unit S/N:103
Examination of product	Unsatisfactory	Unsatisfactory	Unsatisfactory.
Leakage			Satisfactory.
Leakage system			Do.
Scale error	Unsatisfactory	Acceptable	Acceptable.
Slew rate	do	Unsatisfactory	Unsatisfactory.
Position error		Satisfactory	Satisfactory.
Stability (drift)			Acceptable.
Power variation		Unsatisfactory	Unsatisfactory.
Stability of controls:			
(a) Voltage-frequency variation, altitude	Unsatisfactory	do	Satisfactory.
(b) Voltage-frequency variation, airspeed	Satisfactory	Satisfactory	Do.
(c) Airspeed variation			Do.
(d) Altitude variation			Do.
(e) Altitude stability			Do.
Low temperature			Unsatisfactory.

TABLE II.—ROOM TEMPERATURE SCALE ERROR TEST RESULTS, INTERCONTINENTAL DYNAMICS CORP., VACUUM-PRESSURE TEST SETS, PART NO. VPT-30-18100

[In feet]

Test set altitude setting (feet)	Test set S/N:101, error		Test set S/N:102, error		Test set S/N:103, error		Specification tolerance
	Increased altitude	Decreased altitude [1]	Increased altitude	Decreased altitude	Increased altitude	Decreased altitude	
−1,000	+06		[1] +86		+04		±25
0	−14	[1] −45	+21	+03	+02		25
500	−16	[1] −56	+21	+12	−05		25
1,000			+19		−14		25
5,000	[1] −31	[1] −74	+10	−04	−10	[1] −33	25
10,000			+02		−05		25
15,000	+11	[1] −95	−02	[1] −42	+26	−07	30
20,000			+31		+21		40
25,000	+11	[1] −119	+54	−10	+32	−22	50
30,000			+45		[1] +65		60
40,000	+37	[1] −112	+68	−19	+53	−53	80
50,000			+101		[1] +113		100
60,000	+86	−81	[1] +135	+36	[1] +125	+07	120
80,000	+150		+124		−82		160

[1] Value exceeds specification tolerance.

(2D SUBMISSION)

TABLE I.—SUMMARY OF TEST RESULTS, IDC VACUUM-PRESSURE TEST SET (VPT-30-181C0)

Test	Unit S/N: 1101	Unit S/N: 1102	Unit S/N: 1103
Examination of product	Unsatisfactory	Unsatisfactory	Unsatisfactory.
Leakage	Satisfactory	Satisfactory	Satisfactory.
System leakage	do	do	Do.
Scale error	Unsatisfactory	Unsatisfactory	Unsatisfactory.
Slew rate	do	do	Do.
Position error (vertical)			Satisfactory.
Stability	Satisfactory		
Power variation	Unsatisfactory	Acceptable	Unsatisfactory.
Low temperature	Satisfactory	Unsatisfactory	Do.
High temperature	Unsatisfactory	Satisfactory	
Stability of pressure controls:			
(1) Voltage-frequency vari. alt	Satisfactory	do	Satisfactory.
(2) Voltage-frequency vari. airspeed	do	do	Do.
(3) Altitude stability	do		Do.
(4) Airspeed stability	Unsatisfactory		Unsatisfactory.
(5) Leak compensation	Satisfactory	Satisfactory	Satisfactory.
Radio interference		Unsatisfactory	
Low pressure		do	Unsatisfactory.
Humidity	Unsatisfactory		

TABLE II.—ROOM TEMPERATURE SCALE ERROR TEST RESULTS, INTERCONTINENTAL DYNAMICS CORP., VACUUM-PRESSURE TEST SETS, PART NO. VPT-30-18100

[In feet]

Test set altitude setting (feet)	Test set S/N:1101, error		Test set S/N:1102, error		Test set S/N:1103, error		Specification tolerance
	Increased altitude	Decreased altitude	Increased altitude	Decreased altitude	Increased altitude	Decreased altitude	
−1,000	+9	[1] −33	[1] +43	−12	+9	[1] −29	±25
000	+13	−21	+20	−24	+14	−24	25
1,000	−3		[1] +51		−2		25
5,000	+19	[1] −36	[1] +32	[1] −43	+13	[1] −41	25
10,000	+23	[1] −45	[1] +32	−25	+22	[1] −37	25
20,000	+36	[1] −59	+22	[1] −52	+40	[1] −47	40
30,000	−2	[1] −63	−14	[1] −69	−2	[1] −63	60
40,000	+15	−53	+30	−33	+11	−72	80
50,000	+10	−57	+28	−57	−2	−87	100
60,000	+8	−61			−71	[1] −149	120
70,000	−38	−85	+57	+41	[1] −180	[1] −259	140
80,000	−81		−157		[1] −436		160

[1] Values are not within specification tolerance.

(3D SUBMISSION)

TABLE I.—SUMMARY OF TEST RESULTS, IDC VACUUM-PRESSURE TEST SET (VPT-30-18100-2)

Test performed	Spec para.	S/N 1101	S/N 1102	S/N 1103
Examination of product	4.6.1	Acceptable	Acceptable	Acceptable.
Leakage	4.6.2	Satisfactory	Satisfactory	Satisfactory.
System leakage	4.6.2.1	do	do	Do.
Scale error	4.6.3.1	Unsatisfactory	Unsatisfactory	Unsatisfactory.
Slew rate	4.6.3.2	Satisfactory	Satisfactory	Satisfactory.
Position error	4.6.4	do	do	Do.
Stability	4.6.5	do	do	Do.
Low temperature	4.6.6	[1]	[1]	Unsatisfactory.
High temperature	4.6.7	[1]	[1]	Do.
Power variation	4.6.8	Satisfactory	Unsatisfactory	Satisfactory.
Radio interference	4.6.9	do	[1]	[1].
Pressure mod	3.11	Unsatisfactory	Unsatisfactory	Unsatisfactory.
Low pressure	4.6.10	[1]	[1]	Marginal.
Humidity	4.6.12	[1]	Unsatisfactory	[1].
Altitude rate control	3.9.4.1	Unsatisfactory	do	Unsatisfactory
Static pressure fixt	3.16.2	do	do	Do.

[1] Test not performed for this unit.

TABLE II.—INITI L ROOM TEMPERATURE SCALE ERROR TEST RESULTS, IDC VACUUM-PRESSURE TEST SET (VPT-30-18100-2)

[In feet]

Test-set attitude setting (feet)	S/N 1101 error		S/N 1102 error		S/N 1103 error		Specification tolerance
	Increased altitude	Decreased altitude	Increased altitude	Decreased altitude	Increased altitude	Decreased altitude	
−1,000	+12	----------	[1] +100	----------	[1] +56	----------	±25
0,000	+7	+11	[1] +73	[1] +49	[1] +55	[1] +31	±25
1,000	+4	----------	[1] +70	----------	[1] +29	----------	±25
5,000	[1] +33	+19	[1] +92	[1] +73	[1] +56	+17	±25
10,000	[1] +43	----------	[1] +92	----------	[1] +72	----------	±25
20,000	+38	----------	[1] +110	----------	[1] +77	----------	±40
30,000	+59	----------	[1] +111	----------	[1] +64	----------	±60
40,000	[1] +95	+34	[1] +115	+60	+54	−9	±80
50,000	+93	----------	[1] +113	----------	+72	----------	±100
60,000	[1] +125	+105	[1] +128	[1] +125	[1] +125	+66	±120
80,000	+150	+150	+150	+150	+150	+150	±160

[1] Values are not within specification tolerance.

(4TH SUBMISSION)

TABLE I.—SUMMARY OF TEST RESULTS OF IDC VACUUM-PRESSURE TEST SET (VPT-30-18100)

Test	Unit S/N 1101	Unit S/N 1102	Unit S/N 1103
Examination of product	Acceptable	Acceptable	Acceptable.
Leakage			Satisfactory.
System leakage			Do.
Scale error (horizontal position)	Acceptable	Satisfactory	Acceptable.
Scale error (vertical position)	Satisfactory	Acceptable	Satisfactory.
Slew rate			Do.
Stability			Do.
Altitude rate control	Unsatisfactory		Unsatisfactory.
Pressure modulation	do		Do.
Static pressure fixture vacuum			Do.
Low temperature			Satisfactory.
High temperature			Unsatisfactory.
Humidity		Unsatisfactory	
Acoustical noise level	Unsatisfactory	do	Unsatisfactory.

TABLE II.—ROOM TEMPERATURE SCALE ERROR TEST RESULTS WITH PANEL IN HORIZONTAL POSITION, IDC VACUUM-PRESSURE TEST SET (VPT-30-18100-2)

Test set altitude setting	S/N 1101 error (feet)		S/N 1102 error (feet)		S/N 1103 error (feet)		Specification tolerance (feet)
	Inc. alt.	Dec. alt.	Inc. alt.	Dec. alt.	Inc. alt.	Dec. alt.	
Feet:							
−1,000	+6	+3	−9	[1] −46	+15	−18	±25
0	+17	+7	+12	−1	+19	−1	25
1,000	+25	+18	0	−21	−10	----------	25
5,000	+17	−3	+12	−11	[1] +30	+4	25
10,000	[1] +36	−2	+21	−17	[1] +35	0	25
20,000	[1] +52	−4	+31	−17	+38	−5	40
30,000	[1] +53	−2	+40	−17	+43	−4	60
40,000	+56	−4	+30	−45	+45	0	80
50,000	+58	+16	+28	−2	+64	+34	100
60,000	+27	+17	+27	−13	+17	+17	120
70,000	+25	+56	+56	+72	−7	+72	140
80,000	−5	----------	−56	----------	−5	----------	160

[1] Values are not within specification tolerance.

BEFORE THE ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of Aerosonic Corp., under Contract No. N383–91995A

(ASBCA No. 11344)

Civil Defense Personnel Support Center, 2800 South 20th Street, Philadelphia, Pa., Thursday, September 22, 1966.

The above-entitled matter came on for further hearing, pursuant to recess, before the Armed Services Board of Contract Appeals at 9 a.m.

Before Colonel Leonard Petkoff, presiding member.

Appearances: As heretofore noted.

* * * * * * *

By Mr. Lewis:

Q. Could you explain to the Board the relationship of the 120-day pre-production requirement and the testing requirements of the contract.

A. Well, I think the 120-day requirement, as we have said before, was considered reasonable and it was considered reasonable principally because of the industry from which we contemplated receiving bids, the fact that this industry did and had made testers of either equal, slightly less, or comparable complexity.

They had experience, as we pointed out in the case of, certainly, Garrett and Bendix and IDC, and they had a reasonable assurance, that is for themselves, of meeting the contract requirements within 120 days.

* * * * * * *

DEFAULT OF AEROSONIC CORP., MAY 18, 1966

(2) The default of Aerosonic Corporation on the 18th of May 1966 where we were terminated and the letter clearly states all the reasons why we were terminated. The other is the letter dated the 29th of September 1967, which is approximately 16 months after the termination for default and giving us a termination for the convenience of the Government. Meantime, we were not permitted to bid on any Navy requirements, and if you will notice our original bid was for $89,833.00, and the second closest bidder was $207,000.00 for the same item.

—

U.S. NAVY,
AVIATION SUPPLY OFFICE,
Philadelphia, Pa., May 18, 1966.

AEROSONIC CORP.,
Clearwater, Fla.

Modification No. 3 $89,833.60 CR

Subject: Contract N383(19–383)90053A.

Reference:

(a) ASO Certified letter PGB8–9:LS of 4 February 1966 to Aerosonic Corp.
(b) ASO Certified letter PGB8–9:LS of 2 March 1966 to Aerosonic Corp.
(c) ASO Message 112011Z of 11 May 1966 to Aerosonic Corp.

GENTLEMEN: This notice confirms the telegraphic notice of your termination for default issued by reference (c).

By reference (a), your company was advised that the preproduction samples of the MS28075–1 Indicator had failed on the original and second submissions and furnished the reasons for the failure. You were also advised that the Contracting Officer considered such failure as constituting a failure to make progress so as to endanger performance of the contract and a failure to perform the provisions thereof. Your company was afforded an additional opportunity to cure such failure by submitting by 24 March 1966 additional samples conforming to the contract and specification requirements. Reference (a) further stated that in the event of failure to comply with its terms, the subject contract would be subject to termination for default. Your company did submit additional samples within the time specified to the Naval Ammunition Depot, Crane, Indiana, the testing activity. The NAD Crane test report has been received, however, and indicates that the samples did not comply with the requirements of the specification and contract in the following respects:

PROCUREMENT DOCUMENT OF 4 APRIL 1964

(1) *Paragraph 4.6.7 Pointer Lag and Friction.*

Your unit QT–7 did not comply with the Pointer Lag Test. This test was performed twice, with lags of 7.2 and 8.2 seconds in descent and 7.1 and 7.8 seconds

in ascent. (Tolerance 5.5±1.5 seconds.) Unit QT–7 also did not comply with the Friction Test requirements, with readings of 200 FPM in ascent and descent. (Tolerance within 150 FPM of zero.)

(2) *Paragraph 4.6.10 Temperature Change Scale Error.*

Your unit QT–9 did not comply with the Temperature Change Scale Error Test. Readings, corrected for zero error, at 2000 FPM indicated rate of descent through the 4000 to 2000 feet altitude interval, were 2376, 2378, and 2358 FPM at the one-hour intervals during the cooling period. (Tolerance—2000±300 FPM.)

(3) *Paragraph 4.6.11 Low Temperature Scale Error.*

Your units QT–7 and QT–9, did not comply with the requirements of this test. The readings obtained, corrected for zero error, for unit QT–7 were: 4511 FPM through the interval of 2000 to 6000 feet; 4494 FPM through 16000 to 20000 feet; and 4470 FPM through 26000 to 30000 feet, all in the rate of ascent. (Tolerance—4000±400 FPM.) The readings obtained, corrected for zero error, for Unit QT–9 were: 2371 FPM through 4000 to 2000 feet; and 2336 FPM through 30000 to 28000 feet, all in the rate of descent. (Tolerance—2000±300 FPM.)

(4) *Paragraph 4.6.12 Temperature Change Zero Error.*

All of the samples failed to comply with the requirements of this test. The following table lists the data obtained:

	QT–7	QT–8	QT–9	Tolerance FPM
Minutes elapsed:				
1	+500	+300	+100	±300
2	+500	+300	+400	±300
3	+500	+350	+400	±300
4	+500	+350	+400	±300
5	+475	+300	+350	±300
10	+350	+250	+275	±200
15	+250	+200	+225	±200
20	+150	+125	+150	±200
25	+100	+75	+100	±200
30	+50	+50	+50	±200

In view of the aforementioned discrepancies, your latest set of preproduction samples have been rejected as not meeting the specification requirements of Contract N383(19–383)90053A. The Contracting Office considers that your company has failed to cure its failures to make progress and to perform the provisions of the contract. Accordingly, pursuant to the clause of the contract entitled "Default," your right to proceed further with performance under said contract has been terminated pursuant to the clause of the contract entitled "Default," said determination to be effective May 11, 1966.

This notice constitutes a decision that you are in default as specified, and that the failure to perform was not due to causes beyond your control and without your fault or negligence. This is the final decision of the Contracting Officer. Decisions on disputed questions of fact and on other questions that are subject to the procedure of the Disputes Clause may be appealed in accordance with the provisions of the Disputes Clause. If you decide to make such an appeal from the decision, written notice thereof (in triplicate) must be mailed or otherwise furnished to the Contracting Officer within thirty days from the date you receive this decision.

Such notice should indicate that an appeal is intended and should reference this decision and identify the contract by number. The Armed Services Board of Contract Appeals is the authorized representative of the secretary for hearing and determining such disputes. The Rules of the Armed Services Board of Contract Appeals are set forth in the Armed Services Procurement Regulation, Appendix A, Part 2.

You are hereby further advised that the material required under the contract will be procured in the open market against your account and you will be held liable for any excess costs. The Government reserves all rights and remedies provided by law or under the contract in addition to charging excess costs you will be advised at a later date as to the amount of such excess costs, if any.

Very truly yours,

G. A. COOKINHAM,
Contracting Officer.

DEPARTMENT OF THE NAVY,
OFFICE OF THE COMPTROLLER,
Washington D.C., September 29, 1967.

THE AEROSONIC CORP.,
Clearwater, Fla.

Attention: Mr. Herbert J. Frank, President.

GENTLEMEN: This office has been advised that the default termination (ASBCA No. 11596) concerning contract N383(19-383)90053A will be converted to a termination for the convenience of the Government.

Accordingly, in accordance with your request of September 22, 1967 there is enclosed for your files an executed copy of the Deferred Payment Agreement entered into as of April 27, 1967 between the Department of the Navy and your corporation concerning referral of payment on the Government's excess costs claim of $118,094.74 under defaulted contract N383(19-383)90053A pending a decision of your appeal (ASBCA No. 11596) by the Armed Services Board of Contract Appeals.

Very truly yours,

JOHN B. PLOTT,
Director of Contract Financing.

DOCUMENTATION FROM COMMERCE BUSINESS DAILY

(3) The documentation from the Commerce Business Daily supporting my testimony about the sole source to Kollsman Instrument Corporation for the AAU-24/A altimeter for approximately $700 apiece. This is found on page 17 of the December 3rd, 1971 issue; page 16 of the January 14, 1972 issue is the sole source award to Kollsman for a little over $9½ million dollars worth of altitude encoders, and the third is page 25 of the March 9th issue where the Navy sent out to their favorite contractor bids for the 24/A which did result in a savings for the taxpayer.

DECEMBER 3, 1971

66-AAU-24/A Altimeter Mod P00003 to Cont N00019-70-C-0566—Awarded 16 Nov. 71 (No formal RFQ) qty (300)—$532,500—Kollsman Instrument Corp., Elmhurst, NY. Place of Performance: Elmhurst, NY. (A333)
Department of the Navy Air Systems
Command Washington, D.C. 20360

JANUARY 14, 1972

66—AAU-21A, Altimeters-Encoders. Cont. N00019-72-C-0174 awarded 27 Dec. 71 (RFQ N00019-71-Q-0094)—Qty 3,411—$9,684,613—Kollsman Instrument Corp., Elmhurst, NY. Place of Performance Elmhurst, NY. (A010)
Department of the Navy Air Systems
Command, Washington, D.C. 20360

MARCH 9, 1972

66—AAU-24/A Altimeter, Technical Data, Manuals and Support Equipment—Cont. N00019-72-C-0456. Awarded 23 Feb. 72. (RFP N00019-72-R-0038)—Qty: (2883)—$3,163,977—Canadian Commercial Corp., Leigh Instruments Limited, Carleton Place, Ont. CN. Place of Performance: Carleton Place, Ont. CN. (A063)
Department of the Navy Air Systems
Command, Washington, D.C. 20360

SPECIFICATIONS

(4) The specification calls out what the Navy, Air Force and commercial aviation use. We have enclosed the page with the asterisks showing the specifications that we discussed at the hearing under the type MC-3 and MC-4. You will find that the Navy purchased these over the past 10 years. paid anywhere from three to five times more than the Air Force did, and this specification is far below the Air Force, United States Army Air Force, and FAA requirements. You can reference this by the Air Force specification. AAU-8/A, which is also the United States Army Air Force specification, and you can see the difference in accuracy, tolerances, etc. The amount of paper work needed to reproduce these was so large that we were sure that you could order the actual specification from our reference.

FEDERAL AVIATION AGENCY, Washington 25, D.C.

TECHNICAL STANDARD ORDER—Regulations of the Administrator, Part 37

Subject: Altimeter, Pressure Actuated, Sensitive Type TSO–C10b.

Technical standard orders for aircraft materials, parts, processes, and appliances.

* * * * * * *

SUBPART B

§ 37.120 *Aircraft altimeter, pressure actuated, sensitive type—TSO–C10b*—(a) *Applicability*—(1) *Minimum performance standards.* Minimum performance standards are hereby established for aircraft altimeters which specifically are required to be approved for use on civil aircraft of the United States. New models of altimeters manufactured for such use on or after September 1, 1959, shall meet the standards set forth in SAE Aeronautical Standard AS 392C,[1] "Altimeter, Pressure Actuated Sensitive Type," revision date February 1, 1959,[2] with the exceptions listed in subparagraph (2) of this paragraph. Altimeters approved under prior issuances of this section may continue to be manufactured under the earlier provisions.

* * * * * * *

External Case Pressure Test.—The static pressure source of the instrument shall be sealed when an ambient temperature of 25° C. and an ambient pressure of 29.92 inches (absolute) of mercury have been achieved. The ambient pressure shall then be increased at a rate of 20 inches of mercury in two seconds to 50 inches (absolute) of mercury and held at that pressure for three minutes. There shall be no adverse effect on the instrument or its accuracy.

ALPHABETICAL LISTING

Title	Document No.	FSC	PREP	Date	Custodian
Altimeter-encoder AAU-20/A	L—MIL-A-81402	6610	AS	June 15, 1967	AS
Altimeter-encoder, AAU-21/A	QL—MIL-A-81403	6610	AS	do	AS
Altimeter, pressure AAU-16/A	QL—MIL-A-38140A (3)	6610	11	Mar 28, 1968	11
Altimeter, pressure AAU-2-A	QL—MIL-A-27391A (1)	6610	71	July 15, 1963	71
Altimeter, pressure AAU-27/A*	L—MIL-A-83212	6610	11	Mar 21, 1969	11
Altimeter, pressure AAU-7-A*	QL—MIL-A-27198A (4)	6610	11	Dec 2, 1965	11
Altimeter, pressure AAU-8/A*	QL—MIL-A-27229A (3)	6610	11	Aug. 29, 1968	11
Altimeter, pressure, AAU-24/A*	Q—MIL-A-81494	6610	AS	Apr. 15, 1968	AS
Altimeter, pressure, counterpointer	L—MS-280748	6610	AS	Jan. 30, 1959	AS
Altimeter, pressure, counterpointer	QL—MIL-A-19679A (2)	6610	AS	Feb. 20, 1962	AS
Altimeter, pressure, counterpointer, type MC-3 and MC-4*.	L—MS-25450	6610	AS	Oct. 12, 1962	AS
Altimeter, pressure, counterpointer, type MC-3 and MC-4*.	QL—MIL-A-23395	6610	AS	Aug. 15, 1962	AS
Altimeter, pressure, parachutist S	MIL-A-58686A(1)	6610	GL	June 28, 1968	GL
Altimeter, pressure, station	L—MS-24134A	6610	71	May 20, 1969	71
Altimeter, pressure, station	QL—MIL-A-4513 (1)	6660	71	Nov. 12, 1956	71
Altimeter, pressure, 35,000 feet	MIL-A-58088	6610	AV	Nov. 20, 1968	AV
Altimeter; pressure, 50,000 feet	MS-28044D	6610	AS	Mar. 9, 1966	AV AS
Altimeter, pressure, 50,000 feet type MB-1A	Q—MIL-A-6863D (2)	6610	AS	Mar. 9, 1966	AV AS

U.S. ARMY AIR FORCE BIDS

(5) These are the U.S. Army Air Force bids after sole source had been eliminated in 1964. You will note the bid, and so that you do not get mixed up "Specialties" and "Teledyne" are the same company. They just changed names and you can confirm this by looking at the city, Charlottesville, Virginia, where the bids were made from. You will notice that prior to this bid the sole source was over $300 and how rapidly the sole source, which was Teledyne (Specialties) came down to their final price of $133.92 under competitive bidding.

[1] Copies may be obtained from the Society of Automotive Engineers, 485 Lexington Avenue, New York 17, New York.

[2] In addition to the performance standards herein, altimeters when installed in aircraft must meet installation requirements as well as functional and reliability flight tests of the pertinent airworthiness sections of the Civil Air Regulations.

[illegible] TI

[illegible] 4-67-33

[illegible] Jan 17-64

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible] 1513

	Kellinson Ind. Charleston W.Va.	[illegible] Charleston W.Va.	[illegible] Charleston W.Va.
	1	2	3
724	33917	21500	27276
Ave	60	60	60
Time	[illegible]	1730	[illegible]
Oil	AR	AR	AR
P.O.B.	Charleston	Charleston	Charleston
Shipping Point	W.V.	Fla.	Va.
Business	L	S	S
[illegible]	L	S	S
	Use Std Fee		Use Std Fee
			add on 7 [illegible]

cc. Roger Stanford Abstract File 1-27-64 [illegible]

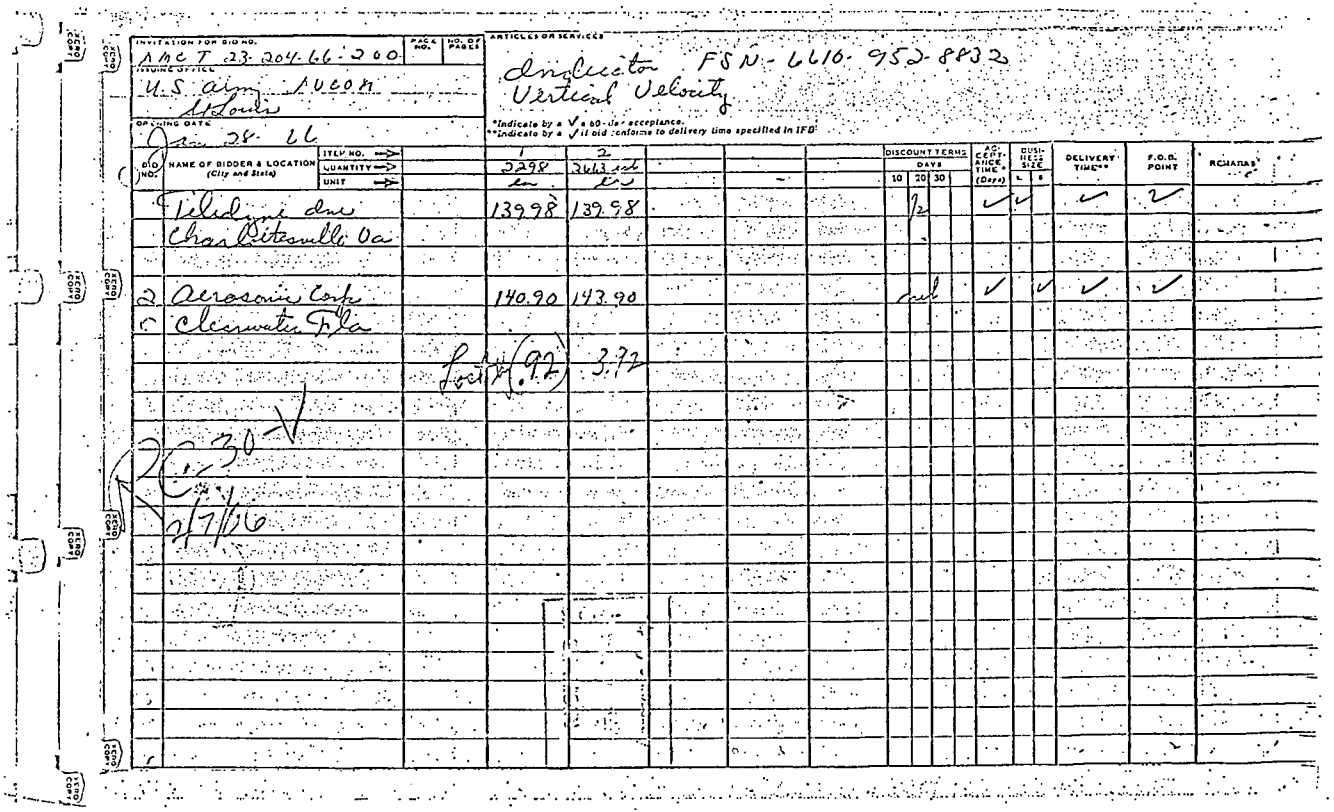
< [illegible] REPORTING [illegible] [illegible]

1572

Bell Arms.T.
33-304-65-48
opened Jan 21-1965
U.S Army AMC
St Louis
RC-30-V
Administrator
FSN-6616-
953-8832

	Aerosonic Corp. Clearwater Fla.		Hydrosystems Inc. Charlottesville Va	
	1		2	
1584	170.70		167.85	
Acc	60		60	
Time	1/5-20		1/5-20	
Del	ad		ad	
Shipping Point	Clearwater		Albemarle Va	
Bus Size	S/S		S/S	

BENTON REPORTING SERVICE
ROPER BLDG., 5TH STREET & TABOR ROAD
PHILADELPHIA 20, PENNA.



INVITATION FOR BID NO. AMCT-23-204-66-200 | PAGE NO. | NO. OF PAGES

ISSUING OFFICE: U.S. Air Force Recom St Louis

OPENING DATE: Jan. 28. 66

ARTICLES OR SERVICES: Angle Gyro FSN-6610-952-8832 Vertical Velocity

*Indicate by a ✓ a 60-day acceptance.
**Indicate by a ✓ if bid conforms to delivery time specified in IFB

BID NO.	NAME OF BIDDER & LOCATION (City and State)	ITEM NO. / QUANTITY / UNIT	1	2				DISCOUNT TERMS DAYS 10	20	30	ACCEPTANCE TIME (Days)	BUSINESS SIZE S	B	DELIVERY TIME**	F.O.B. POINT	REMARKS
			2298 ea	2463 set ea												
1	Teledyne Inc Charlottesville Va		139.98	139.98					1/2		✓	✓		✓	✓	
2	Aerosonic Corp Clearwater Fla		140.90	143.90					net		✓	✓		✓	✓	
			Lot (97)	3.72												
	30 ✓															
	2/7/66															

67-425—72—pt. 5——24

DAAJ01-69B-[illegible]043

U.S. ARMY AVSCOM
ST. LOUIS MO.

OPENING DATE: March 14 '69

ARTICLES OR SERVICES: Indicator Vertical Velocity
Alt 1 FSN 6610-935-4378 Alt 2 6610-952-8832

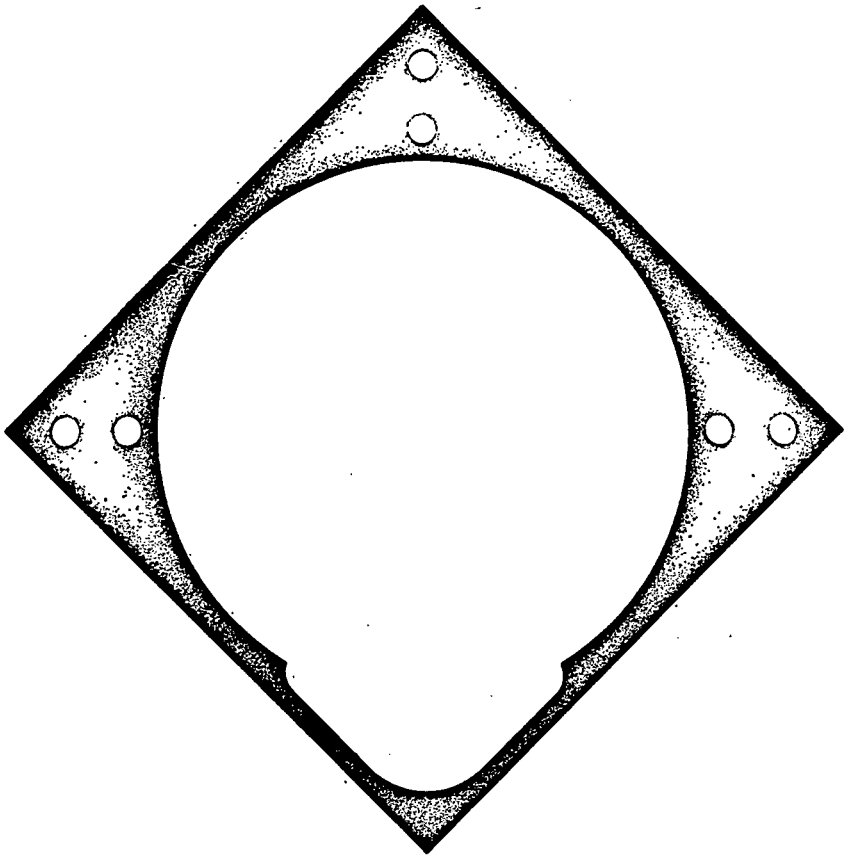
*Indicate by a ✓ a 60-day acceptance.
**Indicate by a ✓ if bid conforms to delivery time specified in IFB

BID NO.	NAME OF BIDDER & LOCATION (City and State)	ITEM NO. 1	1AA	2				DISCOUNT TERMS DAYS 10	20	30		ACCEPTANCE TIME* (Days)	BUSINESS SIZE L	S	DELIVERY TIME**	F.O.B. POINT	REMARKS
	QUANTITY	323	470	4200													
	UNIT	ea	ea	ea													
1	[illegible] Clearwater Fla	134.90	134.90	132.30				2	[illegible]			✓		✓	✓		
2	[illegible] [illegible] Va	133.92	133.92	133.92					1/2			✓	✓		✓		

1575

STAMPING PLATE

(6) We have also enclosed the little plate that was discussed at the hearing.



BIDS BY SMALL BUSINESS AGAINST LARGE BUSINESS

(7) Last is a copy of the various bids made by Small Business against Large Business to show the vast difference in bidding. Our contention is, and it always has been, that the Government has been trying to put small businesses out of business in order to justify the ridiculous prices that the large businesses are quoting. I have also forwarded to you the two bids on the 27/A showing the various bidders. Since both the Bendix Corporation and Lear Siegler have both previously done business with the Navy, it certainly might be interesting for the Joint Economic Committee to ask them why they will bid all Air Force requirements of an indicator that is more complicated than a single indicator being purchased by the Navy, and why they do not do business with the Navy. You might come up with some very, very interesting remarks.

BIDS—AVIATION SUPPLY OFFICE

	Company	Amount
Air speed 383-1185-62:		
3 Bidders	Aerosonic Corp	$57.25
	Kollsman	109.47
	Karnish	59.00
Air speed (383-9-63):		
2 bidders	Aerosonic Corp	155.00
	Kollsman	212.49
Air speed (383-1377-62):		
3 bidders	Aerosonic Corp	54.50
	Karnish	55.00
	Kollsman	109.47
Air speed (383-250-64):		
3 bidders	Aerosonic Corp	52.50
	Karnish	67.86
	Kollsman	187.40
Indicator:		
4 bidders	Aerosonic Corp	54.60
	U.S. Guage	53.73
	Karnish	58.25
	Kollsman	187.40
Indicator 383.242-66:		
4 bidders	Aerosonic Corp	48.25
	U.S. Guage	43.65
	Karnish	49.85
	Kollsman	213.00

Invitation for Bid No. F33651-70-B-0342 Opening Date: Dec 3, 1969 Class: 6610
Commodity: Altimeter AAU-27/A Spec MIL-A-83212 2 en. through 13 14. Same 833 ea 15. Same 583
Buyer: Mr. G. L. Kirk 255-1146 500-900 901-1300 1301-1700 1701-2000 16. Data

	Company & Location	Terms	F.O.B.	Delivery	1. 500-900	901-1300	1301-1700	1701-2000		16. Data	
1.	The Bendix Corp. Inst + Fuze Div				1498.00	1498.00	1498.00	1498.00		12,556.00	
	Div. Mishawaka Ind. Rd. Davenport Iowa	net	dest	as/req.							
2.	Lear Siegler Astro Div.				895.00	895.00	895.00	886.00		no/bid	
	38 Koizal Ct. Armonk N.York	net	dest	as/req.							
3.	Macladd Instrumental Corp				750.00	725.00	692.84	689.70		to be negotiated	
	4250 N.W. 10th Ave Ft. Lauderdale Fla	net	dest	as/req.							
4.	Accessorie Corp				565.00	530.00	490.00	485.00		no/bid	
	1312 N. Dixie Ave 4627 P.O. Box Clearwater Fla.	net	dest	as/req.							
5.	Leich Instruments Limited		Watertown Truck		642.11	606.60	596.10	586.42		26,866.91	
	820 P.O. Box Carlton Place Ontario Canada	net	Canada	as/req.							
6.	Kollsman Instrument Corp				1416.00	1360.00	1318.00	1309.00		included	
	80-08 45th St. Elmhurst N.Y.	net	dest	as/req.							
				estimate	10-200	201-500	501-900	901-1300	1301-1700	1701-2000	bids
			Bidder	#1	1498.00	1498.00	1498.00	1498.00	1498.00	1498.00	1
					1498.00	1498.00	1498.00	1498.00	1498.00	1498.00	2
			Bidder	#2	876.00	877.00	868.00	859.00	850.00	842.00	1
					973.00	965.00	955.00	945.00	935.00	926.00	2
				#3	negotiable to obtain price awarded						1
					750.00	750.00	750.00	725.00	692.84	689.42	2

more end

1578

Invitation for Bid No. F33657-71-B-0371 Opening Date: Dec 30, 1970 Class: 6685
Commodity: Indicating Cabin Air pressure Type M4-1 0001 -0002 Date
Buyer: Jamie Wilcoxon 255-5917

50-150 151-300 301-500 501-700 701-1000

	Company & Location	Terms	F.O.B.	Delivery	0001						0002 Date
1.	Aero Servis Corp		Clean Water		46.98	45.74	44.49	43.25	42.25		
	1212 N. Hercules Clean Water Fla	Net	Fla.	60/req.							
2.	Kearnicks Instruments Inc.		Boots Issue	0	47.70	46.75	45.80	44.90	44.00		—
	110 3rd Ave. Rockhaven Pa	Net	Pa.	60/req.							
3.	Kellerman Instrument Corp		Kellerman	0	290.00	257.00	238.00	224.00	213.00		—
	575 Lindenhill Blvd. Syosset N.Y.	Net	Syosset N.Y.								

1579

Invitation for Bid No. 23-657-68-3-0297 Opening Date: 10-19-67 Class: 6635 CR Palmer 255-4472
Commodity: 1-Indicator Cabin Air pressure
Buyer: Type MA-1 IAW Spec MIL-I-5099A 7/12 ea

	Company & Location	Terms	F.O.B.	Delivery	1				Total		
1.	Kollsman Instrument Corp *	net	Elmhurst N.Y.	60 a/rec.	134.00				95,408.		
	Elmhurst N.Y.		f	0							
2.	U.S. Gauge Div of AMETEK Inc.	net			43.40				30,252.88		
	Sellersville Pa.	60 da	Sellersville Pa	a/rec.							
3.	Kernah Instruments Inc.										
	Jock Haven Pa.	60 days n/f	Jock Haven Pa.	60 a/rec.	35.00				14,920.		
4.	Aerosonic Corp.	60 da		0							
	Clearwater Fla.	net	Clearwater Fla.	60 a/rec.	26.10				8,583.20		
				0							
	* U.S. mfr facilities not used (0219-67-P913)										
	(increase) price 1 to 1½ %										

more end

1580

Invitation for Bid No. F33657-68-B-1151 Opening Date: July 19, 1968 Class: 6610
Commodity: Indicators 100-200 201-300 301-400 401-500 U. 2. Data
Buyer: Mr. C. R. Palmer 255-4472

	Company & Location	Terms	F.O.B.	Delivery	100-200 1	201-300	301-400	401-500	Data 2		
1.	Kearfott Inc. Armonk N. York	net	Armonk N.Y.	as/req.	501.00	450.00	450.00	429.00	no/chg.		
2.	Kollsman Instrument Corp. Elmhurst N. York	net	dest.	104-10 mo. 254-11 mo. 504-[illegible]	1,030.00	1,030.00	1,030.00	1,030.00	no/chg. [illegible]	[illegible]	[illegible]
3.	Aerosonics Corp. 1212 N. Hercules Ave. Clearwater Fla.	net	dest.	as/req.	480.44	478.20	470.60	463.70	no/chg.		
					AC[illegible]						
					K[illegible]	[illegible]		7/15/[illegible]	$44[illegible]	[illegible]	

1581

JULY 25, 1968.

HEADQUARTERS, AERONAUTICAL SYSTEMS DIVISION,
Air Force Systems Command, Wright-Patterson Air Force Base, Ohio

Attention: Curt R. Palmer/ASWMI.

Subject: IFB F33657-68-B-1151, Type AVU-8/A Airspeed Indicator.

GENTLEMEN: Aerosonic Corporation has reviewed its supply of parts and find that we have the major portion of parts and pieces needed to fabricate approximately 160 each subject indicators.

The fabrication of these parts was accomplished at a time period and in such quantities so that a saving can now be reflected in our quote on subject IFB.

In the quantity range of 100-200 we offer a reduction of $40.00 per indicator resulting in a unit price of $440.44. All other conditions of our quote remain unchanged.

Since we were the low bidder on the quantities of 100-200 on Item Nr. 1 of subject IFB, this reduction in price is non-prejudicial to the terms and conditions of this IFB.

We trust the foregoing meets with your approval.

Very truly yours,

AEROSONIC CORP.
KARL BIALES,
Director of Military Sales.

Invitation for Bid No. F33657-70-B-0392 Opening Date: Dec. 18, 1969 Class: 6610
Commodity: Indicated Air speed Pitot Static Spec MS 28045-T1 2. Date
Buyer: K.S. Pascavich 255-4472,

	Company & Location	Terms	F.O.B.	Delivery	1.	2.		Total			
1.	Kollsman Instrument Corp				322.00	no/chg		28014.00			
	Manchester N.H.	Net	Dest	60/Reg		0					
2.	Aerosonic Corp 0			0							
	Clearwater Fla.	net	Dest	60/Reg.	75.63	includes		6579.81			
3.	Ametek T.S. Dept			0							
	Mt Vernon N.Y.	net	Dest	60/Reg	94.35	incl.		8208.45			
4.	Kearfott Div Gen Precision Inc.			0							
	Little Falls N.J.	net	Dest	60/Reg	47.55	Prices	Net	4136.85			
				0		00					

more out

U.S. ARMY AVCOM.
ST. LOUIS MO.

Opening date: March 22 68

Indicator
PN-MS28045T 1 Rev D-

BENTON REPORTING SERVICE
ROPER BLDG. 5th ST. & TABOR RD.
PHILA. 20, PA.

*Indicate by a ✓ a 60-day acceptance.
**Indicate by a ✓ if bid conforms to delivery time specified in IFB

Bid No.	Name of Bidder & Location (City and State)	Item No. / Quantity / Unit	Discount Terms (Days) 10 / 20 / 30	Acceptance (Days)*	Business Size S / B	Delivery Time**	F.O.B. Dest
1	Aerosonic Corp, Clearwater Fla	43.59	nil	✓	✓	✓	✓
2	Misco Inc, Ft. Worth Tex	77.28	1	✓	✓	✓	✓
3	U S Gauge, Sellersville Pa	49.05	nil	✓	✓	✓	✓
4	Karnish Ind, Lock Haven Pa	47.50	nil	✓	✓	✓	✓
5	Kollsman Inst, Elmhurst N.Y.	211.00	nil	✓	✓	✓	✓

1584

Invitation for Bid No. F33657-68-B-0532 Opening Date: Jan. 11, 1968 Class:
Commodity:
Buyer: Miss Drane-Atkins 255-5917 1. Indication - Air speed 10 - 150 Knots 2. Data
Alternate A Alternate B

	Company & Location	Terms	F.O.B.	Delivery	133ea Alternate A	133ea Alternate B		Points	Total A	Total B	
1.	Kearfott Instruments Inc.		dest	c/req.	125.00	72.50		n/bids	16,625.00	9,642.50	
	210 3rd Ave. Lock Haven Pa. 17745	net									
4.	Ocro Sonic Corp.										
	1212 N. Hercules Ave. Clearwater Fla. 33517	net	dest	c/req.	63.50	43.65		200.00	8,445.50	6005.45	
5.	U.S. Gage Div. of Ametek Inc.										
	Sellersville Pa. 18960	net	dest	c/req.	66.60	58.24		n/bids	8,857.80	7745.92	
	Bidder #3 -	Dest	[illegible]	[illegible]	Table	I + II	[illegible]	[illegible]	[illegible]	[illegible]	
		MIL-[illegible]-5416	3 axes	[illegible]	Table	I [illegible]					
		be 3.0 knots	[illegible]		2.0 knots						
		Table II [illegible]	[illegible]		[illegible]						
		3.5 knots	[illegible]		2.5 knots						

more end

1585

DIV. OF PURCH. 428 | 71

U.S. ARMY AVCOM
ST. LOUIS MO.

OPENING DATE April 5-71

Indicator Indicated As Speed
FSN 6610-557-3170.

*Indicate by a √ a 60-day acceptance.
**Indicate by a √ if bid conforms to delivery time specified in IFB

NO.	NAME OF BIDDER & LOCATION (City and State)	ITEM NO.	1
		QUANTITY	2100
		UNIT	ea
1	Kaynish Prod Lock Haven Pa		61.49
2	Kollsman Instr. Syosset N.Y.		294.00
3	Arnetek U.S. Gauge Sellersville Pa		57.36
4	Aerosonic Corp Clearwater Fla		51.40

DISCOUNT TERMS — DAYS: 10 | 20 | 30

NO.	10	20	30	ACCEPTANCE TIME* (Days)	BUSINESS SIZE: L	S	DELIVERY TIME**	F.O.B. POINT	REMARKS
1			nil	✓		✓	✓		
2			nil	✓	✓		✓		
3			nil	✓	✓		✓		
4			nil	✓		✓	✓		

BENTON REPORTING SERVICE
BOX 18368
PHILA., PA. 19120

1586

Invitation for Bid No. F33657-70-B-0291 Opening Date: Nov. 18, 1969 Class: 6610
Commodity: Indicator, Airspeed Type AVU-8/A 60 2. Same 76 ea 3. Same 10 ea 4. Data
Buyer: Mrs. K. S. Prewitch 255-4496

	Company & Location	Terms	F.O.B.	Delivery	1. 60 ea	2. 76 ea	3. 10 ea	4. Data		Total
1.	Aeronics Corp									
	1212 N. Hercules Clearwater, Fla.	Net	dest	90 days	542.00	542.00	542.00	included		79,145.00
2.	Kollsman Instrument Corp									
	80-08 45th Ave. Elmhurst N.Y.	net	dest	90 days	1214.00	1173.00	1550.00	43353.00		

more end

Invitation for Bid No. F23657-71-B-0322 Opening Date: June 8, 1971 Class: 1610
Commodity: Altimeter pressure Type 4; AU-27/A
Buyer: G.L. Kim. 755-4472 2554496 0001

	Company & Location	Terms	F.O.B.	Delivery	101-150	151-200	201-250	251-350
1.	Aeronomic Corp		Normally		600.00	575.00	575.00	570.00
	1212 N. Hercules Pompano Beach Fla.	net		a/o/req.				
2.	The Bendix Corp. Inst. & Life		Destination	0				
	Support Div. Eatontown Jersey.	net	Jersey	a/o/req.	952.00	827.00	812.00	782.50
3.	Lear Instruments Limited		Ontario	0				
	426 P.O. Box Co-Ste. Place Ontario Canada	net	Ontario	a/o/req.	2154.00	1926.00	1790.00	1675.00
4.	Kollsman Instrument Corp		Elmhurst	0				
	575 Underhill Blvd. Syosset, N.Y.	net	N.Y.	a/o/req.	4019.00	3302.00	2925.00	2567.00
				1-50	51-100	101-150	151-200	201-250	251-350
	Option Price I				570.00	570.00	570.00	570.00	570.00	570.00
	Bidder #1 II				622.50	597.50	595.00	585.00	584.00	580.00
	III				650.00	635.00	600.00	587.00	586.00	585.00
	Bidder #2 I				782.50	779.00	774.00	769.00	764.00	759.00
	II				820.00	816.00	811.00	806.00	801.00	796.00
	III				860.00	856.00	851.00	846.00	841.00	836.00
	Bidder #3 I				1274.00	1260.00	1214.00	1242.00	1230.00	1211.00
	II				2183.00	1934.00	1710.00	1660.00	1588.00	1543.00
	III				2183.00	1934.00	1710.00	1600.00	1588.00	1543.00

Request for GAO Investigation

Chairman Proxmire. I am going to ask the General Accounting Office to investigate the very serious charges that you have made. It is not enough to have the Navy answer without the GAO investigating in full and reporting back to us on their findings.

I hope that you will be available to appear before us again. We will have the GAO testify on your charges and we would like you to testify at that time, after the GAO appears.

Concluding Statement

Mr. Frank. I would like to make, if I can, some sort of finishing statement, if I can.

Chairman Proxmire. All right, sir. Go right ahead.

PILOTS RECOMMENDATIONS ON SPECIFICATIONS

Mr. Frank. I just feel that, and I am going to repeat myself, the items that I am talking about can be manufactured for one heck of a lot less money if the manufacturers and the Navy or the Air Force would sit down at a table and mutually agree to requirements and specifications, but in these include some pilots because in all the places that I have ever visited, no engineer that I have ever talked to has a pilot's license. He doesn't know the complications.

I am sure there are pilots that fly but these people that write the specifications have never worked in aircraft instrument factories, and they don't work or don't fly, and I think one of the basic things we have to do is get together even in our little industry, and let industry sit with these engineers and see if we can come up with some form of reducing the requirements that supposedly exist.

And I am personally hoping that in some way the testimony that I have given will bring about a saving to the taxpayers through counselling between the manufacturers and the U.S. Government in writing specifications for these instruments.

Thank you.

Chairman Proxmire. I am sure it will, and not only instant savings in this case but I also hope the fact that you have had the willingness and courage to come forward and risk a great deal, because you do business with the Armed Services still, will set an example to other contractors so we begin to get a far better understanding of a procurement system that will cost less, will be more efficient, and will provide much better service than we have been able to in the past.

It is not a matter of costing too much, alone, but it is also a matter of the performance being shoddy, poor, far less than it should be. Both of these are matters of deep concern to us.

Thank you, Mr. Frank, very much.

(The prepared statement of Mr. Frank follows:)

Prepared Statement of Herbert Frank

Mr. Chairman. Senators, and other members of the Committee:

My name is Herbert Frank. I am the President of the Aerosonic Corporation of Clearwater, Florida, and I am here to bring to your attention what I believe to be utter waste of taxpayers' money and the utter disregard and utter contempt that some Government employees have for the taxpayer. I have been involved

directly for the past 30 years in the design, manufacture and development of aircraft flight instruments—the last 20 being spent as an executive and engineer negotiating and meeting with various government personnel, from Generals and Admirals down to the Technicians. Our Company has had one of the great honors of this country, having been chosen the Employer of the Year for 1966 in encouraging and promoting and employment of the handicapped. We also received a citation from President Eisenhower in 1958 for the same program. I am a pilot, both single and twin engine, with an instrument rating.

Over the last 15 years my corporation has been supplying the Armed Services with aircraft flight instruments, such as altimeters, airspeed indicators, rate of climb indicators, and similar type of instruments. Since 1956 we have conservatively supplied the United States Air Force and the United States Army Air Force with 90% of their airspeed indicators and approximately 50% to 70% of their rate of climb indicators. All during this time I personally have been trying to convince the Military and Civilian personnel of the Armed Services that by eliminating unrealistic requirements, savings of between 15 and 20 million dollars a year would result. I am sincerely sorry to say, not only do they not want to listen, but they go out of their way to label you a trouble maker.

Our corporation has been harrassed, kept out of bids, and in general we have been given a rough time because of our attitude toward some of the ridiculous specifications and requirements that the manufacturer is called on to meet, when in actual fact no such requirement exists in actuality. I can only tell you how appreciative I am toward this Committee in hearing me, and what I have to say and am about to say I have the facts in front of me which should bear out my testimony.

In particular, I do not wish to condemn any specific corporations that are involved in some of the evidence that I have turned up, but I certainly believe that some members of the United States Navy are the biggest perpetrators of what I call utter disregard and contempt for the taxpayer and the dollars he pays. Other military establishments, such as the Air Force and Army, do have their problems also. However, in 20 years of dealing with these services, I personally have found that the United States Army has most effectively tried to do their best for the taxpayer, secondly comes the United States Air Force, and way down on the bottom of the list is the United States Navy. You must understand that I am a small business, doing an inconsequential, small amount of work for the Armed Services, but the utter waste of the taxpayers' dollars, even in my little section of business, is so large that I believe that if you took some of the examples I am going to show you today and multiply these by the tens of thousands of other items that the Armed Services procure, you will find hundreds of millions of dollars that could be saved. I believe we should have a strong military posture. I also believe that with proper management and engineering counsel the cost of the average item being purchased by the United States Government can easily be reduced from between 5% to 25%. The Government engineering personnel have so blatantly specified requirements that are non-existent and nonuseable, they have made the cost of items go from $50 to $300, and the item still does the exact same thing as it did 15 or 20 years ago. It is very difficult to explain to you everything in the short time that I have been given. But here goes—

I would like to start out by showing you two photographs of an instrument called a rate of climb indicator. The specification specifies that the instrument will be placed in a chamber at minus 50° below zero for approximately three hours, at which time it will be taken out of the chamber and brought to room temperature immediately. The instrument will then be read every minute. If you will look at the two photos you will see the instrument at approximately 25° below zero in a readable state, and you will note the instrument after it has been taken out in room temperature and approximately two minutes has elapsed. It is absolutely impossible to read this instrument. For the past fifteen years I have questioned everybody obtainable in both the Air Force and the United States Navy, to enquire why this requirement is in the specification. I might add at this point that this requirement has cost the taxpayers conservatively 20 million dollars. There is no one in the entire Air Force or Navy who can answer why this requirement is in the specification.

Yet it stays in the specification. When you question the Government Engineers you get two basic, standard answers that I am sure the taxpayers will enjoy. (1) "Stop rocking the boat." (2) What do you care, you're getting paid for it." It is this attitude and indifference taken by the engineers of the Armed Services which is costing the taxpayers millions upon millions of dollars a year. These

feudal lords who do not have to give you an answer, won't give you an answer, and know that they don't have to give you an answer. Who are you going to go to? After all, supposedly you do business with these people and after awhile you get to the point of getting a reputation for starting trouble. All you want to do is to save some money for the taxpayers and to do this these government engineers will fight you to the death. Their jobs depend upon complicating specifications, rewriting the specifications to include new and additional tests that have no more bearing on the instrument than the man in the moon, and every time you raise a question—the standard answer—"Stop rocking the boat", "What do you care, you're getting paid for it". Believe me, there is nobody in the United States you can go to to bring these people to an accounting of their actions.

The Navy has what we call preferred contractors. These preferred contractors operate on basic sole source procurements with or without formal negotiation, and I would like to introduce the following evidence to you. I have brought with me many instruments to give you some idea physically of what we are talking about. I am now placing on the desk two instruments—one the 27/A altimeter for the Air Force, two, the 24/A which is the Navy altimeter. Both are identical, or as close to identical as you could want to get. Both tell altitude. The basic difference between the two is that the Air Force altimeter has a higher altitude range. It goes to 50,000 feet, and the Navy altimeter only goes to 38,000 feet. The operation requirements are identical. The test procedures are so close that you cannot tell one from the other. Now, gentlemen, comes the shock. The Navy buys their instrument from a sole source and pays approximately, and I quote the last quotation—$532,500.00 for 300. There was no formal proposal. No bidding—no nothing. This comes to roughly $1700 apiece. Under competitive bidding for the United States Air Force, the 27/A recently sold for $565.00 each in approximately the same quantities as the $1700 Navy Altimeter. In fact, I have with me approximately 10 to 12 bids to show your Committee that this sole source cannot compete in the open bid competition, other than through sole source or negotiated contracts. I do not feel that in a free enterprise the taxpayer should subsidize one corporation over the other and pay three times as much money for the item as under competitive bidding. The Navy has the capability, and has done in the past, kept specific companies out of their procurements by the following methods:

(1) In advising the contractors that such requirements exist;

(2) Advising the contractor that there is no need to further manufacture or qualify such an indicator because there will be no more purchased;

(3) By rejecting the test data submitted to them, stating that the instruments do not meet the specifications;

(4) By defaulting them on programs, which prevents them from rebidding and then after a certain length of time saying the default case is dropped completely. In the latter, since the company is under default action, they cannot bid on these items while under this default position. After the year or year and a half is over, the Navy then drops his charges, the contractor is now producing these items, and the other company is so disgusted they just drop out of the picture.

Such an instance was performed in 1966 where a contractor bid against one Navy preferred contractor. The bid was approximately half the cost of the item that the preferred contractor bid. The one contractor bid somewhere around $300,000.00. The preferred contractor bid somewhere around $650,000.00. Delivery was 120 days and I would like to quote from the contracting officer's statement taken under oath:

"Well, I think the 120-day requirement, as we have said before, was considered reasonable and it was considered reasonable principally because of the industry from which we contemplated receiving bids, the fact that this industry did and had made testers of either equal, slightly less, or comparable complexity.

They had experience, as we pointed out in the case of, certainly, Garrett and Bendix and IDC, and they had a reasonable assurance, that is for themselves, of meeting the contract requirements within 120 days."

Due to the fact that this contractor was not part of the "in" group in the Navy, they were legally defaulted for failure to deliver on time—120 days after the order under the same terms and conditions—120 days."

Approximately four years later—I repeat approximately four years.

Secondly, the U.S. Army Procurement Office (Army-Air Force out of St. Louis) has a good program whereby between six months and a year in advance of procuring any item they normally send to all the contractors who are in-

terested in bidding similar types of components, a letter stating what will be purchased, approximately how many will be purchased and the approximate years they will be purchased. They also included in this information bulletin the previous procurement, the name of the company who was the low bidder and the bid price that the low bidder was paid for this item. This gives everybody more than enough time to become involved in a program if they so wish.

To reiterate how successful this program was in 1964, the Government under a sole source procurement purchased a rate-of-climb indicator and paid approximately $300 apiece from this sole source. With competitive bidding in two years time, the sole source had brought his price down to $139 from approximately $300 and by 1969 with all the prices rising in competitive bidding, the item sold for $129.30. It is amazing to see a man reduce his price from $300 in sole source to $130.00 in competitive bidding. This gives you an idea of exactly how much money is being lost to the taxpayers to these sole source and preferred contractors through this type of procurement.

Chairman PROXMIRE. Our other witness this morning is Mr. Ill. If he will come forward.

Mr. Ill, we introduced you before.

Mr. Ill is Assistant Secretary of the Navy—Installations and Logistics.

We are very happy to have you, sir. You are here with a distinguished admiral, who graced the committee yesterday with his presence.

STATEMENT OF HON. CHARLES L. ILL II, ASSISTANT SECRETARY OF THE NAVY (INSTALLATIONS AND LOGISTICS), ACCOMPANIED BY ADM. R. G. FREEMAN III, DEPUTY FOR PROCUREMENT AND PRODUCTION, NAVAL MATERIAL COMMAND

Mr. ILL. Thank you, Mr. Chairman. Nice to be here.

Chairman PROXMIRE. You have a brief statement. You can proceed any way you wish.

The full statement will be printed in the record, if you want to abbreviate it in any way.

NAVY SHIPBUILDING CLAIMS

Mr. ILL. Mr. Chairman, I appreciate your invitation to appear before this committee to discuss shipbuilders' claims against the Navy and related shipbuilding matters. This is my first opportunity to discuss these matters with the committee and at the outset I would like to state that I am deeply concerned with the situation the Navy faces in its shipbuilding claims and their effects on Navy shipbuilding programs.

Secretary Laird, Secretary Chafee and our military leaders have recently presented their views to the Congress on the seriousness of our position as a maritime Nation and the need for an adequate modern naval force for our national security. I fully share that concern and, to the best of my ability, intend to exert every effort in my present position toward achieving a strong, effective Navy. It is clear to me that we need the ships we are now building and proposing to construct. We need them on time, at a cost we can afford and we need them to perform to our expectations.

Last July in testifying before the Senate Armed Services Committee considering my nomination to this position I stated:

I intend to spend a great deal of time on our major weapon system procurements because of my past background in the procurement field and I hope to

bring more of these programs home within the budgetary structure and time structure that is set out.

I feel as Assistant Secretary for Installations and Logistics it is my responsibility to help to furnish to the operating forces the best weapons, facilities and logistics that we can within a reasonable cost frame. That will be my objective.

It still is my objective.

1969 SHIPBUILDING CLAIMS $582 MILLION—NOW $926 MILLION

Since 1969 shipbuilding claims have risen from $582 million to approximately $926 million today. The preponderance of these claims find their basis in fixed-price contracts written under different acquisition philosophies prevailing during the period of 1964 to 1968 but were not presented until years after contract award. In the aggregate these shipbuilding claims were based upon allegations that Government specifications were inconsistent, ambiguous, deficient or impossible to perform, that requirements beyond the builder's contractual obligations were imposed by Government; that Government-furnished material or information was defective or delivered late; that the Government imposed excessive quality assurance requirements on the builder during his contract performance. Many of these claims were in preparation over a significant period of time and are voluminous in the extreme. In our present claim situation we are thus being confronted with history.

NAVY APPROACH TO CLAIMS

Since 1969 the Navy has placed high priority on and expended considerable effort toward achieving prompt, effective, and equitable resolution of this enormous buildup of shipbuilding claims. During these years, various methods, techniques, approaches, and organizations for claims settlement have been instituted, tested and found inadequate to cope with the magnitude of this problem. Hearings held before this committee during 1969 through 1971 have fully described the problem of shipbuilding claims and previous Navy approaches to it. One of my early acts as Assistant Secretary was to request the Chief of Naval Material to undertake a comprehensive examination of the Navy's handling of claims addressing the various alternatives and methods available within our resources to improve and expedite their resolution. I took this action because of serious concern of the growing magnitude of shipbuilding claims, its impact on the Navy's shipbuilding programs and the lack of significant progress in the Navy to settle, deny or otherwise take action on a growing list of aging claims.

In December 1971, when Adm. I. C. Kidd, Jr., USN, became the Chief of Naval Material he fully shared my concern over shipbuilding claims and pursued my request for a comprehensive review of their handling within the Navy. While the direct responsibility for claims settlement lies with the Chief of Naval Material, Admiral Kidd has kept me fully informed on all matters relating to the treatment of claims and decisions he has made for their prompt resolution. I am both pleased and fully in accord with his actions to strengthen the investigative and review process necessary to resolve this critical problem.

In his statement Admiral Kidd has discussed in some detail the claims settlement procedures he instituted at the beginning of this year. I shall not iterate them here. Prior to their adoption, however, Admiral Kidd and I examined alternatives available with the benefit of the views and recommendations of those most experienced in the handling of claims. The resultant procedures, and the policies they carry out, do, in my judgment, provide a basis for resolving the Navy's claims problem promptly, legally, and equitably.

REVIEW OF NAVY CLAIMS

Because of the importance to the Navy of proper claims disposition, I propose to monitor our progress very closely. To this end I have requested the Chief of Naval Material to present all claim settlements of $10 million or more for my review and concurrence prior to a settlement. In addition, I shall discuss in depth with the Chief of Naval Material all claim settlements he proposes to make of a value between $5 million and $10 million, before contractual action is taken.

My objective in reviewing Navy claims actions is to assure that the Navy position on a claim has a legal basis for entitlement, accompanied by facts meeting the elements of proof necessary to support this entitlement, and adequate factual substantiation for any monetary amount proposed in settlement. I intend to have the General Counsel of the Navy assist me in these reviews.

PREVENTION OF FUTURE CLAIMS

Beyond the resolution of the Navy's existing shipbuilding claims, I view the prevention of future claims in both on-going and prospective shipbuilding programs as of equal importance.

In retrospect, to a large extent, the claims buildup in the last 3 years has been occasioned by breakdowns in contract administration on the part of the Navy and its shipbuilding contractors. Problems arising during construction were not always discussed and resolved in a timely manner and formal change orders were not issued or priced out in circumstances where such action was appropriate. Many claims thus resulted from "constructive changes" which in turn were made possible by court and Contract Appeals Board decisions that have broadly expanded the scope of change orders compensable under the "changes" clause of the general provisions of our contracts.

In the light of this experience, the Navy has developed procedures to facilitate the surfacing of potential claims problems in a timely manner permitting early resolution while all relevant facts and the people involved are readily available.

GAO REVIEW OF CLAIMS

The Navy embarked upon a comprehensive shipbuilding and conversion improvement program which included an extensive number of corrective and preventative actions aimed directly at the elimination or maximum reduction of claims for price increases in future shipbuilding contracts. This effort has been presented in previous testimony before this committee and was recently reviewed by the General Accounting Office. On February 28, 1972, the Comptroller General re-

ported to the Congress the results of the General Accounting Office's review of the causes of shipbuilders' claims for price increases. In evaluating the various improvement actions the Navy has embarked upon, the GAO concludes that they hold considerable promise for minimizing the claims problems.

CHANGES IN DOD PROCUREMENT POLICIES, DOD INSTRUCTION 5000.1

Last August, former Deputy Secretary of Defense David Packard, after extensive examination of Defense procurement problems, promulgated significant changes in DOD acquisition philosophies in a directive on the acquisition of major defense systems, DOD instruction 5000.1. Our present policy brings together essentially all the interrelated elements necessary for successful weapons acquisition and capitalizes, to the best of our ability, on lessons learned over the 1950's and 1960's. We are applying this acquisition philosophy to the maximum extent possible in our new shipbuilding programs.

PATROL FRIGATE AND GUIDED MISSILE HYDROFOIL PROCUREMENT

In planning our patrol frigate (PF) and guided missile hydrofoil (PHM) programs we are considering more flexible types of contracts for construction of the lead ships to accommodate and control the changes invariably arising in construction of a new ship type. We will also provide longer intervals between construction of the lead and follow ships to permit considerably more validation of construction plans before committing follow-on shipyards to their use. This same interval will allow us to perform substantially greater subsystem testing and integration in advance of the point where production decisions must be made.

PROGRESS IN CLAIMS PREVENTION AND REDUCTION

I am encouraged by the progress being made toward the prevention or reduction of claims in our new construction programs although they certainly are not over and believe the Navy has substantially improved its ability to cope with and resolve the claims problem it faces.

Mr. Chairman, this concludes my formal statement.

Chairman PROXMIRE. Thank you, Secretary Ill.

Secretary Ill, you were present during Mr. Frank's testimony, I take it?

Mr. ILL. Yes, sir.

RESPONSE TO MR. FRANK'S CHARGES

Chairman PROXMIRE. I want to give you a chance to respond to his charges. I would like for you to explain, if you can, the serious situation he described to us.

SECRETARY OF DEFENSE'S SMALL BUSINESS INDUSTRY ADVISORY GROUP

Mr. ILL. Mr. Chairman, I, as Mr. Frank was, at one point in my career, was a member of the Secretary of Defense's Small Business

Industry Advisory Group. That was when I was connected with a small industry. I think this was 10 or 15 years ago.

I have fought a lot of the battles that he is talking about. I am not qualified to discuss altimeters in depth as Mr. Frank did. He is obviously an expert in this area. I will be very happy to get the appropriate people and go back through the appropriate records to discuss the matter in toto.

My personal philosophy is certainly to award on a competitive basis as much of our procurement as we possibly can. My philosophy is also that we must help small business to the utmost that we can.

SMALL PROPORTION OF COMPETITIVE BIDDING

Chairman PROXMIRE. All right. You are aware of the fact that a smaller and smaller proportion of our procurement is by competitive bidding, No. 1, and I am not just talking about the Navy, but in all of the services, and a smaller and smaller proportion is going to small business on any kind of a classification.

These two are related. Small business gets a much higher proportion of competitive bidding than it does of negotiation. To the extent we can procure in either respect, either giving small business a greater opportunity or by competitive bidding, it will help the others.

Mr. ILL. I am certainly in accord that we should try to improve our competitive bidding procedures where that form of procurement is practicable, and I assume later on we will get into that, or where competitive bidding has not proved to be the best situation. Certainly for something like an altimeter, I would believe that that could be a very readily procurable item.

REQUEST FOR NAVY INVESTIGATION OF FRANK CHARGES

Chaiman PROXMIRE. Will you have your office investigate the charges that Mr. Frank made in here this morning, and give us a report on your findings?

Mr. ILL. I certainly will, sir, and I had intended to do that before you asked.

Chairman PROXMIRE. I hope you can do it without any harassment of Mr. Frank. When a man has the courage he has and steps on toes and causes discomfort, I am sure he is in difficulty, and I think it is very important that his position be fully respected. I know you won't do it personally.

Mr. ILL. Senator, it certainly will be, and I will try to assure that. I certainly believe he ought to have a chance to stand up and say what he thinks. I quite often have to resolve problems that can't be resolved anywhere else, and I believe that everybody should have a fair shot.

MINUS 50° ALTIMETER REQUIREMENT

Chairman PROXMIRE. Either you or the Admiral—does either one of you have any reaction at all to what seems like a startlingly commonsense criticism on the 50°-below-zero situation he describes with respect to altimeters?

Mr. ILL. I will only comment to this extent, and then I will let the Admiral speak. He is a naval aviator. He can tell us more about the problem.

I was in the electronics business and we had to go through a lot of environmental testing which required very stringent tests similar to those that were discussed by Mr. Frank. When we investigated them in detail we usually found that there were some pretty good reasons for it. I do not know the specific reasons in this instance, and I could not comment on those.

Admiral, would you have any comment on that?

Admiral FREEMAN. Nothing except to say that environmental requirements such as low temperature, high temperature testing are fairly usual for aircraft instruments and electronics.

Chairman PROXMIRE. He pointed out pretty devastatingly that this was the only one they made this requirement on. He said on the other instruments on the instrument panel they didn't make this requirement.

Furthermore, you have the altimeter before the pilot who obviously isn't exposed to the 50 below temperature the way they were in the old days when they flew in an open cockpit.

Do you have any reaction to that?

Similar Requirements for Other Panel Instruments

Admiral FREEMAN. I cannot respond to whether or not we have this requirement on other instruments. I believe that we apply cold soak requirements and hot soak requirements to most of the cockpit instruments and components. That would be something that we will have to review, when we look into the things Mr. Frank has mentioned.

Cold storage is a problem. We operate in a variety of environments in the Navy because of our mobility. This makes it necessary to deal with temperature variation.

The allegations concerning nonreview of specifications—these are problems we do face.

Chairman PROXMIRE. I hope you can check into that. Maybe this is one of the fallout benefits of this hearing, that we can save a little money in this respect. We can at long last end what seems to be an obsolete and unnecessary specification requirement, or justify it, if Mr. Frank is wrong.

AEROSONIC DEFAULT AND NAVY DISCRIMINATION

How do you explain the fact, Secretary Ill, that Mr. Frank's firm was defaulted by the Navy three times, that the Navy withdrew the default order on one occasion, after 1½ years, and that the Armed Services Board of Contract Appeals ruled in Mr. Frank's favor on the other two occasions? It sounds like an injustice has been done and that Mr. Frank's firm has been discriminated against by the Navy.

Mr. ILL. Senator, I do not know the details of this. I will be glad to look into it and furnish a statement for the record for you.

ZUMWALT Z-GRAM

Chairman PROXMIRE. Now yesterday, Secretary Ill, we discussed a telegram from Admiral Zumwalt to Admiral Kidd dated February 7, 1972, and concerning the need to meet certain target outlays for fiscal year 1972. Are you familiar with this telegram, Z-GRAM, I believe is the Navy terminology? Have you seen a copy of it?

Mr. ILL. I am not familiar with that particular telegram. I am familiar with the subject, yes, sir.

CLASSIFICATION OF Z-GRAM

Chairman PROXMIRE. I want to clear up one thing about this telegram. The New York Times this morning reports that the Navy said it was classified "Confidential," implying that I released a confidential document. I can't imagine why this particular document would be classified, since there is nothing in it relating to national security secrets, as far as I can tell. But my copy is not classified.

In fact, it is marked "Unclassified."

Do you know whether this piece of paper is classified or unclassified?

Z-GRAM DATE DISCREPANCY

Mr. ILL. I have an unclassified copy before me, but my dates don't correspond to yours, sir, so I don't know whether we are talking about the same——

Chairman PROXMIRE. What is your date?

Mr. ILL. February 4.

Chairman PROXMIRE. May we have a copy of that?

Mr. ILL. Yes, sir.

Senator PERCY. It sounds like a replay of the ITT hearings.

Mr. ILL. May I have a copy of your February 7?

Senator PERCY. Is there a third copy of this telegram around? [Laughter.]

Mr. ILL. That I cannot tell you, sir.

Chairman PROXMIRE. You are not charging forgery.

Mr. ILL. No, sir.

Chairman PROXMIRE. We won't have to go to the hospital to interrogate Admiral Zumwalt, I take it.

SIGNIFICANCE OF Z-GRAM

What is your understanding of the significance of this instruction from the Chief of Naval Operations? Is it intended to accelerate spending because of an increase in the fiscal year 1972 outlay target, or not?

Mr. ILL. Mr. Chairman, we are in the business of procuring over in the I. & L. branch of the Navy and in CNM. The President puts certain responsibilities, places certain responsibilities on the U.S. Navy. We have to have certain forces in certain places.

Budget Proposals

Based on these requirements, we propose a budget of what it takes us to provide this security, this naval force. This force is then reviewed

and the expenditures, item by item, of everything we wish to spend, how much oil we are going to buy, how many spare parts for the airplanes, how many ships, and all the rest of it, this is all submitted to the Secretary of Defense, who passes it on to the Office of Management and Budget, who then furnishes it to the Congress.

The Congress then approves what portion of that budget they wish, and they pass it back to us, and then it is our responsibility to carry out the directives involved. We have to provide those materials which have all been justified, as a need to satisfy an end.

Delay in Authorizations

We then in the Naval Material Command have to proceed with the business of buying those materials that the Congress has appropriated the money for. Our job is not helped by the fact that sometimes the authorizations come at the end of the calendar year, even in January, sometimes.

We have a job to do. We have to get our contracts committed. We have to buy these weapons in order to provide the security, the national defense, that is required of the Navy as its job.

Performance Monitoring

One of the methods by which we monitor our performance, much as you monitor your performance on a production line by how many units come off the end of the production line, is how many dollars have you committed.

We in the Navy use the dollars as a method of testing the performance of our various procurement offices. I don't wish to intimate that they would sit back and do nothing if we didn't push them and have a monitoring method.

FORMULA FOR WASTE

Chairman PROXMIRE. Doesn't that sound to you, Mr. Ill, as a businessman, that this is a very inefficient measurement of how many dollars you have spent at a certain time, or are getting off that assembly line and spending the money rapidly enough?

It sounds to me like a formula for waste.

Mr. ILL. Mr. Chairman, we issue a very large number of contracts every year. They vary in size from $5 or $10 to hundreds of millions of dollars. We can't just measure the number of purchase orders that are issued. We can and do measure those and do have statistics on that also.

Chairman PROXMIRE. But I should think the best thing would be to be as reluctant about spending that money, as you possibly can. That is one of the reasons in private business that a business proceeds efficiently if it can hold it costs down and only let that money go out when it absolutely has to. It should be a painful process, not a matter of pushing it out as fast as you possibly can to meet a deadline at the end of a year.

COMMITMENT TO DEFENSE READINESS

Mr. ILL. Senator, we have a commitment to have the defense readiness of this country——

Chairman PROXMIRE. Of course.

Mr. ILL (continuing). And in order to do that, we submit those items which we think are necessary to accomplish that task.

Chairman PROXMIRE. I agree with that.

Now, if the telegram from the admiral was on that basis, that we need these particular procurements as fast as we can get them, fine. I couldn't possibly quarrel with that. That is right. We certainly have to put our country in readiness as quickly and efficiently as we can, but to spend the money, pay it out, get it out, see that we can run up as high a score as possible in the expenditure segment is something quite different.

Mr. ILL. We are not trying to run up as high a score as we can. We are trying to get our job done within a prescribed period of time and those are measures we are taking into account.

DEFENSE READINESS VERSUS SPENDING EFFICIENCY AND USE OF OVERTIME

Senator PERCY. Mr. Chairman, would you yield at that point?

What possible relationship could meeting the requirements and the needs of the fleet and having units when they are supposed to be, where they are supposed to be, on schedule, have to the reference in this Z-GRAM of use of unlimited overtime during the remainder of fiscal year 1972? That looks to me like a clear attempt to use those dollars regardless of the efficiency that you can get and the results that you can get for those dollars. Rather it looks like an attempt to just get them used up so they won't somehow be lost. This is not related to delivery schedules, as I read this.

Now, if it is, maybe you could take that telegram and read me the section that relates to meeting ontarget requirements that may be falling behind in meeting due dates and schedules. But just to use unlimited overtime would seem to be costly, and contrary to directives previously issued, asking for reductions in overtime in order to save money.

Mr. ILL. Actually, Senator, the document which I have before me lists a series of suggestions to be looked at. We have—Admiral Kidd and I both have been endeavoring to cut down overtime in order to save money.

These suggestions are looked at. They are not always concurred in. We are endeavoring to procure those materials that are needed for our Navy and the ships in the best businessway we possibly can, but we are trying to get our bills paid on time or as quickly as we can.

We are trying to clean up the backlog of old contracts. We are trying to get the performance of our procurement section up. We are working, striving in those areas to get our performance up, we are not across the board anywhere to my knowledge completely pulling the plug out of any overtime. Overtime is a necessary evil.

For instance, in our shipyards we do run a certain percentage of overtime. This is because we can't afford to maintain the skills and we may run into critical dates and things of this sort that require a very small percentage of overtime, but it is not a heavy percentage and it is not my intention to authorize or suggest increase in overtime on any broad spectrum at all, sir.

Background of Secretary Ill

Senator Percy. Secretary Ill, you mention in your testimony your own past background in the procurement field. You have been in your present capacity for less than a year, then, have you?

Mr. Ill. That is correct, sir.

Senator Percy. And your past background was what, for the record?

Mr. Ill. Well, I started business in the General Cable Corp. when I got out of college and I went through a management training course there, which included a considerable amount of procurement. I worked for them for 3 or 4 years.

Then I joined Page Communications Engineers, or one of its predecessor companies. We went through a partnership or two before we incorporated. And in that I was head of their procuring activity and I ran the procurement activity—everything from purchasing agent on through to senior vice president of the company for most of that period of time—over 16 years.

I had procurement activity under me in one form or another.

Senator Percy. And the last company you were with was what?

Mr. Ill. Page was my primary company. I was involved with several television stations for UHF television licenses, also involved with a small steel company.

Past association with Navy

Senator Percy. Did you do business with the Navy, and were you familiar with the Navy procurement procedures in Naval material? Have you served in the past in the Navy, at any time?

Mr. Ill. No, sir. I was not. I did not serve in the Navy. We were very uniquely unsuccessful in being able to do business with the Navy, I am sorry to say, but we were not—well, actually the form of business that we were in was more land-based communications of a large nature and didn't fit the Navy's pattern.

Complications of Personnel Turnover

Senator Percy. We have been, of course, somewhat hindered in these hearings in that Admiral Kidd understandably was at sea when much of this went on, and there has to be a lot of checking back to get the records and reconstruct it. So we are somewhat inhibited by new personnel.

I am not in any way detracting from your own competence, and so forth, but it is hard to not have before us the very people who had full responsibility at the time some of these huge overruns occurred. It must be frustrating and difficult for new personnel, regardless of their background and experiences, to pick up this complicated story and unravel it all and settle these claims.

Is the problem, as you see it, in your experience now—is there much of a problem in rotation of Naval personnel? You know, of course, what the average tenure of a Naval officer is, and I speak with affection of my own service, but in three years in the Navy I was rotated quite frequently. It seems like I would no sooner get on a job when I would be rotated off it to another job.

AVERAGE OFFICER TENURE 15 MONTHS

The average tenure from the time a man leaves the Academy until he retires is 15 months on a job. Now, there is a problem in these very complicated procurement systems with this, what I consider, excessive rotation of Naval personnel.

Why is it necessary to have it? Is this part of the problem of maintaining a policy in Naval procurement that maximizes efficiency?

TURNOVER IN SHIPBUILDING AREA

Mr. ILL. Senator, I don't know the actual statistics with regard to what the regular rotation is. You have cited them as 15 or 17 months. I do know, and I strongly believe, that continuity in these large weapons systems procurements is important. In my statement I outline that one of the things we are trying to do, and we are pushing very hard, is to solve the problems today as they come up, rather than wait for 2 or 3 years from now when they will be filed as a claim and a lot of the people will not be there anymore. It is not just our people, either. It is not just the Navy people. There are a lot of the contractors' people who are no longer around. There is a large turnover in the shipbuilding area. As a matter of fact, there is a phenomenally large turnover in the shipbuilding community.

But I must concur, yes; that I would like—we like to see our major program managers stay for extended periods of time.

Admiral Freeman, I believe, has been in his job in procurement for 4 years now, which is unusual, but we do recognize in the Navy the importance of trying to maintain continuity.

Our program managers in most of our major weapons systems—we are trying to keep them on extended duty.

Senator PERCY. Because this could well be a good principle. We are not trying to nitpick one particular contract or one altimeter, or anything like that. That is your business, not our business. Our business is with principles that we are trying to get at. Maybe rotation of military personnel in procurement does really in effect enable the civilian establishment to really run the business and the figureheads up there come and go, just as—you know, the bureaucracy looks on the Cabinet officials. I think I have seen many new Cabinet Secretaries, and I am a new boy down here. I have only been here 5 years.

The administrations and top people change so rapidly that the people underneath can really run things in effect and establish and frustrate implementation of policy.

EFFECT OF ROTATION ON PROCUREMENT PRACTICES

But I would like to ask you, Admiral, if in your experience the excessive rotation of personnel in the Navy does in effect impede the establishment of good, solid procurement practices which would be

existing in an on-going corporation which has stability of employment and a turnover that would not anywhere approach the turnover in the procurement personnel of the Navy, who are buying not just millions, but billions of dollars of equipment.

I can recognize part of it goes back to rotating men at sea, making certain that every naval officer is equipped by background and experience and training to be the Chief of Naval Operations, if not the Chairman of the Joint Chiefs of Staff. And there is that aspect.

But what is the price we are paying for this kind of excessive, what I consider excessive, rotation?

Admiral FREEMAN. One of the first steps that Admiral Zumwalt took when he became CNO was in this very important area. He has taken several steps to enhance the career patterns of those people like myself who are predominantly into the materiel acquisition business. There are several who testified on this before this committee—on these types of improvements such as equating certain of our program management billets to major commands. This is also being done for a number of other billets that are involved in procurement; and specifically the procurement jobs at our major procurement commands when filled by captains. These are at the Air Systems Command and the Ships Systems Command, as well as the billet which I now occupy.

ESTABLISHMENT OF WEAPONS ACQUISITION COURSES

We are going to great lengths to establish training programs early, going all the way back to the Naval Academy and introducing new courses such as the one in weapons acquisition at the Navy Postgraduate School in Monterey. The course at Belvoir is handling this same kind of thing; in other words, providing a toolbox for people to use so that by the time an officer arrives, say, at the rank of lieutenant commander, he will be prepared for a materiel acquisition billet.

I think it is important to keep in the foreground the characteristics that make a good manager, and I suggest that you often find these characteristics in officers who have had command at sea. This mix of knowledge is very helpful in filling materiel acquisition billets.

COMPARISON OF MILITARY ROTATION VERSUS CORPS OF ENGINEERS

Senator PERCY. Mr. Chairman, I think it might be helpful to this committee if the subcommittee could obtain from sources available to it a comparison between, say, the Corps of Engineers procurement officers, what the rotation is in the Air Force, Army, and the Navy, of top procurement officials and how it would compare with professional groups such as the Corps of Engineers. I could imagine quite a bit of chaos if you rotated those men as rapidly.

ROTATION OF MILITARY PERSONNEL AMENDMENT

You will recall the amendment I put in to effect savings in the rotation of military personnel a couple of years ago. The Navy has been the one service publicly 2 weeks ago which said it was blocked now because it couldn't adhere to the schedule, but the other services seem to have adjusted and we have saved money.

Senators Goldwater and Stennis also felt it was an excessive turnover into the past. I wonder whether we ought not to take a look at whether or not there is such a professional requirement and skill that is so different than commanding a destroyer at sea, or whatever it may be, that we might require more permanency in those procurement jobs. There may be disadvantages that I am not aware of.

RECOMMENDATIONS IN "REPORT FROM WASTELAND"

Chairman PROXMIRE. I will be delighted to take a look at that. I might add in a book entitled "Report from Wasteland," written by Senator William Proxmire, I have a chapter on this kind of thing and what I recommended and what I think we ought to do is what the British have done with respect to aircraft procurement, and that is take it entirely away from the military officers. After all, being a military officer is one thing, but if we have learned anything since the stone age, we have learned about the efficiency of division of labor and specification.

FULL-TIME PROFESSIONAL PROCUREMENT OFFICIALS

We ought to have full-time professional procurement officials who work 20 or 30 years or a lifetime under the merit system in procurement. There is no reason for bringing somebody in who served at sea for a while and making him a procurement official, or someone who has served as a bombardier in a plane and bringing him into procurement powers. These people can be advisers, maybe, but the procurement officials ought to be professionals, full-time professional people, hired, as I say, on a civil service basis, and I think we could cut a whale of a lot of cost.

Furthermore, you would eliminate a lot of conflict of interest that you have now where Air Force, Navy, Army officers leave the service to go to work for a defense contractor. We have done something about that but not nearly enough.

Mr. Secretary, you referred to this date of February 4. I think you may be confused on that. That is not the date of the document you sent us. That is simply—the February 4 date simply refers to the Secretary of the Navy note on February 4. There is no date on this document, at all. The date here of February 4 refers to Secretary Chafee's note.

Mr. ILL. It may, Senator. I am sorry. I just looked at the document. I thought that was the date of the document, as I looked at it.

Accelerating Expenditures

Chairman Proxmire. Is there anything in Admiral Zumwalt's telegram about new contracts, or does it relate entirely to accelerating and speeding up expenditures on existing contracts?

Mr. Ill. I would have to refer to it, sir.

On a quick perusal, I do not see anything about new contracts but the obligation of funds for new contracts is part of the program, sir.

Secretary Chafee's Note of February 4, 1972

Chairman Proxmire. Let me get into the note from the Secretary of the Navy dated February 4, 1972. Have you seen or received a copy of that note?

Mr. Ill. Yes, sir.

Chairman Proxmire. Can you tell us whether that note contains the same or similar message to the Zumwalt telegram?

Mr. Ill. No. It is not quite the same. I would like to quote it.

Chairman Proxmire. What did the Secretary of the Navy say in his note?

Mr. Ill. I will read it to you, sir. It is from the Secretary of the Navy.

Fiscal year 1972 outlays and obligations. Purpose: To promulgate outlay and obligation targets for fiscal year 1972 by appropriation of revolving fund accounts. The President's budget for fiscal year 1973 includes those programs essential to the material and technological readiness of the naval forces. The budget presents a program execution plan in terms of obligations and expenditures necessary to the acquisition and delivery of materials and services to support essential readiness. The budget also contains estimates of outlays and obligations for fiscal year 1972, the achievement of which requires extraordinary effort and program acceleration. The Department of the Navy is committed to attaining or exceeding these estimates within the limits specified by law.

Would you like me to finish reading the rest of it?

Chairman Proxmire. Speed up this process, accelerate it, as you say, within the limits of the law.

Mr. Ill. Within the limits of the law.

Chairman Proxmire. As rapidly as they can.

Mr. Ill. And its major purpose is in order to provide the improved readiness that we need.

Chairman Proxmire. At least he refers to the readiness. Admiral Zumwalt had no reference at all to the military requirements.

Mr. Ill. I am only referring to the Secretary of the Navy's memo——

Chairman Proxmire. Can you give us a copy of the February 4 Secretary of the Navy's note?

Mr. Ill. We can furnish that.

(The following was subsequently supplied for the record:)

DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., February 4, 1972.

SECNAV NOTICE 7040

From: Secretary of the Navy
Subject: FY 1972 Outlays and Obligations
Enclosure: (1) Monthly Phasing of FY 1972 Planned Total Outlays, (2) Monthly Phasing of FY 1972 Planned Total Obligations

1. *Purpose.*—To promulgate outlay and obligation targets for FY 1972 by appropriation and revolving fund accounts.

2. *Background:*

a. The President's Budget for FY 1973 includes those programs essential to the materiel and technological readiness of naval forces. The budget presents a program execution plan in terms of obligations and expenditures necessary to the acquisition and delivery of materiel and services to support essential readiness. The Budget also contains estimates of outlays and obligations for FY 1972, the achievement of which requires extraordinary effort and program acceleration. The Department of Navy is committed to attaining or exceeding these estimates within the limits specified by law.

b. The outlay estimates in the Budget Document for FY 1973 were based on the assumption that outlays programed for FY 1972 would be achieved. Accordingly, a shortfall in meeting the FY 1972 target will adversely affect the Navy's ability to execute approved programs and remain within the FY 1973 outlay estimates.

c. Monthly and annual targets for FY 1972 outlays and obligations are contained in enclosures (1) and (2). These amounts include the FY 1972 supplemental request and the 1 January 1972 pay raise and may be revised by the Comptroller of the Navy as he deems necessary in the execution of this program.

3. *Responsibility:*

a. The Chief of Naval Operations is responsible for meeting the obligation and expenditure targets for all Navy appropriations except RDT&EN.

b. The Commandant of the Marine Corps is responsible for meeting the obligation and expenditure targets for all Marine Corps appropriations.

c. The Assistant Secretary of the Navy (Research and Development) is responsible for meeting the obligation and expenditure targets for RDT&EN.

d. The Comptroller of the Navy is responsible for (1) prescribing reporting requirements as may be necessary for effective coordinated management of the Department of the Navy efforts and (2) insuring that adequate financial data are available in a timely manner.

4. *Action:*

a. Action addressees shall take all feasible actions to ensure that the targets reflected in enclosures (1) and (2) are achieved. Successful execution will require the personal attention of all executives.

b. The Comptroller of the Navy shall provide weekly status reports on expenditures and monthly reports on obligations, by appropriation, to facilitate performance evaluation.

c. The Chief of Naval Operations, the Commandant of the Marine Corps, and the Assistant Secretary of the Navy (Research and Development) shall be prepared to brief the Secretary of the Navy weekly on the appropriations under their cognizance.

d. Recommendations which would contribute to the attainment of these objectives shall be submitted to revise regulations, procedures, or reports. Recommendations should be susceptible to early resolution by executive action, but must recognize currently authorized manpower ceilings.

JOHN H. CHAFEE,
Secretary of the Navy.

DEPARTMENT OF THE NAVY

MONTHLY PHASING OF FISCAL YEAR 1972 PLANNED OUTLAYS BY APPROPRIATION/FUND

[In millions of dollars]

	Actual July–January	Estimated February–June				
		February	March	April	May	June
MPN:						
Monthly		441.7	437.0	422.0	408.0	468.0
Cumulative	2,874.3	3,316.0	3,753.0	4,175.0	4,583.0	5,051.0
MPMC:						
Monthly		140.5	136.0	135.0	134.0	145.0
Cumulative	767.5	908.0	1,044.0	1,179.0	1,313.0	1,458.0
RPN:						
Monthly		16.8	18.1	17.4	20.5	21.5
Cumulative	97.7	114.5	132.6	150.0	170.5	192.0
RPMC:						
Monthly		6.4	7.0	7.2	6.8	9.8
Cumulative	30.5	36.9	43.9	51.1	57.9	67.7
O. & M., N:						
Monthly		415.1	450.0	410.0	445.0	535.0
Cumulative	2,889.9	3,305.0	3,755.0	4,165.0	4,610.0	5,145.0
O. & M., MC:						
Monthly		29.3	29.0	29.0	30.0	34.0
Cumulative	219.9	249.2	278.2	307.2	337.2	371.2
PAMN:						
Monthly		315.8	345.0	310.0	335.0	394.0
Cumulative	1,551.2	1,867.0	2,212.0	2,522.0	2,857.0	3,251.0
SCN:						
Monthly		195.4	234.0	178.0	190.0	230.0
Cumulative	1,012.6	1,208.0	1,442.0	1,620.0	1,810.0	2,040.0
OPN:						
Monthly		150.0	157.0	168.0	170.0	205.0
Cumulative	835.0	985.0	1,142.0	1,310.0	1,480.0	1,685.0
PMC:						
Monthly		26.6	35.0	33.0	36.0	36.0
Cumulative	18.4	45.0	80.0	113.0	149.0	185.0
R.D.T. & E.N:						
Monthly		178.1	218.0	220.0	225.0	310.0
Cumulative	1,281.9	1,460.0	1,678.0	1,898.0	2,123.0	2,433.0
MCN:						
Monthly		56.7	40.0	57.0	69.0	50.0
Cumulative	178.3	235.0	275.0	332.0	401.0	451.0
MCNR:						
Monthly		.6	.9	1.4	1.7	2.5
Cumulative	1.1	1.7	2.6	4.0	5.7	8.2
Total general funds:						
Monthly		1,973.0	2,107.0	1,988.0	2,071.0	2,441.0
Cumulative	11,758.6	13,731.6	15,838.6	17,826.6	19,897.6	22,338.6
REVENUE AND MANAGEMENT FUNDS						
NSF:						
Monthly		7.1	24.4	34.1	19.3	10.4
Cumulative	−5.6	1.5	25.9	60.0	79.3	89.7
MCSF:						
Monthly		6.6	4.3	−2.0	5.0	4.0
Cumulative	−2.9	3.7	8.0	6.0	11.0	15.0
NIF:						
Monthly		11.8	−9.8	−18.8	−8.8	−8.4
Cumulative	−31.7	−19.9	−29.7	−48.5	−57.3	−65.7
NMF:						
Monthly		3.0	.1	7.1	−7.6	5.4
Cumulative	4.0	7.0	7.1	14.2	6.6	12.0
Other:						
Monthly		−.8	−.4	−.4	−.5	−.4
Cumulative	1.9	1.1	.7	.3	−.2	−.6
Total revenue and management:						
Monthly		27.7	18.6	20.0	7.4	11.0
Cumulative	−34.3	−6.6	12.0	32.0	39.4	50.4
Budget concepts/UND:						
Monthly		1.5	−5.8	6.0	−7.2	5.8
Cumulative	−32.0	−30.5	−36.3	−30.3	−37.5	−31.7
Total Navy Excl. MAP:						
Monthly		2,002.2	2,119.8	2,014.0	2,071.2	2,457.8
Cumulative	11,692.3	13,694.5	15,814.3	17,828.3	19,899.5	22,357.3
MAP:						
Monthly		3.9	8.8	6.8	7.0	6.4
Cumulative	75.1	79.0	87.8	94.6	101.6	108.0
Grand total:						
Monthly		2,006.1	2,128.6	2,020.8	2,078.2	2,464.2
Cumulative	11,767.4	13,773.5	15,902.1	17,922.9	20,001.1	22,465.3

Note: Totals include an estimate for "Miscellaneous expired accounts," which is not shown separately.

DEPARTMENT OF THE NAVY

MONTHLY PHASING OF FISCAL YEAR 1972 PLANNED OBLIGATIONS

[In millions of dollars]

	Actual, July–November	December	January	February	March	April	May	June
MPN:								
Monthly		444.2	469.0	464.9	464.0	434.0	423.1	395.0
Cumulative	2,024.4	2,468.6	2,937.6	3,402.5	3,866.5	4,300.5	4,723.6	5,118.6
MPMC:								
Monthly		108.3	131.1	130.7	130.7	130.6	130.6	130.7
Cumulative	589.1	697.5	828.6	959.3	1,090.0	1,220.6	1,351.2	1,481.9
RPN:								
Monthly		16.3	17.1	17.9	19.8	17.5	20.4	24.7
Cumulative	70.2	86.6	103.6	121.5	141.3	158.8	179.2	203.9
RPMC:								
Monthly		6.0	5.6	5.6	5.6	6.0	6.0	10.0
Cumulative	26.5	32.5	38.1	43.7	49.3	55.3	61.3	71.3
OMN:								
Monthly		471.1	540.0	440.0	443.0	530.0	440.0	604.2
Cumulative	2,780.9	3,252.0	3,792.0	4,232.0	4,675.0	5,205.0	5,645.0	6,249.2
OMMC:								
Monthly		37.5	39.2	35.1	39.4	38.9	39.7	43.8
Cumulative	146.9	184.4	223.6	258.7	298.1	337.0	376.7	420.5
PAMN:								
Monthly		366.6	327.7	215.8	312.0	344.6	232.0	408.3
Cumulative	1,691.6	2,058.2	2,348.9	2,601.7	2,913.7	3,258.3	3,490.3	3,898.6
SCN:								
Monthly		260.9	1,038.6	134.7	103.0	105.3	80.1	390.0
Cumulative	737.8	998.7	2,037.3	2,172.0	2,275.0	2,380.3	2,460.4	2,850.4
OPN:								
Monthly		271.3	176.7	152.3	151.2	150.5	119.2	164.2
Cumulative	939.7	1,211.0	1,387.7	1,540.0	1,691.2	1,841.7	1,960.9	2,125.1
PMC:								
Monthly		20.9	21.9	25.9	32.0	33.0	34.5	35.0
Cumulative	39.2	60.0	81.9	107.8	139.8	172.8	207.3	242.3
R.D.T. & E., Navy:								
Monthly		374.1	162.4	158.0	155.8	148.0	130.6	140.5
Cumulative	1,364.1	1,738.2	1,900.6	2,058.7	2,214.5	2,362.5	2,493.2	2,633.7
MCN:								
Monthly		8.7	33.0	51.0	61.0	51.0	49.0	38.0
Cumulative	188.3	197.0	230.0	281.0	342.0	393.0	442.0	480.0
MCNR:								
Monthly		.2	(1)	1.0	1.5	1.5	1.5	1.0
Cumulative	4.8	5.0	5.0	6.0	7.5	9.0	10.5	11.5
Grand total:								
Monthly		2,386.1	2,962.3	1,832.9	1,919.0	1,990.9	1,706.7	2,385.4
Cumulative	10,603.6	12,989.7	15,952.0	17,784.9	19,703.9	21,694.8	23,401.5	25,786.9

[1] Under $100,000.

Chairman PROXMIRE. Have you talked with Secretary Chafee about his note?

Mr. ILL. I talked originally—there were discussions with regard to our requirements, how we were going to meet our obligations and goals for the year, yes, sir.

Chairman PROXMIRE. Have you written to the Secretary in response to that note?

Mr. ILL. No, I have not. He was directing in that note the Chief of Naval Operations to take the appropriate action, which is the proper chain of command.

Chairman PROXMIRE. Did you write to Admiral Zumwalt with respect to his telegram?

Mr. ILL. I beg your pardon.

Chairman PROXMIRE. Did you write to Admiral Zumwalt with respect to his telegram?

Mr. ILL. No, sir. I did not write to Admiral Zumwalt.

ACTION TAKEN TO IMPLEMENT SECRETARY OF THE NAVY'S INSTRUCTION

Chairman PROXMIRE. What have you done to implement this instruction of the Secretary of the Navy? By that I mean what actions have you taken? And what actions have you caused to be taken?

Mr. ILL. We have reviewed—well, the actual appropriate chain here, Mr. Chairman, is from the Secretary to the Chief of Naval Operations who directed it to the Chief of Naval Material.

Now, the monitoring of the activity that is going on, because it is of a financial nature, has been assigned to the Assistant Secretary of the Navy for Financial Management. I have been involved in regard to the procurement procedures, and things of that nature, and the administration, and we have discussed these things between Admiral Kidd and myself. We have discussed, for instance, the overtime issue.

Chairman PROXMIRE. What I am concerned with is what you have done to implement the acceleration request that he has there, the speeding up of spending.

Have you—can you tell us what instructions you have issued to speed up——

Mr. ILL. I have not issued any specific——

Chairman PROXMIRE. What?

Mr. ILL. I have not issued any instructions, sir.

Chairman PROXMIRE. Well, how does the Secretary's order become effective?

Mr. ILL. Instructions to the Chief of Naval Operations and to the Chief of Naval Material.

Chairman PROXMIRE. Have you discussed this instruction with any other officials in the Department of Defense, outside of the Navy? With Mr. Moot? With Secretary Laird, for example?

Mr. ILL. Not in my immediate recollection at the moment. It has been a topic of discussion at times. I have not, to the best of my recollection, attended any meetings or anything of that nature. I have not had any direction, if that is what you mean.

Chairman PROXMIRE. I can't understand why you, as Secretary of the Navy wouldn't have the responsibility here. You are in the chain of command. Why should it go to Admiral Kidd to do this? Why shouldn't you have the responsibility?

Mr. ILL. He is the Chief of Naval Material. I have the responsibility, as the agent of the Secretary of the Navy, to follow through and watch what he is doing with regard to the——

Chairman PROXMIRE. Well——

Mr. ILL (continuing). Secretary of the Navy.

Chairman PROXMIRE. In this followthrough process you feel there is nothing more required on your part? You have been——

Mr. ILL. I have not issued any—the question you asked me, Mr. Chairman, and I am trying to be fully responsive, you asked me if I had issued direct instructions.

No. I have coordinated with Admiral Kidd. We have discussed this.

Chairman PROXMIRE. Then you approved what Admiral Kidd has done.

Mr. ILL. I approved everything I have seen; yes.

Chairman PROXMIRE. You approved the fact that he has sent teams out to implement these instructions?

Mr. ILL. Yes, sir.

Chairman PROXMIRE. And the teams, I take it, have instructions to implement getting rid of the money.

Mr. ILL. No, sir; not to get rid of the money. It is to accomplish the task that is the Navy's responsibility.

SPENDING ACCELERATION THROUGHOUT DOD

Chairman PROXMIRE. I am told that the decision to accelerate spending was made on a very high level and has implications throughout the Department of Defense and the Federal Government. According to my information, the Defense Department has increased its outlay target for the current year by about $2 billion, and that, therefore, the $400 million increase for the Navy is only a portion of the overall increase. Can you confirm that?

Mr. ILL. No, sir.

$2 BILLION OUTLAY TARGET

Chairman PROXMIRE. Have you ever heard of a $2 billion outlay target increase which the Pentagon is supposed to attain?

Mr. ILL. I do not know that number.

Chairman PROXMIRE. Have you ever discussed this matter with anyone in the White House or the Office of Management and Budget?

Mr. ILL. I have not.

ASSOCIATION WITH 1968 NIXON CAMPAIGN

Chairman PROXMIRE. Earlier I read something—Senator Percy asked about your background and qualifications. Isn't it also true that you worked as a campaign manager in the Nixon campaign during the 1968 election?

Mr. ILL. No, sir; not as a campaign manager. I worked in Mr. Nixon's office here in Washington, Citizens for Nixon and Agnew.

Chairman PROXMIRE. You simply worked as an officer. You were not a campaign manager.

Mr. ILL. I was not a campaign manager. I walked in the front door and asked what I could do. I thought after all these years as a citizen in this country, I should do something about the campaign. I had a little time. I wound up working 7 days a week.

Chairman PROXMIRE. You picked a winner.

Mr. ILL. Yes, sir; you are absolutely 100 percent correct, I did pick a winner.

PRIOR FEDERAL GOVERNMENT EMPLOYMENT

Chairman PROXMIRE. Prior to your experience in the campaign, had you ever worked for the Federal Government?

Mr. ILL. No, sir, I never did.

QUALIFICATIONS FOR NAVY PROCUREMENT POSITION

Chairman PROXMIRE. You answered this in part. I would like to ask you again. What qualifications do you have for your present job, as the head of the Navy's procurement program? You said you had worked at Page for 16 years. You headed three TV stations that were UHF, I guess, stations.

Mr. ILL. Yes, sir; well, in working with Page we worked for many years for various governments all over the world, including the U.S. Government, and purchased many millions and millions of dollars worth of equipment, installing many millions of dollars of systems.

Chairman PROXMIRE. How big is that firm?

Mr. ILL. The firm was bought by the Northrup Corp., oh, I think it is probably about 10 years ago now, sir. I have not been connected with them for 6 years.

Chairman PROXMIRE. How big was it when you were working for them?

Mr. ILL. I believe the year I left they did a business of $100 million.

Chairman PROXMIRE. You did no business with the Navy?

Mr. ILL. Very little, sir.

Chairman PROXMIRE. I understood you to say none. Did you do any business with any other branch of the Government?

Mr. ILL. Yes, sir.

Chairman PROXMIRE. Which branch?

Mr. ILL. We did a lot of business with the Army and a lot of business with the Air Force, and we did business with other governments all over the world.

Chairman PROXMIRE. In procurement?

Mr. ILL. Well, the nature of our work included a large percentage of procurement. What we did, a customer would come in—I am picking a very simple example—and say, we want communications from point A, to point B, what do we need? And we would sit down and design them a system and go out and buy the materials—we were not a manufacturer—buy the materials that were required, assemble this in a system and then install the system for the customer wherever he wanted it. These contracts ranged anywhere from $100,000 to multimillion. We started in an office that you could put in the corner of this room and Mr. Page just moved into a new building with a couple of hundred thousand square feet of floor space.

We bought a great deal of electronic equipment. We bought a great deal of construction equipment. We ran projects all over the world. I ran the operations end of the business as well as the procurement end of the business, so that I have a feel for project management. I had many project managers working for me.

PERSONNEL TURNOVER AND LACK OF CONTINUITY

Chairman PROXMIRE. I don't mean to be critical of you personally, Mr. Ill, but I think you are a shining example of the problem Senator Percy raised a little earlier. Here you have come along with some background in procurement. You had a political connection with the President of the United States. You replaced Mr. Sanders, who had just taken office shortly before these hearings were begun in 1969.

Now, Mr. Sanders is in a different position and you are here. Again, this isn't something peculiar to the Republican administrations. It happens in Democratic administrations. It is not a partisan problem but it is a problem of our Government, the fact that we have this turnover in which people just don't get an opportunity to learn enough about the business so they can be both responsible and have continuity and have the particular experience which should be of an extraordinarily high order.

Wouldn't we be better served if we had a man in your capacity who had served in procurement for 20, 25 years in the Navy, worked his way up, a man whose whole background and experience had been here and demonstrated excellence in this particular field?

Again I don't mean to be critical of you or the Republican Party. Democrats do exactly the same thing.

Mr. ILL. Mr. Chairman, I would like to respond to that and possibly bring up a little of Mr. Frank's testimony.

One of the problems that Mr. Frank stated he had was that for 20 years he had been selling altimeters to the U.S. Navy and always to the same people, and they were biased the whole time. I hope I am restating his——

Chairman PROXMIRE. Yes, he did. The trouble is that the top people——

Mr. ILL. I think this problem——

Chairman PROXMIRE (continuing). Weren't there long enough to get a grip, to know what was going on. They had to rely on people who had been there 20 years, down at a much lower level.

Mr. ILL. I think, sir, as I stated in my statement. One of the things I expect to zero in on is our major supply contracts. I visited virtually every major contractor the Navy does business with. I visit some of the major ones regularly every quarter because we have problems. I think I understand a lot of the problems involved in these detailed procurements, and I am going to try to keep that up.

I have also stated in my statement before the Senate that I would serve in this position as long as the President would like me to serve, and I will do so, so that I do not intend to be here for 30 days or 60 days. I will be here just as long as he would like to have me stay here.

Chairman PROXMIRE. I don't know how long the President will be here. The way they are operating out in Wisconsin, he will be here a long time.

Mr. ILL. I hope he will be here a long time, sir, at least another 4 years.

Chairman PROXMIRE. Well, I don't, but that is what makes politics.

Mr. ILL. I can understand your feelings, sir, but I am a little biased, sir.

Senator PERCY. I share your feelings.

Mr. ILL. Thank you, Senator. It is nice to have you on my side.

INTERSERVICE RIVALRIES AND COMMON PROCUREMENT

Senator PERCY. That will not impede me, however, from asking you a few more questions. Could you comment on the problem of interservice rivalries? And I would like to ask both you and the admiral this question. You have already heard my own personal experience and I would like just as candid and straightforward an answer as possible. We are seeking the truth. We are not trying to embarrass anyone or any service, but we are trying to get at the bottom of why it is that we cannot get the kind of procurement which I felt the Secretary of Defense was trying to install when we had a vigorous attempt two decades ago, to have common procurement by a single lead agency or service. The goal was to avoid the same problems of supplying smaller numbers of units that were not greatly dissimilar but led to small production runs which did not permit the kind of economies

in competitive bidding and the attractiveness for these items that you can have when you combine the needs of the services.

Perhaps, Mr. Secretary, you could comment first and then we will turn to the admiral.

Mr. ILL. All right, sir.

If I were to say that I didn't believe there was any interservice rivalry, I would be a liar. I do think there is some.

Senator PERCY. That is a good forthright statement. I agree with you. And there is a healthy and an unhealthy kind. I am not talking about the healthy kind that is out on the football field or tries to have pride of service that then instills that sense of pride and sense of achievement. I am talking about the destructive kind, the kind that is really unhealthy, that is costly, and that is what you are talking about in saying that some of it does exist.

Mr. ILL. Well, we have had the problem with us for a long time. It isn't easy to resolve or it would have been resolved because there have been many dedicated men leading the Department of Defense who wished to cut down the costs as best they can.

VOLUME OF COMBINED PROCUREMENT

To say that there isn't any pride in invention in-house would not be correct. We have in the Defense Department, with the Defense Supply Agencies, consolidated our procurement for the three services for many, many items.

We have not solved the problem, but they do a tremendous job for all three services, and the volume of business—I do not have the figure at my fingertips, but I would be glad to furnish it to the committee. The total dollar volume of business they do every year, which is done for the three services, is certainly a substantial amount of money.

Now, obviously——

Senator PERCY. Could you give us a report on how much has been done in that field and——

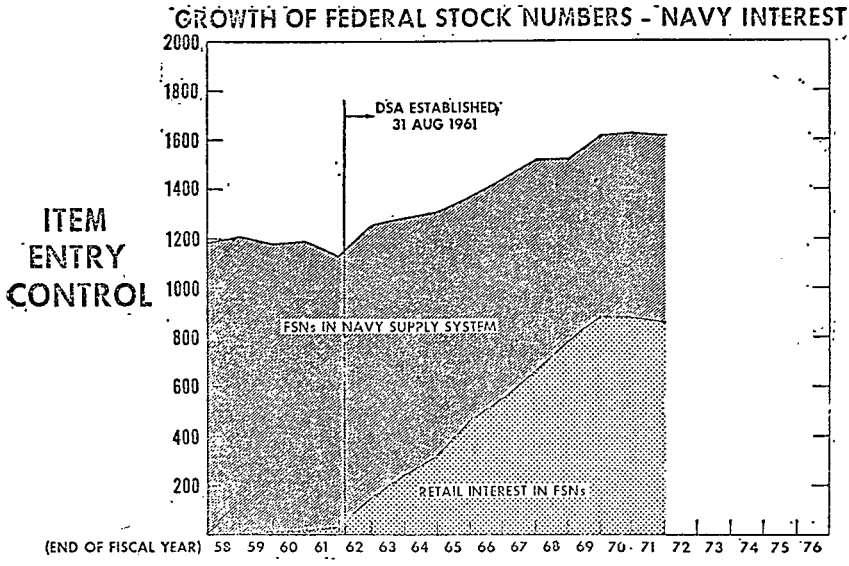
Mr. ILL. Yes, sir.

Senator PERCY (continuing). And then areas that you feel can be open to further togetherness in the services, including altimeters? I think we would just be particularly interested now, pursuing that one, to see whether or not we can at least solve that little problem.

(The following information was subsequently supplied for the record:)

Since its establishment in 1961 the number of items centrally managed by the Defense Supply Agency (DSA) has grown to approximately 1.9 million. Their inventory had a total value of $2.5 billion as of 30 June 1971. The attached chart depicts graphically the decrease in the number of items managed by the Navy and the increase in the number of "Navy Interest" items managed by the Defense Supply Agency.

Future actions in this area hold considerable promise for further consolidation. For instance in recognition of the need for interservice support, the Navy is participating in a joint effort to establish mutual support on commonly used weapon system related consumable items. This effort will result in the elimination of all wholesale item management duplication. In addition to this effort another joint service group is working toward transferring 31 complete Federal supply classes from service management to the Defense Supply Agency. Both of these efforts have strong Navy support and exemplify the continuing emphasis placed on achieving savings through joint logistic support measures.



Source: NAVSUP Records.

Mr. ILL. I certainly agree with you and we will certainly look into that area.

Let me say my own personal opinion. I work very closely with my counterparts in the Army and in the Air Force. We, on many occasions, have resolved interservice problems and I hope we will continue to do that, and we certainly will in all instances where we can.

To tell you that I could know of all of them and solve them all would also be beyond comprehension, but I certainly will do it in every instance that I can, and I will push policies and philosophies to minimize the interservice rivalry.

EXAMINATION OF CLAIMS HANDLING

Senator PERCY. Secretary Ill—and I will come back to that subject a little later—in your testimony you state you are undertaking a comprehensive examination of the Navy's handling of claims addressing the various alternatives and methods available to effect a resolution of the matters under discussion. Can you list for us some of the alternatives you received in answer to your inquiry into this matter? I realize you made the request shortly after July.

It was then made of the Chief of Naval Material who then was rotated in December. What specific alternatives did you receive from both Admiral Kidd and his predecessor?

Mr. ILL. Well, actually we worked on these things as a team, together. We had various members of our staffs involved in the discussions.

We had several recommendations. We had recommendations from Admiral Rickover, whose opinion we all value.

We had recommendations from Gordon Rule, whose name has come up here, and whom we all respect for his knowledge in this area.

We have had a lot of recommendations from different people as to how we should solve the claims problem, and this goes over a period of time.

We looked over the recommendations that we had. We considered putting it in the General Counsel's Office, which has been a very strong suggestion. Admiral Kidd felt strongly that he would have the benefit of reviewing all of these claims, so that they could help stop them in the future.

The key civilian personnel who are now involved in the claims procedures are the senior procurement people in each of the Systems. We thought they could give us the best talent that we could assemble in the U.S. Navy to review these.

BILLION-DOLLAR HEADACHE

Senator PERCY. You inherited a billion-dollar headache and problem. You reviewed the procedures being used that brought that condition about. Are you satisfied now that 9 months later you have a procedure which is new and different and which will correct the past problems and will not result in this kind of claim being made in the future?

Mr. ILL. No, sir; I do not think that it will completely solve the problem. However, I would say this. I have pushed my own philosophy and my own feeling which I have discussed in detail with the Secretary and with Admiral Kidd. He agreed with me.

NEED FOR EQUITABLE CONTRACTS

And that is that we must try to write equitable contracts at the outset. We must—if there are changes, address those changes. If there are major changes in what the contractor expects us to furnish him for one reason or another, let's address that problem as it comes up with the people who know what the facts are today. And this emphasis, I believe, will help out.

Senator PERCY. When you say you need more equitable contracts, are you implying when you get a firm bid from a contractor who has been in business for years and who presumably should stand behind that contract, that you are going to then say: "Are you sure you have thought of this? Are you sure you have made enough allowance for that? Don't you think you had better put a little more money in for this, or what?"

DANGER OF CONCURRENCY

Mr. ILL. No. That is not the point I am trying to make, sir. What I am trying to say is that on certain types of contracts where we did go out on a competitive bid basis, on a fixed-price contract, for example, it might have been better had we produced a lead ship, for instance, on a cost-plus basis—until we had solidified the design and assured ourselves the weapons systems we were going to put on that ship would work. One of the biggest problems we have had and one of the biggest bulk of claims we had stems from the fact that there was a great deal of concurrency which caused delay and disruption and caused late furnished Government material and Government information.

Procurement Plan for Patrol Frigate

Now, for instance, in the new PF program, if it passes the Congress, if the Congress authorizes the funds for this—the procurement plan shows that two shipbuilders will work on the plans with the U.S. Navy for a period of time until they are developed. Then we will build a lead ship.

Then a year and a half or 2 years after that we will start construction of the followon ships. This long period of time will not back up two or three contractors with steel in the yard, people standing by, waiting to go to work, which is part of what caused our claims problem. I think that this kind of procurement will help.

Hydrofoil Lead Ship Construction

We are doing this also in several other procurements—the PHM, which is our hydrofoil program. We are developing a prototype, not actually a prototype, but it is a lead ship again, and we are going to try out the machinery that goes into it, the weapons that go in, and the whole works before we buy a series of 30 ships.

REASON FOR NEW PROCUREMENT METHODS

Senator PERCY. I must say I am just astounded at the way we are feeling our way along in this field as if this is some sort of a new Navy. We have been in the business for a long, long time. What are the new factors that cause us to be experimenting with procurement methods now?

Mr. ILL. This is not an experiment, sir. This type of procurement has been used in the past. I would rather say that the methods that were used in the early 1960's which have caused a great percentage of the claims that we have today were the experiment and were found to be unsuccessful.

AVONDALE HOSTAGE

Senator PERCY. Mr. Chairman, may I ask one more question:

A rather incredible statement was made yesterday, I thought, by Admiral Kidd in which he testified that a major consideration in his decision to settle the Avondale claim was his fear that the contractor would actually hold the ship captive unless settlement took place.

Do you believe that this should have been a major consideration even if there was a question as to validity of the contractor's claim?

Mr. ILL. Senator, Admiral Kidd and I worked on that Avondale provisional payment together. I am completely in accord with what was done.

Let me say this: What we were faced with was, No. 1, we need ships in the fleet. That is a consideration—not the primary one. I am just going to list a series of considerations.

No. 2, we had statements from the parent company of Avondale that they felt that we had breached the contract. I believe those are the terms that were used.

No. 3, we felt that there was a possibility of going into a long litigation which would stop the production of our ships.

No. 4, the best estimate that I can get for reproducing those ships today would be substantially, and I mean very substantially, more than what I believe we can get those ships delivered at a reasonable price from the present builder.

No. 5, we had an estimate from NavShips which said that their valuation of the claim that was coming forward would be more than the amount of money that we were talking about in a provision payment.

No. 6, we feel that we are going to be able to settle or give our position, not necessarily settle, but give the Navy's position to the contractor substantially before December of this year.

Senator PERCY. My time is up. I thank you very much, indeed, and before you leave I would like you, Admiral, to have a chance to comment on interservice rivalry, but I will yield to the chairman.

Chairman PROXMIRE. I take it that your response to Senator Percy, in reply to his last question, was the fact that they had the power, they had the ships, and that you wanted the ships, was a consideration of the—a consideration of support for Admiral Kidd's answer. Is that right?

Mr. ILL. Absolutely, the fact that they——

Chairman PROXMIRE. They would hold them hostage, export the money, like a kidnapper does; give us the money or you don't get your child back. Give us the money or you don't get your ships.

Mr. ILL. Senator, the ball game is not over.

Chairman PROXMIRE. I hope not.

MARKET FOR AVONDALE DESTROYER ESCORT SHIPS

Senator PERCY. Is there a market for these ships?

Mr. ILL. A market for these ships?

Senator PERCY. Can they sell them on the market?

Mr. ILL. At the price we are getting them for, I think we could sell them; yes.

Chairman PROXMIRE. You have given two-thirds of the ball game away. $73 million. You already provided $48 million.

Mr. ILL. I know that there was an agreement or handshake and this committee has gone into that in detail, for something like $73 million.

However, the total claim we are looking at is something like $140 million. Now, if we throw this into the courts, I don't know what Avondale's position would be.

Chairman PROXMIRE. Avondale agreed to take $73 million.

Mr. ILL. I beg your pardon?

Chairman PROXMIRE. Avondale agreed to take $73 million. The $48 million was two-thirds of what they wanted.

Mr. ILL. But if we throw it into the courts, they are no more bound by that decision, I do not believe. I will have to——

Chairman PROXMIRE. We had Mr. Frank testify how he was tossed into default three times by the Navy but they find all kinds of reasons for not defaulting Avondale, a big outfit.

PAYMENT FOR F–14 TEST CRASH AND FOLLOW-ON COSTS

Secretary Ill, apparently the Navy is considering paying for the F–14 airplane that crashed in a test and also for the stretchout costs caused by the delay that followed the crash. Is that correct?

Mr. ILL. Mr. Chairman, I am not prepared to discuss that in detail with you today. I am sorry. The topic that I was furnished was the shipbuilding claims. We are in negotiation—I can speak very generally to it but I can't speak to it in detail.

Chairman PROXMIRE. I don't want you to discuss it in detail. I just want an answer to the question: Yes or no.

Mr. ILL. I can't give you an answer yes or no. I would have to answer the question "No." If you would restate it again sir, I would appreciate it.

Chairman PROXMIRE. The question is: The Navy is considering paying for the F–14 airplane that crashed in a test, and also for the stretchout costs caused by the delay that followed the crash. Is that correct, or not?

Mr. ILL. That is partially true, sir. That is not wholly true and I don't have the complete facts before me at this time.

The crash of the airplane caused a considerable amount of extra instrumentation that we required on the following airplane; that cost money. There has been a delay in the program due to the crash and it has been associated in the first four lots.

Chairman PROXMIRE. Well, that is correct, and that is a matter of philosophy, why should the Navy pay either cost? It wasn't responsible for the crash or the delay. Where the Navy is not responsible for the delay or crash, why should it pay anything? Why should the taxpayer pay?

Mr. ILL. I am not current on it at the moment.

Chairman PROXMIRE. Let's forget about the F–14. Let's take a hypothetical situation. A crash of this kind occurs. It is not the Navy's fault; there is a delay. It is not the Navy's fault. Under those circumstances, can you conceive that the Navy should possibly pay anyway?

GROUND- AND FLIGHT-RISK CLAUSE

Mr. ILL. The admiral is a little better informed on this than I am.

Admiral FREEMAN. I think possibly, Senator, you are talking about the clause we include in most of our airframe contracts, the ground- and flight-risk clause, in which the Government undertakes to be self-insuring. This was the result of some investigations by the General Accounting Office in the mid-1950's, at which time they indicated that they believed it was more appropriate for the Government to self-insure against these kinds of accidents, both on the ground and in the air, in order to avoid paying insurance premiums for something which might not happen. There are some rather large premiums involved.

GOVERNMENT AS SELF-INSURER

The Government, as a self-insurer, is considered a proper philosophy.

Chairman PROXMIRE. Are you saying in this case the Government was self-insured?

Admiral FREEMAN. Under the ground- and flight-risk clause there are exceptions. I don't happen to have the clause with me.

Chairman PROXMIRE. Even though the Government, the Navy, is not at fault, the Navy does pay the cost?

Admiral FREEMAN. Under those clauses; yes, sir.

Chairman PROXMIRE. Why would you get into that kind of a clause? Why would you agree to that kind of situation, that heads they win, tails you lose?

Admiral FREEMAN. It is not quite that way. You look at the tremendous volume of aircraft procurement, procured by both ourselves and the U.S. Air Force and the Army, and I think if you add it up, add up the premiums paid as a hedge or a risk, a reimbursed cost for a risk assumption, you would agree that it is in the best interest of the Government to be self-insuring. That is not——

CLAUSE DESTRUCTIVE TO EFFICIENCY

Chairman PROXMIRE. You see, what concerns me is that it destroys the incentive for doing this efficiently or doing it safely or avoiding a crash or holding down your costs.

Why if you are going to get insurance should you be making an effort? The Government is going to pay for it, anyway.

Admiral FREEMAN. I doubt if there is a contractor that wants to lose a test airplane.

Chairman PROXMIRE. Well, of course he doesn't want to lose it but he is going to take more of a chance if he doesn't have to worry about the cost of it.

Admiral FREEMAN. I don't agree with that.

CAPITULATION ON CLAIMS

Chairman PROXMIRE. You mentioned, Mr. Ill, the Navy efforts to prevent new ship claims from arising. That sounds fine, but how can you hope to prevent new claims when you cave in, you capitulate, you pay, pay, pay, on the old claims? I don't mean any old claims. I mean unsubstantiated claims, as the testimony from GAO and others demonstrated.

The $25 million provisional payment to Avondale is only the latest case in point. You don't think that action is designed to prevent new claims from arising, do you? Isn't that an incentive, so that you are paying claims, unsubstantiated, no records to support them?

Mr. ILL. First, I don't agree it is unsubstantiated. Second of all——

GAO REPORT OF LACK OF SUBSTANTIATION

Chairman PROXMIRE. That was the GAO report, that it was not substantiated. The GAO reported it was not substantiated. They investigated it for months.

Mr. ILL. The GAO has not reviewed the information that is presently in the hands of the Navy.

Chairman PROXMIRE. Well, they did investigate this situation and they couldn't find any basis that would support it.

Mr. ILL. I am afraid, sir, you will have to refer me to the GAO report you are talking about. I think they talked in general about claims, but I have not seen——

Chairman PROXMIRE. On Todd and Lockheed they specifically went in to investigate and found they were not substantiated, and yet claims were paid. Todd was $97 million.

Mr. ILL. That is correct; $97 million to Todd.

Chairman PROXMIRE. And it was not substantiated.

Mr. ILL. Sir, I——

Chairman PROXMIRE. Mr. Rule said the Avondale wasn't substantiated.

Mr. ILL. I tried very hard not to fall back—I understood your criticism about the turnover of civilian personnel and I think I had tried to answer ever question you have asked me, but it is impossible for me to go back into the minute details of everything that has happened over the last 4 or 5 years, which I am sure——

Chairman PROXMIRE. I wouldn't expect you to go into minute details. What I am saying is, how about this philosophy of paying unsubstantiated claims? We have had this colossal explosion of claims. They have gone up to almost a billion dollars, the highest we have had in the history of the Nation, of the country, by far. Isn't it going to get bigger and bigger when there is——

Mr. ILL. No. We are not paying——

Chairman PROXMIRE. What is that?

Mr. ILL. We are not paying any claims that we don't feel are substantiated, that we don't have a basis for payment for.

Chairman PROXMIRE. In the Todd case, that was the GAO finding. In the Lockheed case that was the GAO finding.

Mr. ILL. In the Lockheed case——

Chairman PROXMIRE. And in the Avondale that was the Navy's finding.

Mr. ILL. In the Avondale case there was some justification of expenditures by the contractor. There was not sufficient backup to the $73 million, but we do have——

Chairman PROXMIRE. You rejected the entire thing.

Mr. ILL. We have had teams down there for over a year and a half, since that period of time, and they have developed substantially more information and they have been able to look into the records in detail. That——

Chairman PROXMIRE. The official of Navy claims group headed by Gordon Rule rejected the Avondale claim last July.

Mr. ILL. That is correct.

Chairman PROXMIRE. Yet the payment was made.

Mr. ILL. They rejected it last July, but there has been a lot of new information developed since last July, sir.

Chairman PROXMIRE. Well, this is the—you can understand that looking at it from our standpoint, this is the great difficulty we have. I understand you want the ships, but the cost to the taxpayers——

Mr. ILL. We are not going to pay one nickel more for them than what the substantiation of the claims and the claims group—what our whole claims procedure advises us to pay.

Chairman PROXMIRE. Unless they hold the ships hostage, as they did in the Avondale case.

Mr. ILL. No, sir; I didn't say that. I am not going to discuss what we are going to do in the future, because that would jeopardize my position and the Navy position. Excuse me.

Conclusion

Chairman Proxmire. Mr. Ill, the hour is late, very, very late. You have been most patient. You were very patient to wait while we had Mr. Frank on. We hope you will return. You know you are of great interest to this particular committee. We may have questions we would like to ask about claims in shipbuilding later, so I would like you to come back. My staff will contact your staff and work out a mutually convenient date for that.

Mr. Ill. Thank you very much.

Chairman Proxmire. This concludes the hearings of this subcommittee at the present time, on the claims situation, but they will be resumed in the near future.

The subcommittee stands adjourned.

(Whereupon, at 1:05 p.m., the subcommittee was adjourned, subject to the call of the Chair.)

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