ECONOMICS OF DEFENSE PROCUREMENT: SHIPBUILDING CLAIMS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON PRIORITIES AND ECONOMY IN GOVERNMENT

OF THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

NINETY-FOURTH CONGRESS

SECOND SESSION

AND

NINETY-FIFTH CONGRESS

FIRST SESSION

PART 1

JUNE 7 AND 25, 1976, AND DECEMBER 29, 1977

Printed for the use of the Joint Economic Committee

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MONDAY, JUNE 7, 1976

FRIDAY, June 25, 1976

THURSDAY, DECEMBER 29, 1977

AFTERNOON SESSION

ECONOMICS OF DEFENSE PROCUREMENT: SHIPBUILDING CLAIMS

MONDAY, JUNE 7, 1976

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 5302, Dirksen Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senator Proxmire.

Also present: Richard F. Kaufman, general counsel; and George D. Krumbhaar, Jr., and M. Catherine Miller, minority professional staff members.

OPENING STATEMENT OF SENATOR PROXMIRE, CHAIRMAN

Senator PROXMIRE. The subcommittee will come to order.

This morning the subcommittee resumes a hearing begun last year inquiring into the relationships between the Government and its major contractors. Our focus will be the shipbuilding claims filed by the Navy's shipbuilders against the Navy.

We began looking into the problems surrounding shipbuilding claims in 1969 at a time when few people understood the large amounts of money involved in or the significance of this issue.

Since 1969 hundreds of millions of dollars of shipbuilding claims have been settled by the Navy and additional hundreds of millions of dollars of new shipbuilding claims have been filed. The result is that today there is an unprecedented dollar amount of claims on file or about to be filed.

Over $1.4 billion in shipbuilding claims have been filed against the Navy and more than $400 million are in the process of being filed.

Now, a shipbuilding claim is another term for cost overrun. When actual shipbuilding costs exceed the amount in the contract, and the shipbuilder believes that the additional costs were caused by actions or inactions of the Navy, the shipbuilder may file a claim.

The normal procedure is for the Navy to audit, analyze, and evaluate the claim and then propose an amount to settle it.

In some cases, the Navy has paid close to the face amount of the original claim. In some cases the Navy has paid only a small fraction of the original claim because after an audit and evaluation it was determined that the Government's liability was small.

In some cases the Navy has referred claims to the Justice Department for investigation of possible fraud.

In most instances the causes of the cost overruns which led to the filing of claims concern delays in building the ship. Delay, disruption and other related problems make up the bulk of most claims. The question in all cases is, who is responsible for the delay and disruption?

That question cannot be answered with regard to the pending claims, much less those that have not yet been filed, because they have not been audited, analyzed, or evaluated.

The fact is that three-fourths of the claims filed by Newport News shipbuilding were either received by the Navy for the first time this year or substantially revised this year.

Shipbuilding claims are complicated and the documentation for them is voluminous. It takes many months and sometimes years for a shipbuilder to prepare his claims. It also takes many months for the Navy to fully audit and evaluate the claims.

But the Defense Department has proposed paying the pending claims under its national emergency authority, despite the fact that they have not been fully audited or evaluated.

Obviously, we will never know whether the claims are valid or invalid, legitimate or illegitimate, truthful or false unless they have been fully audited. Furthermore, we will never know whether the Government is legally liable for the amounts in the claims unless they have been fully evaluated by a team of legal experts.

The proposal to pay the claims without an audit is therefore a curious one. It is also a disturbing precedent because it could result in Government bailouts of large private corporations; the filing of additional claims by the same and other contractors in the future, and a breakdown in procurement policies.

The potential impact of such consequences on the budget are enormous and the direct and indirect costs to the taxpayer from what could be a most inflationary action are even larger.

Finally, let me just point out that according to last Friday's Washington Post that the Interior Department has halted construction on the National Visitor Center because of a nearly $5 million cost overrun reported recently by the contractor on that project.

I applaud the action that the Government has taken so far in this case. I strongly believe that the Government should promptly investigate large cost overruns.

I only point out the contrast between the Government's response to this case and to the shipbuilding claims.

Our witness this morning is Adm. H. G. Rickover who is well known to most Americans and needs no introduction. Admiral Rickover has a long and distinguished career of public service in the Navy, and undoubtedly is the outstanding expert on procurement, particularly naval procurement. And he honors us by his presence.

It happens that many of the ships that are the subject of the pending claims are nuclear powered and that Admiral Rickover has had responsibility particularly with respect to these ships. He has also had responsibilities for doing the technical evaluation of some of the claims that are pending and he therefore comes before us as an expert on the problems that we are seeking to understand.

Admiral, go ahead. And we have some questions for you.
Would you like to introduce the gentlemen who are with you?

STATEMENT OF ADM. H. G. RICKOVER, DIRECTOR, NAVAL NUCLEAR PROPULSION PROGRAM, ACCOMPANIED BY T. L. FOSTER, ASSOCIATE DIRECTOR FOR FISCAL MATTERS; AND D. T. LEIGHTON, ASSOCIATE DIRECTOR FOR SURFACE SHIPS AND LIGHT WATER BREEDER REACTOR

Admiral RICKOVER. Thank you, Mr. Chairman. The gentleman on my right is Mr. T. L. Foster who handles financial matters for me.

The gentleman on my left is Mr. D. T. Leighton, who is responsible for surface ships in my program.

Mr. Chairman, I was invited to testify today about procurement and related problems. Your staff, however, has asked me to focus on the shipbuilding claims problem, and particularly on the claims submitted by Newport News.

I have testified previously to this committee and to other committees of Congress regarding the shipbuilding claims problem. The current claims problem permeates nearly all aspects of my work. The Navy must rely on contracts in obtaining the ships, weapons, and the supplies it needs from industry. Contracts set forth the rules under which the work is to be done. The responsibility of Government officials involved in the administration of the work is twofold: First, to insure that the work is performed properly in accordance with the contract terms; second, to insure that public funds are legally spent.

Government contracts provide a mechanism to resolve contract disputes. When the parties are unable to resolve their differences through negotiation, the contractor can request a formal ruling by the contracting officer and, if he disagrees with the contracting officer's decision, he may appeal it to the Armed Services Board of Contract Appeals. There, the contractor can have his case heard by an independent forum. If he disagrees with the decision of the Armed Services Board of Contract Appeals, he can appeal to the Court of Claims.

DOD DECISION TO SHORT-CUT CLAIMS PROCESS

In the area of shipbuilding claims, the Defense Department has decided to shortcut this process in an effort to resolve quickly the current shipbuilding claims against the Navy. The Defense Department has notified Congress of its intent to settle claims with four shipbuilding companies by use of Public Law 85–804. This statute gives the executive branch authority to provide extracontractual relief whenever such action is deemed necessary to facilitate the national defense. Authority to provide such relief has been vested in senior officials of the Defense Department, but subject to congressional review.

For the past several weeks the Defense Department has been negotiating with the four shipbuilders in an effort to reach a settlement it can present to Congress. The Defense Department has stated that it will report the results to the Armed Services Committees on June 10th. I am not involved in these negotiations.

PRESSURE ON NAVY TO SETTLE ON LUMP SUM BASIS

For years, the Navy has been under considerable pressure from some shipbuilders to settle claims on a lump sum or total cost basis which would make potentially unprofitable contracts profitable. These shipbuilders assemble large teams, comprised of lawyers, contract specialists and accountants, to draw up their claims. One shipyard used as many as 100 people to prepare a single claim.

To generate the basis for large omnibus claims, employees are encouraged to search out and report actions and events that may be used as the basis for a claim against the Navy. Even minor technical matters are now treated as contract matters.

CONTRACT CHANGES

As a result, settlement of contract changes has become increasingly difficult. Often the company either refuses to price the changes in advance, quotes excessive and unsupported prices, or demands the right to reopen contract pricing later for other reasons such as the cumulative or ripple effect of changes. Because of the length of time required for ship construction and the continued need to update ship specifications to meet new defense requirements, changes have been and always will be an inherent part of ship construction. Shipbuilders, from many years of experience, are well aware of this when they take Navy shipbuilding contracts. Historically, the changes amount to about 5 percent of the contract work. The Navy, of course, is contractually obligated to equitably adjust contract price and delivery date to reflect the impact of changes. Whenever possible, the Navy tries to reach agreement with the shipbuilder on price and schedule adjustment prior to authorizing the change. However, shipbuilder actions often make this impossible.

CONTRACTOR ACCUSATIONS

Along with the valid changes shipbuilders include in their claims, they include many allegations against Government administration of contracts. It is frequently difficult to sort out their various accusations, let alone determine legal entitlement or assess cost impact. The evidence presented in the claims is from the viewpoint of the contractors, not from that of those paying the bills.

Shipbuilders have complained of untimely delivery of Government furnished equipment and drawings; defective specifications, excessive tests, trials, and inspections; constructive changes to work scope and letters of direction; Government insistence on erroneous contract interpretations; Government recruiting practices; Government interference with contract performance through imposed limitations on work methods and other shipbuilding operations; changes in health, safety, and pollution control laws; Government "abuse of discretion"; Government imposition of management systems; and the Government's unilateral revision of contract requirements.

Sometimes, the same complaint reappears under various descriptions, leaving the impression of widespread Government interference. Other elements of the claim are based on alleged "facts" which contradict one another. Claimed costs seem to increase exponentially as a function of

the so-called cumulative or ripple effect. And all cost increases are compounded, it is claimed, by inflation.

Some shipbuilders defer the negotiating of certain changes for years, until they know what their total final costs will be. These changes are then consolidated into a general allegation of Government responsibility for all delays and increased costs experienced, without relating the individual causes to specific effects. The amount then claimed has often been inflated sufficiently to produce the profit desired by the shipbuilder, even though the claim is finally settled for but a portion of the claimed amount.

Some shipbuilders' claims contend that all delays and increased costs are the Government's fault, even when the shipbuilder must know that much of the delay and increased costs were caused by factors within his contractual responsibility.

NEWPORT NEWS REFUSAL TO CERTIFY CLAIMS

In this connection, it is important to note that Newport News, whose claims comprise the largest portion of outstanding shipbuilders' claims, still refuses to certify that its claims are current, accurate and complete. The Navy is required by Navy procurement directives to obtain such certification before devoting its energies to evaluating data. I believe the company's claims are substantially overstated.

The fact that shipbuilders have been willing to settle their claims for far less than the amount claimed should cause one to question the validity of the amounts our taxpayers are being asked to pay. This may also explain the reluctance of some company officials to certify the claims.

NEED FOR NAVY ANALYSIS

The Navy's normal claims evaluation procedure is to determine and pay only for items of Government responsibility. This requires the Navy to perform a rigorous analysis to determine the legal basis for payment. Theoretically, the burden of proof rests on the contractor to demonstrate legal entitlement. In practice, the Navy itself, to demonstrate that the contractor is not entitled to the larger amounts claimed, often ends up having to construct whatever legitimate case the shipbuilder might have. The Navy analysis is time consuming and uses the time of many technical people, to the neglect of their proper work.

CONTRACTOR MAY CHANGE RATIONALE

Even when Government officials have spent months analyzing voluminous shipbuilders' claims, and have successfully demonstrated which elements of a claim are not valid, the contractor may then withdraw the claim, only to resubmit it based on a new rationale to support his contention that the Government owes him money. The result is to cripple Navy efforts to evaluate claims and to prolong settlement.

CONTRACTOR THREATS TO STOP WORK

Knowing this, some contractors try to force a settlement by threatening to stop work if their claims are not paid quickly. Armed with

voluminous, generally unsupported claims, some shipbuilders and their lobbyists at times take their case directly to Congress, to senior defense officials, and to the press. They accuse working level Navy personnel of wrongfully withholding funds and delaying settlements, of creating a litigious atmosphere, and of undermining good business relations. They allege that the company is in desperate financial straits. They threaten that, unless immediate relief is forthcoming, the Navy will not get its ships, and so on. By these means some shipbuilders believe they will be paid more than if their claims are settled on their legal merits.

A specific example will illustrate this. About 2 years ago, Newport News officials and their superiors at Tenneco began airing complaints concerning the Navy before Congress and in the press. Company officials took the position that they should be guaranteed a 7-percent profit on all Navy shipbuilding contracts after paying interest and other allowable costs.

Despite Newport News' notification as early as October 1974 of its intention to submit claims, the company did not actually submit the claims until recently—$825 million of the $894 million total in the last year, of which $665 million was submitted in the last 6 months. But once these claims were submitted, the pressure to settle them began immediately. On February 19, 1976, Newport News submitted its largest claim on a single contract; a $221 million, 16 volume claim against the carriers *Nimitz* and *Eisenhower*. The very next day the president of Newport News wrote to the chief of naval operations intimating that Newport News was considering stopping work on the aircraft carrier *Vinson* and not entering into new Navy shipbuilding contracts until its claims were resolved.

Six months earlier, Newport News had actually stopped work on a nuclear-powered cruiser, the CGN–41, claiming that the contract option for construction of that ship was invalid. Construction was resumed under court order. However, Newport News still refuses to recognize the validity of the option because they want a higher price than they had previously agreed to contractually. Although Navy lawyers are convinced that Newport News has no valid legal basis for its contentions, it could take years of litigation to establish that point. When Newport News appealed this matter to the GAO, the GAO decided in the Navy's favor. Newport News is now contesting the GAO decision in the Federal court.

NAVY LEGAL COUNSEL AT DISADVANTAGE IN CLAIMS NEGOTIATIONS

In this regard, it should be noted that the Navy is at a disadvantage in litigation of claims due to the imbalance in legal resources between the Government and the contractors submitting claims. In the case of the cruiser dispute, the brunt of the Navy's legal work is being handled by one lawyer, 2 years out of law school, as one of his several assignments. I am not questioning this individual's competence. I simply want to point out the disparity between the counsel representing the Government and the counsel representing Newport News. To date, Newport News charged the Navy over $175,000 for outside counsel fees pertaining to the CGN–41 dispute plus a 7-percent profit for Newport

News itself. It is interesting to me that for several years I have been unable to get the Navy to hire outside counsel to help the Navy prepare its case, yet the Navy is paying Newport News for its outside counsel to fight the Navy, as well as a 7-percent profit for doing so.

NEWPORT NEWS BRINGS PRESSURE ON NAVY

Newport News officials have made their intentions clear. On March 15, 1976, the president of Newport News sent a publicly released letter to one Congressman in which he stated:

> I need to bring all the pressure to bear that I can for a prompt and equitable resolution of the differences between the company and the Navy. Time has run out.

Newport News has brought pressure to bear on the Navy through other public statements; by complaints to defense officials and to Members of Congress; by threats of not taking future Navy business; and by actually stopping work on the CGN–41.

There seems to be a tendency in some quarters to view the shipbuilding claims problem as simply one of human relations. In fact, some claimants would have you believe that the whole problem has been created by a conflict of personalities. They have made shipbuilding claims a political and personal matter. In actuality it is strictly a matter of money. If a shipbuilder intends to hold out for more than he is legally owed, his relations with the Navy will deteriorate until either he convinces the Navy to pay whatever he wants regardless of legal entitlement; or, until the Navy convinces him he will get only what he is legally owed, regardless of the pressures the company may bring to bear. From the Government's standpoint, I view the issue this way: Why bother negotiating and signing contracts if they are not going to be enforced?

NAVY SHOULD INSIST ON CONTRACT COMPLIANCE

To maintain a sound basis for conducting future business, I believe the Navy should insist on compliance with its contracts—in Federal court if necessary. If contractors believe they can evade their contractual obligations by submitting inflated claims; refusing to honor contracts; complaining to higher authority, and the like; then all defense contractors will be encouraged to follow this approach in the future.

Our purpose today is to see to it that the Government gets value for the money it spends. This is a practical problem agreed to by all men of good will.

I try to resist the giving away by the Navy of money that contractors are not legally entitled to. Of course, everyone who testifies is all for economy. But some who testify "for economy" do so for the same reason that a fox hunter might join the SPCA.

Some people say I have no business becoming involved in or criticizing the contracting or other methods of the Defense Department. They say that if any criticism is needed, it should be left to those whose job this is. But some of these people have ceased to be capable of self-criticism. Although these officials have great power to protect the taxpayers, they sometimes appear impotent when called upon to do so. It is as if Prometheus had become manager of only a match factory.

People who try to improve the situation run considerable risk. I am reminded of Admiral St. Vincent—Lord Jarvis—who quelled the mutiny in the Mediterranean Fleet and prepared the British Navy for its later victory by Admiral Nelson at Trafalgar. He became the First Lord of the Admiralty. However, he was removed from office for trying to abolish dockyard corruption.

Although financial dishonesty is a matter of great importance, the real evil that follows general commercial dishonesty is the intellectual dishonesty it generates.

Philosophically, I am also aware that there may be some wealthy corporate officials who, by their actions, appear firmly to believe in the hereafter; also that shrouds have pockets. The recording Angel may occasionally shed a tear for a sinner but I doubt he will do so for these officials.

CLAIMS HAVE NOT GONE THROUGH NORMAL AUDIT OR ANALYSIS

Mr. Chairman, this is a brief summary of what confronts the Navy. I have not read the 64 volumes of claims submitted by Newport News. To my knowledge, neither has anyone else in the Defense Department. The claims have not gone through the normal audit, or technical and legal analysis. However, some general items of interest in the claims have been brought to my attention.

I would be glad to answer any questions you may have.

I would like to make one additional point. An attempt is now being made by the Defense Department to negotiate and settle the claims. However, only one party to those negotiations knows what is in the claims. The other party attempting to reach an agreement has never read the claims. In these circumstances, how can the Government then decide whether the settlement reflects the legal merits of the claim? The issue instead has become one of passion.

What would the Internal Revenue Service do if some working man submitted an income tax return about three times lower than he should have? Would they sit down and argue with him for days and weeks and months, and then, since they hadn't looked at the income tax return and studied it, settle at about one-third to one-half of the difference?

That is an analogous situation, except that in one case a large, powerful corporation is involved, and in the other case an ordinary, defenseless citizen. I think there are more of the latter in this country than there are of the former. It is the Government's responsibility to look out for the ordinary citizen, too.

Senator PROXMIRE. Thank you very much for a most impressive statement, Admiral.

Let me point out in the table that we have here the claims that Newport News, Ingalls and Boland have filed. Newport News has filed claims totalling $151 million, $83 million which as I understand it was revised as of February 1976, 4 months ago.

They filed claims of $159 million about 1 year ago, $78 million about 11 months ago, and $191 million, which was revised in March of 1976, which is the effective date. So it is only 3 months for this sum; $221 million in February of 1976; $92 million in March, just a couple of

months ago; and as you say, what was your figure, three-quarters, 80 percent of this $894 million has been within this year, 1976.

[The table referred to follows:]

CLAIMS BY SHIPBUILDERS AGAINST THE NAVY

[Pending as of Apr. 1, 1976]

Shipbuilder and date received by Navy	Amount of claim
Newport News (Tenneco):	
CGN 36-37:	
June 11, 1973	$35,036,981
Revised Sept. 13, 1973	3,670,662
Revised Nov. 13, 1973	3,664,600
Revised Jan. 1, 1974	848,603
Revised June 3, 1974	6,088,316
Revised Oct. 31, 1974	19,456,498
Revised Feb. 13, 1976	82,274,861
Subtotal	151,040,521
CGN 38-40: June 1975	159,774,936
SSN-688: July, 1975, revised March 1976	78,543,149
SSN-689, 91, 93, 95: July, 1975, revised March 1976	191,567,199
CVN 68-69: February 1976	221,280,223
SSN 686-687: March 1976	92,099,492
Subtotal	894,305,520
Ingalls (Litton):	
LHA 1-5:	
March 1972	270,700,000
Revised March 1973	105,300,000
Revised July 1974	24,000,000
Revised April 1975—Agreement to renegotiate January 1976	104,847,301
Subtotal	504,847,301
Boland marine: DLG-10	3,297,314
Total	1,402,450,135

Admiral RICKOVER. Yes, about $665 million in the last 6 months.

Senator PROXMIRE. These volumes are the claims?

Admiral RICKOVER. Yes, sir. Those are the Newport News claims.

Senator PROXMIRE. Extending over almost one-third of the entire circular table.

Now, these contain, as I understand it, allegations, assertions that have to be checked by the Navy.

CLEMENTS' PROPOSAL

It is not a matter of putting a large number of people to work on each volume, so that they could do it in a matter of days or a few weeks, they have to be checked over a period of time. It takes a lot of time to do it. And it takes months and months to do it, and they have had only a few weeks. And on April 30, as I understand it, the Deputy Secretary of Defense, Mr. Clements, proposed to the Congress under the Proxmire amendment, my amendment, which provided that they have to submit this to the Congress for 60 legislative days before it can be paid, a proposal to pay $750 million of these claims. Is that roughly correct?

Admiral RICKOVER. I believe that is correct, sir.

Senator PROXMIRE. And that will expire as I understand it about the third week in July. And the issue is whether or not—and that is why this hearing is being held—under these circumstances we should insist that, first, there is an audit, an evaluation and analysis so that we know whether or not this amount of money is due and ought to be paid.

Admiral RICKOVER. There is also another issue, sir. The settlement may not encompass all of these claims. It may only settle part of these claims. Other claims will be left outstanding.

Senator PROXMIRE. There are further complications. The GAO has stated that it may well be more—$740 million I think is the precise amount the Secretary has asked—more than $740 million, No. 1, and No. 2, this would only be part of the claims, and there would still be claims pending.

Can you give me the justification of why it is so important that the claims be audited? I think I know, but I would like to have you state it for the record. If the shipbuilders costs have gone up, and they are losing money on their Navy contracts, what is the argument against revising them so that they can make a reasonable profit and stay in business?

WHY CLAIMS SHOULD BE AUDITED

Admiral RICKOVER. Shipbuilding contracts are probably the most generous contracts let by the Defense Department primarily because these contracts provide for escalation. The Bureau of Labor Statistics publishes indices reflecting inflation in the U.S. economy. Shipbuilding contracts contain provisions for escalation payments based on these indices. In that sense, shipbuilders are better off than almost anyone else. Thus, in pursuing claims shipbuilders are inevitably bound to say that all of the fault for other problems in the shipyard adheres to the Government. Without reading all of those claims volumes, I am sure that is what they all say; that everything that has happened at the shipyard is the fault of the Government. Maybe they do not put in the cost of postage stamps. But anything that is attributed to the Government is then hiked up by various other factors. I could give you many examples of that.

Let me take manpower as an example. May I, sir?

Senator PROXMIRE. Yes, sir.

NEWPORT NEWS RESPONSIBLE FOR MUCH OF DELAY AND INCREASED COSTS

Admiral RICKOVER. The Government may be responsible for some delay under these contracts, and any extra costs occasioned thereby. However, the extent of the Government's liability can be determined only by a thorough review and audit. My view, however, is that much of the delay and increased costs was the result of Newport News' failure in the early 1970's to obtain the number of qualified people required to meet its contract schedules.

In 1971 Newport News identified a need to increase manpower from about 19,000 to 30,000 people to accommodate work already under contract. The company was unable to obtain all of the required manpower, and subsequently abandoned its plans. The influx of new, inexperienced people at Newport News caused decreased productivity and increased rework. As a result, ship schedules slipped. Under the terms of the Navy's shipbuilding contracts, Newport News bears responsibility for their inability to hire adequate skilled manpower to meet their contract requirements.

Lack of manpower is the basic reason for the delays and extra costs.

Senator PROXMIRE. Let me follow up on that specific instance that you give, because I think it is an interesting illustration of the fact that the merit of these claims should be challenged and challenged vigorously.

For example, there is a section called "increased cost resulting from Navy recruiting practices." According to Newport News, the Navy hired numbers of workers away from Newport News, causing Newport News to hire new workers who had to be trained.

Admiral RICKOVER. That is a very good illustration, sir.

Senator PROXMIRE. And the increased training costs were $23 million. And Newport News wants the Navy to reimburse it for that $32 million. What is your reaction to that?

Admiral RICKOVER. Newport News claims that the Navy, particularly the Norfolk Naval Shipyard, recruited company employees, and therefore owes Newport News for the cost of recruiting and training replacements. Newport News claims training costs of $25,000 for each production and maintenance worker, and $35,000 for each salaried and design employee hired by the Navy. By the time other Newport News factors are thrown in, the claims include an average charge against the Navy of $42,000 for each person alleged to have been hired by the Navy. If Newport News actually spent $25,000 training each new production and maintenance employee, and $35,000 training each new salaried and design employee, as it claims, its total training costs for 1973 and 1974 would have been $380 million.

Senator PROXMIRE. Where do they get that figure of $42,000 to train employees, $25,000 for the blue-collar worker and $35,000 for the clerical worker, where do they get those figures?

Admiral RICKOVER. The claims do not say, sir.

Senator PROXMIRE. That is the cost of a 4-year Harvard education—maybe it is more than the cost of a Harvard education.

Admiral RICKOVER. Let me complete this, if I may, sir, and then I will answer some of your questions.

Let me show you what, in my opinion, is the vast absurdity of this. To train all of the people they hired during that period, following the Newport News rationale, they would have had to put out $380 million for training. That is more than half the total Newport News labor cost, the entire labor cost, during that period. Yet, according to Defense Contract Audit Agency figures, the company actually spent only $9.2 million for training in that period, about 2½ percent of the per capita training costs included in their claims.

You were talking about absurdities. This claim element is certainly absurd. Imagine a company spending for training half of the entire amount spent for all labor costs.

Further, Newport News employees are eligible to apply for Government jobs. This is a right of all citizens. During the period in question Newport News was attempting to recruit Norfolk Naval Shipyard employees through billboard advertising near the Navy yard, and by sending letters and employment applications to individual naval shipyard employees. Mind you, now, they are accusing the Government on account of its hiring of company employees, but during the same period

the company attempted to recruit Navy people. Can you imagine the howl that would arise if the Navy submitted a claim against Newport News for extra recruiting and training caused by the Navy employees who left to work for Newport News? During the period claimed, Newport News states that 10,493 employees voluntarily left the company. Newport News estimated that about 760 of these 10,000 people subsequently were employed by the Navy. This is about 7 percent of the total. I wonder if Newport News is preparing claims against those who hired the other 93 percent? At the rate of $42,000 a person they could claim that someone owes them over $400 million for hiring these people away from them.

There is also a philosophical aspect to this. Suppose the Army drafts a man who works for Newport News, suppose a Newport News man volunteers to enter the Armed Services, or suppose he becomes a postman. The Government, on the same basis would be required to pay the company. That amounts to involuntary servitude. I don't think the officials of that company have ever read the 14th, 15th, and 16th amendments, which abolished involuntary servitude in 1863. I think they ought to read the Constitution. Is the Government required when it makes a contract with a company to have agreed to involuntary servitude, in theory or practice?

Mr. Chairman, if you worked for Newport News and you quit to become a Senator, they would attempt to charge the Government.

Now, there are many defense contractors in the Norfolk, Va., area who probably have hired Newport News people and whose people in turn have been hired by Newport News. Will there be claims and counterclaims for this?

Senator PROXMIRE. You are saying in the first place that it is absurd to charge the Federal Government with the cost of training people who left Newport News to work for the Government in some respect, No. 1. And No. 2, the amount of the cost seems to me to be ridiculous. I don't know. It is conceivable that there might be some way that you can justify very high cost. But $25,000 or $35,000 per employee——

Admiral RICKOVER. As I said, at the rate claimed, training costs would amount to half their total labor cost. Now you have an idea of what the Government is faced with in looking at these 64 volumes. Most of them contain similar exaggerations.

PARKINSON'S LAW

Senator PROXMIRE. Newport News is claiming $100 million based on what they call Parkinson's law, of which you may have heard. Newport News said the Government delayed ship deliveries, and this caused the workers to become less productive. Could you explain whether the Navy did delay the deliveries, and if it did, how it could make a $100 million claim for the reduced productivity of its own workers? Doesn't this amount to charging the Government for corporate featherbedding?

Admiral RICKOVER. There may also be a "Peter Principle" hidden somewhere in all these claims, and several other theories that I have heard of, such as Murphy's law.

Senator PROXMIRE. If something can go wrong it always will.

Admiral RICKOVER. Yes, sir. Perhaps those who train pigeons to guide missiles have also inspired a rationale for claims. Nobody has looked at these claims except the people who wrote them. I doubt if any responsible official of that company has ever read those volumes. If one had, the claims would probably have never been submitted.

Senator PROXMIRE. Let me just read this, the language in the claim itself, because I just didn't mention Parkinson's law as something the columnists could use. This is what they said:

It has just been a few years (1957) since C. Northcote Parkinson introduced the now famous law which deals with the deterioration of labor. Professor Parkinson stated: "Work expands to fill the time available for its completion." Although this law may have been given some humorous connotation, particularly about the British bureaucratic system, Parkinson accurately described this one aspect of actual human behavior. Workers not only tend to use up the allotted time to perform a given task, but they also tend to use up more time than should be normally required to complete the task. People tend to learn from past experiences, and when too much time is utilized to perform previous tasks, additional time will also be required to perform subsequent tasks. Experiments by a few psychologists have been conducted in order to prove or disprove Parkinson's law and to better understand human motivation from which Parkinson deduced his law. These experiments affirm the effects of Parkinson's law on deterioration of labor, and support the contractor's request for equitable adjustment in the contract due to Government actions which caused the period of performance to be expanded.

Now, there isn't any question that Mr. Parkinson has something, as I think we realize, that there is the tendency in bureaucracy—if you stretch out the amount of time to perform a particular task, the bureaucracy will take their sweet time in doing it. But the whole point in having a private firm bid and work on this is that they will have the intelligence and the efficiency and the discipline not to let this bureaucratic law apply here like it does to British bureaucracy, and I am sure to every bureaucracy. This should be an incentive for them to hold down their cost. If they don't need workers they lay off workers. That is done.

Admiral RICKOVER. Sir, that principle sadly became known to Adam and Eve when they invited the snake to join them.

Now, let me tell you about Professor Parkinson. I actually met him. He was a British professor who in 1957 postulated that in a bureaucracy there is inexorable growth over time of the number of people hired to accomplish a given amount of work. The Defense Department is a prime example of this. Newport News is now trying to apply Parkinson's law to justify their claims. The company states that their workers became less efficient every time the schedule was revised. According to Newport News, 15 minutes out of every productive labor hour spent in the month following the schedule change was wasted due to Parkinson's law. Presumably it wouldn't have been wasted if Parkinson had never written his law. In the second month, Newport News claims 13 minutes an hour was wasted due to Parkinson's law; the third month, 9½ minutes, and so on, until the next scheduled revision, when the calculation is repeated.

Senator PROXMIRE. Where do they get these figures, 15 minutes, 13 minutes?

Admiral RICKOVER. The claims do not tell where those figures come from. The company must have Parkinsonoligists on its staff to determine how much time was lost.

SHORTAGE OF SKILLED LABOR AT NEWPORT NEWS

There are several obvious problems with the Newport News approach. First, much of the delay causing schedule revisions was due to a shortage of skilled paid labor, which is Newport News' responsibility, not the Government's. Second, the company had not too many people, but rather too few people. Third, I do not see any appropriate analogies between a tendency of bureaucracies to expand and the impact of a schedule revision in a private shipyard. Finally, there is no basis for the figures used in the Newport News calculation.

Senator PROXMIRE. What you are saying now is that they didn't have an excess of workers, they had a shortage in fact?

Admiral RICKOVER. Yes, sir. They had too few skilled workers. That is the basic problem underlying all these claims. Newport News was unable to hire the people it needed.

Furthermore, and they have a perfect right to do so, they established a new commercial yard right alongside the Navy yard and now they have to use people in that yard and cannot man the Navy shipyard.

Now, let me get back to the Parkinson thing. Can you imagine a janitor who, upon finding out that a schedule has been changed, becomes so sad that he goes home, complains to his wife, mopes, and is so sad in fact that the next month he is only 75 percent efficient, and it takes him about 10 months to get over it.

Just think about that. That gives you a concept of what is contained in these claims volumes.

Since Mr. Parkinson's law is included in every one of these claims, I took occasion to call several people who I know in industry. I called the commanding officers of three naval shipyards and asked them if they had ever seen the phenomenon that when a schedule was changed everybody was so sad that the next month they only worked for three-quarters of each hour. They said they had never heard of such a thing. I also talked to a man who had a leading position in a private shipyard employing about 17,000 people, and he said that he never heard of such a thing.

This illustrates the extent to which Newport News has gone in attempting to justify their claims and why they want them settled on a lump basis without anyone looking at the claims. I think that to do this would be one of the biggest ripoffs in the history of the United States. Let me add one more thing. The fact that shipbuilders traditionally settle for one-half or less of the amount claimed shows that these are not valid claims.

Senator PROXMIRE. It also shows that we certainly ought to have an audit and an anlysis and evaluation before we pay a penny.

PUBLIC LAW 85–804

Admiral RICKOVER. Sir, that is now up to Congress. Congress has given to the Defense Department the right to try to settle these claims under Public Law 85–804. But Congress has a veto power over the settlement. Of course, the Defense Department wants the company to continue to do its job, instead of threatening to stop work and the like. That is why they are attempting this.

CLAIMS BASED ON ENVIRONMENTAL LAWS

Senator PROXMIRE. Admiral, you mentoned the fact that Newport News also does commercial as well as Navy work. But I notice it alleges that all the added costs due to the Federal environment laws should be charged to the Navy. Should the Navy have to pay any of those costs, and if so, shouldn't the commercial work be a part of it?

EFFECTS OF COMMERCIAL ACTIVITIES ON CLAIMS BASED ON ENVIRONMENTAL LAWS

Admiral RICKOVER. This is an issue that has been called to my attention in the areas of claims for changes in Government laws and regulations such as environmental and occupational safety regulations. While I do not consider that Newport News should be entitled to a price adjustment for these items, it is worth noting the method used by Newport News to allocate these costs. Newport News does not allocate any of the alleged extra costs to its commercial work even though these regulations apply to that work as well as Navy work. Since the total impact of these regulations is allocated to Novy contracts, the effect of paying the amounts claimed would be to increase the profit of commercial work at the expense of the Navy. If Newport News properly allocated these costs among all shipyard work, the amounts of all the claims would be reduced. You see, they have already taken this up in overhead, which is required by cost accounting standards.

Senator PROXMIRE. Does that apply also to the antipollution laws?

Admiral RICKOVER. Yes, sir. That is an overhead item, and they are charging that now to overhead. But they also put the same amounts into this claim so that they get immediate payment, instead of charging it off over a period of years, according to the rules on overhead.

Senator PROXMIRE. Then you are saying it is double accounting?

DOUBLE CHARGING

Admiral RICKOVER. It would appear that it is double charging, that is right.

EXCESSIVE GOVERNMENT INSPECTORS

Senator PROXMIRE. Now, Newport News claims about excessive Government inspectors. And in the claims for the nuclear cruisers 38, 39, and 40, it says that there were 2,900 Government inspectors. Were there really 2,900 Government inspectors in this yard?

NUMBER OF GOVERNMENT WORKERS

Admiral RICKOVER. No, sir, of course not. And Newport News well knows this. I will give you some facts. In its management summary, Newport News leaves the impression that the Navy has 2,900 inspectors. The shipyard fails to mention that of the 2,900 Government inspectors, over 2,000 were members of the Navy crew getting ready to take the aircraft carier *Nimitz* to sea and were not even allowed on the same pier as the cruisers. The remaining 700 or 800 Government personnel at the shipyard includes members of other ships' forces. Only

a small number of people were directly responsible for inspecting the contractor's work.

Senator PROXMIRE. You say there were not 2,900, but 2,000 of these were naval personnel?

Admiral RICKOVER. Some of the people in the Engineering Department, as required by the Navy, would inspect the work after Newport News did it, and if they found something wrong they would complain to their captain.

Senator PROXMIRE. And one of their claims is that they have excessive inspection, and it is documented by the fact that there were at Newport News 2,900 inspectors when, as you say, two-thirds of these were naval personnel who weren't even permitted in the yard, and of the remaining number, this is all the Government personnel involved?

Admiral RICKOVER. Yes, sir. They were there for every kind of purpose, including mess cooks.

Incidentally, there was an item in the paper the other day of some bright law student reading back in history and noticing that around the time of the Civil War a law was passed making it possible for any citizen to sue anyone who made what he considered a false claim against the Government. I would be very careful on some of the items in these books. If some people want to pay their way through college it only costs $10 to file a case.

Senator PROXMIRE. I understand that you believe that most of the Navy changes did not delay construction or increase costs. Do you have some examples of the changes that could cause a delay in construction?

GOVERNMENT CHANGES

Admiral RICKOVER. The major part of the delay, by far the major part, is due to the fact that Newport News was not manning the ships to the degree required to meet their schedules. Now, the Navy does owe Newport News some additional money for contract changes. However, that amount cannot be determined until the company identifies the costs and justifies it. Navy policy is to negotiate the price and delivery impact of a contract change before it is issued. But some shipbuilders, including Newport News, refuse to do this. The Navy would like to work on the basis that if it has a change to be made, the cost and schedular impact would be settled ahead of time. Yet frequently the company asks for very exorbitant prices, and the Navy just will not stand for it.

Now, I mentioned earlier that all of the changes on the average ship equal about 5 percent of the total construction cost. That is all. Years later when the shipbuilder knows what his final costs are, he makes his claims around any unpriced changes and makes a general allegation of Government responsibility for all delays and increased costs experienced, without relating individual causes to specific effects. Shipbuilders are often correct in claiming that the Government owes them some money for certain actions. The problem usually is that the amount claimed bears no relation to the impact of the Government actions.

NEED FOR NAVY TO KEEP RUNNING RECORD OF CHANGES

Senator PROXMIRE. Admiral, why doesn't the Navy keep track, keep a running record of its changes and delays in delivery dates, and

so forth, and require the contractor to report any other delays currently, up to date, perhaps at the end of every week or every month, so that there is a clear public record of what the delays are, so that the Navy as a prudent buyer would have some notion of what is happening to its cost? Anybody buying a home has had the experience of wanting a little change in his house, and the architect or the contractor, you are giving him a hard time with this. But most of us have enough sense to require the contractor to tell us what it is going to cost. And it seems to me that that is a very simple procedure that the Navy should follow.

Admiral RICKOVER. Senator Proxmire, a contract is based on good faith. The Navy simply doesn't have the people to monitor the work that closely. As I mentioned before, one young lawyer is bearing the brunt of the Navy legal work on the CGN–41 dispute.

Senator PROXMIRE. When we are going to pay three-quarters of a billion dollars—that is the proposal of the Under Secretary of Defense—it seems to me that it would be worthwhile to make a small investment to keep track.

Admiral RICKOVER. The Congress has limited the number of people the Navy can hire. Therefore, the Navy uses them for the most important thing, which, in a shipyard, is to get the ships built properly. The Navy does not have the people, and it really shouldn't be necessary. This sort of situation did not exist until about 6 to 8 years ago. This is a brand new situation. Also, there is a different kind of people involved. This is particularly true since the conglomerates took over. The conglomerates wouldn't care if they were building ships or manufacturing horse turds. Their main goal is to make money, no matter how.

Senator PROXMIRE. After all, if we are foolish enough to go ahead and pay claims like this, we can expect it. If you or I would run a corporation, no matter how idealistic you may be, that bottom line is essential, if you are going to keep your job you have a responsibility to your stockholders to make money and file claims for everything in sight. You can't expect to rely somehow on just being a good person or having a patriotic desire to be as ethical as possible. When these people can make hundreds of millions or billions of dollars by filing these claims and get away with it, they will do it.

Admiral RICKOVER. Yes, sir. You have been around Washington for a long enough time to know that not far away from here is a huge building with large printing presses that turn out money. These people would like to get some of it.

Senator PROXMIRE. What I am trying to say is that we have to provide the discipline, we have to provide the restraint, and we have to just refuse to pay these claims unless they are audited and documented and we know exactly what we are paying.

Admiral RICKOVER. I agree with you, sir. I would not pay a single claim against the U.S. Government unless it is legal. That is what I have been advocating. But to be legal with contractors, particularly the large ones, is not in fashion anymore. They have political influence, they contribute to campaign funds, and they know Members of Congress and high officials in the Defense Department. How does one sole person in the Navy Department fight that sort of a situation? The only thing I can do is what you have asked me to do—air the case. I will

give you some examples of what is contained in these claims. This is a very important statement.

BACKGROUND OF NEWPORT NEWS CLAIMS

In late 1972 and early 1973 the Navy and Newport News settled several delay issues which the company is not attempting to reopen. Mind you, they were settled by mutual agreement. In February 1973, Newport News and the Navy agreed to a full and final settlement for all claims, including delays and disruptions for late delivery of Government-furnished equipment and information on the CVAN–68, that is the *Nimitz*, and the CVAN–69. Yet Newport News now claims the Navy should pay them an additional $10 million on this contract for these very same delays on the basis that Newport News did not anticipate these costs when they negotiated the previous settlement. Now they are reopening something which they signed off and settled.

I will give you another example.

In December 1972 the chairman of the board of Newport News agreed to a claim release and an extension in contract delivery dates of about 66 weeks for two submarines, the 686 and 687 because of a strike at a Newport News subcontractor. Now Newport News claims the Navy is responsible for 134 weeks delay on these ships, a period which includes the 66-week delay for which the company already gave a claims release. At the $250,000 per week delay rate included in the claim, the shipyard is requesting $20 million in delay costs it previously agreed were not the Government's responsibility. Why not, Mr. Chairman? The Government is an easy mark. All the contractor has to do is add another 10 volumes which the Government won't read. They can just ask for anything they want, and it will be settled by agreement.

DISRUPTION

Senator PROXMIRE. Now, Newport News claims the Navy owes it $15 million for what they call disruption, in addition to the contract changes and excessive inspection they allege disruption was caused by late fines, purchase orders, security requirements, and several other factors. Is that amount warranted?

Admiral RICKOVER. It is obvious you are in Government and not in industry, Mr. Chairman, it is not $15 million, it is $158 million. But that is merely a bagatelle.

Senator PROXMIRE. I stand corrected. Our figure is $15 million. You said $158 million?

Admiral RICKOVER. That is correct, it should be $158 million. I will attempt to answer your question.

IMPOSSIBLE TO EVALUATE CLAIM FROM DATA SUBMITTED

From the data submitted by Newport News it is impossible to evaluate this part of the claim. The company makes no attempt to establish a cause-and-effect relationship. The company calculated the $158 million claimed for disruption by assigning to every man-hour of effort on Navy shipbuilding contracts a penalty ranging from 1 to 8 minutes of extra effort for each man-hour of effort expended. Supposedly the

extra effort was required due to the disruptive effect of Government actions. The company admits that their analysis is based on engineering judgment as to the degree of disruption. To evaluate the company's allegations would require a detailed review to determine how contract work was disrupted; precisely when disruptions occured; the locations on ships or in the yard where the disruption occurred; which class of crafts were disrupted; the work schedule before, during and after the disruption; and what action was taken by the company to mitigate disruptions; and how many people were disrupted for how long. The company's claims do not provide sufficient data for the Navy to make such an evaluation. Yet, that is one of the major points in the claims. It is up to the Navy to prove that the contractor is wrong, which is putting the shoe on the wrong foot. This is the type of fouled up mess the Navy has gotten itself into. Now, contractors will submit anything and everything and refuse to certify it, and then require the Navy to show where they are wrong.

DID CONTRACTOR SIT ON CLAIMS?

Senator PROXMIRE. Admiral, one of the most disturbing aspects of this is that it appears that many of these claims were prepared months before they were filed. It appears that they accumulated them, documented them, prepared them, and finished them, and then sat on them for awhile. And then they came in, in February or March, with the claims.

Admiral RICKOVER. I have some information on that, sir.

Senator PROXMIRE. If that is the case, it seems to me that it may have been calculated, especially in view of the timing of the Under Secretary's requests to Congress to pay $750 million in claims; it may have been calculated to provide a situation in which there wouldn't be time to analyze and audit these claims.

Admiral RICKOVER. I, of course, can't say what went on in their minds. But there is a Latin expression that goes to the effect that facts speak for themselves—Res ipse loquatur. You are a lawyer and understand these things.

Senator PROXMIRE. I am not a lawyer.

Admiral RICKOVER. Res ipse loquatur.

LAG BETWEEN PRICING AND SUBMITTAL OF CLAIMS

The Newport News claims indicate that the SSN–686 and 687 claim was priced out in May 1975. The claim was not submitted to the Navy until March 1976, 10 months later.

The president of Newport News has stated that "if the 688 class matters could in effect be settled, maybe the 686 and 687 claims wouldn't have to be submitted."

Other Newport News claims also show a timing lag between when the pricing was completed and when the claim was submitted.

Newport News announced in October 1974, its intention to file claims under all these contracts. The effect of saving them up resulted in over $800 million of Newport News claims submitted to the Navy in the 12-month period. And, as I mentioned before, $665 million was submitted in the last 6 months.

The large claims backlog is now being cited to justify a quick settlement without looking into the details of the claims. Newport News claims include a charge to the Navy of $2.7 million for 110 man-years of effort in preparing its claims. Obviously the Navy cannot evaluate these claims quickly even if the company substantiated them and certified them.

Senator PROXMIRE. Admiral, there is a Navy procurement regulation that requires contractors to certify under oath that their claims are current, complete, and accurate. Has Newport News certified its claims?

REFUSAL TO CERTIFY MOST CLAIMS

Admiral RICKOVER. With one exception, Newport News has refused to certify that its shipbuilding claims are current, complete, and accurate, notwithstanding Navy requirements. In one case where Newport News submitted the required certifications the facts are as follows.

In October 1975, after repeated requests by the Navy, Newport News certified a $142 million claim against the first five 688 class submarines. The Navy began its evaluation of the claim. In early March 1976, 6 months later, Navy officials told Newport News they were ready to make a $10 million provisional payment against the claim. Five days after such notification, and just before the provisional payment of $10 million was to be made, the company submitted a revised claim almost doubling the amount of the entire claim. Newport News officials refused to certify the revised claim, and backup sheets on the second claim showed that most of the calculations for that claim were performed by August 1975, 2 months prior to the date of the Newport News certification that the first claim was current, complete, and accurate.

Mr. Chairman, do you get the import of this last statement? They had the second claim ready when they certified the first one?

Newport News officials have been trying to negotiate resolution of the certification issue with senior Navy officials. At one point the company was suggesting that it would provide the required certification if the Navy would agree in advance that the word "current" would not mean current, "complete" would not mean complete, "accurate" would not mean accurate, and that the certification would have no significance with regard to the false claims statute.

If the Navy would agree with these conditions, the company would then certify the claims.

ARE CLAIMS FRAUDULENT?

Senator PROXMIRE. Admiral, you have testified about inflated figures, unsubstantiated allegations charging the Navy with commercial costs, and possible double accounting. Is it possible that these claims were not only inflated and exaggerated, but that they are also fraudulent?

CLAIMS GREATLY EXAGGERATED AND UNSUPPORTED

Admiral RICKOVER. Mr. Chairman, the determination of whether or not a claim is fraudulent is a legal one. I am not competent to make this determination. In my opinion, however, the claims are greatly exag-

gerated and unsupported. Stating it another way, if the Navy were to accept the claims at face value, the Government would pay far more than I believe it legally owes under these contracts. To determine how much of the claims are valid would require a detailed technical review and audit by the Navy.

For nearly all of the Newport News claims this hasn't been done. To the extent that these claims have been reviewed to date the Navy legal, contract, and technical personnel have found them to be grossly overstated.

Senator PROXMIRE. What evidence is there, if any, that these were intentionally exaggerated?

WHO IS RESPONSIBLE FOR DELAYS?

Admiral RICKOVER. I have no evidence, sir. All I know is that they put lots of people to work drumming up as many claims as they can.

Senator PROXMIRE. Doesn't much of the claim question boil down to whether Newport News or the Navy is responsible for the delays? And isn't it correct that the contractor had severe labor turnover problems, and shortages of skilled workers and a high reject work rate?

Admiral RICKOVER. Yes, sir. The company also set up another brand-new yard where ships are being built on a firm fixed price basis for the Maritime Administration. The Navy contracts are fixed price, too. But the Navy has incentive features and change clauses and other provisions in our contract against which to submit claims.

Senator PROXMIRE. How about the commercials, do they have changes, too?

Admiral RICKOVER. I don't know the number, sir. But I would doubt that they have many.

Senator PROXMIRE. Nothing in this proportion, at least?

Admiral RICKOVER. No, sir. That is a question you might ask the company. Are they attempting to get money from the companies for whom they are building these commercial ships?

Senator PROXMIRE. Are you saying overall that the contractor is responsible for most of these cost overruns, and that the contracts are not inequitable as the contractor alleges?

Admiral RICKOVER. There is no question that there are some elements of Navy responsibility as I have mentioned.

I have one further comment on that. About $430 million of the $894 claimed by Newport News is for the cost of the delay. Forty-eight percent of the Newport News claims is attributed to delay costs. The claims are based on the assumption that the Government is responsible for all the delays that have taken place. Further, the Navy's experience is that the costs per day of delay claimed by Newport News are usually inflated. The Navy doubtless owes Newport News for some costs for delays on these contracts. However, to determine the proper amount will require extensive analysis. Based on past experience, and the preliminary reviews we have made so far of these claims, I am confident that the amount which Newport News is legally entitled for delay is a small fraction of the $430 million claimed by Newport News.

Senator PROXMIRE. There have been public statements about the financial plight of the shipbuilding industry, and that shipbuilders are losing money on Navy contracts. What are the facts as you understand them?

FINANCES OF SHIPBUILDERS NOT AVAILABLE TO DOD

Admiral RICKOVER. I doubt that any one in the Government knows the real financial condition of the shipbuilders and their parent conglomerates. The figures are not made available to the Defense Department in a form than can be verified. In shipbuilding, annual profit figures can fluctuate widely, depending on management estimates of final progress toward completion, costs, and revenues. Often shipbuilders refuse to make their records substantiating these estimates available to the Defense Department. As a result, DOD cannot confirm or refute company figures. For 1975, however, General Dynamics and Tenneco reported record net profits of $84.5 million and $342.9 million, respectively. These were record profits. Newport News reported record profits in 1975 of $30.3 million, the highest in its 89-year history. Since acquisition by Tenneco in mid-1968, Newport News has never reported a loss.

Senator PROXMIRE. What do you think as a matter of public policy of requiring contractors to report to the Defense Department at least what their profits are so that that information is available?

Admiral RICKOVER. I have a recommendation on that that I will come to in a minute, if I may, sir.

PROFITS BASED ON PROJECTED CLAIMS SETTLEMENTS

In reporting to stockholders and to the Securities and Exchange Commission, shipbuilders have calculated profits based on projected claim settlements. The Defense Department does not get access to the reports behind company profit calculations. Therefore, no one in the Defense Department can determine with any certainty the financial condition of a shipyard or its parent conglomerate. I recommend legislation that would require the SEC to make public the records behind company profit calculations. This will help protect the so-called owners of the corporation, the stockholders. And at the very least, the record should be made freely available to the Government agencies against whom claims are being made.

Senator PROXMIRE. That answers the question.

Admiral RICKOVER. Don't you have something to do with the SEC, Mr. Chairman?

Senator PROXMIRE. Yes, they are under the jurisdiction of the Banking Committee that usually meets in this room.

The claims problem demonstrates that there is something wrong with the way the Navy procures ships. What do you think the problem is, and what is its solution?

LACK OF MANNING AND POOR PRODUCTIVITY

Admiral RICKOVER. The Navy has deliberately decided to go to private shipbuilders for new ships. I think that is a good idea. Navy yards do primarily repair work which private shipbuilders also do. The current problem plaguing some private shipbuilders is lack of manning and poor productivity. In this situation, shipbuilders naturally try to find a source of money to cover their increased costs.

INSUFFICIENT PEOPLE TO HANDLE CLAIMS

You asked what is wrong with Navy shipbuilding practices? The main deficiency is that there are insufficient people to handle the shipbuilding claims problem. The Navy is limited in the number of people it can have at Navy shipyards. It is limited in the number of people it can have at headquarters to follow the legal work. Therefore, the technical people are the only ones available to look at these claims. It is difficult to review and document the claims. Yet, if the Navy is permitted, it will do the job, regardless of what it takes.

NAVY NEEDS OUTSIDE COUNSEL

The Navy should be allowed to hire outside counsel. That provision is contained in the present House Armed Services Committee authorization bill. Currently the Navy spurns outside legal assistance.

The Navy is not even able to stop people leaving claims review positions in the Navy to work for outside claims lawyers that prosecute the same claims against the Navy.

I wrote a letter to the ABA, the American Bar Association, regarding the matter of lawyers switching sides. The ABA stated that it was unethical for them to do so unless the Government waives its rights in a specific case. I later found out that claims lawyers as well as the attorney in the Department of Justice, who had previously ruled against the Navy, were the driving forces behind this opinion.

This is what the Navy is up against. The Navy needs to get some help from the rest of the Government.

NAVY NEEDS 5-YEAR SHIPBUILDING PROGRAM

Another problem the Navy has is that the shipbuilding program is changed annually. If the Navy were able to get a 5-year shipbuilding program it could do a lot better planning. It cannot do it now.

MANY CLAIMS MAY NOT BE JUSTIFIED

Senator PROXMIRE. Admiral, I want to thank you very, very much. You have been a superb witness, as you always are. And I might point out that I think you make a devastatingly powerful case that the Congress should be very careful about simply approving forthwith $747 million in claims being paid, as the Defense Department has proposed without auditing, and analyzing, and evaluating those claims to see if they are justified. The case that you have made is that many of these claims may well not be justified, and we will be paying money without justification, the taxpayer's money, and a great deal of it.

Admiral RICKOVER. Sir, the $747 million does not constitute a complete settlement of outstanding claims.

Senator PROXMIRE. I might point out that the Deputy Secretary of Defense, Mr. Clements, will testify before this subcommittee on June 25, in about 2 weeks. And we will be questioning him on the basis of the fine record you have made. And I thank you very much.

Admiral RICKOVER. Thank you, sir, for your kindness.

Senator PROXMIRE. Incidentally, we have other questions that we would like to submit to you for answers, to be included in the record, that you may reply to in writing.

Admiral RICKOVER. Thank you, sir. I will do so.

[The questions and answers referred to follow:]

RESPONSE OF ADM. H. G. RICKOVER TO ADDITIONAL WRITTEN QUESTIONS POSED BY SENATOR PROXMIRE

Senator PROXMIRE. What is the status of the Navy review of the Newport News claims?

STATUS OF NAVY REVIEWS OF NEWPORT NEWS CLAIMS

Admiral RICKOVER. The Navy has completed its review of the first claim under the DLGN 36/37 contract. While it would not be appropriate to disclose the exact amount the Navy considers that this claim is worth, it is only a small fraction of the claimed amount of $69 million. The Navy cannot settle this claim, however, until it is determined to what extent the second large claim on this contract impacts the first.

The Navy has also completed its review of a portion of the first claim under the SSN 688 contracts. This was done to enable the Navy to make a provisional payment against this claim. Again, the Navy has determined that the portion of the claim that has been reviewed is worth only a small fraction of the claimed amount for that portion. This provisional payment was also held up to determine the impact of the second claim submitted under these contracts.

The Navy has not completed its review of the other Newport News claims.

Senator PROXMIRE. You have recommended that if the Public Law 85–804 approach is used, that the Navy should acquire title to the shipyard as a condition of a Public Law 85–804 settlement. Would you comment on this recommendation?

NAVY SHOULD PURCHASE SHIPYARDS IN SOME INSTANCES

Admiral RICKOVER. I believe that government should rely, whenever possible, on private industry to provide the facilities and personnel needed for defense work. I am not eager to see the government buy out the shipyards as long as they do not take advantage of the Navy's dependence on their facilities to break their contracts. Much of the impetus for the decision to provide shipbuilders extra-contractual relief stems from statements that without such relief certain essential shipbuilders will stop work on existing contracts and will refuse to take future Navy work. If essential contractors can void their contracts by refusing to perform work until the Navy meets its latest terms, the Navy is in an untenable position. In those circumstances the Navy would be better off to buy out the shipbuilders interest in the shipyard and have it operated by private industry as a government-owned, contractor-operated plant. In that manner, the shipbuilders could get the guaranteed profit they want, the Navy would be assured of a continued source of supply, and perhaps government and contractor personnel could then devote their efforts to shipbuilding, not to fighting claims.

The government-owned, contractor-operated method of operations is widely used in defense contracting. The Army, the Air Force and the Navy have built major portions of weapon systems in such plants.

Senator PROXMIRE. You have recommended that the Navy enforce its shipbuilding contracts and that claims be settled in accordance with prescribed procedures. What problems do you envision if the Public Law 85–804 approach is used?

PROBLEMS WITH USE OF PL 85–804

Admiral RICKOVER. There are many potential problems with the use of Public Law 85–804. While I believe they are recognized and are being worked on by the Department of Defense team assigned to implement the Public Law 85–804 decision there are no readily apparent answers. Some of the obvious questions are:

(*a*) How can the Government determine what a fair and equitable settlement would be without a thorough review and analysis of each claim?

(*b*) How can the need to by-pass normal settlement procedures be justified when shipbuilders themselves have elected to submit large, after-the-fact, get-

well claims rather than pricing out and settling individual items of government-responsibility as they occur?

(c) How can the need for immediate extra-contractual relief be justified in cases where shipbuilders or their parent conglomerates are reporting record profits?

(d) How can Public Law 85–804 relief be granted in the absence of a formal request and documentation as to the need for such relief from the contractors concerned?

(e) How can the use of Public Law 85–804 be justified in this case without undermining the requirement contained in the Armed Services Procurement Regulation that all other legal or administrative remedies must first be exhausted?

(f) How can settlements be reached that do not encourage future claims?

(g) How can settlements be reached which will not encourage other government contractors and subcontractors to seek extra-contractual relief or not encourage them to adopt a practice of trying to improve their financial position by submitting massive claims?

(h) How can the government maintain effective business relationships if contractors can conclude that the government will not enforce its contracts?

Senator PROXMIRE. Some shipbuilders, particularly Newport News, have complained that the Navy takes too long to settle claims. Why is the claims review process such a lengthy one?

CLAIMS REVIEW PROCESS

Admiral RICKOVER. Each element of a claim must be subjected to a detailed legal, technical and contractual review to determine (1) if the contractor is legally entitled to a contract adjustment for that claim element, and (2) the amount of any adjustment. Because current Navy legal support is inadequate, the burden of claims review falls upon technical people who must at the same time perform their primary duties. This further extends the time required to properly review claims.

In the case of Newport News the problem is further exacerbated because the claims themselves are massive, consisting of 64 volumes. Further, Newport News has refused to certify that the claims are current, complete and accurate even though the Navy is required to obtain such a certification by Navy Procurement Directives. Also, Newport News typically does not show a relationship in the claims between alleged government actions and resultant increased cost or delays. The claims simply list a series of alleged government actions and then contend that the government is responsible for all increased cost and delays. Finally, Newport News continually diverts government effort from the claims review process by taking actions such as refusing to pre-price change orders and threatening to stop work that requires government personnel to drop what they are doing to attempt to address these new issues.

Thus, even though the claims review process must be relatively lengthy to insure that the taxpayer's interests are properly protected, the current time periods required for review could be shortened considerably if Newport News assisted by submitting claims that related cause and effect and certified the claims.

Senator PROXMIRE. Some officials in the Department of Defense have made statements to the effect that Navy shipbuilding contracts were inequitable and did not adequately protect shipbuilders against the effects of inflation. What are your views on that?

ARE SHIPBUILDING CONTRACTS INEQUITABLE?

Admiral RICKOVER. I do not consider that Navy shipbuilding contracts have been either unfair or inequitable in their coverage of escalation. In fact, shipbuilders are better protected from the effects of inflation than are other fixed priced defense contractors. There are several reasons for this. First, shipbuilders receive escalation payments based on changes in indices that the Bureau of Labor Statistics prepares especially for the shipbuilding industry. Second, some shipbuilders also include additional contingencies in their bid when they anticipate that the impact of inflation will be greater than the amount that they will be paid under the escalation provisions of the contract. Third, the price of contract changes for extra work or for government-responsible delay also include contingencies for escalation. Finally, to the extent the shipbuilder incurs costs due

to inflation that are greater than is covered by the escalation clauses of the contract or the contingencies included in the contract price, the shipbuilder can recover most of these excess costs under the cost sharing provision of the contract up to a ceiling price—even if the excess is not due to government-responsible causes. It should be noted that under these escalation provisions the shipbuilder is protected regardless of the rate of inflation since the indices determining the escalation payment reflect the actual amount of inflation in the economy. Shipbuilders agreed to accept the risk for cost increases beyond the contract ceiling price, including the effects of inflation, unless, under the terms of their contracts, responsibility rested with the Government. This arrangement insures that the shipbuilders are well protected as long as they perform within the contract delivery and ceiling price. I consider this arrangement as both fair and equitable.

Apparently the argument that Navy shipbuilding contracts do not adequately protect against the effects of inflation was generated within the government. Even Newport News has not made this allegation in its claims.

Senator PROXMIRE. Our next witness is William R. Cardwell of Newport News, Va.

Mr. Cardwell, will you come forward, please?

Mr. Cardwell is a former employee and official of Newport News Shipbuilding. He worked at the shipyard for 18 years prior to leaving that company in February of this year.

Mr. Cardwell wrote to me several weeks ago indicating that he had information concerning the construction of ships, which are the basis of the Newport News claims and the claims themselves. I instructed my staff to contact Mr. Cardwell and find out what he knew. Mr. Cardwell agreed to meet with the staff, and he has been most cooperative.

He also agreed to testify this morning at my invitation. And we are very pleased to have him.

I also asked the staff to corroborate insofar as it is possible Mr. Cardwell's statement to assure that he is who he says he is. And the staff has attempted to do this through other sources. And I am reasonably confident that Mr. Cardwell is a reliable, truthful individual, with extensive experience in the Newport News Shipbuilding Co.

And it seems to me that your father was also active in the company. So it is a kind of family tradition, is that correct?

Mr. CARDWELL. Yes, sir.

Senator PROXMIRE. Before proceeding, Mr. Cardwell, will you rise?

Do you solemnly swear that the testimony you will present this morning is the truth, the whole truth, and nothing but the truth, so help you God?

Mr. CARDWELL. I do.

Senator PROXMIRE. Mr. Cardwell, if you have anything to say to us go right ahead, and then we have some questions for you.

STATEMENT OF WILLIAM R. CARDWELL, FORMER EMPLOYEE AND OFFICIAL, NEWPORT NEWS SHIPBUILDING CO., NEWPORT NEWS, VA.

Mr. CARDWELL. You have said most of what I was going to say to start with, Senator.

I presently am a real estate salesman. And prior to that I was employed by Newport News Shipbuilding for approximately 18 years.

The last several years was spent in the production department of that company.

I was heavily involved in developing the original schedules of the SSN 688, the *Rivers*, and the SSN 687, which would be the *Russell.*

SCHEDULE FOR 636 CLASS SUBMARINES UNREALISTIC

I might add that on that original schedule we originally scheduled it for 2½ years, all our 636 class submarines. And their average construction time was 3 years. And because of this, and because of the historical data, there was no question that when the original schedule was put on the street—I developed that schedule myself—there was no way possible that we could build that ship in 2½ years. And everybody in the company knew it.

CHANGE ORDERS USED TO COVER UP INEFFICIENCY

I was also involved in processing change orders for these vessels. And in my opinion the changes by the Government had very little if any effect on the delays experienced during construction. In fact, in most cases we used these changes as crutches to cover up our inefficiency in late work.

COST ESCALATION CLAUSE

It is also my belief that the Bureau of Navy Standards Cost Index rose about 4 percent while the yard costs rose about 39 percent during the period of these ships. And they made out like a bandit, I might say, for this cost escalation clause that was in the contract. And I would suggest to prove this that you have a cost analysis made on a month by month basis. And I believe you will find that the yard, as Admiral Rickover has said, is ripping off the Government pure and simple.

RESPONSIBILITY OF SHIPYARD

The problems encountered by the yard in my opinion cannot be blamed on the Government, they are solely the responsibility of the shipyard.

And I will answer your questions.

Senator PROXMIRE. Mr. Cardwell, will you tell us why you left the company in February?

NEWPORT NEWS REDUCTION IN FORCE

Mr. CARDWELL. I was dismissed on February 11 after 18 years service, I really don't know why. My whole section was dismissed. They said they didn't need us anymore. There was a reduction in force of the production department I was in, I think it was about 425 in number. And I understand 200 were put out on the street that morning.

Senator PROXMIRE. Were people junior to you kept, or was it in view of the fact that since they were reducing the forces that it seemed appropriate that you be laid off?

Mr. CARDWELL. I didn't think it was appropriate. But evidently somebody that wanted to make some money did. I got laid off. The

man next to me had 20-some years service, he was 55 years old, and had six children in college, and he probably knew more about shipbuilding than anybody. Of course he made more money than the others.

Senator PROXMIRE. Was your work generally in the area of production control in the ship construction in Newport News? Tell us briefly what went into the master construction schedule and what went into the revisions and how often they were revised.

CONSTRUCTION SCHEDULE SQUEEZED

Mr. CARDWELL. The master construction schedule was an official document by means of which the shipyard and the Government supposedly kept track of the progress of the construction of the ship. It was developed over a period of some months prior to 1971. I think the keel was laid in June of 1971. And we started working on the master construction some years before, or a year before. It was developed by myself and two other gentlemen in the section from historical data. When we dug into the historical data on past 637 class submarines it was evident from the wording that there was no way that the ship could be built in 2½ years. But we just started squeezing, and as we squeezed, we shortened times that we knew were accurate, because they were data that had been taken over the years on how long it takes to do a particular job, until we got it down to 2½ years. And we put it out on the street, and it was signed by high company officials and went to the Navy.

Senator PROXMIRE. Were you part of management at this time?

Mr. CARDWELL. Yes, sir.

Senator PROXMIRE. Did the people above you know what was going on?

Mr. CARDWELL. Yes, sir. And as we went along the road, I think they went through revision okay. It started with the master construction schedule, and A, B, C, and so on, skipping I. As the Navy would demand a new schedule and to show them that we would make up this time, we just shortened it a little more, pure and simple, and gave it to them.

I might comment that we knew all along, as I said from the start, that we weren't going to build a ship in that length of time. And we had our own little document that we had worked out, which I don't have of course. And when I walked out I walked out with my coat and my hat, and that is all.

Senator PROXMIRE. Will you explain what you mean by knowing that you weren't going to be able to build the ship within that time. Was that unrealistic schedule—was that proposed by Newport News, or was it something insisted upon by the Navy? How did you arrive at the schedule?

14-WEEK DELAY A HOAX

Mr. CARDWELL. We were under contract to deliver on December 5, 1973. So I was told to put out a schedule showing delivery on December 5, 1973, until such time later on in the game that I was told we had moved it up a little bit. They gave us 14 weeks, or something. And we had a strike in DeLaval, who made the main engine complex, and the main and vital hydraulic turbines, and so forth. They went

on a strike in 1971, I believe, September on through December. And we claimed a 14-week delay, which was a complete hoax, it only enabled us to hope to catch up. We weren't ready to put it——

Senator PROXMIRE. You say it was a big hoax. In what way was the 14-month delay a complete hoax?

Mr. CARDWELL. 14-week delay.

Senator PROXMIRE. The 14-week delay, was it caused by a strike?

Mr. CARDWELL. There was a strike; yes, sir.

Senator PROXMIRE. How much of the delay was caused by the strike?

Mr. CARDWELL. I think maybe 2 or 3 days. If you check the record, when the pump finally came in it was several weeks to months before they were ever put in the ship anyway.

Senator PROXMIRE. So they were so far behind at that point——

Mr. CARDWELL. We were behind. Like I say, they used it as a crutch to try to gain time. And I think the Navy finally did agree to delay delivery until March 3, 1974, at the time.

Senator PROXMIRE. What is the significance of the construction schedules? How are they used in the shipyards?

Mr. CARDWELL. Well, the master construction schedule is solely a document used by the Navy and the management of the shipyard. Under the master construction schedule a group indexing schedule is made, which is a very complex, big thick book which goes down to the trades, and which is supported to make sure that the proper manpower and men and so forth are there at the proper time to build a certain section of the ship, or a certain element. And I don't know whether I am answering your question or not.

Senator PROXMIRE. Let me ask you some details about it, and perhaps that will bring it out. Is it correct that two sets of master construction schedule restrictions were prepared, and that there was a published set of schedules which was forwarded to the Navy, and there was a secret or unpublished set of schedules which was for shipyard use only?

TWO SETS OF SCHEDULES KEPT

Mr. CARDWELL. Well, there was a second set, which I referred to a few minutes ago as the document we had in our office, which we had worked up, showing when we were going to really deliver the ship.

Senator PROXMIRE. And that was kept from the Navy?

Mr. CARDWELL. But that wasn't sent through the yard, right, it was kept in the production control office or the program manager's office.

Senator PROXMIRE. What was the reason for having those two sets of schedules?

Mr. CARDWELL. Well, I don't know for the second one, other than to tell us what we were doing. We knew what was happening. And the Navy did, too, I think if the truth was known. I can't visualize them not knowing what was going on in that shipyard.

UNPUBLISHED SCHEDULES MORE REALISTIC

Senator PROXMIRE. Is it correct that the published or official schedules which went to the Navy showed that the yard was falling behind on the ships, but indicated that the work would be made up in the

following period, but that the unpublished schedules which went to the construction department were more realistic and indicated that less work was to be accomplished in the following period?

Mr. CARDWELL. Part of that statement is true.

Senator PROXMIRE. What part is true and what part is not?

Mr. CARDWELL. The part where you said the schedule which went to the Navy showed we were falling behind, but we would make it up. The other part, those schedules did not go down to the waterfront, they stayed in the production control office. In other words, management know it.

Senator PROXMIRE. They didn't go to the construction department?

Mr. CARDWELL. No, sir, not the other ones. Now, they had kept——

Senator PROXMIRE. The management knew it and you had your own books indicating——

Mr. CARDWELL. We knew when we were going to deliver the ship, yes, sir. And it wasn't what the master construction schedule said, the one that went to the Navy.

Senator PROXMIRE. Let me try to clarify what is happening with some hypothetical numbers. The schedule would show that a number of events or jobs were to be accomplished over the life of the projects?

Mr. CARDWELL. Right.

Senator PROXMIRE. And when all the events were accomplished the ship would be delivered?

Mr. CARDWELL. That is true.

Senator PROXMIRE. The schedule would also show the number of events to be accomplished in the next few weeks?

Mr. CARDWELL. That is true.

Senator PROXMIRE. Let's suppose that the published schedule which went to the Navy showed that 100 events were to be accomplished in the next 4 weeks. Is it correct that the unpublished schedule could show that only 50 events were to be accomplished?

Mr. CARDWELL. That is true.

Senator PROXMIRE. Now, the significance of this is, then, that while the Navy was being told 100 events were to be accomplished, in fact management intended only 50, there was to be less progress than the Navy thought there would be, is that correct?

Mr. CARDWELL. That is correct.

Senator PROXMIRE. Now, was the reason for all of this that the yard was falling behind in its work?

LACK OF SKILLED LABOR

Mr. CARDWELL. Yes; we were falling behind, yes, sir. We couldn't keep up. Some of the reasons why—I guess you are going to ask me why we weren't going to keep up. Admiral Rickover went over some of the reasons. We didn't have the skilled labor to do it. It was just like a man that spends too much money. I think at one time the shipyard was a small shipyard, and it handled one or two nuclear ships, and some overhauls, and so on. And then we got to a point where it went out and got all these contracts, and we just didn't have enough skilled manpower to go around, especially in the pipefitters trade and

the welders trade. The welding rejects were very high during the construction of the SSN–686.

MANAGEMENT DID NOT WANT NAVY TO KNOW YARD FALLING BEHIND

Senator PROXMIRE. Is it correct that the management did not want the Navy to know how far it was behind in the construction of ships, and that it was falling further and further behind?

Mr. CARDWELL. In my opinion, yes, sir.

Senator PROXMIRE. In your opinion what was the purpose behind this tactic? Why didn't the management want the Navy to know how far behind it was?

Mr. CARDWELL. I couldn't answer that question, Senator, why they didn't want them to know. You would have to ask the person in the shipyard. I don't know the answer to that question.

Senator PROXMIRE. In your opinion why was the shipyard falling so far behind?

Mr. CARDWELL. We didn't understand it ourselves. There were too many contracts and not enough experienced men.

Senator PROXMIRE. Can you discuss briefly some of the manpower problems you had in the yard? Was there a shortage of skilled workers, and if so, in what area?

SKILLED MANPOWER PROBLEMS

Mr. CARDWELL. I think I just went over that briefly. The two big areas that I am familiar with are the welding trade and the pipefitters trade. The pipefitters were at a premium. We were delayed in the construction of 688 and 687 because the pipe banks were not installed. The pipe banks go right inside the hull of the ship. And they have to be put in before any equipment can be put inside the various sections. They are built in a pipe shop and then put in and tested on the ship, because once the other equipment goes in you can't get to the pipe banks. And these pipe banks, we just didn't have the people to build them or to install them.

Senator PROXMIRE. There was a shortage, then, of skilled workers?

Mr. CARDWELL. Right. And in the north area of the yard where the hull units were being built, the shipyard claimed that escalation had cost them money, but I say that most of those hundred units took over double the man-hours that it took to build the previous sections on 637 class submarines.

Senator PROXMIRE. Did the shortage of skilled workmen also cause a lot of rework and contribute to spending more time during the construction phases than it estimated?

Mr. CARDWELL. It certainly did. Because when you have inexperienced people building your hulls and working in your ship, it means that when the inspectors come, this probably would have to be done over.

Senator PROXMIRE. In your opinion, then, would you say that the lack of skilled workers was very costly to the yard? Was this a large cause of the delays and the cost overrun?

Mr. CARDWELL. Yes, sir, I would say that is a true statement.

USE OF CHANGE ORDERS

Senator PROXMIRE. Earlier you mentioned the change orders, and I believe you stated that most of the change orders did not cause delay or disruption in the construction of ships, the change orders?

Mr. CARDWELL. Yes, sir.

Senator PROXMIRE. Can you explain that?

Mr. CARDWELL. Well, from the wording——

Senator PROXMIRE. Let me just make it a little easier for you by asking, how were the change orders used in the preparation of claims here?

Mr. CARDWELL. Well, I personally was put on loan to the contract department to work up the statistics for the changed sectors. And I went through and picked out every change that we could possibly attribute to the Government, and listed them. And they are right in those volumes. And during the course of construction somebody in the upper management got the bright idea of using the duplicative impact which you heard Admiral Rickover mention. Some of those changes in there that had a cumulative impact on them have less than 5 hours labor involved. And they are in that claim right there. We put a cumulative impact on anything that has as much as 1 hour of production manpower. If it is 1 hour of production worker's time during that day we could put on those changes, we put cumulative impact on the changes.

The changes, like I said before, we used as a crutch. We looked for Government changes to hide our inefficiency and lateness in not making the schedule.

Senator PROXMIRE. So that you were taking changes that caused minimal delay and lumping them together to show a huge impact of delay, and therefore a very big cost?

Mr. CARDWELL. Yes, sir.

Senator PROXMIRE. Now, was this a misstatement, inadequate indication of what the cost of delay was? Is that the way the delay was exaggerated?

Mr. CARDWELL. I would say that is right. Like I said before, I don't think there was any delay caused by Navy changes, if the truth were known.

MEMBER OF NEWPORT NEWS CLAIMS TEAM

Senator PROXMIRE. When did you become a member of the claims team, and what were you told when you began work with claims?

Mr. CARDWELL. I became a member sometime in late 1974. And I was called into a meeting of the team. And there were about 50 people that had formed this team. And I was called in because I had handled the changes during the construction of the 686. And I was told to go through and pick out every single thing, no matter how small, that I could find, that there was any proper way that we could blame the Government for the delay of the ship.

Senator PROXMIRE. Were items other than changes placed into the claims even though they did not increase the shipyard costs?

Mr. CARDWELL. Repeat that.

Senator PROXMIRE. Were items other than changes placed into the claims even though they did not increase the shipyard costs?

Mr. CARDWELL. Sir, I don't know about other items——

Senator PROXMIRE. Delays of various kinds, and so forth, that might not have been the result of changes requested by the Navy.

Mr. CARDWELL. The only thing I worked on on the claim was the change section.

Senator PROXMIRE. How about the strike, isn't that an example?

Mr. CARDWELL. The strike is in there. And I mentioned that.

Senator PROXMIRE. That wouldn't be a change, that was a delay caused by something else?

Mr. CARDWELL. Right, But I didn't have anything to do with preparing that, although that chart that is in volume 2, book 5, section 7(c), I believe, that chart was drawn by me sometime prior to joining the claims team.

Senator PROXMIRE. I understand that the valve company supplying valves to Newport News had a strike, and that strike has been made the basis of a part of the claim. Will you tell us whether the strike in fact caused a delay in the construction?

Mr. CARDWELL. Yes, by DeLaval.

CLAIMS KNOWINGLY EXAGGERATED

Senator PROXMIRE. Is it your testimony that much of the claims you worked on included exaggerated, unsupported, or inaccurate figures?

Mr. CARDWELL. Yes, sir.

Senator PROXMIRE. And that this was done with the direction or the knowledge of Newport News Shipbuilding?

Mr. CARDWELL. Yes, sir.

Senator PROXMIRE. Mr. Cardwell, I want to thank you very much. It is not easy to do what you have done this morning. And it is a real public service. And it takes a lot of courage. And it is the kind of action that on the basis of experience that I have had on this committee is likely to cause you some difficulty in the future. And I want to express my admiration and gratitude to you for coming forward the way you have.

Mr. CARDWELL. Yes, sir.

Senator PROXMIRE. We will continue hearings on this subject in approximately 2 weeks, when the Deputy Secretary of Defense, William Clements, will testify. The subcommittee stands recessed.

[Whereupon, at 11:45 a.m., the subcommittee recessed, to reconvene at 10 a.m., Friday, June 25, 1976.]

ECONOMICS OF DEFENSE PROCUREMENT: SHIPBUILDING CLAIMS

FRIDAY, JUNE 25, 1976

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 10:10 a.m., in room S-407, the Capitol Building, Hon William Proxmire (chairman of the subcommittee) presiding.

Present: Senator Proxmire and Representative Pike.

Also present: Richard F. Kaufman, general counsel; and George D. Krumbhaar, Jr., and M. Catherine Miller, minority professional staff members.

OPENING STATEMENT OF SENATOR PROXMIRE, CHAIRMAN

Senator PROXMIRE. The subcommittee will come to order.

Today's hearing on shipbuilding claims is being conducted against a backdrop of major uncertainties which if not cleared up in the near future could lead to a crisis.

The immediate cause of the present situation is that several large shipbuilders have been unable to build and deliver ships to the Navy on time and for the agreed upon amounts.

These failures have resulted in huge cost overruns on many of the nuclear and nonnuclear ships built over the past several years.

Three of the shipbuilders, all subsidiaries of major conglomerates, Tenneco, Litton, and General Dynamics—have filed or are in the process of filing claims against the Navy totaling nearly $2 billion.

The shipbuilder's claims represent their assertions that the Government and the taxpayer should reimburse them for all of their cost overruns.

Does the American taxpayer owe these three conglomerates $2 billion?

There is only one objective and equitable way to answer this question. Claims must be fully audited, analyzed, and evaluated by the Government.

It would be improper, as a general proposition, for the Government to pay any claim by a private firm or individual that has not been audited. In light of this evidence which has been brought forth to this subcommittee, from an examination of the claims documented as

well as testimony from witnesses, it would be grossly improper to pay these claims prior to a complete audit and evaluation.

The Newport News claims in particular cannot stand up to rigorous examination. The evidence presented so far shows that they are based on inflated figures, unsupported allegations, attempts to charge the Government with the costs of commercial activities, and possible double counting.

Following receipt of the earlier testimony I asked in writing that the Secretary of the Navy initiate an investigation of the Newport News claims to determine whether they should be turned over to the Justice Department for criminal investigation. The Navy has not yet responded to my request.

Now Newport News is continuing its tactics of applying pressure on the Government in an effort to obtain payment of its claims without an audit. First it took a year or more to prepare most of its claims, they then sat on them for months before officially filing them in February and March of this year. Then shortly after its claims were filed, it set up an immediate hue and cry because the claims had not been resolved.

Within the past 2 weeks it has bombarded the Navy with a series of letters threatening to stop work on Navy ships. One week ago, on June 18, it delivered an ultimatum to the Navy with respect to one of the ships, the nuclear carrier CVN 70. The letter from Newport News amounts to a threat to stop work on June 25, today, on the carrier if certain assurances are not provided by the Navy.

Now these pressure tactics cannot be allowed to succeed. The Government cannot permit any private firm, event a giant conglomerate corporation, to dictate the terms on which it will continue doing business if those terms constitute a bailout or if they would impose unfair burdens on the taxpayer.

We have here on the chart a listing of the claims. You can see the claims of Newport News and Tenneco. They are $894 million in total. But the significant fact is that they submitted them so recently and revised them so recently, most of them in the last 3 or 4 months, a very major portion of the claims.

To settle them forthwith without having an opportunity to go into them would not be prudent in my view especially when you can see how enormous they are. The blue covered books are Newport News, 8 columns of books. Those are Newport News claims. They contain allegations that have to be investigated. It is obvious that it would take a matter of months and perhaps even longer to thoroughly and responsibly examine the legitimacy of these claims.

This big pile of documents represents Litton claims. This indicates how big and complicated and difficult this claims problem is.

Our first witness is Hon. William P. Clements, Deputy Secretary of Defense, who is accompanied by a distinguished group of officials from the Defense Department who I would like Secretary Clements to introduce. Following the Secretary's testimony we will hear from Rear Adm. Kenneth L. Woodfin, USN, retired.

Secretary Clements, I am very pleased that you could be here today and if you will proceed with your statement we have some questions.

STATEMENT OF HON. WILLIAM P. CLEMENTS, DEPUTY SECRETARY OF DEFENSE, ACCOMPANIED BY FRANK A. SHRONTZ, ASSISTANT SECRETARY OF DEFENSE, INSTALLATIONS AND LOGISTICS; RICHARD A. WILEY, GENERAL COUNSEL, OFFICE OF THE SECRETARY OF DEFENSE; JACK L. BOWERS, ASSISTANT SECRETARY OF THE NAVY, INSTALLATIONS AND LOGISTICS; GARY D. PENISTEN, ASSISTANT SECRETARY OF THE NAVY, FINANCIAL MANAGEMENT; FREDERICK H. MICHAELIS, CHIEF, NAVAL MATERIAL COMMAND; AND VICE ADM. R. C. GOODING, COMMANDER, NAVAL SEA SYSTEMS COMMAND

Secretary CLEMENTS. Thank you, Senator Proxmire.

Senator PROXMIRE. If you would like to abbreviate your statement in any way, we will be happy to have it printed in full in the record. It is an excellent statement.

Secretary CLEMENTS. I will abbreviate it although I do want in the record the full statement as you have stated, Senator Proxmire. I also would like to respond to some of the particulars in your statement which I will address informally and outside of my statement after I have finished the abbreviated presentation.

I would like also to introduce before I start Secretary Shrontz, who is the Assistant Secretary of Defense for Installations and Logistics, Counsel Wiley, General Counsel of the Office of the Secretary of Defense; Mr. Bowers, who is the Assistant Secretary of the Navy for Installations and Logistics; Mr. Penisten, who is Assistant Secretary of the Navy for Financial Management; Admiral Michaelis, who is the Chief of Navy Material, and Admiral Gooding. I think that you already know most of these people but they will be in a support position as we might need them.

Senator PROXMIRE. All right, sir. Go right ahead.

REVIEWS OF SHIPBUILDING PROGRAM

Secretary CLEMENTS. Mr. Chairman and members of the subcommittee, I am pleased to have this opportunity to discuss with you the serious matters that beset the Navy's shipbuilding program. Seven years ago the Secretary of Defense, Melvin Laird, in his first official appearances before the Congress, spoke of the urgent need for a comprehensive review of the Navy shipbuilding program.

He cited an estimated deficit of $600 million to $700 million of funds required to complete ships then in the ongoing building program.

He spoke of large cost overruns, of multi-million dollar claims, of programed ship cancellations. He said we must begin to get this program under better control.

In the intervening 7 years this program has not lacked oversight, review, studies in detail by the Congress, the GAO, the Commission on American Shipbuilding, the Navy, the industry and others. Annually since 1968 the Senate and House Appropriations and Armed Services Committees have made significant comment on the Navy's shipbuilding claims problems.

Mr. Chairman, as you know, your subcommittee conducted extensive hearings on the acquisition of weapons systems in the period 1969–73. The Navy's shipbuilding program is thoroughly covered in your committee's reports with very detailed comments and explanation by Admiral Kidd, Admiral Rickover, Gordon Rule, F. Trowbridge vom Baur, Gilbert Cuneo and others.

In 1970 and 1974 the Seapower Subcommittee of the HASC held extensive hearings on the state of the Navy's shipbuilding program, naval shipyards and private shipyards. The conclusions of the subcommittee's report of December 31, 1974, are most pertinent to our discussions today.

As you know I assumed my present office as Deputy Secretary of Defense in January 1973. From the beginning of my work in the Pentagon, I have been concerned with overseeing the management of the weapons acquisition process. Of all our major systems acquisition programs I believe the problems in the Navy combatant ship acquisition program have been and are long enduring, most vexatious, and very difficult to bring under orderly control and management by the Secretary of the Navy and the Secretary of Defense.

SUMMARY OF SHIPBUILDING CLAIMS

Mr. Chairman, I would like to summarize the scope of the Navy's shipbuilding claims problem for the period January 1, 1969, through April 1, 1976.

In category A, settlements made, there were 54 claims for a claimed amount of $1,317 million which were settled for $631 million or 47.9 percent. About 77 percent of the settlements were for conventional ships, such as, aircraft carrier, destroyers, destroyer escorts, amphibious ships, fleet tenders, and fleet auxiliaries. The remainder were for nuclear submarines.

In category B, outstanding REA's or claims, there are eight REA's in hand for a total of $1,402 million. In addition REA's for more than $300 million are expected to be filed before the end of 1976. About two-thirds of these claims are for nuclear ships.

The category C, ASBCA decisions, record is very brief. Up to April 1976 only two shipbuilders appeals for relief had been decided. The Lockheed Shipbuilding Co. claim for $62 million settlement has been upheld by the board.

The claimed amount of $23 million by General Dynamics of Quincy was denied. However, General Dynamics has filed suit in the U.S. Court of Claims for increased performance costs of $12 million found to have been incurred by the ASBCA in its denial decision.

In category D there are four shipbuilders appeals before the ASBCA in the total amount of $149 million.

From the foregoing, it can be said that the overall universe of the shipbuilding claims problem since January 1969 to April 1976 amounts to $3,189 million. Of this amount $1,317 million have been settled and $1,872 million are pending. Clearly the most severe claim problem is in current ongoing ship construction projects.

I have attached in tabular form a statistical summary of the 11 Navy shipbuilding contracts involved in the claims problem. This summary

is consistent with the claims summaries but is directed toward a presentation of pertinent data affecting the 11 contracts from whence the claims originated.

As you can note from the total or bottom line of the summary table, these 11 contracts concern 70 naval ships built or building for delivery in the 1974–81 time period. The current ceiling price plus projected escalation payments at completion of these 70 ships is $8,237.2 million. The Navy estimate of cost at completion of these ships is $8,647.4 million.

Overall, the summary indicates a loss to the shipbuilders of $468.6 million. As shown in the table the slippage from original contract date varies from 1 to 4 years among these 11 contracts.

Now it is this slippage and potential for more slippage that is the crux of the claims problem.

Much of the contentiousness that marks the relations between the Navy and the shipbuilders stems from the charge and countercharge of assessments of responsbility for these delays.

Mr. Chairman, other important aspects in appreciating the complexity of the shipbuilding claims problem are the elements of time and resources involved in their administration.

Table I is an analysis of the time increments involved in 48 negotiated settlements in the period January 1, 1969, through April 1, 1976. From this table you can see that almost half were settled under 2 years time and over half required 2 to more than 4 years time.

Table II on this shows the time periods of six completed ASBCA cases in the period January 1969 through April 1, 1976. It took 6½ to 7 years from time of original filing of the claim to ASBCA decision in the Lockheed cases; it required over 5 years for the General Dynamics case.

Table III shows that as of April 1, 1976, the four pending cases before the ASBCA originated from claims initiated more than 5 years ago. Three of the cases had been docketed in the board 4 to 5 years ago.

CRITICAL IMPACT OF PRESENT CONDITIONS IN NAVY SHIPBUILDING PROGRAM ON NATIONAL DEFENSE

Mr. Chairman, I would like now to briefly comment on several specific situations, which exist in the Navy's shipbuilding program which have hardened my resolve to seek direct and early remedial action.

THE NEWPORT NEWS SITUATION

The Newport News Shipbuilding & Drydock Co., situation. First the inability to this date of both Navy and Newport News to definitize the contract for the construction of the CVN 70, the Vinson, even though in April 1974 the Navy formally exercised the unpriced option in the CVN 68–69 contract for the construction of the CVN 70.

Second, the stop work action Newport News took in August 1975 in regard to the CGN–41 construction project. The Navy sought an injunction in the U.S. District Court for the Eastern District of Virginia at that time. As a result of that legal action, the district court

judge directed Newport News and Navy to continue the CGN–41 project on an interim 12 month modus operandi basis wherein Newport News is reimbursed its costs plus a fee while the parties try to negotiate their differences.

It is my understanding that up to the present no real progress has been made toward a mutual agreement regarding the CGN–4 contract.

Next, the great reluctance of Newport News last year to bid on the Navy's fiscal year 1975 SSN 688 class follow on production request for proposal.

And last, more recently, in a letter of June 14, the president of Newport News has informed me that he considers his company is being subject to irreparable damage as a result of the failure of the Government to respond to Newport News' requests for equitable adjustment. He expressed his concern for what he termed the significant and serious deterioration of day-to-day relationships between the Navy and the company.

He further states that if Newport News is unable to promptly reach a reconciliation with the Navy, the company plans to withdraw from continued participation in the nuclear naval shipbuilding program.

THE ELECTRIC BOAT SITUATION

The Electric Boat Division of General Dynamics Corp., has currently in hand contracts for 18 SSN 688 class submarines and four Trident submarines. Three additional Trident submarines are programed to be awarded in fiscal year 1977 and 1978.

Recently a settlement of $97 million on a claim for $232 million was made by the Navy on the first production flight of seven SSN 688 boats. As part of this settlement EB is required to submit by December 1976 the balance of their claim against this contract and any claim against the second production flight of SSN 688's. Claims of approximately $300 million are expected.

General Dynamics has recently made a significant capital investment at Electric Boat of about $140 million for facilities for Trident production and the creation and out-fitting of the Quonset Point division of EB. The Government has given General Dynamics assurances of pricing arrangements to assist in amortizing this investment as Navy work progresses over the next several years.

The Navy is the only customer EB has. To be a viable enterprise it must be financially sound. I am uneasy in this regard—especially when I realize that the Navy's current plans for submarine construction are limited to EB and Newport News.

THE INGALLS SHIPBUILDING/LITTON SITUATION

Litton currently has under contract 5 LHA's and 30 DD963 class destroyers. Deliveries on both these contracts have just begun. Despite the many problems of management, design, facilities installation, production processing, quality control, work force recruitment and retention, there is now in place at Pascagoula a modern shipbuilding complex which is an unquestioned national asset for defense purposes.

However, in a financial sense we are faced with a giant dilemma. It is now my understanding that Litton anticipates a $474 million loss in the LHA contract and a $69 million loss in the DD963 contract.

It would appear that absent any remedial action the viability of this shipbuilding complex may be short lived.

THE GENERAL SITUATION AS RELATES TO OTHER MAJOR SHIPBUILDERS

As has been brought out in the hearings of the HASC Seapower Subcommittee, Bethlehem Steel Shipbiulding Co., and Sun Shipbuilding Co., for several years have adopted a policy of not participating in the Navy's shipbuilding program because of their abhorrence of the contractual arrangements and the business relations that ensue.

Recently in connection with the first follow on production of the Navy's FFG program, I was very concerned at the lack of response by the industry to Navy's RFP. Although eight companies BIW, Todd, Newport News, Avondale, Defoe, National Steel, Lockheed, Litton, were tendered RFP's and had received a detailed pre-RFP briefing by the Navy on the planned production program, only two contractors responded, BIW and Todd.

On inquiry I learned that Avondale's top management was vehemently opposed to certain policies and practices used in naval ship procurements, and perhaps more importantly Avondale was quite dissatisfied with the Navy's handling of their major claim for $169 million for the 27 ship DE production program which had been completed in September 1974.

Defoe, a small shipbuilder, indicated it could not afford the large expense involved in preparation of the bid as outlined in the request for proposal.

Lockheed, National Steel, Litton, and Newport News had an assortment of reasons for not participating. The fiscal years 1972 and 1973 submarine tender request for proposal received limited response from the industry on the basis of the solicitation for a fixed price incentive type contract. The Navy finally negotiated for this shipbuilding project on a sole source cost type contract, with Lockheed Shipbuilding at Seattle in November 1974.

REVIEW OF RECENT ACTIVITY TO INVOKE AUTHORITY OF PUBLIC LAW 85–804

Mr. Chairman, in a letter of April 2, 1976, to Senator Stennis I informed him of our intention to invoke Public Law 85–804 to remedy the serious problems that exist between the Navy and four of its major shipbuilders which threaten the national defense. I included a copy of this letter with this statement.

On April 30, in letters I formally notified both chairmen of the House and Senate Armed Services Committees our intent to use Public Law 85–804.

On March 30, I appointed a Shipbuilding Executive Committee to guide and monitor all actions necessary by the Navy Department and to advise and assist me in the application of Public Law 85–804.

This committee has been very active since March 30, familiarizing themselves with the Navy's total shipbuilding program, with the con-

tracts which are the subject of claims or requests for equitable adjustment with the nature and content of these requests and have been conducting negotiations with the contractors.

My charge to the committee directed that they examine those shipbuilding contracts entered into the 1968–73 time period referred to previously to determine precisely how to reform them, and particularly to provide for escalation recovery which reflects current Navy Department shipbuilding contract practice notwithstanding the existing provision of these contracts.

During May and early June the negotiation team of Secretary Shrontz conducted negotiations with the four shipbuilders. I had hoped that agreements in principle would be achieved with the shipbuilders prior to June 10, and had advised Chairman Stennis and Chairman Price of my intention, in any case, to advise them by that date of the details of our agreements or of our failure to achieve agreement.

On June 9, in letters to the Speaker of the House and the President of the Senate, I regretfully informed them of our failure to reach agreement with the shipbuilders.

THE CRISIS NATURE OF THE NAVY'S SHIPBUILDING PROGRAM

In seeking to apply the extraordinarily broad authority of Public Law 85–804 I was mindful of the statement in the report of the Committee on the Judiciary which accompanied the bill authorizing the making, amendment, and modification of contracts to facilitate the national defense, which became Public Law 85–804. The committee report stated:

> This broad power is designed to provide the flexibility required by the government to deal with the variety of situations which will inevitably arise in the multi-billion dollar defense program and for which other statute authority is inadequate. By providing means for dealing expeditiously and fairly with contractors the enactment of this bill will help assure that vital military projects will proceed without the interruptions generated by misunderstandings, ambiguities and temporary financial difficulties.

It is my judgment that the largest part of the problem which we recognize in the ongoing shipbuilding contracts signed in the period 1968–73 can be overcome by a reformation of the provision for escalation.

Mr. Chairman, over the past 3 years I have discussed the problems in the Navy's shipbuilding program with the House and Senate Armed Services Committees. I believe I can say that there is a mutual appreciation of the gravity of these problems and the need to take remedial action.

Of course the Seapower Subcommittee of the HASC and your subcommittee have long since expressed concern and have done much to document and to expose these problems to public review.

PUBLIC LAW 85–804

Mr. Chairman, I want to emphasize that in proposing to invoke the extraordinary powers of Public Law 85–804, we were not seeking a quick and easy method of claims settlement.

We are not trying to bail out contractors and who have been inefficient and guilty of mismanagement.

On the contrary we are seeking an early and comprehensive resolution of the many problems that currently handicap the construction of naval ships currently building and which threaten to seriously impair planned additional new construction. It is my judgment that this constitutes a serious threat to the national defense.

Mr. Chairman, in my statement I have repeated much of the background material which I have previously discussed with the Senate and Armed Services Committees at hearings in connection with our proposed use of Public Law 85–804.

FAILURE TO GAIN AGREEMENT WITH SHIPBUILDERS

As I have mentioned, on June 9, I regretfully had to report to the Congress our failure to gain a mutual agreement with all four shipbuilders. Where does this leave us? What do we do now?

Before addressing these questions I would like to say that:

The National Defense requires a strong Navy and we must have the shipbuilding industry working with us to efficiently complete our presently authorized programs and to be ready, able, and willing to undertake new authorizations for naval construction that are so sorely needed.

It is my judgment that the Navy shipbuilding program is in a critical situation which threatens the national defense.

RELATIONS BETWEEN SHIPBUILDERS DETERIORATING

For the past 6 years or more the business and working relations between the Navy and its major shipbuilders have been deteriorating which has brought about increasing acrimony and the application of significant resources by the Government and the shipbuilders to claim generation, and claim review. Today the outstanding unresolved claims/REA's are at an all time high.

RESPONSIBILITY OF SECRETARY OF DEFENSE

The Secretary of Defense in concert with the Secretary of the Navy has the responsibility on an immediate basis to initiate corrective actions in the management of the Navy's shipbuilding program and more specifically toward resolving the grave contractual problems that currently exist.

Where does this leave us? At the moment my Executive Shipbuilding Committee is reviewing the record of the negotiations and considering alternatives. The Navy is going forward with its plans for the review and analysis of the REA's.

Concerning the shipbuilders, I hope we shall see some initiatives in the way of alternative proposals. I am aware of Newport News indicating a reluctant determination to stop participating in the Navy's shipbuilding programs. I am also aware of the serious financial status of Ingalls/Litton and its difficult negative cash flow problem.

What do we do now?

Mr. Chairman, there is no question that the Government must see that the 70 ships in the 11 contracts that represent the fiscal year 1976 and prior year programs are constructed, fitted out and added to the operating fleets. Similarly we need working with the Congress to provide for the efficient carrying out of the Navy's shipbuilding program of fiscal year 1977 and outyears which are so essential to our national defense.

The mechanics of achieving those goals on an equitable and prompt basis is our immediate problem and our responsibility. I would be obliged for such assistance and advice as your committee may have toward resolving our immediate problem.

Mr. Chairman, this completes my statement. I am ready to start participating in any questions you might have.

[The prepared statement of Secretary Clements, together with attachments, follows:]

PREPARED STATEMENT OF HON. WILLIAM P. CLEMENTS

I. INTRODUCTION

Mr. Chairman, members of the Subcommittee on Priorities and Economy in Government, I am pleased to have this opportunity to discuss with you the serious matters that beset the Navy's shipbuilding program. Seven years ago (March 1969) the Secretary of Defense, Melvin Laird, in his first official appearances before the Congress, spoke of the urgent need for a comprehensive review of the Navy shipbuilding program. He cited an estimated deficit of $600–$700 million of funds required to complete ships then in the on-going building program. He spoke of large cost over-runs, of multi-million dollar claims, of programmed ship cancellations. He said we must begin to get this program under better control.

In the intervening seven years this program has not lacked oversight, review, studies in detail by the Congress, the GAO, the Commission on American Shipbuilding, the Navy, the industry and others. Annually since 1968, the Senate and House Appropriations and Armed Services Committees have made significant comment on the Navy's shipbuilding claims problems. Mr. Chairman, as you know, your Subcommittee conducted extensive hearings on "The Acquisition of Weapons Systems" in the period 1969–73. The Navy's shipbuilding program is thoroughly covered in your Committee's reports with very detailed comments and explanation by Admiral Kidd, Admiral Rickover, Gordon Rule, F. Trowbridge vom Baur, Gilbert Cuneo and others.

In 1970 and 1974, the Seapower Subcommittee of the HASC held extensive hearings on the state of the Navy's shipbuilding program, Naval shipyards and private shipyards. I quote the conclusions in the Subcommittee's report of 31 December 1974, which I believe are most pertinent to our discussions today.

"1. A viable, healthy system of shipyards—both naval and private—is necessary to our national security. But our shipbuilding program is experiencing serious difficulties, with major new construction concentrated in only three yards and with severe manpower problems that have adversely affected costs and schedules in two of those yards. One of the key causes of trouble has been the inability of shipyards to plan for the future because of the lack of a clearcut, long-range national program and a pattern of peaks and valleys in shipyard activity.

"2. The building of naval combatant vessels is extraordinarily complex. In the past, however, the problems of the shipyards have been relegated to the lower levels of management by the Executive Branch. One of the purposes of the subcommittee in conducting the hearings has been achieved by the hearings themselves: to focus adequate attention on the problems of the shipbuilding industry by the highest officers of the Department of Defense and other departments of the Executive Branch. But the problems of shipyards do not admit of easy, one-time solutions; they require sustained, outstanding management from the highest levels.

"3. The statutory ban on certain cancellation charges over $5 million on multi-year contracts can in some cases add too much to the price of ships.

"4. Naval shipyards are vital to the Navy and to the overall health of the shipbuilding industry in the United States. The limitation on civilian personnel working in the naval shipyards puts an undue burden on these yards in trying to manage their resources in a cost-effective manner. The policy of not allowing new construction in the naval yards prohibits the most economical use of these facilities while at the same time fostering the undesirable concentration of new construction in just a few yards.

"5. All shipyards are critically short of trained manpower and in some instances shortages of skilled workers are causing scheduled delays with accompanying cost overruns. The cognizant agencies of the Government have in the past failed to provide the training assistance required. The subcommittee considers this especially deplorable in view of the fact that millions of dollars have been allocated to training programs where there was no assurance of available jobs at the conclusion of the training.

"6. There have been long delays in the settlement of shipbuilders' claims. In part, delays have been due to the necessity of carefully considering each element of complex claims; in part, to the changing nature of contractor submissions; and, in part, to delays by shipbuilders in producing evidence in support of claims. Nevertheless, the present procedures allow for unacceptable delay in settlement of claims. The Navy has had to refer some recent claims to the Department of Justice for possible legal action. Huge claims have been submitted to the Navy in recent months and others are threatened. These can only result in overwhelming Navy personnel responsible for the programs unless they can be given adequate professional assistance. The Navy has not been able to pay interest on claims found to be just, although in such cases the contractor's money has been tied up for substantial periods.

"7. Unanticipated inflation has caused losses on some shipbuilding contracts and led to charges of substantial cost overruns. In the past the Navy has been constrained from using realistic escalation factors in cost estimates for future fiscal years, but more acceptable procedures are now being permitted.

"8. While the subcommittee appreciates that the margin of profit for shipbuilders has not always been adequate on naval combatant vessel programs, assured profits cannot be legislated and experience has proved that cost plus contracts lead to abuses that cannot be completely prevented under any procedure yet devised.

"9. Representatives of the shipbuilding industry expressed considerable criticism of the Government for excessive supervision at the local construction level, particularly in the action of Government accountants. The Department of Defense has recently issued new guidelines that put some restraints on its accountants in their relationship with shipbuilding personnel.

"10. All of the evidence examined by the subcommittee in this and earlier studies indicate the Navy should enter the 1980's with an absolute minimum of 600 ships. The present Navy has under 500 ships. To build the new ships needed, the Navy has had to give up older assets; but there is a limit to this process. To reach the desired total of over 600 ships by the 1980's, the Navy will have to construct ships at the rate of at least 35 per year."

As you know, I assumed my present office as Deputy Secretary of Defense in January 1973. From the beginning of my work in the Pentagon, I have been concerned with overseeing the management of the weapons acquisition process. Of all our major systems acquisition programs I believe the problems in the Navy combatant ship acquisition program have been and are long enduring, most vexatious, and very difficult to bring under orderly control and management by the Secretary of the Navy and the Secretary of Defense. And while I do not dispute conclusion No. 2 of the Seapower Subcommittee Report (quoted above), I want to say, Mr. Chairman, that I personally have focused a considerable amount of my working time since taking office on the Navy's shipbuilding program and, more recently, I have become heavily occupied with it.

II. BACKGROUND DATA ON THE SHIPBUILDING CLAIMS PROBLEM

Mr. Chairman, I would like to summarize the scope of the Navy's Shipbuilding Claims problem for the period 1 January 1969 through 1 April 1976. I will do this using four categories; viz

Category A.—Settlements made 1 January 1969 to 1 April 1976.

Category B.—Requests for Equitable Adjustment Outstanding as of 1 April 1976.

Category C.—Armed Services Board of Contract Appeals (ASBCA) Decisions on Shipbuilding Claims 1 January 1969 to 1 April 1976.

Category D.—Claims pending before the Armed Services Board of Contract Appeals (ASBCA) as of 1 April 1976.

In Category "A" (settlements made) there were 54 claims for a claimed amount of $1,317 million which were settled for $631 million (or 47.9 percent). About 77 percent of the settlements were for conventional ships, i.e., Aircraft Carrier, Destroyers, Destroyer Escorts, Amphibious Ships, Fleet Tenders, and Fleet Auxiliaries. The remainder were for nuclear submarines.

In Category "B" (outstanding REA's or Claims) there are eight ERAs in hand for a total of $1,402 million. In addition, REAs for more than $300 million are expected to be filed before the end of 1976. About two-thirds of these claims for nuclear ships. The large LHA claim in the amount of $505 million forms the bulk of the conventional ship claims.

The Category "C" (ASBCA decisions) record is very brief. Up to 1 April 1976, only two shipbuilders' appeals for relief had been decided. The Lockheed Shipbuilding Company claim for $62 million settlement has been upheld by the Board. The claimed amount of $23 million by General Dynamics (Quincy) was denied. However, General Dynamics has filed suit in the U.S. Court of Claims for increased performance costs of $12 million found to have been incurred by the ASBCA in its denial decision. It should be noted, however, that very recently, on 16 April, the Board awarded Litton $17 million on a $30 million claim for the SSN 680 project docketed by the Board almost four years ago in August 1972.

In Category "D" there are four shipbuilders' appeals before the ASBCA in the total amount of $149 million.

From the foregoing, it can be said that the overall universe of the shipbuilding claims problem since January 1969 to 1 April 1976 amounts to $3,189 million. Of this amount, $1,317 million have been settled and $1,872 million are pending. Clearly the most severe claim problem is in current on-going ship construction projects and we have concentrated in this area in developing solutions.

I have attached to this statement in tabular form a more detailed breakdown of the four categories of claims discussed.

I have also attached in tabular form a statistical summary of the 11 Navy shipbuilding contracts involved in the claims problem. This summary is consistent with the claims summaries but is directed toward a presentation of pertinent data affecting the 11 contracts from whence the claims originated.

As you can note from the total (or bottom) line of this summary table, these 11 contracts concern 70 naval ships built or building for delivery in the 1974–1981 time period. The current ceiling price plus projected escalation payments at completion of these 70 ships is $8,237.2 million. The Navy estimate of cost at completion of these ships is $8,647.4 million. Overall, the summary indicates a loss to the shipbuilders of $468.6 million.

As shown in the table the slippage from original contract date varies from one to four years among these 11 contracts.

Now it is this slippage (and potential for more slippage) that is the crux of the claims problem. Slippage in delivery is the result of delays. Delays result from many causes including Acts of God, disruption incident to changes (formal or constructive), late Government furnished equipment (GFE) or information (GFI), inadequate work force (quantity and/or quality), low productivity, design errors requiring correction, strikes, impact of untoward events of other work projects (either Government or commercial) in shipyard. Much of the contentiousness that marks the relations between the Navy and the shipbuilders stems from the charge and countercharge of assessments of responsibility for these delays.

Mr. Chairman, other important aspects in appreciating the complexity of the shipbuilding claims problem are the elements of time and resources involved in their administration. The following are a few specific examples of resources involved—

(a) *Litton/Ingalls LHA claim*

Navy effort.—213 personnel, 18 months, at estimated cost of $8 million.

Contractor effort.—202 personnel, 18 months.

(b) *Newport News claims in hand*

Navy effort.—150 plus personnel, 19 months. $5–7 million.

Contractor effort.—100 plus personnel, 18 months. (Exclusive of claim preparation which was 150 people, $2 million—14 months.)

(c) *Litton Ingalls "Project X Claim" and two smaller claims*

Navy effort.—236 personnel, 22 months, $9 million

Contractor effort.—100 personnel, 12 months, for claim preparation; litigation effort not included.

The following three tables show the time involved in handling claims.

TABLE I.—TABLE OF DATA DERIVED FROM 48 NAVY SHIPBUILDING CONTRACTS, NEGOTIATED CLAIMS SETTLEMENTS, JANUARY 1969–APRIL 1976

Face value of claim as submitted	Number of claims	Months to settle: Less than 12	12–24	24–36	36–48	More than 48
Less than $10,000,000	25	0	11	6	6	2
$10,000,000 to $50,000,000	19	1	5	1	8	4
$50,000,000 to $100,000,000	2	1	1			
More than $100,000,000	2		1			1
Total	48	2	18	7	14	7

Table I is an analysis of the time increments involved in 48 negotiated settlements in the period January 1, 1969, through April 1, 1976. From this table you can see that almost half were settled under two years time and over half required two to more than four years time.

TABLE II.—TABLE OF DATA DERIVED FROM 6 ASBCA DOCKETED NAVY SHIPBUILDING CONTRACT CASES COMPLETED

Contract	Claim filed	C.O. decision	ASBCA decision	Claim amount (millions)	Award amount (millions)
Lockheed 4785–DEs	November 1968	June 1973	October 1975	$59.3	
Lockheed 4660–LPD	January 1969	do	do	38.2	$61.6
Lockheed 4765–LPD	February 1969	do	do	39.8	
Lockheed 4802–LPD	do	do	do	32.9	
General Dynamics 4509–SSN	January 1968	January 1969	May 1973	12.9	(1)
General Dynamics 4583–SSN	do	do	do	12.7	

[1] General Dynamics appeal to U.S. Court of Claims September 1973.

Table II shows the time periods of the six completed ASBCA cases in the period January 1, 1969 through April 1, 1976. It took six and one-half to seven years from time of original filing of the claim to ASBCA decision in the Lockheed cases; it required over five years for the General Dynamics cases.

TABLE III.—TABLE OF DATA DERIVED FROM 4 PENDING ASBCA-DOCKETED NAVY SHIPBUILDING CONTRACT CASES

Contract	Claim filed	C.O. decision	Date docketed, ASBCA	Claim amount (thousands)
Litton (Ingalls):				
Project X	May 1971	(1)	July 1972	$107,821
0342–SSN [2]	November 1970	July 1972	August 1972	31,156
Merritt-Chapman (Navy Yard Ship): 3920–, etc.	March 1971	February 1971	April 1971	6,844
Todd: 0256–AGOR	January 1971	December 1974	January 1975	2,965

[1] No C.O. decision.

[2] ASBCA decision of Apr. 16, 1976 determined adjusted claim to be $30,335,136 and also determined contractor entitled to $17,175,764 increase in contract ceiling price.

Table III shows that as of 1 April 1976, the four pending cases before the ASBCA had originated from claims initiated more than five years ago. Three of the cases had been docketed in the board four to five years ago.

III. CRITICAL IMPACT OF PRESENT CONDITIONS IN NAVY SHIPBUILDING PROGRAM ON NATIONAL DEFENSE

Mr. Chairman, I would like now to briefly comment on several specific situations which exist in the Navy's shipbuilding prorgam which have hardened my resolve to seek and direct early remedial action.

The Newport News Shipbuilding & Dry Dock Co. situation

(a) The inability to this date of both Navy and Newport News to definitize the contract for the construction of the CVN 70 (*Vinson*), even though, in April 1974, the Navy formally exercised the unpriced option in the CVN 68–69 contract for the construction of the CVN 70. In fact, Newport News has informed me that they will not continue their present work on the CVN 70 project or attempt to negotiate pricing and other terms until and unless the Navy takes positive steps to act on Newport News' requests for equitable adjustment (REAs).

(b) The stop work action Newport News took in August of 1975 in regard to the CGN–41 construction project. The Navy sought an injunction in the U.S. District Court for the Eastern District of Virginia at that time. As a result of that legal action, the District Court judge directed Newport News and Navy to continue the CGN–41 project on an interim 12-month modus operandi basis wherein Newport News is reimbursed its costs plus a fee while the parties tried to negotiate their differences. It is my understanding that up to the present no real progress has been made towards a mutual agreement regarding the CGN–41 contract.

(c) The great reluctance of Newport News last year to bid on the Navy's fiscal year 1975 SSN (688 class) follow-on production request for proposal (RFP). After repeated requests by the Navy, the company did submit a bid proposal and sought and received a significantly improved escalation clause in the new contract that was negotiated.

(d) More recently, in a letter of June 14, the President of Newport News has informed me that he considers his company is being subject to irreparable damage as a result of the failure of the Government to respond to Newport News' requests for equitable adjustment. He expressed his concern for what he termed the significant and serious deterioration of day-to-day relationships between the Navy and the Company. He further states that if Newport News is unable to promptly reach a reconciliation with the Navy, the company plans to withdraw from continued participation in the nuclear naval shipbuilding program.

The Electric Boat situation

The E. B. Division of General Dynamics Corp. has currently in hand contracts for 18 SSN–688 class submarines and four Trident submarines. Three additional Trident submarines are programmed to be awarded in FYs 77 and 78. Recently a settlement of $97 million on a claim for $232 million was made by the Navy on the first production flight of seven SSN 688 boats. As part of this settlement, E. B. is required to submit by December 1976 the balance of their claim against this contract and any claim against the second production flight of SSN 688s. Claims of approximately $300 million are expected.

General Dynamics has recently made a significant capital investment at Electric Boat (about $140 million) for facilities for Trident production and the creation and outfitting of the Quonset Point Division of E. B. The Government has given General Dynamics assurances of pricing arrangements to assist in amortizing this investment as Navy work progresses over the next several years.

The Navy is the only customer E. B. has. To be a viable enterprise it must be financially sound. I am uneasy in this regard—especially when I realize that the Navy's current plans for submarine construction are limited to E. B. and Newport News.

The Ingalls Shipbuilding/Litton situation

Litton currently has under contract five LHAs and 30 DD963 class destroyers. Deliveries on both these contracts have just begun. Despite the many problems of management, design, facilities installation, production processing, quality control, work force recruitment and retention, there is now in place at Pascagoula a

modern shipbuilding complex which is an unquestioned national asset for defense purposes. However, in a financial sense we are faced with a giant dilemma. It is now my understanding that Litton anticipates a $474 million loss in the LHA contract and a $69 million loss in the DD963 contract. It would appear that absent any remedial action, the viability of this shipbuilding complex may be short lived.

The General situation as relates to other major shipbuilders

As has been brought out in the hearings of the HASC Seapower Subcommittee, Bethlehem Steel Shipbuilding Co. and Sun Shipbuilding Co. for several years have adopted a policy of not participating in the Navy's shipbuilding program because of their abhorrence of the contractual arrangements and the business relations that ensue.

Recently, in connection with the first follow-on production of the Navy's FFG program, I was very concerned at the lack of response by the industry to Navy's RFP. Although eight companies (BIW, Todd, Newport News, Avondale, Defoe, National Steel, Lockheed, Litton) were tendered RFPs and had received a detailed pre-RFP briefing by the Navy on the planned production program, only two contractors responded—BIW and Todd. On inquiry, I learned that Avondale's top management was vehemently opposed to certain policies and practices used in naval ship procurements and, perhaps more importantly, Avondale was quite dissatisfied with the Navy's delayed handling of their major claim for $169 million for the 27 ship DE production program which had been completed in September 1974. As a result, the Avondale top management, directed by their parent—Ogden Corporation, elected not to participate in the FFG program. Defoe, a smaller shipbuilder, indicated it could not afford the large expense involved in preparation of the bid as outlined in the RFP. Lockheed, National Steel, Litton and Newport News had an assortment of reasons for not participating including: current workload, no real interest in FFG program because they thought it had been locked in to BIW and Todd from the start, current claims settlement problems, etc.

The fiscal years 1972 and 1973 submarine tender (AS) RFP received limited response from the industry on the basis of the soliciation for a fixed price incentive type contract. The Navy finally negotiated for this shipbuilding project on a sole-source, cost type contract, with Lockheed Shipbuilding at Seattle in November 1974.

IV. REVIEW OF RECENT ACTIVITY TO INVOKE AUTHORITY OF PUBLIC LAW 85-804

Mr. Chairman, in a letter of 2 April 1976 to Senator Stennis, I informed him of our intention to invoke Public Law 85-804 to remedy the serious problems that exist between the Navy and four of its major shipbuilders which threaten the national defense. I attach a copy of this letter to this statement.

On 30 April in letters I formally notified both Chairmen of the House and Senate Armed Services Committees of our intent to use Public Law 85-804. In these letters I said:

"Although the exact terms of the plan under Public Law 85-804 cannot be determined until current negotiations with the shipbuilders involved have been completed, it is reasonably certain that the additional cost to the Government will be between $500 and $700 million. The plan, on the other hand, contemplates the withdrawal of contractor claims totalling approximately $1.8 billion. The President's fiscal year 1977 budget request for Shipbuilding and Conversion, Navy includes $1,623 million for Cost growth and Escalation. The Public Law 85-804 plan as outlined above cannot be accomplished within that budget request on a full funding basis. To maintain the policy of full funding will require approximately $400 million additional. I will keep your committee informed as the details of our proposed plan of action under Public Law 85-804 become more firm."

On 30 March I appointed a Shipbuilding Executive Committee to guide and monitor all actions necessary by the Navy Department and to advise and assist me in the application of Public Law 85-804. This Committee is chaired by Mr. F. A. Shrontz, the ASD (I&L) and has as members:

Mr. R. A. Wiley, General Counsel, Department of Defense.
Mr. G. D. Penisten, Assistant Secretary of Navy (Financial Management).
Mr. W. K. Brehm, Assistant Secretary of Defense (Legislative Affairs).
Adm. F. H. Michaelis, USN, Chief of Navy Material.

Vice Adm. R. C. Gooding, USN, Commander, Naval Sea Systems Command.

This Committee has been very active since March 30 familiarizing themselves with the Navy's total shipbuilding program, with the contracts which are the subject of claims or requests for equitable adjustment, with the nature and content of these requests, and have been conducting negotiations with the contractors (Newport News, Electric Boat, Litton and National Steel). Supporting the Committee is a working group chaired by RADM L. E. Hopkins (SC) USN, Deputy Commander for Contracts, Naval Sea Systems Command.

My charge to the Committee directed that they examine those shipbuilding contracts entered into in the 1968–1973 time period referred to previously to determine precisely how to reform them, and particularly to provide for escalation recovery which reflects current Navy Department shipbuilding contract practice notwithstanding the existing provision of these contracts.

During May and early June, Secretary Shrontz's negotiation team conducted negotiations with the four shipbuilders. I had hoped that agreements in principle would be achieved with the shipbuilders prior to June 10 and had advised Chairmen Stennis and Price of my intention, in any case, to advise them by that date of the details of our agreements or of our failure to achieve agreement.

On June 9, in letters to the Speaker of the House and the President of the Senate, I regretfully informed them of our failure to reach agreement with the shipbuilders. In those letters I said:

"I regret to inform you that despite intensive efforts on the part of the Government negotiators and the shipbuilders representatives, we have not been able to reach agreement with all four shipbuilders concerned. In the case of the Electric Boat Division of General Dynamics Corporation and the National Steel and Shipbuilding Company, an agreement in principle can be obtained to retrofit a total of three contracts with the new escalation clause. However, we have not been able to reach agreement with the Ingalls Shipbuilding Division of Litton or the Newport News Shipbuilding and Dry Dock Company of Tenneco, Inc. We are also of the opinion that it will be impossible for us at this time to conclude negotiations with either Litton or Newport News on a basis satisfactory to the U.S. Government and within the framework of the specific Public Law 85–804 approach I proposed to the Congress.

"While two of the shipbuilders have accepted the Government proposal in principle, our plan contemplated on overall approach which would yield a solution to the problems of the four shipbuilders. For this reason, I am withdrawing my formal notification to the two Armed Services Committees of April 30 of my intent to invoke Public Law 85–804 in connection with the shipbuilders' contract disputes with the Navy addressed in the letters mentioned above. I would like to take this action without prejudice to my returning to the Congress in the near future with an alternative solution if one can be found for this grave matter.

"For the present, the Navy will proceed expeditiously to process the shipbuilders claims on hand. I intend to continue my close surveillance of this effort. I will also examine what other contractual actions (including extraordinary) might be appropriate.

"We request that the Congress retain in the fiscal year 1977 authorization the funds identified in the President's fiscal year 1977 budget request for cost growth (including claims) and escalation in the Navy's SCN appropriation and that the authorization act provide flexibility in the use of such funds for claims settlement as required. I can assure you that I will keep the Congress fully informed on a timely basis of any significant actions we may initiate to apply these funds in the settlement of the shipbuilders' claims.

"Finally, Mr. Speaker, the impact on our national defense of the unsatisfactory business relations which exist with our key shipbuilders today is most serious. I cannot overemphasize the urgency of our finding an early resolution to this problem which threatens the completion of our present ongoing shipbuilding program (fiscal year 1976 and prior) and clearly hampers the planning and programming for an enlarged shipbuilding program in fiscal year 1977 and the out years."

V. THE CRISIS NATURE OF THE NAVY'S SHIPBUILDING PROGRAM

In seeking to apply the extraordinary broad authority of Public Law 85–804 I was mindful of the statement in the report of the Committee on Judiciary which accompanied the bill authorizing the making, amendment, and modification of contracts to facilitate the national defense, which became Public Law 85–804.

The Committee report stated:

"This broad power is designed to provide the flexibility required by the Government to deal with the variety of situations which will inevitably arise in a multi-billion dollar defense program and for which other statute authority is inadequate. By providing means for dealing expeditiously and fairly with contractors the enactment of this bill will help assure that vital military projects will proceed without the interruptions generated by misunderstandings, ambiguities, and temporary financial difficulties."

It is my judgment that the largest part of the problems which we recognize in the on-going shipbuilding contracts signed in the period 1968–1973, can be overcome by a reformation of the provision for escalation.

Mr. Chairman, over the past three years I have discussed the problems in the Navy's shipbuilding program with the House and Senate Armed Services Committees. I believe I can say that there is mutual appreciation of the gravity of these problems and the need to take remedial action. Of course, the Seapower Subcommittee of the HASC and your Subcommittee have long since expressed concern and have done much to document and to expose these problems to public review.

Today, however, with the growing recognition of the maritime challenge that faces the United States for the next two decades, it is becoming more apparent that the Navy and the shipbuilders must not only promptly and efficiently deliver the ships in the ongoing program (fiscal year 1976 and prior years), but also must gear up to taking on new and likely larger shipbuilding authorizations in fiscal year 1977 and the outer years. I believe firmly that the United States has the necessary physical shipbuilding capacity. I believe the country's shipbuilders and their production work force can respond to the challenge of the immediate and near future. I also strongly believe the Navy can design the ships and manage, with the shipbuilders, the construction of these ships so vital to our national defense.

My beliefs, however, are caveatted by my present conviction that the present unsatisfactory state of business relations between the Navy and its major shipbuilders must be quickly and equitably resolved. I have discussed this with Secretary Middendorf, Admiral Holloway and many other senior Navy officials over the past year. And although I know the Navy has been diligently trying to find ways and means to bring about more expeditious, legal, and equitable settlement of the many shipbuilding claims, Secretary Rumsfeld and I believe we must now face up to the basic responsibility of the Secretary of Defense to react to this threat to the national defense.

Mr. Chairman, I want to emphasize that in proposing to invoke the extraordinary powers of Public Law 80–804, we were not seeking a quick and easy method of claims settlement. We are not trying to bail out contractors who have been inefficient and guilty of mismanagement.

On the contrary, we are seeking an early and comprehensive resolution of the many problems that currently handicap the construction of naval ships currently building and which threaten to seriously impair planned additional new construction. It is my judgment that this constitutes a serious threat to the national defense.

VI. CONCLUDING COMMENT

Mr. Chairman, in my statement I have repeated much of the background material which I have previously discussed with the Senate and House Armed Services Committee at hearings in connection with our proposed use of Public Law 85–804. As I have mentioned, on June 9th I regretfully had to report to the Congress our failure to gain a mutual agreement with all four shipbuilders. Where does this leave us? What do we do now?

Before addressing these questions I'd like to say that:

The national defense requires a strong Navy and we must have the shipbuilding industry working with us to efficiently complete our presently authorized programs and be ready, able, and willing to undertake new authorizations for naval construction that are so sorely needed.

It is my judgment that the Navy shipbuilding program is in a critical situation which threatens the national defense.

For the past six years or more the business and working relations between the Navy and its major shipbuilders have been deteriorating which has brought about increasing acrimony and the application of significant resources (by the

Government and the shipbuilders) to claim generation, and claim review. Today, the outstanding unresolved claims/REAs are at an all-time high.

The Secretary of Defense in concert with the Secretary of the Navy has the responsibility on an immediate basis, to initiate corrective actions in the management of the Navy's shipbuilding program and more specifically towards resolving the grave contractual problems that currently exist.

Where does this leave us? At the moment, my Executive Shipbuilding Committee is reviewing the record of the negotiations and considering alternatives. The Navy is going forward with its plans for the review and analysis of the REAs.

Concerning the shipbuilders, I hope we shall see some initiatives in the way of alternative proposals. I'm aware of Newport News indicating a reluctant determination to stop participating in the Navy's shipbuilding programs. I am also aware of the serious financial status of Ingalls/Litton and its difficult negative cash flow problem.

What do we do now?

Mr. Chairman, there is no question that the Government must see that the 70 ships in the 11 contracts that represent the fiscal year 1976 and prior year programs are consructed, fitted out and added to the operating fleets. Similarly, we need, working with the Congress, to provide for the efficient carrying out of the Navy's shipbuilding program of fiscal year 1977 and outyears which are so essential to our national defense.

The mechanics of achieving those goals on an equitable and prompt basis is our immediate problem and our responsibility. I would be obliged for such assistance and advice as your committee may have towards resolving our immediate problem.

Mr. Chairman, this completes my statement. I stand ready with my colleagues now to deal with your questions.

Thank you.

STATISTICAL SUMMARY, NAVY SHIPBUILDING PROGRAM, CLAIMS, REQUESTS FOR EQUITABLE ADJUSTMENT CATEGORY A SETTLEMENTS, JAN. 1, 1969–APR. 1, 1976

	Number of claims	Claimed amount (thousands)	Settlement amount (thousands)	Settlement as percentage of claim (percent)	Types of vessels
General Dynamics:					
Electric Boat Division	8	$294,600	$122,600	41.6	SSN, SSBN.
Quincy Division	8	216,755	[1] 90,124	41.6	AE, AS, AOR, LSD.
Total	16	511,355	212,724	41.6	
Litton Systems (Ingalls)	3	34,119	19,922	58.4	SSN, AE, LPH.
Newport News Shipbuilding and Drydock Co.	10	145,562	78,220	53.7	CVA, SSBN, SSN, LCC, LKA.
Alabama Drydock and Shipbuilding Co	1	14,219	4,977	35.0	ASR.
Avondale Shipyards	2	169,144	80,000	47.3	DE.
Bethlehem Steel	2	52,178	18,501	35.5	AE, AO.
Defoe Shipbuilding	5	16,063	4,478	27.9	DDG, DE, AGOR, T-AGS,
Lockheed Shipbuilding	9	208,923	[2] 79,452	38.0	DEG, AO, DE, AGEH, AE DE, LPD.
National Steel and Shipbuilding	1	49,200	35,300	71.7	LST.
Northwest Marine	1	2,092	372	17.8	AGOR.
Todd Shipbuilding	4	114,634	96,890	84.5	DE.
Total	54	1,317,488	630,836	47.9	
Recapitulation:					
Nuclear	14	339,152	144,705	42.7	
Non-nuclear	40	978,336	486,131	49.7	
Total	54	1,317,488	630,836	47.9	
Percent of total nuclear		25.7	22.9		
Percent of total nonnuclear		74.3	77.1		
Total		100.0	100.0		

[1] Includes settlement amount for $25,600,000 claim decision of ASBCA on which ASBCA denied contractor's appeal; ASBCA found that contractor had incurred $12,282,523 additional costs; contractor's suit for such amount is pending in U.S. Court of Claims.

[2] Includes finding of entitlement of $61,612,158 by ASBCA on claims of $170,192,538.

STATISTICAL SUMMARY—NAVY SHIPBUILDING PROGRAM

Category B—Requests for equitable adjustment, pending as of April 1, 1976

	Amount of claim
Pending as of April 1, 1976: Boland Marine, DLG–10 [1]	$3, 297, 314
Litton Systems (Ingalls),[2] LHA	504, 847, 301
Newport News Shipbuilding & Drydock Co.:	
DLGN 36–37	151, 040, 521
DLGN 38–40	159, 774, 936
SSN–688	78, 543, 149
SSN 689–91–93–95	191, 567, 199
CVN 68–69	221, 280, 223
SSN 686–87	92, 099, 492
Subtotal	894, 305, 520
Total	1, 402, 450, 135
Recapitulation:	
Nonnuclear (36.2 percent)	508, 144, 605
Nuclear (63.8 percent)	894, 305, 520
Total (100 percent)	1, 402, 450, 125

[1] Conversion and modernization contract.
[2] Litton has very recently indicated that additional requests for equitable adjustment will be submitted which will bring the total to about $800 million.

Notes: Anticipated to be received in current year 1976: General Dynamics Corp. (Electric Boat Division) $300 million; National Steel & Shipbuilding Co., $20 million.

STATISTICAL SUMMARY, NAVY SHIPBUILDING PROGRAM, CATEGORY C—ASBCA DECISIONS, JAN. 1, 1969–APR. 1, 1976

	Date of ASBCA decision	Claim amount	Amount approved by ASBCA
General Dynamics Corp. (Quincy)	May 14, 1973	$23, 416, 246	(1)
Lockheed Shipbuilding Co	May 13, 1972 [2]	170, 192, 538	[3] $61, 612, 158
Total		[4] 193, 608, 784	[4] 61, 612, 158

[1] ASBCA denied contractor's claim. In an appendix to the ASBCA decision, the Board found the contractor's increased performance costs to be $12,282,523. Suit has been filed in the U.S. Court of Claims.
[2] Reaffirmed Oct. 24, 1975.
[3] Award made by ASBCA based on tentative agreement between Navy and contractor but lacking higher authority approval. Amount of award not yet paid due to allegation of possible fraud.
[4] Does not include decision of ASBCA of Apr. 16, 1976 in which the Board determined the adjusted claim to be $30,335,136 and in which the Board determined $17,175,764 to be due the contractor (Litton Systems-Ingalls, SSN 680 claim).

STATISTICAL SUMMARY—NAVY SHIPBUILDING PROGRAM

Category D—Claims pending before the Armed Services Board of Contract Appeals as of April 1, 1976

	Amount of claim (in thousands)
Litton Systems (Ingalls):	
Project X	$107, 821
SSN–680 [1]	[1] 31, 156
LHA ($505 million)[2]	
Subtotal	138, 977
Merrit-Chapman & Scott (formerly New York Shipbuilding)	6, 844
Todd Shipbuilding Co., Agor	2, 965
Total	148, 786

[1] ASBCA decision of April 16, 1976, awards contractor $16,535,771; claim as adjusted stated to be $30,335,136.
[2] The LHA claim pending before the ASBCA was withdrawn from the docket to permit further negotiations. The LHA claim is included in the schedule of category B—requests for equitable adjustment.

STATISTICAL CONTRACT SUMMARY OF NAVY SHIPBUILDING CONTRACTS, AS OF APR. 1, 1976

[Dollar amounts in millions]

Contractor and contract number	Ship type	Initial target price	Initial ceiling price	Current target price	Current ceiling price	Projected (Navy) estimate at completion [1]	Current ceiling price and projected estimate at completion	Navy estimated cost at completion [2]	Profit or loss [2]	Estimated shippage from original contract date (months)	Present claim
Electric Boat Division, General Dynamics Corp.:											
N00024-71-C-0268	SSN(698)	$412.9	$428.1	$516.7	$535.8	$103.2	$639.0	$744.5	[3] (105.9)	19	[4] $300.0
N00024-74-C-0206	SSN(688)	769.9	846.8	777.1	854.7	401.9	1,256.6	1,283.9	(28.8)	16	
Total	(18)	1,182.8	1,274.9	1,293.8	1,390.5	505.1	1,895.6	2,028.4	[3] (1,34.7)		[4] 300.0
Ingalls Shipbuilding Division, Litton Systems, Inc.:											
N00024-69-C-0283	LHA	[5] 672.2	[5] 776.0	806.0	807.6	165.1	972.7	1,294.9	(319.0)	48	504.8
N00024-70-C-0275	DD(963)	1,789.2	2,139.9	2,156.0	2,253.0	824.6	[6] 3,077.6	2,866.0	112.0	12	
Total	(35)	2,461.4	2,915.9	2,962.0	3,060.6	989.7	4,050.3	4,160.9	[7] (207.0)		504.8
Newport News Shipbuilding and Dry Dock Co. (Tenneco Corp. subsidiary):											
N00024-67-C-0325	CVN	638.4	760.0	668.8	791.3	163.8	[6] 955.1	941.4	31.3	22	221.3
N00024-68-C-0355	CGN	143.5	175.0	148.4	179.9	22.3	202.2	233.1	(15.9)	18	151.0
N00024-69-C-0307	SSN(686)	88.0	96.8	89.5	98.4	10.6	109.0	133.9	(25.1)	14	92.1
N00024-70-C-0252	CGN	328.2	386.4	344.5	404.0	152.5	556.5	602.6	(38.8)	22	159.8
N00024-70-C-0269	SSN(688)	74.5	83.0	78.4	86.9	10.8	97.7	123.0	(25.3)	24	78.5
N00024-71-C-0270	SSN(688)	247.6	249.5	251.5	253.4	48.6	302.0	355.8	(53.6)	23	191.6
Total	(16)	1,520.2	1,750.7	1,581.1	1,813.9	408.6	2,222.5	2,389.8	(127.4)		894.3
National Steel and Shipbuilding Co. N00024-73-C-0227	AOR(7)	51.4	58.9	52.0	59.5	9.3	[6] 68.8	68.3	0.5	9	[4] 20.0
Total (70 ships)		5,215.8	6,000.4	5,888.9	6,324.5	1,912.7	8,237.2	8,647.4	(468.6)	[8]	[9] 1,719.1

[1] Based on old escalation clause presently in these contracts.
[2] Navy's present estimate; represents some variations from contractor estimates.
[3] After settlement for $97,000,000 of claims for $231,000,000 (April 1976).
[4] Anticipated claims.
[5] Original contract called for 9 vessels; 4 vessels were terminated; figure shown is for 5 vessels plus termination charge.
[6] Contracts estimated to be profitable; therefore contract price is expected to be less than ceiling price.
[7] Very recently, the Ingalls Shipbuilding Division of Litton has forcasted leases of $174,000,000 on contract 0283 (LHA) and $69,000,000 on contract 0275 (DD963) as against previous forecasts of a loss of $314,000,000 and a profit of $122,000,000. The Navy's estimates of profit and loss were based on that previous forecast.
[8] 1 to 4 yrs.
[9] In addition to these claims, $148,786,000 of claims are pending before the ASBCA. Also there is a claim of $3,297,314 under a conversion and modernization contract. Total REA's plus ASBCA claims $1,872,000,000,000.

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C., April 2, 1976.

Hon. JOHN C. STENNIS,
Chairman, U.S. Committee on Armed Services,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: At the request of Secretary Rumsfeld, I am writing to respond to the comments in your letter of March 19th to him relating to the management problems in the Navy's shipbuilding program. You noted that in your committee report last year it was emphasized that, "the ultimate responsibility for approval, management, and program execution lies with the Secretary of Defense." You also commented on the substantial delays in ship deliveries, the large increases in cost growth and escalation for fiscal year 1975 and prior year ships, and the large backlog of claims and requests for equitable adjustment ($1.7 billion). Finally, you said that contracting and management methods must be devised which will resolve and dispose of these continuing problems in the Navy's shipbuilding program.

Since assuming my present office in January 1973, I have been seriously concerned with and have made special inquiry into the management problems that beset the Navy's shipbuilding program. The planning, programing and budgeting for new construction of Naval ships receives much attention and high-level review both in the Navy Department and in OSD. Over the past ten years, however, the management of program execution of approved and appropriated shipbuilding projects has been, at best, marginal. Immediate evidence of this, of course, is the present $1.7 billion backlog of claims and R.E.A.'s. In the Hearings of the Subcommittee on Economy in Government of the Joint Economic Committee (Proxmire Committee) in December 1969 and in the Seapower Subcommittee of the House Armed Services Committee in 1970 and in 1974, the Navy's shipbuilding program and claims problem were subject to close review and critical analysis. The Proxmire Committee Hearings were particularly critical of Navy management and the shipbuilding contractors. The Bennett Seapower Subcommittee Report was critical of the shipbuilding industry and somewhat critical of Navy planning but showed a certain empathy for the problems of the shipbuilders. There are several GAO reports of the past six years that have been critical of certain Navy claims settlements.

Events of the past 18 months in the Navy's shipbuilding program both as they relate to the overall management of the ongoing program and the precipitous increase in the claims backlog unfortunately indicate that our management of this important defense program is unsatisfactory. In addition to the large claims there exists an atmosphere of sharp litigation and mutual distrust between the Navy and its major shipbuilders. The net result has been to divert the efforts of all parties from their primary job of constructing new naval vessels and seriously threatens the validity of current planning for expanded naval ship construction in the Fiscal Years 1977–85.

The cumulative effect of the many problems that have beset the Navy shipbuilding program has had a crippling impact on the Navy's ability to acquire the ships needed for our national defense. The solution to many of these problems involved policies which could be adjusted through administrative action and many such actions have been taken. However, one of the more serious problems (and one which has generated other problems) is that the traditional escalation clause included in Navy shipbuilding contracts did not offer adequate protection for contractors when contract performance occurred later than or was extended beyond the originally scheduled period for whatever reason. The degree to which this inequity existed was brought home to us through the effects of the runaway inflation of 1973–1974. In recognition of this serious shortcoming of the traditional escalation clause, recently awarded shipbuilding contracts (e.g., Trident, SSN711, FFG) contain distinctly different formulas for escalation which provide significantly more protection to the contractor against unforeseen economic events. This new type of escalation coverage offers a reasonable basis on which the Navy and the shipbuilders can continue a satisfactory business relationship.

Nevertheless, the Navy today has 11 major shipbuilding contracts which still contain the old escalation clause. These contracts include virtually every major combatant ship destined for the fleet of the 1980's and beyond. I am satisfied that a major portion of the present claims were generated directly or indirectly by this inequitable situation and that shipbuilders will continue to pursue this laborious avenue of financial relief so long as the fundamental problem is not

corrected. While it is not the policy of the Government to relieve contractors from the burdens of unprofitable contracts fairly entered into, neither is it in the Government's interest to persist in attempting to enforce contracts of such importance to the national defense when their terms have proven to be unworkable or inequitable.

In sum, Mr. Chairman, Secretary Rumsfeld and I share the concerns you raised in your March 19th letter in regard to DoD's management of the Navy shipbuilding program. We recognize the responsibility we have on an immediate basis to initiate corrective action to surmount what constitutes a serious threat to our national defense. In February, I officially alerted the Secretary of the Navy and the Chief of Naval Operations of my determination to take remedial action.

On 24 March, I informed them that I have determined—that because of this threat to our national defense and also in equity to rectify certain injustices or unfair consequences that have flowed to certain shipbuilders—to take action under Public Law 85–804. I am convinced that unless this extraordinary action is taken, and concurred in by the Congress, currently authorized ships necessary to the security of our nation will not be completed. I have established a Shipbuilding Executive Committee to assist and advise me in this action. For your information, I enclose a copy of my memorandum establishing this Committee.

In closing, Mr. Chairman, Secretary Rumsfeld and I are very aware of the critical and emergency nature of our Navy's shipbuilding program. We must and we will take forceful action to bring early and equitable remedies to the end that our national defense may be strongly supported by an adequate and modern Navy.

Sincerely,

WILLIAM P. CLEMENTS.

Enclosure.

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C., March 30, 1976.

MEMORANDUM FOR THE ASSISTANT SECRETARY OF DEFENSE
(INSTALLATIONS & LOGISTICS)

Subject: Shipbuilding Executive Committee.

Since assuming my present office in January 1973, I have been seriously concerned with and have made special inquiry into the problems of the Navy shipbuilding program. I consider its present status to be unsatisfactory. It represents the culmination of long standing disputes between the Navy and its major shipbuilders which has brought about an atmosphere of sharp litigation and mutual distrust. The net result has been to divert the efforts of all parties from their primary job of constructing new naval vessels and seriously threatens the validity of current planning for expanded naval ship construction in the FYs 77–85.

Accordingly, I believe it is imperative that the SecDef take immediate action under P.L. 85–804 to surmount this serious threat to the national defense. In a meeting with the SecNav and the CNO on 24 March, I determined that certain long existent contracts between the Department of the Navy and private shipbuilders will be reformed as appropriate, and particularly to provide for escalation recovery in these contracts which reflects current Navy Department shipbuilding contract practice notwithstanding the existing provisions of the contracts.

In order to carry out this decision, I desire you to serve as Chairman of an Executive Committee to guide and monitor all Navy Department actions necessary for this purpose. The Assistant Secretary of Defense (Legislative Affairs), the General Counsel of the Department of Defense, the Assistant Secretary of the Navy (Financial Management), the Chief of Naval Material and the Commander, Naval Sea Systems Command will serve as members of the committee.

I request that you keep me informed of progress in carrying out this decision.

WILLIAM P. CLEMENTS, Jr.

Senator PROXMIRE. Thank you, Secretary Clements. Admiral Gooding, I understand you don't have an opening statement.

Admiral GOODING. That is correct.

Senator PROXMIRE. Under the circumstances I will question you, Secretary Clements, and when you are through, I will ask Admiral

Woodfin and Admiral Evans to join Admiral Gooding and we will get their viewpoint which may be a little different from yours.

Secretary CLEMENTS. I don't think it will be.

Senator PROXMIRE. In your prepared statement, you say slippage is the crux of the claims problem, that slippage is the result of delays and delays result from many problems. You site some of the causes for delays, some of which are the responsibilities of the Navy and some of which are the responsibility of the contractor.

Is that a fair summary of this part of your statement?

FAULTS ON BOTH SIDES

Secretary CLEMENTS. Yes, sir. I think the kind of accommodation we have been seeking between the Navy and the shipyards recognizes that there are faults on both sides. There generally is. Under those circumstances, we have been trying to bring about negotiations in good faith.

Senator PROXMIRE. Now naturally the contractor as we might expect seeks to attribute as much of the delays as possible to actions or inactions of the Government when he submits the claim.

Is it your view that the Navy should accept such assertions at face value and negotiate on that basis?

INTENTION TO NEGOTIATE IN GOOD FAITH

Secretary CLEMENTS. Of course not. In your opening statement, for instance, there was a statement that was made that we were thinking in terms of paying these claims on a face value basis, that very little documentation had accompanied these claims and that we were going to reimburse these contractors for all of their overruns. I think that was the expression.

Senator PROXMIRE. No, I don't say that, but go ahead.

Secretary CLEMENTS. These kinds of inferences are completely without foundation. I know that other people have been before you, some in uniform and otherwise, who have testified in that direction.

But you have before you the people who are responsible for carrying forward these negotiations and there is not one of these people present today who would tell you that there is any intention whatsoever to pay these claims at face value, to pay these contractors for all of their overruns, or to have anything but a complete, honest, straightforward negotiation in good faith based entirely on the merits of the claim.

Senator PROXMIRE. Well, what you say nobody would disagree with. What concerns me is that you did serve notice on the Congress that you intended to make a settlement, a substantial settlement, hundreds of millions of dollars before the claims were audited, before there was any real opportunity to have a chance to determine whether or not these claims were justified.

NO EFFORT TO SETTLE CLAIMS

Secretary CLEMENTS. That just isn't true. I never said anything of the kind. What I did say was, we have proposed to reform those contracts with respect to escalation and in consideration of our reform-

ing the contracts in regard to escalation, these contractors would drop their claims.

We made no effort whatsoever to settle claims per se. Now this has been grossly misunderstood by everybody concerned.

Senator PROXMIRE. Let me ask you a simple question. Were those claims audited?

CLAIMS PARTLY AUDITED

Secretary CLEMENTS. To a degree they were audited and to a degree they were not. It depends on what you are talking about, audited. You have here a certain amount of documentation relating to those claims.

As I have told you before, you could practically fill this room with the documents related to those claims if you had the full documentation. If you mean are all of those pieces of paper audited and by whom, the answer is I don't know to what you refer.

If you are talking about are those accounts of the contractors audited in the normal process, are they subject to our audit, are they constantly under review and monitoring by our contracts division in the Navy both internally to the shipyard and by our people, the answer is "Yes."

BUSINESS ABOUT CERTIFICATION IS BALONEY

There has been a lot of conversation about are these claims certified and that is a position that has no validity whatsoever because the contract provides that they have to submit claims that are valid and there can be no question about that.

If they are not valid they are subject to prosecution through the courts. If you would care for Counsel Wiley to speak to this as our General Counsel, he will be happy to. But this business about a certification of the claims is baloney.

There is no other word for it.

Senator PROXMIRE. Are you familar with the Navy instruction 43651A and Navy procurement directive 1-54201 that must be followed in settlement of claims against the Navy?

Secretary CLEMENTS. I am not but I am sure some of the people that are with me are familiar with that reference.

Senator PROXMIRE. Is it your testimony that the factual investigation, the documentation requirements, and the requirements for an audit, for a legal memorandum or entitlement have been completed or complied with in the cases of these claims?

NAVY REGULATIONS NOT COMPLIED WITH

Secretary CLEMENTS. Not in toto, no sir.

Senator PROXMIRE. Isn't it correct that these claims have not been fully audited, analyzed, or evaluated?

Secretary CLEMENTS. Well, I think that literally that probably is true. But you have to definitize what you are talking about in that regard.

Senator PROXMIRE. You have answered that. Unfortunately we are in the last 5 minutes of a rollcall so I am going to have to run. I yield to Congressman Pike to Chair the meeting.

LHA COSTS

Representative PIKE. [presiding]. I have been on the Armed Services Committee for a couple of years now. I remember the issue was there back when I was. I am interested in the last table that you have provided us with in your prepared statement.

While the summary is readable I am not sure it is understandable. Under your Litton system statistics summary, you show an initial target price for the LHA, and I take it that is the whole program, is that correct, $672 million?

Mr. SHRONTZ. No, sir. That is the contract price. There are additional moneys outside of that for total program.

Representative PIKE. All right. That was the contract target price.

Admiral GOODING. Yes, sir. There was also a contract ceiling price.

Representative PIKE. The contract said that that contract called for nine vessels but the figure shown is for five vessels, is that right?

Admiral GOODING. That is correct.

Representative PIKE. What was the contract price for the whole nine vessels?

Admiral GOODING. It would be nine-fifths of this number, approximately.

Representative PIKE. In other words it was a direct proportionate reduction in the contract price when you went from nine ships to five ships?

Admiral GOODING. Yes, sir, except that the contract provided that if the Navy terminated part of the program, which the Navy did, the contractor would be entitled to cancellation charges of various amounts depending on how many ships were canceled.

Since the Navy canceled four ships, the contractor received I think $109.7 million in cancellation charges and that was approximately right.

Representative PIKE. Now I would like to go over to the Counsel and ask you, Mr. Wiley, what does the contract mean as far as penalties for noncompliance are concerned?

When you sign a contract with a great big company like Ingalls, what does it mean if they don't perform?

GOVERNMENT RIGHTS UNDER DEFAULT CLAUSE

Mr. WILEY. The Government has the right under the default clauses of the contract to terminate the contract for default, to have the work done elsewhere and to hold the contractor responsible for any excess cost to the Government. That is the remedy provided for in the contract itself.

Representative PIKE. That is what the contract says. As a practical matter, can you do it?

Mr. WILEY. That would depend on the other options available to the Government, to the Navy as to alternative placess at which to have the work done.

Representative PIKE. I am asking you now not as a matter of theory but I am asking you whether you can do it or not? Can you take these ships that were supposed to be built in one place and when you find that the contractor has not performed, can you just as a practical matter go have them built somewhere else?

Mr. WILEY. First I would have to defer to the Navy representatives to answer that question as to a business matter. Apart from the terms of the contract itself as I am sure you are aware, potentially there are certain other remedies available to the Government.

For example, last summer in 1975, the Navy did go to court and seek an injunction for specific performances against Newport News in relation to construction of the CGN–41.

Representative PIKE. Well, I think you see where my questions are leading. What I am trying to say is that you have in your contract a remedy for taking the job away from them after the ways are all set up, after the forms are all set up, after the work force is all there and then saying this will be done in some other shipyard.

A MEANINGLESS REMEDY

I think that is a meaningless remedy. Have you ever seen it exercised in your career in the—as a counselor for the Navy?

Mr. WILEY. No; I have not.

Representative PIKE. What have you ever seen happen that really hurt a Navy shipyard builder that did not perform a Navy contract?

Mr. WILEY. In effect the contractors have lost money on the particular contract.

Representative PIKE. Are your audits sufficiently accurate so that you are sure they lost money on the particular contract?

LITTON LOSING ON LHA CONTRACT

Secretary CLEMENTS. Mr. Congressman, I would like to inject myself in this. There is no question whatsoever that this is true. In the instance of Ingalls, we got permission from both Ingalls and their parent Litton and we employed outside auditors, Haskins and Sells in addition to our own internal Navy and DOD auditors. We are absolutely satisfied that in this instance, there is a significant multihundred million dollar loss involved in the construction of those LHA ships.

Representative PIKE. Now——

Secretary CLEMENTS. I have with me our financial management chief of the Navy, Admiral Gooding, and Admiral Michaelis. There is no argument about this.

Representative PIKE. At the same time this company was losing money on this contract with the Navy, did it have other contracts with the Navy that it was making money on?

Secretary CLEMENTS. I have to defer to Admiral Michaelis. I know of no other contracts that would give them a profit.

Admiral MICHAELIS. We have two contracts with them, the LHA and the destroyer contract, the 963. At the present time up until the latest estimate came in on the two contracts for cost at completion, they had been showing a profit on the destroyer contract.

They are now showing a loss on the destroyer contract. So both of them, according to Litton's latest statement, which I think is 77–1 in terms of their quarterly statements, is that—they are showing a loss on both contracts.

Representative PIKE. Do they have other contracts to your knowledge with the Air Force and with the Army?

Admiral MICHAELIS. I was speaking of Litton's ship building division.

Secretary CLEMENTS. They have a small submarine modification contract for the Navy and it in no way offsets those two contracts.

Representative PIKE. All right. We are dealing with a conglomerate. Does Litton, not this particular branch of Litton, does Litton have other contracts with the Navy?

Admiral GOODING. Yes, sir.

Representative PIKE. Are they making money on those other contracts with the Navy?

Admiral GOODING. Mr. Pike, I have no idea.

Representative PIKE. Does Litton have other contracts with the Air Force and the Army?

Admiral GOODING. I know they have contracts with the Air Force. I am not aware of any Army contracts but there may be some.

Senator PROXMIRE. I would like to call your attention, Mr. Secretary, to this chart.

Secretary CLEMENTS. Mr. Chairman, before I take on attention to the chart, I want to come back to Congressman Pike. Now I want to supply for the record with your permission some data on these other contracts because I don't want to leave the inference that they are in some manner—I am talking about Litton the parent—doing sufficient work for the Department of Defense in other areas that would compensate them for huge losses that they are taking down there on this LHA contract, because that is not so.

I want the record to reflect that.

Representative PIKE. If you want to pursue that, may I proceed for another minute or two?

Senator PROXMIRE. Sure.

Representative PIKE. What percentage of Litton's business do they do with the Defense Department?

Secretary CLEMENTS. I will supply that for the record with your permission. It is not a major proportion.

[The information referred to follows:]

Litton Industries, Inc., annual report for the fiscal year ended 31 July 1975 states:

"Approximately 34 percent and 29 percent of the sales and service revenues of the Company for the years ended July 31, 1975, and July 31, 1974, respectively, arose from U.S. Government contracts and subcontracts."

Sales and service revenues were $3,432,592,000 and $3,081,978,000 for July 31, 1975, and 1974, respectively.

LACK OF AUDITS ON SHIPBUILDING CLAIMS

Senator PROXMIRE. Now, Mr. Secretary, these are the claims and you propose to pay between $500 and $750 million. There is a partial audit on the first claim and no audit on this claim for the Newport News, no audit on the third, no audit on the fourth, fifth, sixth, and the General Dynamics is an estimate.

And yet this is the sum for which the $500 to $700 million would be paid with a partial audit on $151 million and no audit on the rest of them. What is your answer?

Secretary CLEMENTS. My answer is the same as before. You are trying to compare an elephant and a flea.

Senator PROXMIRE. I have got the elephant.

CONTRACTS BEING REFORMED

Secretary CLEMENTS. There isn't any relationship. We have never claimed that we were settling these claims in this process. What we are doing is reforming these contracts and by reforming the contract esclation clause, the contractors will then drop these claims, audit or no audit. I am not interested in the audit.

Now if we go the other way and we have to process these claims I am with you, they absolutely will have to be audited. There isn't any question about it. It will be a multiyear, drawn out process involving people, many, many lawyers and a very acrimonious atmosphere.

PAYING UNAUDITED CLAIMS BAD PRECEDENT

Senator PROXMIRE. Mr. Secretary, it seems to me this is the worst kind of precedent for the taxpayer. If we are going to make a readjustment of a contract to the tune of half a billion dollars or three quarters of a billion without determining whether or not there is substanial fault on the part of the Government to justify that, it seems to me that this is a precedent that could haunt the taxpayer for a long time.

I can imagine not only shipbuilders but other contractors taking advantage of this kind of a precedent to make any kind of a claim they wish on the assumption that maybe it will be settled at 40 or 50 cents on the dollar.

POSSIBILITY OF NAVY NOT GETTING SHIPS IT NEEDS

Secretary CLEMENTS. Senator Proxmire, that sounds good and I know that that will have a lot of appeal to a lot of people. But in my judgment, that position is wrong and to the contrary, I think I have as much interest in the taxpayer's dollar as you do. In my judgment, the exact opposite is true.

If we proceed the way we are going, two things will happen. We are not going to get the Navy ships, No. 1, and if and when and how we finally do get them, they are going to cost us far, far more than we are talking about settling these claims for.

In the final analysis, it is going to cost the taxpayers not less money, but more money and there will also be significant delay in getting the Navy ships besides. I disagree strongly with what you said.

ADMIRAL WOODFIN SAYS CONTRACTS EQUITABLE

Senator PROXMIRE. Admiral Woodfin, the Navy's Procurement Office, says the contracts in question are not inequitable and if the shipbuilders had performed on time and within the contract cost, the escalation clauses would have protected them from the effects of the inflation.

The escalation clauses were geared to BLA price changes. Do you agree or disagree with that statement?

CONTRACTS NOT EQUITABLE

Secretary CLEMENTS. I disagree completely.

Senator PROXMIRE. Why?

Secretary CLEMENTS. Because I don't think the escalation clauses are equitable and the Navy has proved the point. As a matter of fact, because in the subsequent contracts in General Dynamics——

Senator PROXMIRE. Even if they had delivered on time, they would not have been reimbursed on their costs?

Secretary CLEMENTS. It depends on the time sequence and it depends on the claims—the changes during the course of the contract. The Navy has now introduced with General Dynamics under their Trident submarine contract, a far more equitable escalation clause. Until they agreed to that, it was not possible for General Dynamics to be induced into taking that contract. The same type of a new escalation clause is in the FFG contract with Bath Iron Works. Newport News, on the 688 contract which they have signed, also have a different escalation clause. So if the Navy thinks that they had such a wonderful escalation clause in the past, why is it that they could not get any contracts signed with that old escalation clause in these new contracts?

It was not possible.

Representative PIKE. Would the Senator yield?

Senator PROXMIRE. Yes.

Representative PIKE. How does the new clause differ from the clause in this contract?

Secretary CLEMENTS. I would like Mr. Shrontz to address that in detail.

NEW ESCALATION CLAUSE

Mr. SHRONTZ. The old clause was based upon a fixed program expenditure curve which went from zero to target price and did span the time between contract initiation and original contract delivery. It would be true that if a shipbuilder assuming the indices were accurate, was able to build within the time period originally allowed——

Representative PIKE. When you say within the time period originally allowed you mean within the contract?

Mr. SHRONTZ. Within the initial contract time period.

Representative PIKE. If he had complied with the contract?

Mr. SHRONTZ. Yes; and had stated in the contract price, he probably would have been able to recover a majority of his escalation cost although the contracts did not cover overhead escalation costs.

But to the extent that there were delays, whether caused by the Navy or the shipbuilders, that did not adjust the contract from the point of original contract delivery onward. He got no further escalation, even if he was still below his target price.

Representative PIKE. He got no escalation but as to any delays caused by the Navy, he got reimbursed did he not?

Mr. SHRONTZ. Except that the Navy and the contractors in many instances were unable to agree on the cause of the delay and the extent of the delay.

Representative PIKE. That is true under any circumstances.

Mr. SHRONTZ. Let me continue. When those agreements piled up they eventually became claims and that accounts for a percentage of what we are looking at on the board.

Representative PIKE. Tell me what your new escalation clause is.

Mr. SHRONTZ. The proposed clause that we were suggesting retrofitting would have followed the actual expenditure curve that the shipbuilders experienced in time. It would have capped the escalation index at the original contract date but would have allowed the contractor to continue to receive escalation at that rate until the actual point at which the ships were delivered and accepted.

Except that——

CONTRACTS NOW COST-PLUS

Representative PIKE. You are turning it into a cost-plus contract.

Mr. SHRONTZ. Except that at the point at which that contractor reached ceiling price which has happened in a great many contracts, at that point he got no further escalation.

Representative PIKE. When he reached ceiling price, what does he get?

Mr. SHRONTZ. When he reaches ceiling price all costs beyond that to complete the contract are on him, escalation or otherwise.

Representative PIKE. What happens when he comes back to you and says, "We can't do it for that price"?

Mr. SHRONTZ. I don't know that we have a contractor who said that we are unwilling at this point in time to complete a contract simply because we have exceeded ceiling price.

Secretary CLEMENTS. I don't know of any such instance.

Representative PIKE. Isn't Newport News saying in the present case that they can't proceed under the old contract?

Secretary CLEMENTS. I think, Mr. Congressman, you may be referring to the CGN–41 contract that has been under negotiation and was tied to an older contract going back, I think, to 1968.

Admiral GOODING. About that.

Secretary CLEMENTS. That contractor took a multiple ship contract, meaning he was going to build several ships, but then at a point the contract had to be renegotiated as to price and then existing conditions. The CGN–41 falls under that. It was an option where the Navy had an option to say yes, we want to build a ship. But then it had to be mutually negotiated.

So far, it has not been able to be negotiated.

Representative PIKE. Let me get back to your change in the escalation clause. All you are saying, really, is that we have a new escalation clause which is going to be more expensive and it is going to cost the taxpayers more and that this is the reason that the shipyards are willing to go along with it, because they are going to get more money out of it.

TWO SHIPBUILDERS UNWILLING TO ACCEPT NEW ESCALATION CLAUSE

Mr. SHRONTZ. Two of the shipyards indicated they were unwilling to go along with it and at the moment are preferring to pursue their claim remedies. But it was our judgment that this new clause would be a more fair sharing of the escalation burden which I think we all

agree was unanticipated back in the 1969–70 time period when those contracts were executed.

That new clause, Congressman Pike, does not cause the shipbuilders to fully recover their escalation but it does give them some escalation beyond the original contract price.

Senator PROXMIRE. If the shipbuilders had performed on time and within the contract cost would the escalation clauses have protected them from the effects of inflation, Admiral Gooding?

SHIPBUILDERS WOULD HAVE BEEN PROTECTED HAD THEY PERFORMED ON TIME

Admiral GOODING. I agree with that. Had they been able to perform on time, the escalation clause would have protected them more than it turned out to do.

Senator PROXMIRE. If the Navy is responsible for the delays, they should reimburse the shipbuilders. I agree with that.

Secretary CLEMENTS. I agree.

Senator PROXMIRE. But the Government should not reimburse the shipbuilders for delays for which the shipbuilders are responsible. Do you agree with that?

Secretary CLEMENTS. Yes, sir.

GOVERNMENT SHOULD NOT REIMBURSE FOR SHIPBUILDERS' DELAYS

Senator PROXMIRE. The slippage is the crux of the claims problem, as you put it. But doesn't that bring us back to the claims themselves? Isn't it just impossible to determine who is responsible for the delays until the claims are fully audited and examined?

TRACKING CLAIMS TIME CONSUMING AND EXPENSIVE

Secretary CLEMENTS. Well, if we go that route we fall back to where we are right now, that is the position that we are in right now, the 85–804 negotiations have ceased. So if we are in that position of just tracking the claims—they are going to have to be processed in the normal manner, go right through the court process—it is going to be a very long, drawn-out expensive affair. I want you to know right now in my judgment, we are going to incur a significant delay and it is going to be more costly in the long run to us than by reforming the contracts.

Senator PROXMIRE. Nobody knows that.

Secretary CLEMENTS. I said, "in my judgment."

Senator PROXMIRE. You may be right but there is no way to tell if you are being fair to the taxpayer until you find out whose fault the delay is.

Secretary CLEMENTS. Senator Proxmire, I think that is why the people elected you and that is why I was appointed up here to render honest judgments. We have a disagreement about it.

Senator PROXMIRE. The Newport News is trying to use your statement in a court case. Is it correct to say that your comments have been taken out of context and that you do not intend to imply that the Navy contracts are unfair or inequitable and therefore unenforceable?

STATEMENTS TAKEN OUT OF CONTEXT

Secretary CLEMENTS. I think they have been taken out of context to some degree. I certainly do think that the question of equity is most personable. I think that more important—it is a very significant point here. I think far more important than what you have raised is the testimony before you here just the other day of Admiral Rickover where he said that these conglomerates have no more interest in building ships than they do manufacturing horse turds. I think that that really is at the heart of the problem.

That kind of acrimonious atmosphere is at the very, very gut issue of what is happening here. I think that is far more pertinent than the question that you asked.

Senator PROXMIRE. Well, I think you and I both have great admiration for Admiral Rickover even though we may disagree with him. He has done a great deal for this country.

Secretary CLEMENTS. I agree.

Senator PROXMIRE. His particular views on the attitude of the shipbuilders—my own feeling, it just is not relevant. The important thing is whether or not we are going to follow a system to require the Government to know when it makes a payment that that payment is necessary, just, required, and some basis for it, an audit, a motion of who is at fault and what we are paying for.

Secretary CLEMENTS. I disagree with you because I think it is pertinent and it is relevant. Because when he makes that kind of statement, in a position of responsibility that he has, what he really does is cast an atmosphere over the whole negotiation and he impugns the integrity of these companies.

Now these companies have been engaged for many, many years in the building of Navy ships. They have a great record of doing this and we have as the American free enterprise system, we have pride in these shipyards as a commercial entity.

To cast that kind of shadow on these people, I want the record to be absolutely straight that that kind of statement does not reflect the attitude of the Department of Defense, the Office of the Secretary of Defense, or the Navy.

Senator PROXMIRE. Well, I accept that and I think you and I both have great respect for free enterprise and for the accomplishments of successful business corporations. At the same time let's get on with the merits.

Will you assure this committee that the shipbuilding claims will be handled in accordance with established Navy procedures and the claims settlements procedures will not again be disrupted by attempts to pay the claims irrespective of their merits?

Secretary CLEMENTS. I will handle these claims in a manner that we deem appropriate and that is within the law.

Senator PROXMIRE. Does that mean you will attempt to make these payments independent of the merits?

Secretary CLEMENTS. No, sir; it does not mean that at all.

Senator PROXMIRE. That was my question.

Secretary CLEMENTS. We are going to retain unto ourselves the authority and responsibility that we have under the law; we are going to work with the Navy; we are going to work with the shipyards and

we are going to try to reach whatever reasonable conclusion and accommodation we can in the best interests of this country and with the national security interest.

Senator PROXMIRE. Will you assure this committee that shipbuilding claims will be handled in strict accordance with established Navy procedures? I presume you would not disagree with that.

NAVY PROCEDURES MAY BE CHANGED

Secretary CLEMENTS. Those procedures are man made and they can be changed.

Senator PROXMIRE. Nevertheless, until they are changed——

Secretary CLEMENTS. Well, I may change them.

Senator PROXMIRE. That may be a proper action. What I am saying, however, is until they are changed, you would act according to the procedures?

MAY NOT FOLLOW NAVY PROCEDURES

Secretary CLEMENTS. I'm not sure that I am going to agree to your statement, Senator Proxmire.

Senator PROXMIRE. Then let's take another part. The Navy's claim settlement efforts will not be disrupted to pay—by offers to pay the claims independent of their merits. If you disagree with that, you are telling me you will try to settle the claims without reference to the merits.

Secretary CLEMENTS. Your questions remind me of asking me when I beat my wife last.

Senator PROXMIRE. Well, when did you? [Laughter.]

Secretary CLEMENTS. She is here. You might ask her that question. [Laughter.]

Senator PROXMIRE. Well, I don't know how I can construe your response, Mr. Secretary, as meaning anything except that you would persist in attempting to pay the claims independent of their merits.

Secretary CLEMENTS. On the contrary, we are going to proceed to try to bring about an accommodation of these shipyards based on the merits of the situation and in the interests of national security. That is what we are going to do.

Senator PROXMIRE. All right. I know you are sensitive to charges that the Defense Department is seeking to bail out shipbuilders.

Secretary CLEMENTS. I am sensitive as hell on that. I am positively not bailing out anybody.

Senator PROXMIRE. We have had testimony showing that there has been mismanagement and inefficiency in the Litton and Newport News yards. But are you sure that there is no mismanagement without an audit of their claims?

Secretary CLEMENTS. There is mismanagement and inefficiency and acrimony and enough blame to go around to everybody concerned.

NEED FOR AUDITS

Senator PROXMIRE. Doesn't that call out for an audit to determine the extent of that so when you make a payment you are not compensating for inefficiency and waste and incompetence here?

Secretary CLEMENTS. You can be sure, Senator Proxmire, that we are going to look after the taxpayer's money with the utmost sense of responsibility and certainly in a fiduciary interest basis.

I am a taxpayer and I want to be sure that my money is protected also.

Senator PROXMIRE. Look at the chart. On one huge contract after another, no audit, no audit, no aduit, no audit, no audit, no audit.

Secretary CLEMENTS. Senator Proxmire, you know we are not going to do that.

Senator PROXMIRE. Paying claims without audits is exactly what you proposed. Your proposal was pending on April 30 before the Congress. You withdrew it.

Secretary CLEMENTS. I don't agree with that, your chart or that procedure. Anything we do is going to be done with the utmost prudence.

Senator PROXMIRE. On April 30 you told the Congress under the law that you intended to make a payment of three-quarters—half a billion dollars to three-quarters of a billion dollars to these shipyards and in accordance—the basis of the claims that they had filed.

Secretary CLEMENTS. No, sir, that is not correct and I vigorously disagree with that. I have said it about three times.

Senator PROXMIRE. What was the basis for making this proposal?

PROPOSAL WAS TO REFORM CONTRACTS NOT PAY CLAIMS

Secretary CLEMENTS. We asked permission and talked to both the House and the Senate Armed Services Committees and had their general concurrence to the principle that we would carry on the negotiations with these shipyards in reforming those contracts and in consideration of the reforming of the contracts, they would drop all claims relating to those contracts.

Senator PROXMIRE. That sounds to me like just another way of saying that you are paying off the claims for $500 to $750 million. I don't know how I can interpret it any other way. That is what it is.

Secretary CLEMENTS. It is not.

Senator PROXMIRE. How did you arrive at the $500 to $750 million figure?

Secretary CLEMENTS. There are some very senior members of those committees of both Houses who agree with me and not with you.

Senator PROXMIRE. Well, there is always——

Representative PIKE. Will the gentleman yield?

Senator PROXMIRE. Yes.

Representative PIKE. Having served on one of those committees, Mr. Secretary, I would be amazed to learn that the senior members did not agree with you. [Laughter.]

Secretary CLEMENTS. You would be amazed to learn that they did not agree with me?

Representative PIKE. I cannot remember a time when the senior members of the Armed Services Committee did not agree with anything the Pentagon wanted.

Secretary CLEMENTS. I can cite you many instances. Yes; I can.

Representative PIKE. Not now, but——

Secretary CLEMENTS. Can I supply it for the record?

Representative PIKE. Give me a few where the House Armed Services Committee turned you down.

Secretary CLEMENTS. We are engaged in several items that are currently—and I am not being facetious—in conference now—our budget where we have serious disagreement with certain senior members of the committee and the committee as a whole, where certain items that we feel are very important have not been included and have been taken out or cut from our budget.

You are aware of this. My God, the Senate and the House over the past 4 or 5 or 6 years have cut roughly $40 billion out of our budget requests. Under those circumstances, how can you say they agree with us all the time?

Representative PIKE. We were talking about the senior members of the committee.

Secretary CLEMENTS. They are the ones who made the cuts. Without their leadership those cuts would not have been made.

Representative PIKE. You mean the rest of the committee did not vote on it?

Secretary CLEMENTS. No, sir, but I can assure you that they were done with the concurrence of the senior members and they did concur and the record will so show.

Representative PIKE. Having lived there for 14 years, Mr. Secretary, all I can say is that the ability of the Pentagon to get what it wants out of the House Armed Services Committee—I have no knowledge of the Senate Armed Services Committee—has always been a great miracle to me.

Secretary CLEMENTS. Thank you, Mr. Pike. I consider that a compliment.

Representative PIKE. I am sure you do. You like the way the committee works.

Senator PROXMIRE. How did you arrive at the $500 to $750 million figure—that you thought you could settle these claims for?

ACKNOWLEDGES CLAIMS NOT FULLY REVIEWED

Mr. SHRONTZ. As Secretary Clements has said, our objective was not to try to determine the merit of the claims. We now readily acknowledge that they had not been fully reviewed. Some of them had been received very recently. They had not been audited and negotiated. Our objective was to put into the contracts a clause that we felt was more suitable for covering unknown escalations than the clause that currently existed.

Senator PROXMIRE. How did you arrive at the $500 to $750 million?

Mr. SHRONTZ. We took the clauses and determined the generation of dollars and we took the clauses and the cost to the Government would have been the cost of the new clauses in offsetting escalation versus those originally in the contract.

Senator PROXMIRE. Isn't this what Congressman Pike said before, you converted this into a cost plus contract?

Mr. SHRONTZ. We are not dealing with basic cost. We are dealing with escalation increment. We are not proposing to pay these costs over and above ceiling prices.

Senator PROXMIRE. Did you or did you not pay them all of the costs that occurred?

Mr. SHRONTZ. No, that was one of the problems we had with the shipbuilders. We took the specific clause we were starting from which does not fully cover escalation and we used that baseline to determine the amount of money.

LITTON WOULD HAVE LOST MONEY WITH NEW ESCALATION CLAUSE

Secretary CLEMENTS. Senator Proxmire, this result in the case of Ingalls, for instance, would have left them with a cash loss on the LHA contract of somewhere close to $200 million. We can't give you that exact number, whether it was slightly over or slightly less.

Senator PROXMIRE. How do you know that was that figure? Was that Ingalls' or the Navy's?

Secretary CLEMENTS. It is both Ingalls' and the Navy's number. The Ingalls' number was larger than the Navy. It is close to $200 million.

Senator PROXMIRE. It was Ingalls' figure though?

Admiral GOODING. No, sir. It was a combination of Navy's calculation, Ingalls' figures and Navy calculations and it is a $200 million loss.

Secretary CLEMENTS. After the application of the new clause. Even if we had done this, that loss would have continued. They are not through with that contract. They have to build additional ships under that contract, and their other contract on the 963's is turning into a loss. Don't think of this in terms of a bailout.

Senator PROXMIRE. They have had colossal overruns and you are maintaining that you are going to buy off parts of those cost overruns.

Secretary CLEMENTS. I am not talking in terms of that at all.

Senator PROXMIRE. That is the effect.

Secretary CLEMENTS. I am telling you that we have a colossal problem here and a colossal lawsuit and eventually it will be resolved. The Navy does not deny that they owe Ingalls in this instance some moneys. There isn't any argument about that. They do. Now it has not been determined just how much that is.

Senator PROXMIRE. That is right. You can't tell us that a rigorous audit would show that you owe them $500 to $750 million.

Secretary CLEMENTS. I am not going to say that at all.

HOW CAN LITTON LOSS BE DETERMINED WITHOUT AUDIT?

Representative PIKE. Which contract was it, Mr. Secretary, on which they lost or would have lost $200 million?

Secretary CLEMENTS. The LHA.

Representative PIKE. Is that one of the contracts which was completely audited?

Secretary CLEMENTS. No, sir.

Representative PIKE. Then how do you know they would have lost $200 million?

Secretary CLEMENTS. Because they were—they already have.

Representative PIKE. Somebody has estimated that they have. But without an audit, how do you know that the estimate is right?

CONTRACT COSTS HAVE BEEN AUDITED

Mr. SHRONTZ. Well, the Navy today is in the process of reviewing the latest Ingalls estimates at completion. I don't think they are yet prepared to say whether they fully agree. But the costs of the contract, Congressman Pike, are audited. What has not been audited is the value of the claim that they have submitted. To the extent that they recover eventually a portion of that claim, clearly that will offset the loss, but we won't know at this point what recovery that they will achieve.

Representative PIKE. The audit has nothing to do with their actual costs as opposed to their alleged costs?

Mr. SHRONTZ. You are speaking of the claim now?

Representative PIKE. Yes. When they make a claim, you don't look at their actual costs.

Mr. SHRONTZ. Absolutely.

Secretary CLEMENTS. But these two things are not necessarily related.

Representative PIKE. Well, I don't know how you can make a judgment as to what their costs are—and you have gone into the realm of costs—without auditing.

Mr. SHRONTZ. Well, it is true that when Secretary Clements talks about an estimated $200 million loss even after the new clause has been retrofit, that is the estimate to the point of completion.

All I am telling you is the costs to date have been audited.

Secretary CLEMENTS. That is my point. When I talk about already have, they have a cash loss in the contract to date on an audited cost basis. Forget claims. They have that loss right now.

Representative PIKE. And that is not to the date of completion? That is now?

Secretary CLEMENTS. No, sir.

Representative PIKE. The $200 million now?

Secretary CLEMENTS. Under the retrofit contract—there would be certain moneys that would flow in that would cover the additional cost as accrued on the completion of the contract and these things about offset. Are you with me here?

Representative PIKE. I think so. What you are saying is that no matter what happens from here out, if we restructure the contract in this manner, their losses are not going to increase?

Secretary CLEMENTS. That is right. They will be about $200 million.

FUTURE OVERRUNS WOULD BE BORNE BY TAXPAYER

Representative PIKE. In other words, future cost increases or overruns or whatever you want to call them will not be borne by the company but will be borne by the taxpayers?

Secretary CLEMENTS. Largely that is true and that $200 million loss would be maintained. They would have a cash loss in that contract of about $200 million. They already do. That is a cost item today.

Representative PIKE. But essentially the bottom line is they have lost $200 million regardless of what the contract says. We are saying we

are going to freeze your loss at $200 million and the taxpayer is going to pick up the rest of the overruns.

Secretary CLEMENTS. We are not saying that at all because that would not be according to the contract as reformed.

Representative PIKE. That would be the result.

Secretary CLEMENTS. The result would be approximately that.

Representative PIKE. Mr. Wiley, is what you propose to do legal without additional legislation?

Mr. WILEY. Your question, I take it, is whether we could reform or modify the contracts, refitting the new escalation clause in place of the old without proceeding——

Representative PIKE. Changing the terms of the contract.

Mr. WILEY. Well——

Representative PIKE. Is it legal without new legislation?

Mr. WILEY. The phrase "new legislation," I am not sure about.

Representative PIKE. Without congressional approval. Let's put it that way.

DOD COULD AMEND CONTRACTS OUTSIDE PUBLIC LAW 85–804

Mr. WILEY. As we have testified before at earlier hearings, it is our judgment, and this judgment is concurred in by the General Counsel of the General Accounting Office with whom we have conferred, that as a sheer legal issue it is likely that we would have legal power to amend these contracts in the fashion that has been discussed outside Public Law 85–804.

However, two questions. One, is funding authorization required for the contract? Two, there is not absolute clarity on the legal question involved and at our conference with the GAO Counsel, he and we concurred that to eliminate any residual question in anyone's mind, and because of the size of the problem and the importance of Secretary Clements' outline to the DOD—all of those discussions indicated that it would be much wiser and desirable from the Congress point of view, as well as ours, to have this brought out in the beginning.

Secretary CLEMENTS. And thoroughly discussed in the overview committees of the Congress. I would not be comfortable doing it on any other basis. Whatever we do in this regard, we are going to have congressional approval or we are not going to do it.

Senator PROXMIRE. The committee had testimony that Newport News claims are not only greatly inflated and exaggerated but maybe based on fraudulent misrepresentation. I have asked the Secretary of the Navy to conduct an investigation into the possibility of a fraud. Will you assure us you will take no action to interfere with that investigation?

WILL NOT INTERFERE WITH NAVY INVESTIGATION

Secretary CLEMENTS. I will take no action to interfere and I will encourage it if those allegations are true. But I want you to know again that that kind of a statement from—I know the source, Admiral Rickover, and that relates right back to his horse's turd attitude.

Senator PROXMIRE. We have had it from others. That is not a fair characterization of the Admiral's view here. We have had that charge

of fraudulent misrepresentation from others including an official who had worked at the Newport News shipyards for 18 years.

Secretary CLEMENTS. It was in his testimony before you the other day, too.

Senator PROXMIRE. It has been supported by others, but are you aware that the Justice Department is now investigating a possibility of fraud in two previous shipbuilding claims involving Lockheed and Litton?

Secretary Clements, do you agree that shipbuilders and other defense contractors have an obligation not to submit exaggerated claims and that all evidence of such claims should be turned over to the Justice Department?

Secretary CLEMENTS. Yes, sir. I could not agree more, sir.

Senator PROXMIRE. Both companies, Litton and Newport News have been reporting record profits. Newport News has reported a profit every year since Tenneco acquired the shipyard. How do you reconcile the claims of the financial hardship with record profits?

Secretary CLEMENTS. On the one hand, you have a parent or a conglomerate that has a No. 1 company in it and then you have the subsidiaries or divisions. In this instance we are talking about Newport News Shipbuilding as a subsidiary of Tenneco.

Senator PROXMIRE. Newport News Shipbuilding has reported a profit every year since it was acquired in 1968.

NEWPORT NEWS PROFITS NOT SUFFICIENT

Secretary CLEMENTS. Senator Proxmire, I think you have to relate that on the basis of compared to what. Those profits, as I recall the record—and I will supply those for the record, and put them in the record—but those profits have been very, very small compared to the volume of business that they are doing.

So I don't consider that their profits have been significant in any sense of the word. The last time I looked at those numbers, it involved doing several billion dollars worth of Navy shipyard construction and ending up with less than 1 percent profit.

[The information referred to follows:]

[Dollars in thousands]

	Tenneco (consolidated)			Newport News Shipbuilding		
	Operating revenues and other income	Income [1]	Percent	Operating revenues and other income	Income [1]	Percent
Year:						
1975	$5,630,338	$822,377	14.6	$613,500	$30,300	4.9
1974	5,063,604	791,787	15.6	490,352	10,941	2.2
1973	3,940,161	482,743	12.3	477,875	5,820	1.2
1972	3,323,517	402,981	12.1	462,318	17,890	3.9
1971	2,884,356	384,591	13.3	380,810	19,201	5.0
1970	2,593,969	324,947	12.5	359,732	25,657	7.1
1969	2,459,815	198,904	8.1	314,144	17,586	5.6

[1] Before interest, Federal income taxes, outside stockholders interest, and extraordinary items.

Note: From annual report of Tenneco, Inc., with respect to Newport News Shipbuilding and Dry Dock Co.: In 1975 commercial work contributed in excess of 50 percent of income but represented only 28 percent of operating revenues and other income. Navy shipbuilding and other Government contracts were only marginally profitable.

Senator PROXMIRE. If the shipbuilding contracts were causing these companies hardships, how do you explain the fact that Litton and Newport News have saved up their claims and have not submitted them until recently?

If they were in trouble, and needed the cash, the natural thing for any company to do was to make the claim right away.

TAKES YEARS FOR CLAIMS TO MATURE

Secretary CLEMENTS. It takes years sometimes, Senator Proxmire, for these claims to mature. In the case of some of these claims you have listed up here they have been, so to speak, cooking for a long, long time. They are not recent claims as has been inferred.

Senator PROXMIRE. Do you believe the Government should guarantee profits on its contracts even if the cost overruns are caused by inefficiency?

Secretary CLEMENTS. I have been a contractor for 40 years and I never had anybody guarantee me a profit. I don't believe in that.

Senator PROXMIRE. I am glad to hear that.

Secretary CLEMENTS. You don't believe it? [Laughter.]

Senator PROXMIRE. I am sure as far as your own business operations are concerned, you feel that way, I know you have been a very successful businessman. But in the dealing of the Defense Department with contractors that does not seem to be reflected in the attitude.

It is certainly a permissive, soft, easy attitude.

Secretary CLEMENTS. I don't agree with that at all.

Senator PROXMIRE. Newport News has threatened to stop work. Can the Navy get their ships built elsewhere if Newport News carries out its threats or is the Navy totally dependent on Newport News?

GOVERNMENT NOT DEPENDENT ON ANY SHIPYARD

Secretary CLEMENTS. We are not totally dependent on any shipyard. However, when you say that and you consider all alternatives, for instance building the *Vinson*, the new *Nimitz* class carrier in some other shipyard would be a very difficult proposition.

We could do it and I can assure you that we will do it if necessary. But it is going to involve a costly process and it is going to cost us considerably in time as well as money.

Somebody has recently referred to this situation as being that Newport had the Navy and me over a barrel.

I quickly want to lay that to rest. We are not over a barrel. We are not under a barrel. We are not in any way connected with a barrel. [Laughter.]

We will get those ships built, we will do it properly; and we will have the quality assurance that we require.

But we are going to lose time and we are going to lose a great deal of money if that comes about.

Senator PROXMIRE. What steps have you taken to assure that the Navy will get the ships if Newport News carries out its threats?

Secretary CLEMENTS. I don't want to get into that with you at this point. We have made our plans and I think that they are appropriate. We will take what actions we see are necessary when that time comes.

Senator PROXMIRE. I understand that you have had extensive discussions with the heads of shipyards who have filed claims in effect that shipbuilders have gone around Navy officials and have sought you out instead.

NAVY FULLY INFORMED OF DISCUSSIONS WITH SHIPBUILDERS

Secretary CLEMENTS. That is not so. I want to interrupt. I take violent exception to that and the Navy has been kept fully informed of any discussions that I had. I have not discussed these claims without a person present with me at all times.

Senator PROXMIRE. I did not say that. Isn't it true that you have discussed these claims with the head of Litton and Newport News?

Secretary CLEMENTS. For 3½ years I have been discussing these claims with them.

Senator PROXMIRE. Isn't it possible that contractors are trying to shortcut the normal Navy procedures so as to avoid their claims?

CRITICISM OF ADM. RICKOVER

Secretary CLEMENTS. No, sir. I would not be a party to that. Any negotiations we have had have always included participation by the Navy. We have kept them—I have kept them fully informed and they in turn have informed me.

I don't think there is any breakdown whatsoever in this process except one and that is in the area of the so-called 08 division which is headed up by Admiral Rickover and there is a breakdown there.

Senator PROXMIRE. Mr. Secretary, I am sure that was not your intent.

Secretary CLEMENTS. Wasn't my intent to do what?

Senator PROXMIRE. That has been the effect so far, that to avoid the regular Navy channels——

Secretary CLEMENTS. I don't agree with that, Senator Proxmire. I don't think you know what you are talking about.

DEFENDS ADM. RICKOVER

Senator PROXMIRE. I think Admiral Rickover knows what he is talking about. He has had more experience in procurement than any other person in our Government.

He has had a great record and he has done a superb job with the nuclear submarines. On that basis we have to give him judgment, his work, his word, his experience, what he has told us a great deal of weight.

Secretary CLEMENTS. If he says I have short circuited the Navy procedures, he has misrepresented the facts and I will tell him so as soon as I get back to the Pentagon.

Senator PROXMIRE. I am sure you will and I am sure he will have a response. [Laughter.]

Secretary CLEMENTS. There is no doubt about that in my mind either.

Representative PIKE. Mr. Secretary, just a couple of questions while the Senator goes for a vote. I apologize for not having been here throughout all of your statement. I have been trying to read it as you were responding to questions.

CLAIMS AS A PERCENTAGE OF SHIPBUILDING CONTRACTS

From January 1969 to April 1, 1976, shipbuilding claims totaled about $3.2 billion; $3,189,000,000 is the figure in your statement. What is that as a percentage of shipbuilding contracts during that time?

Secretary CLEMENTS. Admiral Gooding? I think he is better qualified to respond to that.

Mr. SHRONTZ. Shipbuilding contracts during that time were roughly $16½ billion. So if we take 3.2——

Representative PIKE. About 20 percent?

Admiral GOODING. Yes, sir.

Representative PIKE. Isn't 20 percent in claims over contracts pretty high just as a matter of actual—is that the way the jobs have been going for 7¼ years?

Admiral GOODING. Mr. Pike, I have no way of knowing whether that is high or low. It is a fact. I don't know whether it is high or low.

Secretary CLEMENTS. Mr. Pike, on the record I want to be sure the record shows that I think it is high. I agree with you. I think it is high because you have to consider that in those contracts there is a procedure for handling change orders as you move forward.

Representative PIKE. We are talking about claims now. We are not talking about cost overruns or change orders or anything else. We are talking about after the change orders, after the settlements. You wind up with claims totaling 20 percent of the contract price. That seems to me terribly high.

Secretary CLEMENTS. I agree with you.

Representative PIKE. It makes me sort of question the whole procedure——

Secretary CLEMENTS. Now you are seeing the light of day. This is the procedure.

Representative PIKE. Yes, but the problem has been there for 7¼ years.

Secretary CLEMENTS. I have been working on it for 3¼ years.

Representative PIKE. How are you doing?

Secretary CLEMENTS. Not worth a damn.

LACK OF PROGRESS IN SETTLING CLAIMS PROBLEM

Representative PIKE. I appreciate your candor, Mr. Secretary. But what do you need over a period of 7¼ years to get from not worth a damn to progress?

Secretary CLEMENTS. I need some constructive help and less flagrant and flamboyant statements. Not from you, of course.

Representative PIKE. In all candor, Mr. Secretary, I don't think that you help in a particular situation, the vitriolic language, when you come in here and pick up a phrase which Admiral Rickover used which may have been a little bit intemperate and repeat it a couple of times and say this is the problem.

You know as well as I do that all the newspapers are going to be talking about as a result of your testimony today is the fact that you came in and referred to the horse turd comments of Admiral Rickover.

Secretary CLEMENTS. Do you think that that is an accident?

Representative PIKE. I don't think that is an accident and I know perfectly well that I don't have to defend Admiral Rickover because he will come back at you just as hard.

But if you are concerned about solving the problem—all you are doing is escalating the warfare. That is my point.

Secretary CLEMENTS. You may be right. We will see.

Senator PROXMIRE. Mr. Secretary, I did not hear all of that exchange, but I am inclined to think that it is a surprise that you agree with Congressman Pike on this. I hope that the two fine public servants like you and Admiral Rickover, both of whom are skilled and competent in the area of defense, will find a way of getting together in such a way that you will agree that Admiral Rickover is right. [Laughter.]

Thank you very much. Admiral Gooding will stay at the table and Admiral Evans and Admiral Woodfin will come forward.

Thank you very much.

Secretary CLEMENTS. Thank you, Senator.

[The following letter from Rear Adm. S. J. Evans, retired, was received subsequent to the hearing, in response to a request by Senator Proxmire, and is included for the record:]

ANNANDALE, VA.,
July 27, 1976.

HON. WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government,
Joint Economic Committee, Congress of the United States,
Washington, D.C.

DEAR MR. CHAIRMAN: Your letter of July 9, 1976 requested that I comment on the testimony of Deputy Secretary of Defense Clements before your Subcommittee on June 25, 1976.

I was present for Mr. Clements' testimony and have reviewed the transcript of that hearing. As you are aware, the preponderance of Mr. Clements' testimony presents his opinions on the issues involved in the current contractual dispute between the Navy and Newport News. Later in that hearing, I provided my opinions on many of these same issues. In general, I do not believe that further comment by me on the differences in our respective opinions would serve a useful purpose.

The one exception to this relates to Mr. Clements' opinion regarding the fairness and equity of the Navy's contracts with Newport News. Because of the reference to these comments in court by lawyers representing Newport News on the CGN 41 option dispute, I believe it important that this matter be more fully considered.

In a letter to Senator Stennis and in subsequent testimony before the House and Senate Armed Services Committees, Mr. Clements made statements to the effect that Navy shipbuilding contracts awarded in the late 1960's and early 1970's were unfair and inequitable—principally because of the escalation provisions included in those contracts. These statements were repeated in his testimony before your Subcommittee. It is my understanding that the allegation of "unfairness" is one of the issues central to the Newport News defenses in the litigation regarding the CGN 41 option.

I further understand that, in a pre-trial conference on this lawsuit, the attorneys representing Newport News made reference to Mr. Clements' statements in supporting their position. Because of the potential importance of these statements in the resolution of this litigation, I would like the record to be clear that Mr. Clements' opinion was not unanimously held by those in the Navy Department who were involved with this contract nor, to my knowledge, has the Justice Department, who is responsible for the litigation, come to any such conclusion.

In carrying out my duties regarding the CGN 41, I examined in depth the terms and conditions of the contract containing the option for this ship. In my judgment, this contract, with its escalation provisions, is fair and equitable. Specifically, the contract provides that Newport News will receive quarterly payments to reimburse it for the effect of inflation on labor and material expenditures, including the labor and material portions of overhead, for the work originally pro-

jected to be accomplished in each quarter to meet the construction milestones and delivery date agreed to in the contract. Most Defense contracts do not have escalation payment provisions, thus the contractor bears the risk of unanticipated inflation. In most Navy shipbuilding contracts, however, escalation payments are made based on the contract's target cost and indices especially prepared for the shipbuilding industry by the Bureau of Labor Statistics (BLS). The contract with Newport News for nuclear powered cruisers gives the shipbuilder even greater protection against inflation. This contract provides that Newport News will be paid escalation based on the ceiling price of the contract and changes in the shipyard's own labor index up to 125% of the change in the BLS index. Since these escalation payments are based on changes in inflation indices including changes in the Newport News labor index, the shipbuilder is adequately covered regardless of the actual rate of inflation. Lack of coverage for inflation can occur only after the shipbuilder falls behind schedule or overruns the contract ceiling price. Even then, if the cause of delay or increased cost is Government responsible, the Navy will adjust the contract to cover the increased cost through fair and equitable resolution of claims. In this contract, contract changes, which usually amount to 5% of the final contract price, are also covered by the escalation provisions so that the contractor receives protection from inflation for these changes. These provisions seem eminently fair and reasonable to me.

The other issue on which I believe further comment is necessary concerns a matter of fact regarding the following statement of Mr. Clements on the nature of the Navy's option for the construction of CGN 41:

"That contractor (Newport News) took a multiple ship contract (N00024–70–C–0252), meaning that he was going to build several ships, but then at a point the contract had to be renegotiated as to price and then existing conditions. The (CGN) 41 falls under that. It was an option, see, an option, where the Navy had an option to say yes, we want to build a ship. But then it had to be mutually negotiated.

"So far, it had (sic) not been able to be negotiated."

Mr. Clements' statement leaves me with the impression that the requirement for Newport News to construct and deliver CGN 41 is subject to negotiation and that the option was entirely undefinitized regarding price, delivery date, and other terms and conditions.

The option for construction of CGN 41, exercised by the Navy on January 31, 1975, was a binding option for Newport News to construct and deliver CGN 41. There is neither need for, nor room for, negotiation on this point. The option terms included a fixed delivery date established in fact by Mr. Diesel, President of Newport News, and a maximum cost, profit and price. The only items open to negotiation under the terms of the option are a downward revision in price, the specific escalation tables to be used under the contract of which this option is a part, and some minor administrative provisions. In summary, my personal conviction is that the Navy exercised a binding option with Newport News for construction of CGN 41 and the major contractual provisions of this option had already been established when the option was exercised.

I trust this reply responds to your request.

Sincerely,

S. J. EVANS.

INTRODUCTION OF ADM. KENNETH L. WOODFIN

Senator PROXMIRE. Our next witness is Rear Adm. K. L. Woodfin, USN retired, who retired from the Navy a year ago and is currently employed in private industry. Prior to retiring from the Navy he was the Deputy Chief of Naval Material for Procurement and Production, the top Navy military procurement official.

He also served as Deputy Commander for Contracts, Naval Ship Systems Command where he was responsible for the negotiation and award of many of the shipbuilding contracts under which Newport News has submitted claims.

In addition, Admiral Woodfin was responsible for contracting officers' decision on both the Litton LHA claim and the Litton submarine claim which is now being investigated for possible fraud.

Admiral Woodfin has been invited to testify because of the many years of experience in Navy procurement and because of his direct involvement with many of the shipbuilding contracts and claims which we are now considering.

Admiral Woodfin, please proceed with your statement.

STATEMENT OF REAR ADM. KENNETH L. WOODFIN, RETIRED, VICE PRESIDENT FOR BUSINESS MANAGEMENT, BURNS & ROE, INC., ORADELL, N.J.

Admiral WOODFIN. I am basing my comments today on my direct experience with Navy shipbuilding contracts during the period from 1970 up to my retirement from the Navy in May 1975. During the period June 1975 through May 1976, I was Assistant Administrator for Procurement at NASA. In June 1976 I resigned from NASA and accepted a position as vice president for business management at Burns and Roe, Inc., an engineering consulting firm in Oradell, N.J.

I am expressing my views today as a private individual and not as a representative of the Navy or the administration. During the period 1970 to 1975 I was Deputy Commander for Contracts, Naval Ships Systems Command and Deputy Chief of Naval Material, Procurement and Production.

PROGRESS MADE UNTIL 1975

During that period I consider that real progress was made in resolving the Navy's shipbuilding claims backlog in that approximately 40 shipbuilding claims involving $1 billion were settled using a Navy developed claim review and settlement process.

In the year since I left the Navy, regrettably, it does not appear that the contractual situation between the Navy and its shipbuilders has improved significantly. In view of this I fully appreciate the Defense Department's urgent need to improve this relationship as the Navy proceeds into a period of increased contracting for naval warships.

My knowledge of the recently withdrawn Department of Defense proposal to settle shipbuilding claims by application of Public Law 85-804 comes almost entirely from published news accounts and public statements by the Defense Department.

From these accounts it appears that the Defense Department originally proposed to settle about $1.8 billion of recently submitted and potential shipbuilding claims from General Dynamics, Newport News, Litton Shipbuilding, and National Steel outside of the Navy's normal claims review and settlement process for about $500 to $700 million although I understand that no settlement agreements with the individual companies have been negotiated.

The stated justification for granting extra-contractual relief is that Navy shipbuilding contracts have been unfair and inequitable, particularly with respect to escalation provisions and have proven to be unworkable.

I understand that there has not yet been an official Government determination of the amount the Navy legally owes against these claims. However, the Defense Department proposed to use Public Law

85–804 to correct the so-called inequities quickly and thereby promote better relations between the shipbuilders and the Navy and then facilitate carrying out the Navy's new shipbuilding program.

RECENT APPROACH UNIQUE

This is a unique approach since as I recall the use of Public Law 85–804 requires that all the other avenues of relief have been exhausted and that only by recourse to this extraordinary authority can the necessary end be achieved.

Even though the earlier mentioned Public Law 85–804 settlement proposal has been withdrawn by the Department of Defense, there are several important points which I believe the committee should consider in any future settlement proposals.

SHIPBUILDING CLAIMS FIGURES CAN BE MISLEADING

Shipbuilding claims figures can be misleading and should not be accepted at face value. Typically shipbuilding claims are greatly exaggravated by inflation. In effect the Navy escalation clause constitutes a negotiation.

A $1.8 billion claims backlog does not mean that the shipbuilders expect to get $1.8 billion or from my experience that they actually believe they are entitled to such sums under these contracts. Also claim amounts are often expressed in terms of a ceiling price adjustment to a fixed price incentive contract. Under such contracts how much more the contractor is actualy paid depends on his actual costs in relation to the overall pricing structure of his contract.

Thus it is possible that even if the Navy agreed to pay the total, $1.8 billion, in shipbuilding claims at the 100 cents on the dollar, the actual increased cash payment to the contractors could be hundreds of millions less. More importantly the value of any claims settlement depends on what kind of a claims release is obtained so any proposed settlement should be carefully reviewed in this regard.

CONTRACTORS SHOULD NOT BE EXCUSED FROM CONTRACT TERMS

I see no reason why shipbuilders or other Government contractors should be excused from the terms of their contracts, except in rare cases where otherwise the contractor would not be able to complete his contract and there is no practicable alternative to obtaining the item in question.

Insofar as the Government owes the shipbuilders money against their claims orderly processes have been established to see that they are reimbursed in amounts to which they are legally entitled.

CONTRACTS NOT INEQUITABLE

The escalation provisions used in Navy shipbuilding contracts during the late 1960's and early 1970's were not, in my opinion, inequitable when negotiated, as has been alleged. Keep in mind that as long as a shipbuilder performed on time and within the target cost of his contract, the escalation clause protected him from the effects of inflation because his escalation payments were geared to indices.

To the extent shipbuilders believed that these escalation provisions might not fully reimburse them for all the effects of inflation, many of them included additional contingencies in their pricing. Thus even though the period of double digit inflation escalation payments to shipbuilders were geared to the actual inflation experienced in the shipbuilding industry and as such provided better protection than that enjoyed by the rest of the defense industry.

Further, to the extent the Government added work or caused delays, shipbuilders are entitled to full reimbursement including escalation, for the additional costs of these actions under the changes article, and and unfortunately some shipbuilders have refused to price changes in order to retain these entitlements as a backbone for future claims.

DEFENSE CONTRACTS OTHER THAN SHIPBUILDING DID NOT CONTAIN ESCALATION CLAUSES

As I recall during the period in question, 1967–71, the armed services procurement regulation did not encourage the use of escalation provisions in defense contracts, except for shipbuilding contracts. Thus most other defense contractors did not have escalation clauses, even on long-term contracts which may have lasted 3 or 4 years or more, and had to bear the entire brunt of double digit inflation themselves whereas shipbuilders did not.

Of course, to the extent a shipbuilder delivers late or overruns his contract for reasons that are his responsibility, his problems are aggravated by inflation. In effect the Navy escalation clause constitutes a form of liquidated damage well understood by the contracting parties. If shipbuilders are excused from their contracts on the basis that the contract did not provide adequate protection against inflation every other defense contractor and subcontractor should logically contend that they have a basis to request similar relief.

SHIPBUILDERS ARE HARD AND SKILLFUL NEGOTIATORS

It has been alleged that the Navy awarded unfair and inappropriate shipbuilding contracts. I disagree. At the time negotiated, I believe both parties considered them fair. I have found shipbuilders to be hard and skillful negotiators.

Year after year shipbuilders send their most experienced, senior negotiators and lawyers to the bargaining table where they are generally confronted by Navy negotiators who often have far less experience. Generally shipbuilders negotiating personnel have had many years of experience in negotiating with the Navy, and are expert in the intricacies of shipbuilding contracts.

In contrast because of the turnover problem their Navy negotiating team counterparts, in some cases stay on the job for only a short time. Many negotiations were difficult and hard fought, but in the end compromises were made and agreements reached. For example, when the Navy pushed for lower target costs to both encourage tighter cost controls and at times to meet budget constraints at a particular shipyard, the contractor insisted on protective share lines and a ceiling price that would protect him in the event he overran the target costs.

SHIPBUILDERS DID NOT ACCEPT CONTRACTS AGAINST THEIR WILL

I cannot recall any situation where the Navy knowingly outwitted and outnegotiated experienced and knowledgeable shipbuilders or that the shipbuilders accepted contracts against their will. Naturally negotiations are and should continue to be an adversary relationship. Conversely I have been concerned that the Navy is generally in a poor negotiating position since there is a severely limited number of shipbuilders qualified to build its ships. But I prefer this limited competition to none at all.

CLAIMS SETTLEMENTS

Some shipbuilders complain to high levels of the Defense Department about—and to the Congress about delays in settling shipbuilding claims. This undoubtedly generates pressure on contracting officers to accelerate the claim settlement process. I believe that the Navy has improved the timeliness of its processing approach without sacrificing the full determination of legal entitlement.

Frequently a shipbuilder may have a set figure in mind that it must recover, regardless of the merits of the claim in order to make its desired profit objective. When the initial Navy analysis concludes the Government owes a much smaller amount, quick settlement by negotiation appears virtually impossible.

On the other hand where both parties are accelerating the factfinding process, recent data indicates that even complex claims could be settled in approximately a year.

Factfinding remains the key, particularly in the complex shipbuilding atmosphere, and I can visualize no real shortcuts to the process of determining what acts or inacts of the Government have caused the basis for a contract change.

QUESTIONABLE PRESSURE TACTICS

Recent accounts of some shipbuilders refusing to honor contracts, threatening to stop work and stating that they will not accept new contracts, are questionable pressure tactics growing out of obvious overruns on the 1967–71 period contracts. I believe that since 1973 the Navy has recognized some of the problems of shipbuilding contracts through the use of even more liberal escalation clauses to meet the shipbuilders' problems of material and labor shortages and the virtual elimination of multiyear contracts to avoid any total package procurement problems.

I also have been concerned at the apparent steady deterioration in both the Navy's and the shipbuilders' ability to estimate manufacturing and weapon system integration costs on new complex warships. As a result of this concern I have reluctantly advocated in future contracts the use of cost-type contracts for some of the more complex lead ships.

I agree with the House Armed Services Committee's historic concern over the uncontrolled aspects of cost-type contracts for shipbuilding, but unless and until the shipbuilders can better control productivity some cost-type contracts appear to be a necessary interim alternative.

However, in the case of the present contracts in force, I believe that, if there is to be any integrity to the Government contracting process, the shipbuilders should honor their contracts and continue to take new contracts under the more liberal contract approaches I have just mentioned.

PUBLIC LAW 85–804

As I stated earlier, I can appreciate the Defense Department's desire to resolve the claims backlog quickly and obviously the Navy should pay where money is due. It is also obvious that senior Defense officials have authority, subject to congressional approval, to apply Public Law 85–804 for this purpose.

I recognize also that it is, of course, possible that a Public Law 85–804 settlement could be obtained under certain circumstances that would be equitable to the Government.

NAVY NEGOTIATORS PLACED IN UNFAVORABLE POSITION

However, by announcing publicly that the Navy contracts are inequitable, announcing a decision to provide extracontractual relief, setting a date for completion of settlement negotiations, and announcing how much it is willing to pay, all before a specific arrangement and contractual release has been agreed to with the shipbuilders, Defense officials have put their negotiators in the most unfavorable negotiating position I can imagine.

I fear that as long as shipbuilders can achieve a vastly superior position by going to high level Government officials, they have little incentive to deal with the designated Navy contracting officers.

In such an environment, it appears that it will be increasingly difficult to enforce future contracts and settle claims on their legal merits in accordance with established Navy procedures which by the way seem to be acceptable to the GAO.

Thus I cannot accept the theory that by use of Public Law 85–804 we can expect to resolve Navy differences with its major shipbuilders. Instead it appears we should proceed to an accelerated settlement of these claims in the established manner, while at the same time insuring that our new contracts do not create the same bases for claim assertion.

Thank you, Mr. Chairman. That concludes my statement.

Senator PROXMIRE. Thank you for an excellent statement. I would like to apologize for not having given you an adequate introduction. Everybody knows the Secretary, of course. He has been before the committee many times. I will just say that Admiral Woodfin retired from the Navy a year ago, and is currently employed in private industry.

INTRODUCTION OF REAR ADM. S. J. EVANS

Admiral Evans recently retired from the Navy. He is currently the Assistant Administrator for Procurement for NASA. Admiral Evans is here today as a private citizen and not as a representative of NASA. Prior to retiring from the Navy in May 1976, Admiral Evans was the Deputy Commander of the Naval Material Command for Procurement and Production, the top procurement job in the Navy. In this

capacity he was responsible for Navy procurement policy and review and approval of shipbuilding contract awards and claim settlements.

He also was designated as the Navy's chief negotiator on the CGN 41 option dispute with Newport News. Prior to this Admiral Evans was Director of Contracts at the Navy Air Systems Command where he personally handled the F–14 dispute with Grumman.

Admiral Evans has had many years of Navy procurement experience and has been invited to testify because of his broad experience in procurement and his specific knowledge of current disputes on Navy shipbuilding contracts.

Admiral, it is a pleasure to have you here with us today.

INTRODUCTION OF VICE ADM. R. C. GOODING

Vice Adm. R. C. Gooding, Commander, Naval Sea Systems Command. Admiral Gooding has been in charge of Navy shipbuilding including Navy shipbuilding contracts for nearly 5 years. The subcommittee invited Admiral Gooding to testify regarding his personal views on various aspects of the Navy shipbuilding claims problem.

All three of you gentlemen are eminently qualified to testify on this matter. We are very grateful to you. I know it is not easy to come forward under these circumstances to testify at a time when you can't agree all the way with the Secretary of Defense.

It would be much more pleasant if you could agree with him. I want to thank you for your willingness to perform what I am sure is not a pleasant task.

SHIPBUILDERS' DELAYS IN DOCUMENTATING AND SUBMITTING CLAIMS

Admiral Gooding, the Navy has been criticized for long delays in settling claims. Isn't it true that Litton began to document its $504 million claim only in the last few months, that Litton has now notified the Navy it will increase this claim and most of the Newport News claims have been submitted in the last year?

Admiral GOODING. That is true, sir.

Senator PROXMIRE. Is it correct that General Dynamics has not yet submitted its claim?

Admiral GOODING. It has submitted one claim. It has yet to submit any further claim.

Senator PROXMIRE. So this last claim that is listed here on the chart, No. 8, General Dynamics, the SSM, that is simply a guess that it would be a $400 million figure?

Admiral GOODING. Yes, sir. I don't recognize that guess. My guess is $300 million. But yes, that is a guess.

Senator PROXMIRE. But even your $300 million guess is based on an estimate without having a claim submitted at all?

Admiral GOODING. That is correct, sir.

LACK OF AUDITS

Senator PROXMIRE. Is it not correct that the Navy has not conducted a thorough or complete audit or analysis of the pending claims?

Admiral GOODING. That is correct.

OVERSTATEMENT AND FAT IN CLAIMS

Senator PROXMIRE. Is there a substantial amount of overstatement and fat in the Newport and Litton claims in your opinion?

Admiral GOODING. Yes.

Senator PROXMIRE. Would you like to say a little bit more about that?

Admiral GOODING. Ask another way. I have answered that one.

Senator PROXMIRE. Is there a substantial amount of overstatement, overexaggeration, or fat in the claims and how much?

Admiral GOODING. I don't know how much.

Senator PROXMIRE. What is the evidence that there is overstatement?

PERCENTAGE PAYOFF UNDER 50 PERCENT

Admiral GOODING. It is common for the Government to decide that there are parts of the claim to which there is no legal entitlement. Witness the fact that our percentage payoff on the face amount is something less than 50 percent over the last 7 years.

DIVERSION OF SCARCE MANPOWER

Senator PROXMIRE. We have had testimony showing that Newport News mismanaged its manpower program and that it shifted manpower to commercial work at the expense of Navy contracts. Have you had any indication that the company diverted scarce manpower from Navy contracts to commercial work and this has increased the problem of meeting its contractual obligations to the Navy.

Admiral GOODING. Yes, sir. In the past few months no substantial shift in manpower took place until the first of this year but it is going on and it is increasing.

Senator PROXMIRE. In your opinion, is it likely that a full audit analysis and review of the Newport News or Litton claim will show one or both of them are entitled to less money than they have been recently offered, strictly on the basis of their claims, the merit of their claims?

Admiral GOODING. Without analysis, Mr. Proxmire, I can only speculate on that.

Senator PROXMIRE. The question is, is it likely. On the basis of your experience, is there perhaps a 20 to 40 percent probability that the claim may be less than that?

Admiral GOODING. There is some possibility that the claim would be less than that. I would hesitate to say what it is.

Senator PROXMIRE. Newport News certified that the first claim they submitted on the SSN was complete, current and accurate. The contractor submitted a revised claim for twice the amount of the first. Apparently the backup data of the revised claim had backup sheets dated several months after that.

The data in the second claim indicates the first certification was an error.

NAVY CONSIDERING ACTION ON REVISION OF CERTIFIED CLAIM

Admiral GOODING. We are considering that very question at the moment, Mr. Chairman. I don't know the eventual outcome of our deliberations.

Senator PROXMIRE. What kind of action is possible?

Admiral GOODING. I am not even sure I know that. We did get a certificate on the first claim. We did not on the second claim. Parts of the second claim appeared to have modified parts of the first claim. We have a problem.

Senator PROXMIRE. Is there any penalty for filing a false claim?

Admiral WOODFIN. The False Claims Act provides for a $10,000 fine for false swearing against the Government.

Senator PROXMIRE. Did they sign a false oath in your opinion?

Admiral GOODING. Mr. Chairman, I can't answer that. I don't know.

Senator PROXMIRE. Now Admiral Woodfin, you were involved in shipbuilding procurement for many years. What is your opinion of the allegations that the Navy awarded unfair and unappropriate shipbuilding contracts?

NAVY DID NOT INTENTIONALLY AWARD UNFAIR OR INEQUITABLE CONTRACT

Admiral WOODFIN. I don't believe the Navy intentionally awarded an unfair or inequitable contract——

Senator PROXMIRE. They didn't intend it but your statement was very clear in saying that you felt that the negotiations were if anything balanced on the side of the shipbuilder.

They had the experience, the know how, the expertise, the people.

Admiral WOODFIN. The Navy had a competent estimating group. The Navy thought it could estimate ships costs with some degree of accuracy. The Navy also felt that the shipbuilders had competent estimating groups.

The Navy and the shipbuilders reached a mutual agreement as to the time of delivery of the ships. The actual shipbuilding escalation provisions in Navy contracts, if anything, actually favored the shipbuilder. These provisions tend to front load the payment and provide the shipbuilder cash ahead of his needs. In that respect, you must say the contracts are fair, provided the contractor can do anywhere near what he contracted to do.

I am concerned now in restrospect that neither of the parties seemed to know what they were doing in the estimating process. There have been significant overruns, much to the surprise of the Navy and to the surprise of the shipbuilders. These overruns do not obviate the shipbuilders' contractual responsibilities. Nor does it reach to the Navys providing amendments without consideration unless there is some basis I don't understand.

Senator PROXMIRE. Admiral Evans, would you like to comment on that?

Admiral EVANS. Yes, but there are one or two comments I would like on the record. I am here at your request and, as you stated, as a private individual. I would like to make clear that any observations, opinions, comments I make are mine and are not in any way representing those of any Federal agency or department.

I do not have a statement for the following reasons. I first became aware of your request for my presence here late Monday afternoon

when I was committed to be out of the State on business. At that point, I believe I wrote you a letter and explained my reasons.

I became aware of the request to my agency on Wednesday morning when I was in Mississippi. On the basis of that and in deference to your request, I curtailed that visit and returned home last night rather late. I have had no opportunity to prepare any form of comments, to develop any notes.

Therefore whatever I say has to be predicated solely on my personal knowledge and on my memory and subject to limitations of both.

During my year as Deputy Chief of Navy Material for Procurement and Production, I was involved in and familiar with the award of several contracts, several of which were referenced here today, an award to Bath Iron Works with respect to construction of FFG ships and an award to Newport News for what was known as the third flight of the SSN 638.

In both cases in my judgment the terms and conditions of those contracts were extremely equitable.

NEWPORT NEWS CONTRACTS EQUITABLE

In the terms of Newport News, the terms and conditions written there reflected the fact that we had a limited source to negotiate with and if we wanted to award to Newport News we had to go to the terms and conditions which we did. I consider them extremely fair and equitable.

Beyond that, my familiarity with the contracts to which Admiral Woodfin referred are in detail confined to the CGN 41, with which I am familiar, and the settlement of the claim of General Dynamics for the first flight 688 submarines.

In each case I had an opportunity and a duty to examine in some depth the terms and conditions and, whereas I was not a party to the negotiations and cannot recapture the situation as existed at the time of the award, it appears to me that had they been performed within the time frame that they were fully and freely negotiated, both contracts would have been fair and equitable, and in all probability profitable to build.

Senator PROXMIRE. Congressman Pike.

Representative PIKE. Thank you very much, Mr. Chairman. First of all, I would like to join Senator Proxmire in commending you in particular, Admiral Woodfin, for what I think is a real fine statement. It does reflect something which I think it I have observed every single time you look at any procurement, large or small.

GOVERNMENT NEGOTIATORS OFTEN OUTMANNED

It has always appeared to me that those who were negotiating on behalf of the Government were always just a little bit outmanned and outgeneralled by those who were negotiating on behalf of industry.

The industry people were more experienced by and large. They were infinitely better paid, they were trained and pure specialists. I have seen this from the procurement of little tiny objects where the people

who were representing the Government did not know what they were doing, to the big things where the Government puts its first team in.

Still the industry people have higher priced lawyers, more time and all this stuff. What interests me—I am going to have to disagree with one thing you say and you do say it reluctantly, you don't see any real alterntive except going to cost plus contracts at the present time.

To me this is just sort of a statement of failure in our ability to do anything else and make it meaningful. You have got a problem which I tried to raise earlier. Once a keel is laid, What can you do?

You can't move it somewhere else. You can't go somewhere else. In all of your experience, have you ever seen that happen?

Admiral WOODFIN. There was a submarine that was moved from New York Ship to Ingalls Shipbuilding for completion that I can recall, this submarine was completed at very high expense to the Government.

Representative PIKE. After construction was started?

Admiral WOODFIN. Yes. It was towed down there and almost sank in the towing process.

Representative PIKE. Was that the story that proved you could not do it?

Admiral WOODFIN. It certainly would discourage our doing it in the future. We would not readily move semicompleted ships. There is one question, though. Why would one continue to add additional ships at a shipyard where you are in great financial trouble?

Representative PIKE. I could not agree with you more.

GOVERNMENT NOT INEPT

Admiral GOODING. I squirmed a little bit at the picture Admiral Woodfin painted of our negotiations. I hope you are not drawing the conclusion that the government is inept. We may be outmanned and outgeneralled but we are not all that bad.

Representative PIKE. You are not that bad and I don't mean to draw any conclusion except to say that industry again has $100,000 a year men representing them and you have got $30,000 a year men representing you.

Industry has people who have lived with particular ships and problems and furthermore they are going to be there next year and the year after and the year after that.

You people are going to be moving around. Believe me, I do not mean to downplay your motivation or your dedication. However, I will accept your characterization, that you are outgeneralled and outmanned when these things come on.

Admiral GOODING. Will you also accept that we are not totally inept?

Representative PIKE. I will also accept that you are not totally inept. It is not a question of change in terminology. It is just a question of change in emphasis. Admiral Woodfin, what, in your judgment, will happen to the system as far as the morale of contract officers if we establish this precedent whereby the whole system is chucked?

We don't bother auditing the claims. We ignore the claims and we just go a different route.

PUBLIC LAW 85–804 APPROACH COULD LEAD TO REVIEW OF CLAIMS ALREADY SETTLED

Admiral WOODFIN. Well, I cannot believe it is in the best interest of either shipbuilding or defense industry because I see no reason as was said earlier for this to be an isolated case for entitlement under Public Law 85–804.

In fact, it is my understanding that some of the ship builders who settled claims with the Navy in the past are looking at this and saying why did we settle if on the former basis these claims are going to be settled without the agony the Navy put us through to prove our case?

I would think there would be a retrospective hue and cry and a large insurgence of claimants on the Armed Services Board of Contract Appeals for some type of relief from claim settlements already reached.

DETERMINE ENTITLEMENT BEFORE SETTLEMENT

Why should this approach be confined to shipbuilding? Others settled on the basis of taking a large loss. As Secretary Clements says, I agree that these settlements will likely involve losses. But I think in some instances, we need to look very closely at real entitlement before we make a settlement agreement.

I differ with Secretary Clements that you can in fact reform contracts and add escalation to contracts without a detailed review of the entitlement aspects of a contract without consideration. The consideration clause was in that contract, what the equity of that contract was to some extent.

I think we must go about claim settlement in an orderly process.

Representative PIKE. Admiral Evans, it was mentioned earlier that you had some part of the F–14 contract negotiations. I would like you to make a comparison, if you are able to do so, between what the escalation clause was in that contract, what the equity of that contract was and the settlement of that contract was as compared to what the Navy is proposing to do now.

GRUMMAN F–14 CONTRACT ENFORCED

Admiral EVANS. Mr. Pike, the philosophy I have heard expressed is entirely different. In the Grumman situation there were eight options in that contract. Escalation did not commence until the 6th production lot. The issue in that case was one of whether or not Grumman was financially capable to produce the 5th production lot. As you recall, the Navy and Grumman sharply differed with respect to their capability to perform their obligations.

It went to the point where I exercised the option requiring them under the contract to produce that fifth lot, and they stopped work. In the final analysis I think the outcome demonstrated, albeit substantial financial damage to the corporation, they have the capability of producing that lot.

The corporation lost on the aircraft itself some $280 million. That was lessened by profit on ground support equipment, test equipment, spares and the like. The conditions were different. Our view in that

case—and I was a party to the negotiations—was that the corporation could in fact produce that particular lot without the impairment they claimed would occur.

In that case they said they would go bankrupt. We took every action we could to enforce the provisions of that contract both in the interests of the procurement process and the obligations incurred by both parties in entering into that contract freely and from the standpoint of the Navy which needed those aircraft.

I personally saw no alternative to obtaining F–14's from another source. The final result of that as I recall is that Grumman's set worth dropped from $200 million to $67 million and they were in severe financial straits with respect to their ability to continue operations because of lack of cash.

In the instance here, I have very little data with respect to the financial condition and cash position of at least Newport News. I am aware of the profit statements that have recently been published.

Nothing I have seen suggests anywhere near the same degree of financial impairment whatsoever.

Representative PIKE. There isn't any question in any of your minds, is there, as to the ability of these corporations to continue to produce these ships, financial ability, is there?

Admiral GOODING. Personally I don't know that much about the financial health of the corporations themselves because the Department of Defense does not have access to corporate books.

Maybe one of these two gentlemen knows more about than I.

Representative PIKE. In the case of Grumman, didn't the DOD get access to the books?

Admiral EVANS. Yes, sir. In that case Grumman had no external lines of credit. I don't think that is applicable here.

PROBLEM OF PRECEDENT

Representative PIKE. Thank you. I am through, Senator. I just wanted to comment that Secretary Clements made a rather strong pitch for the equity of the situation. I think we are all interested in equity. But I really don't find any equity in treating some corporations based soley on the equity of a contract and the amount of their loss and others driving right to the wall and into something approaching bankruptcy and insolvency.

I think what we are doing here creates a precedent which will haunt us for a long time.

DIFFICULTY OF CLAIMS EVALUATION

Senator PROXMIRE. Thank you, very, very much, Congressman Pike. Admiral Gooding, you stated shipbuilding claims have been grossly exaggerated and poorly supported. It appears some shipbuilders worked backwards, first determining how much money they want from the Government and thinking up reasons why they can allege the Government owes them that much.

Doesn't that make the Navy's claim evaluation job unnecessarily difficult?

Admiral GOODING. It certainly does not help it.

Senator PROXMIRE. You also said none of the pending claims have been fully audited. The General Dynamics has not been filed much less audited. The Litton claim is not fully documented.

It seems impossible under these circumstances to move any faster to settle these claims. It is unfair to blame the Navy for lack of processes.

CLAIMS CAN BE PROCESSED QUICKER

Admiral GOODING. I believe it is possible to process claims quicker than we have in the past.

Senator PROXMIRE. Claims generally, yes. But I am speaking of the ones that have come in in the last few months. To check them out—this is just the surface.

Admiral GOODING. Despite that, I still think it is possible we might be able to process those very claims in less than—less time than we have in the past.

Senator PROXMIRE. Could they be processed and paid off by now?

Admiral GOODING. Oh, no. The reason is that over the past, say, 4 years, we have been evolving into the current method of processing claims and we now know what it is. We had some growing pains, some learning pains, when we started this out but the process is pretty well clear cut. There may indeed be places where we can save a little time without reducing the rigor of the settlement.

Senator PROXMIRE. How long should it reasonably take to process claims of this size, 12 months, 18 months?

Admiral GOODING. Somewhere in there, 12 to 18 months.

Senator PROXMIRE. Admiral Evans, there has been testimony before this committee regarding several specific elements contained in the Newport News claim which I consider to be representative of attempts on Newport News to obtain payment from the Government on specious grounds.

Can you give us your opinion of the Newport News claim of $97 million for deterioration of labor which the company bases on Parkinson's law and $32 million for Navy's recruiting practices?

CGN 38–40 CLAIM

Admiral EVANS. I believe you are referring to the claim on the board No. 2 there, that is the CGN 38 to 40. That is the only claim I have read entirely of this library you have here.

I did read that claim. I did so not from the viewpoint of entering into settlements negotiations with it. However, from the standpoint of my responsibilities with respect to the CGN–41 and my responsibilities with the Navy Department under that court order, I read that claim last November. So I am talking from memory. My dominant impression of that 38–40 claim is that it was a mass of facts, some of which appeared possible and relevant, some of which I had difficulty seeing any relevancy in.

However, I found no connection in the claim itself between the recitation of facts and the consequences that the company alleged flowed from the facts. What that meant to me was that in order to address that claim in a serious fashion, it would have meant extensive factfinding, probing, development of additional information on the part of the Navy from the company in the process of doing it.

I did find or at least draw the conclusion from the reading that the allegations in the claim did not relate to the position that the Navy or Newport News was in on the CGN–41 itself, which was my main purpose.

With respect to the recruiting practices or with respect to another element of the claim, it spoke to 2,900 inspectors. I would not have spent much time seriously entertaining that at all, although that must be read if that is what is submitted.

That claim to my knowledge when I left the Navy had neither been certified nor was there an affidavit submitted in connection with that claim, although it had been requested.

Senator PROXMIRE. Admiral Woodfin, can you give us your opinion of the Newport News claim of $97 million for deterioration of labor which the company bases on Parkinson's law?

Admiral WOODFIN. I have no knowledge of that. It was submitted after my retirement from the Navy.

PARKINSON'S LAW

Senator PROXMIRE. Do you think Parkinson's law is a serious attempt—it would seem to me that anybody who asked for $97 million is pretty serious. But when they base it on Parkinson's law, Parkinson I am sure would not expect this to be done.

Admiral WOODFIN. I can't believe that the claim as asserted was anything more than an attempt to open negotiations, Senator. I would think that there must be some basis for some claim against the Navy in overrun part of which the Navy may bear responsibility. But I think in some cases the contractors were pressed for time to get a claim on the record.

CLAIMS AND CORPORATE BALANCE SHEET

Then I think they expect to better develop the claim related to the facts that occurred. I think they are afraid to not assert a claim. You must remember in some cases had Newport News not asserted a claim, they could not have presented a positive balance sheet figure for the Newport News shipbuilding. How could you submit a positive profit position if you forecasted a loss?

Senator PROXMIRE. There sounds like a financial technique for their stockholders.

Admiral WOODFIN. In many cases, claims are asserted as contingent assets until they can resolve reimbursement. Shipbuilders assert claims to keep their balance sheet in good condition.

This is understandable if there is reasonable hope of getting reimbursement.

Senator PROXMIRE. I would think the SEC would have an interest in this. I think we should call that to their attention. If they do that kind of thing, it seems like an intentional misstatement.

Admiral WOODFIN. I don't see this is a likelihood. The accountants are quite interested in this area. You will find these claims either thoroughly footnoted or thoroughly discussed as a questionable asset by the public accountants involved.

Senator PROXMIRE. That fact should tell us something about the willingness to settle these claims without an audit, without a thorough investigation, without some kind of solid documentation. Admiral Woodfin, Admiral Rickover testified that the primary reason for the delay on Newport News was the company's inability to obtain the manpower it needed to adequately perform the work.

You were involved with shipbuilding contracts during the period when Newport News was trying to build up its work force.

Do you agree with Admiral Rickover's assessment?

NEWPORT NEWS LABOR PROBLEMS

Admiral WOODFIN. I think Newport News encountered two problems. First was the difficulty in obtaining labor which does not seem to be claimable since Newport News guaranteed to provide the labor. Second, Newport News did encounter productivity problems probably more severe than the labor work force recruiting problem.

Newport News was faced with a less skilled labor mix than they anticipated and they encountered difficulty with the plain fact that they had a greater labor turnover than had been anticipated.

Senator PROXMIRE. You said productivity. That is another way of saying incompetent labor.

Admiral WOODFIN. It was not what Newport News expected.

Senator PROXMIRE. Admiral Evans.

Admiral EVANS. I have seen data where Newport News was trying to build its labor force up to something like 30,000. There is also data with respect to turnover of employees which is considerably higher than they had previously experienced. As I believe came out in the previous testimony this morning, there is evidence of reduction of manning of certain Navy ships and increasing of manning in commercial ships.

The yard as a whole is never able to reach the peak force that it indicated to the Navy it was its intention to do at the time it entered into some of these contracts.

Senator PROXMIRE. Is that the Navy's fault or Newport News' fault?

Admiral EVANS. I don't see how it was the Navy's fault. We did not make the plans. Nor did we suggest the workloads, particularly in commercial construction. To the contrary. There was concern expressed as to the ability of them to do both at the same time.

CLAIMS TACTICS

Senator PROXMIRE. Let me come to a question that I know is difficult for you gentlemen to handle, but I ask you to do your best with it. The shipyards and Newport News in particular have been successful in getting senior defense officials to listen to their complaints and to take extraordinary action by appealing directly to these senior officials.

In your opinion what effect do these tactics have on the Navy's ability to enforce its contracts and to deal successfully with shipbuilders? Admiral Woodfin?

Admiral WOODFIN. Well, I don't like to skip that one but Admiral Gooding is far more qualified to talk about his ability to deal with

them right now. Any time that contracting matters are escalated to a higher level than the contracting officer, whether it is Admiral Michaelis, the Secretary of the Navy, or the Secretary of Defense, it makes Admiral Gooding's job far more difficult. I think as his former assistant I would have preferred to settle these matters myself at my level if at all possible.

I think he would prefer that, too. But I would not speak for him.

Admiral GOODING. I do not disagree with that statement, sir.

Senator PROXMIRE. Admiral Evans.

Admiral EVANS. I certainly don't disagree with that statement, either.

Senator PROXMIRE. What you are saying as I understand it then—and correct me if I am wrong—is that if the contracting officers are going to be able to maintain their ability to deal effectively and hold down costs and to have their position respected and their negotiating positions strong, they suffer greatly when the shipbuilders are able to go over their heads and get some kind of reversal.

This not only affects the instant dispute, whatever it is, but it affects the relations of the Navy contracting officer with that particular contract probably throughout and very likely on other contracts.

Is that correct?

CONTRACT CHANGES

Admiral WOODFIN. That is true. I am particularly interested in the negotiation of contract changes between the parties. I think it would be highly beneficial if both parties could agree on changes as they occur and price them as they occur. I think one of the big problems hehre is that the changes are sometimes understood by both parties but the shipbuilders are not sure what the ultimate cost is going to be so they hold back change pricing.

That in itself contributes to these big claims.

Senator PROXMIRE. There is a rollcall and the hour is late. You gentlemen have been extremely helpful and patient. Let me ask Admiral Michaelis who is present if he would respond to this. Admiral Michaelis, you have been present throughout the testimony of Admirals Gooding, Woodfin, and Evans. Would you like to comment on any of their testimony either to agree or disagree?

SHIPBUILDERS' CONTRACTS WITH HIGH OFFICIALS

Admiral MICHAELIS. Well, I don't have the direct experience in handling contracts that these gentlemen have had. I have a personal feeling that we must be quite definitive when we speak of the actions or the visitations of the shipbuilders and their relationship to higher authority. I think they have certainly a proper right that they exercise to seek out members higher in the Government.

When this has happened, I have been kept thoroughly informed of those visits when it had anything to do with the——

Senator PROXMIRE. Let me interrupt. Almost every Senator has been involved in a similar experience when he is called on by constituents—what I would—what I am concerned about is the action that would be taken by the senior official.

When people appeal to them, they should say this belongs to Admiral Jones or Smith or whoever is in charge and you will have to deal with him.

If on review you find that there is a clear injustice of some kind done, an irregularity, a prejudice or some situation that has to be corrected, then you step in. But short of that it would seem that you disrupt the situation badly if you take over negotiations to the extent that has been done in this case.

Admiral MICHAELIS. Well, I certainly feel—I am dividing this into two parts really. I certainly feel that any time that there has been a visit that has involved a contractual matter that has got to be taken up in either the air area or the ships area, I have received information on that pretty quickly.

It has come down from such personages as the Secretary of the Navy. I apparently am not tuned to the kind of a problem that is being discussed here because I have not had this kind of a problem, sir.

Now with regard to the 85–804, and I think you are referring to that——

Senator PROXMIRE. Let me just say that you are not responsible, as you said to begin with, for these particular specific programs the way these gentlemen have been. Is that correct?

Admiral MICHAELIS. That is correct. They do the contracting business. They do the contracting.

Senator PROXMIRE. It is understandable that you have not had this kind of difficult situation of interference by the higher authorities.

Admiral MICHAELIS. I think that is true. But a great part of it passes through me, sir. I have the responsibility for naval material. Whatever it may be I have an oversight position with regard to its contracts that are being worked.

Senator PROXMIRE. Isn't it possible that appeals to the higher ups make it difficult for men like these to do—who do have these responsibilities?

Mr. BOWERS. There are not cases where these——

Senator PROXMIRE. What is your name, sir?

Mr. BOWERS. Senator, my name is Jack L. Bowers, and I am Assistant Secretary of the Navy for Installations and Logistics.

We do not have these instances when we are progressing satisfactorily. They only occur when we are bogged down and not making the necessary progress.

Now in the specific case that we are talking about here, because of the volumination of the problems at the Deputy Secretary of Defense level, we asked the Navy to come forward with recommendations for solutions.

Senator PROXMIRE. Let me interrupt to say in this particular case, they had just filed the claims. There is no evidence of a bottleneck. It has been testified here that it would take a year or 18 months to settle these.

Mr. BOWERS. We were talking about problems of long standing and even though these had been submitted recently they put us on notice a year and a half ago that they were coming.

Let me go on. The Navy was asked to come forward to the Deputy Secretary with potential solutions and these solutions were worked

out at the contracting officer level. There were several alternatives. We took those to Secretary Clements and he chose from among our recommendations and this was accomplished at the proper working level.

He chose one of them. We went forward with it.

Senator PROXMIRE. Well, gentlemen, I want to thank all of you very, very much. This has been an extremely helpful hearing. I hope on the basis of the fine record you have made here, I hope we can get action.

I hope we will get ships and save the taxpayers money and provide for the responsible cooperation we have had in the past. Thank you very much.

[Whereupon, at 12:45 p.m., the subcommittee adjourned, subject to the call of the Chair.]

ECONOMICS OF DEFENSE PROCUREMENT: SHIPPING CLAIMS

THURSDAY, DECEMBER 29, 1977

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 9:35 a.m., in room 5302, Dirksen Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senator Proxmire.

Also present: Richard F. Kaufman, general counsel; and Mark Borchelt, administrative assistant.

OPENING STATEMENT OF SENATOR PROXMIRE, CHAIRMAN

Senator PROXMIRE. The subcommittee will come to order.

This morning the subcommittee is conducting hearings—this afternoon, too, I might say—on shipbuilding claims against the Navy. This is a matter which has become very troublesome and, I might add, extremely expensive in recent years.

Shipbuilding claims against the Navy are a chronic problem, but it may be about to become acute. The current backlog is about $2.7 billion. To put that figure in perspective, in 1967 claims were equal to less than 1 percent of the Navy's shipbuilding program. The present amount of pending claims is equal to about 50 percent of the Navy's 1977 shipbuilding program.

Despite arguments by the Navy that progress is being made in the handling of claims, the total grows year by year. In 1967 there were less than $100 million in claims pending. In 1969, when the subcommittee held its first hearing on this subject, the figure was about $500 million, and now I say it is 5 times that size, 27 times as big as it was a brief 10 years ago.

The problem is not that there is a large backlog in the usual sense. The bulk of the present claims were filed recently. The Navy has succeeded in settling a large number of claims over the years.

The problem is that the claims are getting larger and larger and the suspicion grows that they are nothing more than corporate bailouts.

The Navy's own claims settlement process bears all the characteristics of a fast claims breeder reactor. The process seems to create more claims than it consumes. In addition, there have been charges of fraud with respect to several claims.

The present situation cannot continue indefinitely. The three largest shipbuilders are engaged in heated claims disputes with the Navy. Two companies, Litton and Tenneco, have threatened to stop work on Navy ships unless their claims were settled to their satisfaction.

The shipbuilding industry is an important part of the national economy, employing about 60,000 persons. It is vital to the national defense effort. It seems self-evident that the claims problem should not be allowed to fester and grow worse.

I have high hopes that the new administration, unbound by the abortive efforts of the past, will be able to bring about a solution to this problem in a way that is equitable to the shipbuilders and the taxpayers.

Today's hearing, which resumes an inquiry that was begun in 1976, is intended to review the progress that has been made and to gather information that may be of use to others in Congress.

Our first witness this morning is Adm. H. G. Rickover, who requires no introduction. I am very pleased and honored to welcome Admiral Rickover before this subcommittee. He has testified to this subcommittee and other committees on numerous occasions and he has earned the respect and the gratitude of the entire Congress. We have all learned to rely on the admiral for truthful, incisive comments and his record for accuracy, I think, is unequaled. He has been proven right time and time again and he has been trying to bring the problem of shipbuilding claims to our attention for a number of years.

Admiral, you may proceed with your statement and I would like to ask questions as you go along, if that is all right. Also, after you complete your testimony, you may add additional material and expand your remarks for the record.

STATEMENT OF ADM. H. G. RICKOVER, DEPUTY COMMANDER, NUCLEAR PROPULSION DIRECTORATE, NAVAL SEA SYSTEMS COMMAND, DEPARTMENT OF THE NAVY, ACCOMPANIED BY DAVID T. LEIGHTON, PROGRAM MANAGER, SURFACE SHIP NUCLEAR PROPULSION; AND THOMAS L. FOSTER, SPECIAL ASSISTANT FOR FISCAL MATTERS

Admiral RICKOVER. Thank you, Mr. Chairman.

You have requested that I testify about shipbuilding claims and possible violations of fraud or false claims statutes contained in claims against the Navy. The views I express are my own and not necessarily those of the Navy or any of my superiors. I note in the newspapers that you have been mixed up in garbage in New York City and I think this will give you a further education in garbage—the garbage with which the U.S. Government must deal. I consider much of the claims problem to be garbage, as I will explain later on.

Senator PROXMIRE. This garbage may not have the same quality as the garbage I was dealing in yesterday——

Admiral RICKOVER. Thank you, sir.

Senator PROXMIRE [continuing]. Or the same fragrance as I was working with yesterday.

Admiral RICKOVER. Well, I think you are young enough to have a keen sense of smell. I think you would find it worse because ordinary

garbage can be cleared away instantly, but this type of garbage has been festering for a long time and it is important to find out why; this is what I believe to be the object of this testimony. Is that correct, sir?

Senator PROXMIRE. Yes, sir.

Admiral RICKOVER. I am going to skip portions of my prepared statement. It is too long for presentation here, and you have it for the record so I have reduced it by about one-third in order to save time.

Senator PROXMIRE. Fine.

Admiral RICKOVER. May I ask, Mr. Chairman, whether my voice can be heard?

Senator PROXMIRE. Yes, fine.

Admiral RICKOVER. The March 1969 Todd shipbuilding claims settlement was the first involving large so-called omnibus shipbuilding claims. Such claims, sometimes titled "total cost" claims, do not show a cause and effect relationship between alleged government-responsible actions and the amount claimed. In essence, a shipbuilder, when faced with a projected cost overrun, makes a large claim based on general allegations that the Government is at fault and, therefore, should reimburse the shipbuilder for all his costs plus his desired profit, regardless of his own performance.

These large shipbuilding claims seem to be "built backware." That is, the shipbuilder estimates how much he wants and then assigns people to make up a claim that will yield that amount. Here is an extract from a report of one shipbuilder's internal company meeting in which his people were instructed how to prepare a large shipbuilding claim:

> Division Planning will provide an estimate of man-hours to complete the contract. This estimate will be compared with the original of total manufacturing man-hours to do the contract, and the difference will be justified in a saleable manner.
>
> * * * * * * *

and I use the X because I don't wish to identify the person—

> Mr. X stated that [the company] would have to use that information and data which would sell. Any data which would not sell would have to be omitted.

If claims prepared in this manner are paid independent of their legal merits, the effect is to convert fixed-price contracts into cost-plus contracts. That is a primary reason we now have these claims. You said your object was to find out the causes for the claims problem, and what to do about it.

Here, is one clue right now: The lack of integrity in submission of claims.

The Todd claims exceeded $114 million and were settled for $96.5 million, about 84 cents on the dollar. In an April 1971 report the General Accounting Office was harshly critical of the Todd settlement.

Heartened by the greatly inflated Todd settlement, many private shipbuilders and their claims lawyers seized upon vague, unsubstantiated claims as a means of getting well on unprofitable contracts. As a result, the Navy was inundated with omnibus shipbuilding claims. In 1968, outstanding claims totaled $66 million; in 1971, $605 million; in 1974, $1.3 billion; today, $2.7 billion.

In their campaign to have their claims paid, shipbuilders place the blame entirely on the Government. They frequently attribute their problems to inflation, faulty defense procurement policies, improper administration of shipbuilding contracts by the Navy, and a host of other reasons, all of which they contend are beyond their control. Shipbuilder inefficiencies, mismanagement, low productivity, and other problems are rarely, if ever, acknowledged in the claims or in public announcements by company officials.

Shipbuilders should make a fair profit if their performance warrants it. That is the basis on which fixed-price incentive-fee ship construction contracts are negotiated. But in my opinion it is wrong for corporate officials to use claims, public relations, and political clout to pass on to the Government the results of their own poor management.

I have testified repeatedly about deficiencies in nearly all aspects of shipyard operations: Ineffective cost controls and cost reporting systems; costs not related to progress in a manner that identifies potential overruns in time to take corrective action; subcontract procurements not managed in a businesslike manner; excessive sole-source subcontract procurements; superficial negotiations of subcontracts; poor productivity, including widespread idleness and loafing; inadequate material controls; overtime not properly controlled; ineffective internal audit systems; and excessive overhead costs.

In the current environment, however, it is apparently easier to let costs come out where they will and submit claims than it is to establish better controls over the work.

Senator PROXMIRE. Admiral, as I understand the thesis that you have here, it is that we don't really have the kind of incentive for efficiency we usually can expect where the one way that a contractor in private contracts or working for the Government can do better to make a profit is to be more efficient and hold down costs. As I understand it, the shipbuilders have learned it is just as profitable to be inefficient as to be efficient, so long as the Government makes generous settlements of inflated and largely worthless claims.

Is that an accurate statement of your views?

Admiral RICKOVER. In my view, it is to their advantage to be inefficient in today's climate. This is where the Government itself is promoting business inefficiency.

Senator PROXMIRE. How is it more to their advantage to be inefficient?

Admiral RICKOVER. Because if you do a proper job, you are not going to make too high a profit on the shipbuilding contract. A shipbuilder can make far more profits by submitting claims even if the claims are completely unjustified.

Suppose a group of Government claims analysts find that the actual value of a claim is $1 million. They will also take two other factors into account. They include what is called litigative cost—an estimated cost to the Government to litigate the claims before all the various tribunals.

Then they take the second factor into account, litigative risk; which is the chance of losing in court. Thus the offer made by the Government is not the actual value of the claim, but the value plus all these other factors.

So a $2 or $3 million claim value can result in a settlement offer by the Government of $19 or $20 million. The actual settlements also tend to be higher than the claim's true worth. For example, the first settlement made by the present board which is considering Newport News and Electric Boat claims, offered Newport News a certain amount which included these factors, and the settlement that resulted in paying all Newport News' costs plus a profit.

There appears to be no chance of losing. In fact, I can tell you from my experience with claims not only in the shipbuilding industry, but all over, it actually pays a man to submit a claim, even if he has no case whatsoever, because he will get some settlement and that settlement will more than take care of his expenses. It may take awhile for your claim to be processed, analyzed, and settled, but it is a way you could make money.

Senator PROXMIRE. Before you finish with that point, Admiral, I caught at the beginning of your remarks an implication that you might be saying that profits could be achieved without claims may be inadequate; at least the shipbuilding business, you said, is not a high-profit business. Did you imply that maybe we should have a system that permits higher profits for those who perform their contract on time and brought it in on schedule without claims?

Admiral RICKOVER. Mr. Chairman, shipbuilding contracts have to be mutually acceptable. We are not dealing with innocent high school girls here. We are dealing with large conglomerates who know exactly what they are doing. So they cannot say, as they attempt to all the time, that they were inveigled by somebody to take a contract.

Imagine a company like Tenneco, one of the largest conglomerates in this country, being inveigled to take an unfair contract. Shipbuilding contracts already do provide—through cost-sharing provisions—for rewarding efficient shipbuilders. More efficient shipbuilders thus tend to make more profit. These cost-sharing provisions are in existing Navy shipbuilding contracts and have been in existence for years.

Does that answer your question, sir?

Senator PROXMIRE. Yes, and with regard to the amount of them and the handling of unsubstantiated shipbuilding claims, has there been any improvement since your 1976 appearance before this subcommittee, just a year ago?

Admiral RICKOVER. Yes, there has been some improvement in this sense.

One time I suggested to Mr. Clements, and he adopted the idea, of setting up a claims board with whom no one—including myself—should interfere. Mr. Clements set up what is known as the Manganaro Board. That Board has been considering the Newport News and Electric Boat claims.

After considerable study they have determined the value of several of the claims and proposed settlements. The first offer was on the Newport News CGN 36/37 claims and was ultimately accepted by Newport News, Newport News made a profit on that contract.

The next settlement offer—I am not familiar with the terms—was proposed by the board several months ago to Newport News. To my knowledge, the board has not yet received an answer.

The Navy Claims Settlement Board, in my opinion, from the results they have gotten and the caliber of the people on it, is acting in a very honorable and professional manner.

Now, I may be getting ahead of my self, but just 2 or 3 weeks ago the Assistant Secretary of the Navy in charge for all shipbuilding matters ordered the Board to cease considering the Electric Boat claim when the Board was within a few days of finding out how much the claim was truly worth.

Look at the situation Congress is going to be placed in by that action. The Navy may come up with a proposition to provide extra contractual relief using the authority of Public Law 85–804; and here was a case where it was possible, with a few more days of work, to find out what that claim was worth. Yet just at that point, the Board was ordered not to pursue it any more.

Sir, do you understand the significance of what I am saying? I am saying this: Year after year, since these large claims have started, various officials in the Navy and the Defense Department have used their own magic in trying to settle claims and they have never been able to settle them.

Senator PROXMIRE. But you are saying they now seemed to be making progress and they set up the Board and the Board may be now undermined and they may be worse off than before?

Admiral RICKOVER. That's right, and the origin of that Board was based on the premise that nobody should interfere with them. Now, an official of the Navy is stopping the Board from finding out the claim's actual worth after it had been considering this claim for many months; and had just a few days to go.

I don't know what that means to you, sir. You will have to figure that out for yourself, but it certainly is a question worth asking.

Senator PROXMIRE. The head of that Board will be before us. He will follow you as a witness.

Admiral RICKOVER. The official set up another board of people who apparently have had no considerable experience with claims and he has announced that the claims will have to be settled quickly. How is he going to settle the claims quickly with new people when the Manganaro Board staffed with competent people took half a year to a year to analyze a claim? What kind of a magic is he going to use?

There is only one magic, Mr. Chairman, and I don't have to mention it, a giveaway. That is all you can do under the circumstances.

Senator PROXMIRE. OK, go right ahead.

Admiral RICKOVER. If the Navy is not interested in finding what the legal entitlement is, then the only way to reach a settlement position is through judgment. I certainly would prefer to trust the judgment of a professional, experienced board more than I would civilian superiors who tend to be imbued with concepts of big business. Whether they like it or not, or whether they admit it or not, they act like Charlie Wilson of General Motors when he said, "What is good for General Motors is good for the United States." He was correct from his standpoint. He was an honorable man and he had been in General Motors a good many years, and he had learned all the business concepts and how to do business.

But, the U.S. Government is intended for the people of the United States and not for one particular rich segment.

Senator PROXMIRE. Go right ahead, sir.

Admiral RICKOVER. Have I answered your questions?

Senator PROXMIRE. Yes, sir, you certainly have.

Admiral RICKOVER. Sometimes the impetus for claims comes from firms that specialize in this work. In fact, a whole claims industry is sprouting. This again is the answer to your question as to what has caused this claims situation.

Here is a promotional letter one company I deal with received from one of these claims specialists:

> Dear Sir: We are specialists in all phases of Government and commercial contracting. Our specialty is the ability to obtain additional funds from fixed-price customers.

Mark that, Mr. Chairman. This is typical of these firms.

> This is done via the constructive change basis, which means that the entire transaction is evaluated from the date of the order or contract to the date of actual delivery. All the extras, such as extra work performance, or delays, or interruptions are transposed into dollars and thus presented to the customer for reimbursement.
>
> This essentially is collecting for delivering something beyond the bargain.

And I repeat, Mr. Chairman:

> This essentially is collecting for delivering something beyond the bargain. The obvious changes are easy enough, but the subtle or hidden changes that are not apparent, either to buyer or seller, are the ones that we can transpose into a dollar recovery.
>
> Our credentials are available for your review, and our references range from the smallest companies to those appearing on the Fortune 500. A meeting may be beneficial.

If we create a business climate in this country where this is the way our capitalist system works, then the capitalists who are profiting from it are wrecking the only reason for their existence.

Really, I am a great capitalist. I believe in the capitalist system and I resent very much those individuals in it who, in order to acquire even more wealth than they have, subordinate the entire legal and perhaps moral system of this country.

If we keep on with morality of this kind, the future will be bleak for the United States.

Senator PROXMIRE. Admiral, before you go ahead, can you explain what you mean by "serious productivity problems in the Newport News and Electric Boat shipyards"? You refer to that in your prepared statement. Is it a matter of poor management, undercapitalization, obsolete equipment, or poorly trained work force or some combination of those factors?

Admiral RICKOVER. Let me tell you specifically about Electric Boat just from what I have been reading in the newspapers.

The General Dynamics Co. put in a new manager at Electric Boat. One of the first acts of the new manager was to lay off 3,000 people and to indicate there might be more. He found lots of loafing, idleness, people walking around the yard doing nothing, and he is trying to do something about it.

Now, that productivity situation was entirely within the control and responsibility of General Dynamics. General Dynamics knew this situation was going on for a long time but took no action. So what are we doing when we award one of these contracts to a large corporation? What is the point of getting the corporation to build ships?

Senator PROXMIRE. Could I ask, Admiral, because I think the newspaper observations are useful, but have you or your staff observed these conditions at any of the Electric Boat yards, personally and directly?

Admiral RICKOVER. Yes, sir, we have not only observed it, but previously have reported it to the company. I have a team inspect each yard we do business with about once every 2 years. This team sends a number of people, about seven or eight, to each such shipyard to spend about a week at each place and issue a report. We give a copy of these reports to both private and public yards.

Senator PROXMIRE. Would you give for the record specific examples for each of the yards? I don't want to take the time now.

Admiral RICKOVER. I am sure, sir. There is much confidential data in them. I would rather not provide them. Shipyards have copies. They were furnished these reports.

Senator PROXMIRE. Give us what documentation you have. It is a very serious charge and I think it would be helpful. You are an expert in this. It is not a matter of a newspaper reporter observing that people are idle, but you know what you are doing when you say this, your staff does. You know what wasteful idleness really means in shipbuilding, so anything you give us to give us a better understanding would be helpful.

Admiral RICKOVER. Sir, I cannot make the decision to give you these reports. They are official Navy reports and if you desire them, I suggest you ask the Navy Department and let them decide.

Senator PROXMIRE. Supposing you do this: Could you arrange to have access by the GAO to these reports so they can review the data and give us a report so we have some objective study of the specific conditions?

Admiral RICKOVER. Again, sir, I would suggest that if you care to follow that line, that you ask the Navy Department. It is not up to me to do that, sir.

Senator PROXMIRE. All right, go right ahead.

Admiral RICKOVER. I will continue from my prepared statement.

The letter I read is from a smalltime operator. The Washington law firms that specialize in claims against the Government are more sophisticated in their marketing efforts. They make companies aware of their services through seminars and publications on Government contracts and claims. At billing rates of up to $100 or more an hour, claims lawyers will develop and promote legal theories to blame the Government for any cost overruns their client incurs, or to contest the validity of a contract.

Sir, at this point I would like to tell you some experience I have had with a claims law firm. Would you like to hear it? My personal experience?

Senator PROXMIRE. Yes, go ahead.

Admiral RICKOVER. A law firm, representing a corporation, has been taking my deposition this month. I can't remember the name of the law firm but I am sure one of their representatives is here, busy taking notes with which to question me during the deposition. I have already attended nine of these deposition taking sessions and two more are scheduled. The lawyers have already taken up 35 hours of my time. The attempt is being made to show that I am responsible for the entire claims situation.

That is analogous to proving that the devil is Christ. It goes along that line.

Before the deposition I though I knew something about law, I had studied various aspects of law in my lifetime. I studied about Roman law and the natural law and I know that Louisiana has a code of laws because it was originally French. I have read about the lives of various lawyers.

But let me tell you this, Mr. Chairman: One has to experience facing up to eight lawyers at a time while they pass notes and whisper among each other to really understand them. I have thought about this a great deal. When I came back to the deposition sessions after Christmas, I said to these lawyers, "I suppose some of you were at church celebrating the Nativity of the Lord Jesus Christ, and I am sure you heard in one form or another that all men should follow in His footsteps." This is on the record what I am telling you.

It didn't affect anyone. They kept right on with the harassment, with their attempts at entrapment. It is a game. Each one of them is probably getting paid $100 an hour and the longer they prolong the harassment, the more money they make. It seems to me if they ever had any sense of obligation to the community and particularly to the Government, it is gone.

Not all lawyers are that way, but I think it is really the fault of the law schools which are training people to be sharp. I took the trouble to read into the record of the depositions the American Bar Association rules on the ethics of lawyers.

I will quote from them for you. This is not exactly verbatim, but it has the ideas.

"Lawyers should maintain the highest standards of ethical conduct." Mind you, it is not me saying this, but the ABA. Having already dealt with the American Bar Association, I have recommended they change their name to ABPA, the American Bar Protective Association.

A lawyer should refrain from all legal and morally reprehensible conduct. A lawyer may continue in his representation of his client even though his client is elected to pusue a course of conduct contrary to the advice of the lawyer so long as he does not thereby knowingly assist the client to engage in illegal conduct or to take a frivolous legal position.

It is the duty of a lawyer to represent his client with zeal which does not militate against his concurrent obligation to treat with consideration all persons involved in the legal process and to avoid the infliction of needless harm.

A lawyer should not ask a witness a question solely for the purpose of harassing or embarrassing him. Every lawyer owes a solemn duty—I am sure there are some lawyers at this hearing, but I am also sure my reading this will have absolutely no effect on some of them—every lawyer owes a solemn duty to act as a member of a learned profession, to conduct himself so as to reflect credit on the legal profession and to inspire confidence, respect, and trust of his clients and of the public.

That is the end of the American Bar Association rule.

I added, "What bothers me most about this is not your harassment," and this is in the deposition record, "but we have intelligent people here with good minds who have been trained by society and now you are really acting against society. To me this is a form of intellectual masturbation."

Even that drew no reaction. Even when I told them, you know, "You can fool people on Earth, but if you do believe in God, do you think you are fooling the Lord Jesus Christ?"

That got no response.

Senator PROXMIRE. Let me ask you this: You say so far this month you have been subjected to 35 hours of interrogation——

Admiral RICKOVER. Thirty-five hours. Let me add to that.

Senator PROXMIRE [continuing]. For the CGN case?

Admiral RICKOVER. Yes, sir, the CGN-41 case. The other day I asked when would this deposition be over, by Fourth of July? And he said, "Yes." I said, "How about Declaration Day?" I could not get a firm answer.

So here I am. I have a large job to do and these sessions go on 4 hours at a time. I am working 12 to 14 hours a day, and I am subjected to this harassment, all so that some large corporation can make more money and the way to do it is to defame the witness. Their attempt is to prove that I am entirely responsible——

Senator PROXMIRE. So there are eight lawyers?

Admiral RICKOVER. Up to eight.

Senator PROXMIRE. And they question you all at one time?

Admiral RICKOVER. Yes, sir.

Senator PROXMIRE. Who represents you as your attorney?

Admiral RICKOVER. The Department of Justice represents me.

Senator PROXMIRE. In your view do they do an adequate job of representation?

Admiral RICKOVER. The Department of Justice lawyer is doing an outstanding job. But even the Department of Justice doesn't have anywhere near the people they need to fight a burgeoning crisis of litigation. The Chief Justice of the United States, himself, said essentially what I am saying.

Senator PROXMIRE. Let's see if I understand what you feel is the purpose of this.

Do you feel that the depositions are a form of harassment intended to intimidate you and by intimidating you by example, keep other Government officials from speaking out against inflated and possible fraudulent claims and other abuses?

Admiral RICKOVER. Absolutely, sir, absolutely. I have almost no private time of my own any more or I get very little sleep and I have to go to these sessions and I have to be as respectful as I can to what I consider ghouls.

Senator PROXMIRE. So this is a way of shutting you up so you don't——

Admiral RICKOVER. Yes, sir, they are teaching a good object lesson for anyone else in Government service. If you are going to take us on this is what you are going to be subjected to. Yes, sir, absolutely. Whether you can do anything about it or not, I don't know.

You have become somewhat expert in garbage and maybe your knowledge will help you.

Senator PROXMIRE. Go right ahead, sir.

Admiral RICKOVER. I will continue now, sir.

The strength of the claims lawyers lies in their ability to delay and harass the Government. They well know that with the high rate of personnel turnover in Government time works to their advantage.

They also know that the Government cannot assign anywhere near the equivalent resources to the case and that eventually they can wear the Government down.

Lawyers are supposed to be officers of the court charged with responsibility for searching out the truth. My experience has been that most claims lawyers try to hide or distort the truth.

We really need a Diogenes to try to find what I consider an honest claims lawyer.

The ultimate leverage these shipbuilders have is their control over the facilities needed to build ships the Navy vitally needs. Because partially completed ships cannot be transferred from one shipyard to another, they are sometimes held hostage in contract disputes. Both Litton and Newport News have threatened work stoppages, thus forcing the Navy into court in order to require them to continue work. But Federal judges are not able to hear complex shipbuilding contract disputes and render judgments in a short time. In the two cases mentioned, the Navy was ordered to continue to pay the contractor's incurred costs pending resolution of the dispute. This is what both shipbuilders wanted.

Within the Defense Department, contract disputes have been made more difficult by the involvement of senior officials in matters that their subordinates should be handling. Many large and politically influential Defense contractors have ready access to Defense Department and Navy officials throughout the chain of command. They use these contacts to their advantage.

I suspect that most contractor officials prefer to deal with senior Defense officials because they are not as familiar with contractual details as the working level officials and, therefore, tend to be more sympathetic to contractor complaints.

Senator PROXMIRE. Apropos dealing with senior officials, you get to a level of seniority among officials where they are political appointees. I don't mean that in any perverse sense. I mean that they are in a position to carry out the policies of the President of the United States. They are appointed by the President. They are a part of the new administration.

In your opinion is there a greater or a lesser tendency under the new administration for large and influential Defense contractors to have access to the Pentagon and Navy high-level officials?

Admiral RICKOVER. Probably not quite as much, sir. From the rumors I hear, it still obtains though.

Senator PROXMIRE. Do top contractor officials still deal directly with the top Navy officials to settle problems such as claims and thereby undermine the efforts of middle-level procurement officials who are responsible for these problems?

Admiral RICKOVER. Not only Navy officials, but Department of Defense officials.

Senator PROXMIRE. So you say a little less, but it is still there?

Admiral RICKOVER. It is still there, sir.

Senator PROXMIRE. And still a major problem and roughly of the same magnitude?

Admiral RICKOVER. When somebody gets one of these big jobs in Government, all of a sudden he is in the news, involving in spending billions of dollars and then—this is true of many people—he becomes a judge. He sees an onerous problem and he wants to get it settled.

That's no problem. I could have settled these claims as far as I am concerned, if any party had to do it—just give them the money they want.

That is what apparently happened in the Todd claim settlement Some senior Defense officials apparently do not care about strict legal entitlement. They have a great national responsibility and have to look at the "big picture."

Do you understand what the "big picture" is? That is where you give other people's—the taxpayers'—money away, but you are looking at the thing from a broad national and international standpoint. All of a sudden when you get appointed to that job, you get a diploma that certifies you have that authority.

It is just like many of our ambassadors. They pretty soon begin to think they are representing the other country to the United States rather than the United States to the other country. And as long as Government money is involved, officials are only a short time on the job before they tend to forget who they are representing. When you have a budget of about $500 million, a billion dollars is like stage money.

What does it all mean? This is an attitude in my opinion which is generated in those people. They think they are big problem solvers and in order to be a big problem solver, you have to exercise that ability to prove that you are. It is easy to settle claims. It is the easiest thing in the world.

If I want to give some company an extra $200 or $300 million, that is easy. That is what the issue is. There have been meetings between senior Defense officials and contractors, of which no records were kept and those responsible for administering the disputed contracts were not even informed. I have alluded to that in testimony previously, sir.

Senator PROXMIRE. All right, sir, go ahead.

Admiral RICKOVER. I think this is dead wrong.

There has been a high turnover of senior Navy and Defense officials. Each new arrival, although not acquainted with details of the claims wants to apply his own magic formula to resolve the problem. Most of these attempts have been futile. Some have actually exacerbated the problem.

In April 1976, former Deputy Secretary of Defense Clements announced he would try to dispose of the Navy's $1.3 billion backlog of shipbuilding claims by providing extra-contractual relief under Public Law 85–804. The plan as to involve Litton, Tenneco, General Dynamics, and National Steel. This effort was abandoned when neither Litton nor Newport News would accept the maximum figure Mr. Clements felt he could offer.

In July 1976, following collapse of the Public Law 85–804 plan, Mr. Clements approved the establishment of an independent three-man Navy Claims Settlement Board to evaluate shipbuilding claims and try to settle them on their merits. A directive was issued to the effect that no one be permitted to interfere with or give unsolicited advice to the Board.

Initially, the Board was assigned all Newport News Shipbuilding claims, which totaled $894 million.[1] I mentioned before I was the one

[1] In March 1977, the Board was also assigned the Electric Boat SSN–688 class claim for $544 million.

who suggested such a Board and that I and others not interfere with that Board where claims were involved.

The Board has settled one of the Newport News claims, the one against the contract for construction of the nuclear cruisers U.S.S. *California* (CGN–36) and U.S.S. *South Carolina* (CGN–37). This $151-million claim was settled for $44.3 million, less than one-third the amount claimed. The Board is still negotiating with Newport News to resolve the remaining Newport News claims.

On December 1, 1977, just as the Navy Claims Settlement Board was about to complete its evaluation of the Electric Boat claim, the Chief of Naval Material, who as instructed by his superior, directed that the Board terminate its efforts on that claim and furnish the data they had thus far developed to a special steering group under the Assistant Secretary of the Navy.

Senator PROXMIRE. Admiral, what you seem to be telling us in your summary here is that the Navy claims review activities that have taken place since 1969 show that that the Navy has had great difficulty in devising a procedure for handling claims and then sticking to it. It seems that every time a claims group begins getting effective, it is abolished or undermined, while the tendency of the Navy or Pentagon brass to intervene and deal directly with the contractor reasserts itself over and over again.

Do you see that same thing happening today?

Admiral RICKOVER. Yes, sir, that is exactly what is happening. I think I alluded to why. Every one of these people comes in and immediately is given a certificate of his office which intitles him to vast knowledge of claims or any other subject with which he wants to dabble. They have the power and they use it. I have testified previously as to the relations between the civilian supervisors and the military.

There is certainly a valid reason for having put civilians in charge of running the Defense Establishment. That lesson was bitterly learned by the English. The Founding Fathers wisely put the provision in the Constitution for civilian control of the military. However, that civilian control was intended to prevent the military, to use a gross example, "from having a man on horseback."

This has now turned around, in contractual matters which the military is handling and is not an issue of war or peace. The military is required or coerced into going to their civilian superiors and finding out what recommendation on contracts to make to their civilian superiors. They even clear the letters with them.

That is a gross misuse of the constitutional power of civilian control.

Senator PROXMIRE. Let me briefly review the Electric Boat claim. As I understand it, the contractor filed two claims totaling $540 million against the Navy in December 1976, just a year ago, is that correct?

Admiral RICKOVER. That is correct.

Senator PROXMIRE. The Navy assigned these to the Navy Claims Settlement Board headed by Admiral Manganaro for recommendations and formal opinions, is that correct?

Admiral RICKOVER. That is correct, sir.

Senator PROXMIRE. Now you say a few weeks ago, on December 1, 1977, the claim was taken away from the Board in order to furnish

the data it had developed to a special steering group under Assistant Secretary Edward Hidalgo, is that correct?

Admiral RICKOVER. That is correct, sir.

Senator PROXMIRE. On the face of it just as the Board may have been nearing completion of its evaluation, the Electric Boat Co. claim, the claim was pulled away from them?

Admiral RICKOVER. They only had a few more days to go.

Senator PROXMIRE. It is as if someone did not want the Manganaro Board to finish its work. Does it seem that way to you?

Admiral RICKOVER. Yes, sir. It certainly does.

Senator PROXMIRE. In your opinion is this the sort of action likely to undermine the efforts of subordinates and, in fact, has had a demoralizing effect within the Navy?

Admiral RICKOVER. The Manganaro Board, to get its information and technical advice, has necessarily had to go to various elements in the Naval Sea Systems Command, including my staff. We have spent, I would say, thousands of hours evaluating and giving information to the Manganaro Board. This is all done away with with one stroke. The whole thing will be settled and somebody is going to become a great hero, he settled the claim. It is just like putting up a building, the man who always gets the credit is the man that lays the last brick, not all the workers who have been working perhaps for years.

But if that last brick is faulty, the whole edifice will fall and that is what is happening to the taxpayers of this country. Officials appear to be more interested in getting rid of problems by giving away government money than in really solving the problem.

Now, if a giveaway today could really solve the problem, that would be different. That could be an excuse. It is like a war. A general has to fight a battle and a lot of his people get killed. If he brings peace to his country, he has done a good job. But the in claims war, peace through giveaways will do exactly the opposite. It will encourage contractors even more to continue this system of submitting claims.

Senator PROXMIRE. Do you suspect a giveway in the Electric Boat claim?

Admiral RICKOVER. I can't say that because I do not know what the——

Senator PROXMIRE. I don't ask you to make a charge. I say, do you suspect that that may be the case?

Admiral RICKOVER. I cannot answer that because you are asking me to enter a man's mind and figure out by what line of reasoning he reaches this decision. He may have in his mind a very logical reason. I think this is something for you to discover, sir. You should get at the bottom of this.

Senator PROXMIRE. If they are planning a giveaway, is this the kind of step they would take, to first shut down the Manganaro Board?

Admiral RICKOVER. I don't know, sir. I think that you can judge that better than I. You have had more experience in Government and you can use——

Senator PROXMIRE. Admiral, you have had more experience in procurement than anyone who has ever served in this country. You have what, 50 or 55 years of experience?

Admiral RICKOVER. I entered the Navy in 1916. It is almost 1978 now.

Senator PROXMIRE. You started when I was less than 1 year old, so you have obviously had considerably more experience than I.

Admiral RICKOVER. I was 18 years old at the time. I ought to know more than you do, but it is obvious from the fact you were able to make Senator that you are smarter than I am.

Senator PROXMIRE. Well, I am sure you would be demoted if you occupied any other position, Admiral, including President.

Go right ahead, sir.

Admiral RICKOVER. The problem of inflated claims exists at all three private shipbuilders with whom I have dealt: Ingalls shipbuilding Division of Litton Industries—notice there is a conglomorate involved with each one—Newport News Shipbuilding and Dry Dock Co. a subsidiary of Tenneco; and Electric Boat Division of General Dynamics Corp.

In prior hearings I have pointed out the problems I encountered in Ingalls' $40 million claim on their contract for construction of the SSN's 680, 682, and 683. Each time Government analysts refuted a portion of this claim. Litton revised the claim and resubmitted it.

In the interim, a new president of Litton was appointed. I told him about this. I suggested he get a brandnew start and look over the history of this claim and do the proper honest thing.

Do you know what he did? He came right back and resubmitted the claim for just about the same amount.

Between November 1970 and July 1972, when a contracting officer's decision was issued, Litton had submitted five different versions of the claim—but the amount of the claim always remained about the same.

The claim was revised a sixth time in the appeal to the Armed Services Board of Contract Appeals (ASBCA) and a seventh during the Board's hearing. Each revision required extensive analysis and evaluation by Government personnel. After a 4-month hearing on the matter and lengthy deliberation, the ASBCA—obviously bogged down by the mass of data—awarded Ingalls roughly half the amount claimed. That is just like the judgment in the Bible, you know, if you cannot settle the problem, we will cut the baby in half. That is the easy way to settle it.

After reviewing the Litton submarine claim, I reported to my superiors apparent irregularities in the claim. A subsequent 2½-year investigation by the Justice Department resulted in Litton being indicted in Federal Court for violation of Federal statutes prohibiting the submission of false claims.

However, a Federal judge dismissed the indictment without hearing the case, citing an alleged procedural irregularity. The Justice Department has appealed the judge's decision. You can be certain that the law firm they hired in this case was just about as large and prestigious as could be.

In June 1976, I testified at length before this committee about Newport News claims. I cited many examples of grossly exaggerated and inflated items in the claim, including $97 million for "Parkinson's law" and $32 million for "Navy Recruiting Practices." The record of the June 1976, hearings explains these and other claim items in detail, and shows how exorbitant they were.

For example, Newport News claimed as if they had spent $200 or $300 million in training people. Their own records show it was about $9½ million, yet they submitted a claim on a basis of having spent 30 times as much as their own records showed.

I don't know what you call that, sir.

The one claim the Navy Claims Settlement Board has been able to settle shows that the Newport News claims are greatly inflated. In February 1977, the Navy Claims Settlement Board was able to settle the $151 million cruisers CGN 36 and 37 claim for $44.3 million—only 29 percent of the total amount claimed.

This settlement resulted in Newport News recovering all of its costs and a profit despite: (1) The very significant manpower problems Newport News experienced in building these ships; (2) the 18-month delay in delivery of both ships from the original contract delivery dates during a period of double-digit inflation; and (3) all the difficulties encountered by Newport News during the construction of these ships regardless of cause or responsibility.

I think it would be a good idea to get into how that amount of money was ultimately determined, $44.3 million. What were all the factors taken into account in arriving at that figure?

To get into this, you will really get an idea what happens to the taxpayers' money. Of course, today, some say that $30 million, $40 million, or $100 million is not much, you know.

I have no way of knowing what proportion of the remaining $743 million of Newport News claim is valid. The Navy Claims Settlement Board is still considering them. However, in accordance with naval directives, I have submitted to appropriate naval authorities four reports on Newport News claim items under my technical cognizance which I believe warrant investigation for possible violation of fraud of false claims statutes.

Since my review of claims items under my technical cognizance is incomplete, there may be more, Further, I understand that other people reviewing the claims have reported additional claim items for investigation.

A similar situation exists with regard to the $544-million claim submitted by Electric Boat under two contracts for consturction of 18 SSN 688 class submarines. The claim was submitted on December 1, 1976. The general manager of Electric Boat certified this claim as "current, complete, and accurate." He also certified the claim as accurately reflecting "the material damages or contract adjustments for which the Navy is allegedly liable."

The Electric Boat claim cites numerous Government actions which the company alleges caused all delays and increased costs experienced on the SSN 688 submarines at Electric Boat. Yet, there were many contractor-responsible problems at Electric Boat which adversely affected production. These problems include a shortage of skilled manpower, poor productivity, startup of new facilities, and a 5-month labor strike.

Based on a review of claim elements under my technical cognizance, I have submitted to the appropriate naval authorities a report on 18 Electric Boat claim elements which I believe should be investigated for possible violation of fraud or false claim statutes.

Senator PROXMIRE. Before you go ahead, and before I ask you any questions about the allegations of fraud, I want to say that I was not aware of this testimony until last night when I read your prepared statement.

As you fully recognize, these are serious charges and this is not a court of law in which this charge will be judged. Neither I nor the committee can pass judgment on those charges and in fairness, I believe that the contractor should have a chance to publicly reply to charges in the same forum.

So, I hereby invite spokesmen for Newport News and Electric Boat to do so, if they choose. We will be glad to entertain any suggestions as to when they would like to appear before the subcommittee in open session and testify.

We would be happy to have them. We will arrange at their convenience to have a hearing for them.

Can you describe, Admiral, some ot the items in the Newport News claims which you believe might be possible violations of the false claims statutes.

You have not given us the details.

Admiral RICKOVER. Yes; I can do that. I have reported to the appropriate authorities, specific items and claims which are examples of the following:

Statements which are demonstrably untrue; statements apparently designed to mislead; withholding of documents which would disprove allegations of Government responsibility; alleged Government responsibility for costs which are the shipbuilder's responsibility, under the contract; claims for costs that have already been reimbursed; claims for costs which have not or will not be incurred.

Based on what I have reported and what I understand others have observed in the claims, I have recommended that the Navy and the Justice Department apply the necessary resources to investigate thoroughly the Newport News and Electric Boat claims for possible violations of Federal statutes.

Senator PROXMIRE. Now, in your prepared statement, you say that you submitted to the appropriate naval authorities four reports on Newport News claim items under your technical cognizance which you believe warrant investigation for possible violation of fraud or false claims statutes.

When did you file those four reports and to whom were the reports filed?

Admiral RICKOVER. I don't know the exact date, but I know I filed some over 6 months ago but there was no action.

Senator PROXMIRE. To whom were they filed?

Admiral RICKOVER. They were filed——

Senator PROXMIRE. To what office?

Admiral RICKOVER. I believe I forwarded them to the officer in the Naval Sea Systems Command, who is responsible for this sort of thing, I don't know his title, but with copies to all my superiors. So no one can say that they didn't get copies.

Senator PROXMIRE. And with copies to the Secretary of the Navy?

Admiral RICKOVER. Yes, sir, either that or to his assistant. One way or the other.

Senator PROXMIRE. How about Assistant Secretary Hidalgo?

Admiral RICKOVER. Oh, yes, he got it.[1]

Senator PROXMIRE. You say two attorneys in the Navy's General Counsel's Office were told to review the report you filed about Newport News and you indicate they worked only part time on the report; is that correct?

Admiral RICKOVER. Yes, sir, compare this, for example, to the legal effort of Newport News on the minor issue of the CGN–41 dispute. There, it has taken all these depositions I mentioned to you and with a large number of lawyers.

You can see now how a large conglomerate handles a case like this as compared with the Navy. There is so much of this. These companies know they can overwhelm the Navy. They know that very well, they can keep on forever because they will always make money doing it.

Senator PROXMIRE. Now, those two attorneys in the Navy's General Counsel's Office reviewing the report, have they contacted you or your staff and discussed the matter with you?

Admiral RICKOVER. They may have contacted my staff, not me. I don't remember their contacting me but I believe they have contacted my staff.

Senator PROXMIRE. Has Secretary Hidalgo discussed the Newport News fraud reports with you?

Admiral RICKOVER. No, sir.

Senator PROXMIRE. Has Navy Secretary Claytor?

Admiral RICKOVER. No, sir.

Senator PROXMIRE. Or did any other high Naval official discuss the Newport News claims review?

Admiral RICKOVER. No, sir.

Senator PROXMIRE. I have similar questions about the Electric Boat claims. Can you describe some of the items in those claims that you believe might be possible violations of the fraud statutes?

Admiral RICKOVER. Mr. Chairman, I mentioned some a few moments ago. I mentioned about seven such items. Those characterizations apply to both Electric Boat and Newport News.

Senator PROXMIRE. Now, when did you fill the Electric Boat report and to whom was that report submitted?

Admiral RICKOVER. That was early in December, early this month.

Senator PROXMIRE. Do you know if that report was sent to the Navy's General Counsel's Office, whether it was assigned for review to the same two attorneys?

Admiral RICKOVER. We don't know what he did with it. We are not kept informed about what goes on.

Senator PROXMIRE. You were not told about that?

Admiral RICKOVER. No one talked to me about that.

Senator PROXMIRE. What do you think of that procedure? Don't you think that procedure is unfortunate, shouldn't you be kept informed? Shouldn't you be aware as the person who filed the claim what the status is?

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[1] Subsequent to the hearing Admiral Rickover notified the subcommittee that his testimoney was in error in that he had not sent copies of the four reports involving Newport News to the Navy Secretariat.

Admiral RICKOVER. I think it has been sent to the attorneys. But no high officials—certainly, the Secretary of the Navy has never talked to me about anything of substance except I have seen him and we greeted each other. He is a very busy man.

Senator PROXMIRE. You say that this was assigned to attorneys in the Navy's General Counsel's Office?

Admiral RICKOVER. Yes, sir, the same two.

Senator PROXMIRE. The same two, all right, that is my question.

Admiral RICKOVER. They have many cases of this kind besides this.

Senator PROXMIRE. Have they discussed these with you or your staff?

Admiral RICKOVER. Not with me, sir.

Senator PROXMIRE. With your staff?

Admiral RICKOVER. Not to my knowledge, sir.

Senator PROXMIRE. They have not discussed it with your staff either.

Admiral RICKOVER. Not that I know of, sir.

Senator PROXMIRE. You say neither Secretary Hidalgo nor Secretary Claytor discussed the Electric Boat case with you?

Admiral RICKOVER. They have not.

Senator PROXMIRE. Have any high naval officials consulted you about the fraud report?

Admiral RICKOVER. No, sir.

Senator PROXMIRE. Has Secretary Claytor or any high official discussed the shipbuildings claims or any policy matter with you of this kind?

Admiral RICKOVER. Mr. Hidalgo has to a certain extent, but not for anything specific. Mr. Hidalgo visited me late last mouth and told me that, I believe, he was setting up some new group to solve the claims situation. That is all.

He asked to come over and see me and he saw me and that is about all that went on.

Senator PROXMIRE. All right, sir, go ahead.

Admiral RICKOVER. He didn't discuss with me taking the Electric Boat claim away from——

Senator PROXMIRE. Of course, when he came to discuss with you setting up a new group that was an opportunity for you to indicate your sentiments, as you have indicated them so clearly this morning.

Admiral RICKOVER. I have indicated my sentiments to Mr. Hidalgo.

Senator PROXMIRE. So he knows how you feel?

Admiral RICKOVER. Yes, sir, he gets copies of all the letters.

Senator PROXMIRE. All right.

Admiral RICKOVER. He does know my feelings, yes, sir.

Senator PROXMIRE. Go right ahead.

Admiral RICKOVER. That doesn't necessarily mean he agrees with me; he has got his own problems.

I will proceed, now. I have no way of knowing what proportion of the remaining $743 million of Newport News' claims are valid. The Navy Claims Settlement Board is still considering them.

However, in accordance with naval directives, I have submitted to appropriate naval authorities four reports on Newport News' claim items under my technical cognizance which I believe warrant investigation.

Senior Navy and Defense officials seem reluctant to investigate grossly inflated claims by shipbuilders, some of which involve hundreds of millions of dollars. This reluctance could stem from several reasons.

Many of these officials came from industry or from law firms and may see nothing wrong with what these companies are doing to try to enhance their profits. Some may be reluctant to pursue the false claims issue, for fear of being criticized for not promoting "good relations" with contractors, or for scuttling a potential claims settlement, or for not seeing the "big picture." Moreover, corporations can bring great pressure to bear and cause delays so that it might take years to complete an investigation.

Some of these officials leave the Defense Department ultimately to get high paying positions in companies they previously dealt with. I am sure you know more about that than I do.

Large shipbuilding claims can be important to conglomerates as a means to defer or perhaps avoid having to report losses to their stockholders. The profit projections they use assume a given recovery under the claims.

To the extent the figure assumed is greater than the amount the Navy determines it legally owes, the company has a strong incentive to avoid settlement through whatever means are available, including lengthy litigation, while it tries to pressure the Navy into a higher settlement offer.

Inflated claims also increase a shipbuilder's chances of getting paid more money than he is contractually owed, or getting a lucrative settlement based on the Government's assessment of litigative risk and litigative cost.

"Litigative risk" is the amount Navy lawyers include in claims settlement offers to account for the possibility of losing in the Armed Services Board of Contract Appeals or in court.

"Litigative cost" is the amount the Government estimates it will spend to defend itself before the Board or in court. The larger and more complex a claim is, the more costly it is for the Government to litigate and the greater the risk that a shipbuilder, with his high-priced lawyers, can obfuscate the issues and win a favorable decision in litigation.

Of course, litigative risk and litigative cost are highly subjective assessments which can be used to pay off claims while ostensibly settling them only on their so-called legal merits.

Senator PROXMIRE. Admiral, you indicate the Navy is setting claims not just for what they are worth but for their value plus other factors that may have nothing at all to do with the intrinsic worth of the claim.

Litigative cost is one of the factors. Can you estimate how much the Navy might allow for the cost of defending itself in court and what other factors get lumped into the settlement?

Admiral RICKOVER. I understand you have Admiral Manganaro as the next witness. Since he has been personally involved with this, he would be the best source of information on this subject. I am sure you will ask him to give you specific figures on various claims, what the actual merit was and what the Navy offered.

You see, it is this difference between what is owed and what is paid including the litigative cost and litigative risk, that makes it profitable for any contractor to keep on forever. Our system encourages claims. The way our officials act and the way the whole thing is settled, encourages claims.

For example, take the "Golden Handshake" agreement that one commander of the Naval Sea Systems Command made with a contractor and was ultimately proved by the Navy's subsequent investigation to be invalid. I think the contractor was paid $62 million, but the Navy ultimately found the claim was worth only $7 million or $8 million. This was the Lockheed case. The Navy realized the large settlement was unmerited. But by some error of the Deputy Secretary of Defense, by some slight neglect, the company was paid the full amount. The Armed Services Contract Board of Appeals even ruled in favor of the contractor.

Senator PROXMIRE. That they ought to get the error use amount?

Admiral RICKOVER. Yes, sir.

Senator PROXMIRE. And they got it?

Admiral RICKOVER. Yes, and they were allowed to keep the extra $50-some million.

Senator PROXMIRE. Now, don't you think that that is a lesson for anyone who does business with the Government? I fully expect to see as a result of this that every Government contractor will now begin to file claims.

Admiral RICKOVER. The only way to stop it is to put their officials in jail. That is the only way to stop it—like the electric companies case. It is the only way you will ever stop this.

Senator PROXMIRE. Go ahead, sir.

Admiral RICKOVER. If Federal statutes covering fraud and false claims are not enforced, contractors will continue inflating their claims. Under these conditions, the Government will continue to waste millions of dollars evaluating highly inflated claims which have little or no substance.

In my opinion, the Defense Department and the Justice Department should strictly enforce the False Claims Act and criminal statutes, including those pertaining to fraud. Prior to settling a claim, the contracting officer should be required to certify that no evidence of fraud or false claims has been uncovered in his review. If such an affidavit cannot be made, all evidence discovered should be thoroughly investigated for possible fraud, with the assistance of the Justice Department.

I have testified previously and at length regarding the need for other improvements in the area of shipbuilding claims.

I want to interrupt here and say that in my dialog with these eight lawyers, I suggested to them that it was obvious they were trying to drag this on just to make lots more money. I inquired whether they were aware of that statute passed about the time of the Civil War or shortly thereafter that anyone could sue a company for defrauding the Government and be reimbursed a share of the amount of fraud found. I told them they could make lots more money that way with what they knew already if their objective was money.

They could make much more money, because the claims are so large they and their companies, as far as one can foresee, would be able to

become quite wealthy. But they looked at me as they always do, as if I were some dumbell subject to scrutiny.

If I cared for money, I would get out of the Navy and start that line of business.

Here are my recommendations:

First. Authorize the Navy to hire outside counsel and such other assistance as is necessary to help with claims and claims-related matters. The idea of using outside counsel was killed by the former top Navy lawyer and by the Justice Department. I don't know what their attitude would be at this time.

Second. Develop a permanent group of outside claims specialists, including technical personnel, procurement experts, and attorneys to review and analyze major claims, do legal research, prepare legal documents, interview witnesses, and help prepare the Government's defense under the direction of Government personnel.

Third. Require as a matter of law that prior to evaluation of any claim, the Government must obtain and the contractor must submit a signed certificate from a senior contractor official that the claim and its supporting data are current, complete, and accurate.

That was included in a bill by the House last year, requiring certification, but it was cut out in the Senate committee.

Fourth. Costs incurred by the Navy in evaluation of invalid portions of claims should be set off against the amount determined to be legitimately owed. This should discourage shipbuilders from using frivolous items in their claims.

Fifth. Prohibit contractors from changing their claim after it has been finally submitted to the contracting officer.

Sixth. Require litigants and their attorneys to disclose at the outset of any commercial litigation all facts, whether favorable or unfavorable, relating to their lawsuit. In filing a case before the courts or administrative boards, the plaintiff and his attorneys should be required to sign a stringent certificate that the information submitted in support thereof is current, complete, and accurate.

Criminal penalties and disbarment proceedings should be invoked for false certifications. Of course, if you deal with the American Bar Protective Association, that won't happen.

Under our present system, some shipbuilders contend that they are not required to disclose facts which would tend to undermine their claims.

Seventh. Change the operation of the Armed Services Board of Contract Appeals as follows:

(*a*) Give the Government the same right as contractors to appeal adverse decisions of the Armed Services Board of Contract Appeals. That would certainly have helped in the long Litton case, where you may remember, Mr. Chairman, they changed their claims seven times.

Every time the Government pointed out that an item did not seem proper, they would come in with a new claim. They came in seven times and the Navy, and others had to consider this claim all over again. That is the leeway a contractor has.

(*b*) Next, until such right of appeal to the courts is granted, the Department of Defense should provide for internal review of Armed Services Board of Contract Appeals decisions.

(c) Make any material obtained by contractors under the Freedom of Information Act, which is not obtainable by discovery proceedings, inadmissible against the government before any Contract Board of Appeals or in any litigation.

(d) Discontinue trials de novo before the Armed Services Board of Contract Appeals. Only evidence submitted to he contracting officer should be allowed before the Armed Services Board of Contract Appeals. Today a shipbuilder can present the Board an entirely different case than he has presented to the contracting officer.

(e) Promulgate a Board rule that law firms who violate the ABA Code of Professional Responsibility are not allowed to appear before the Board.

There has been a tendency for some of our transient Defense and Navy officials to believe the shipbuilding claims problem can be solved if only a way can be found to pay contractors their projected losses.

These officials forget that if the Government had picked up the tab for such losses at any time in recent years, we would still have large claims today. For example, 5 years ago the Litton LHA claim was for about $270 million. By 1976, the claim had grown to over $500 million. Today, the Litton LHA claim totals over $1 billion. So the major point here is just paying them off doesn't solve the problem, in fact it encourages them to continue to submit claims.

You settle it for one amount and it starts all over again. Your object, as I understood from hearing your remarks at the opening of this testimony to find a permanent way to handle claims. What some officials are doing now is actually encouraging the continuance of this problem. When somebody tastes blood, he knows he can get more. It is as simple as that.

I think any housewife could understand that, but, apparently, some senior officials are so fouled up with their inner cogitations and supposed loyalties that they don't see that simple point that a housewife could readily understand. If she goes to a grocery store that overcharges her, she would not go to that store again. She would not do business with them. But we keep on.

Of course, this is only the taxpayer's money, and as I said previously, it is spent by some as if it were stage money.

The Electric Boat 688 class claim is another example. In early 1976 the Navy settled all outstanding claims on the first SSN 688 class. submarine contract through May 20, 1975, for $97 million.

Then, General Dynamics officials offered the Navy a total claims release on both the first and second SSN 688 class contracts for an additional $53 million. The Navy could not accept that offer since it covered a claim which had not yet been presented.

Shortly after the $97 million settlement, Deputy Secretary of Defense Clements introduced his plan to settle shipbuilding claims using Public Law 85–804. Uuder that plan, General Dynamics and the Defense Department reached tentative agreement to settle all remaining claims on the two SSN 688 class contracts at Electric Boat for about $170 million—almost $120 million more than the company's previous settlement offer.

As late as November 1976 General Dynamics was still asking the Defense Department to accept the $170 million Public Law 85–804 claims settlement.

Mind you, that is November a year ago.

By February 1977, however, the company's cost estimates for the SSN 688 class construction program increased such that even a $170 million settlement would have left the company deeply in the red.

Moreover, costs have been overrunning so that even if the Government had in February 1977 paid Electric Boat all losses being projected at that time, the company would again find itself in a substantial loss position by the 1st of December.

Had the Government paid off the losses being projected on the 1st of December, the company would again find itself in a projected loss position as of today. To anyone considering a one-time payoff as a solution to the shipbuilding claims problem, this should be a sobering thought.

In extraordinary cases where the Government decides to bail out a shipbuilder under Public Law 85–804, the Navy should insure future access to the shipyard's production facilities.

This could be done by buying the shipyard and having a contractor operate it as a Government-owned, contractor-operated plant. Alternatively, the Navy might be able to enter into a long-term leasing arrangement so that if the contractor subsequently threatened to deny the facilities for Navy work, the Navy could make them available to another contractor.

Keep in mind I am only advocating the Government-owned contractor-operated plan in cases where the Government decides it must bail out an essential shipbuilder. Moreover, I advocate the Government paying fair value for any shipyard it would acquire under these circumstances as part of the overall settlement so that the Government would not in any sense be confiscating private property.

The last minute withdrawal of the Electric Boat claim from the Navy Claims Settlement Board and a new agreement to defer litigation on the Litton contract dispute indicate the possibility of another effort to settle the claims at these two yards on other than their legal merits.

As I have previously explained, I believe the Government should enforce its contracts. However, I also recognize that senior defense officials have responsibilities far broader than my own and may, for their own reasons, arrive at different conclusions.

Defense officials have the authority to settle claims by granting extra-contractual relief under Public Law 85–804 whenever they determine this would facilitate national defense. In such cases, however, great care should be taken.

I believe that the following criteria should be applied in resolution of the claims on a basis other than strict legal entitlement:

The true financial condition of the corporation should be determined by Government audit. Take the case of Tenneco and Newport News, they have been reporting record profits all along. The same is true of General Dynamics and Electric Boat.

Attempts to reach an overall settlement of shipbuilding claims should in no way prejudice the Government's ability to enforce the terms and conditions of existing government contracts.

The worth of the claims should be determined. That is absolutely essential in my opinion before a claim comes up to Congress for resolution under Public Law 85–804 or another manner. You cannot

go someplace if you don't know from where to start. You have to find out what each claim is really worth and I hope that what is intended by some Government officials will not obviate that step.

The provision of extra-contractual relief should not in any way excuse a contractor from any legal liability he might have under Federal fraud or false claims statutes.

Again, in my opinion, this issue will not be solved until the people who submit claims have to stand behind them.

The settlement should not establish a precedent which the Navy would be unwilling to apply to other claims-troubled contractors if they are essential to national defense and if their continued ability to perform is in jeopardy.

The Government should try to get back, to the greatest extent possible, as much in value as it gives up.

The settlement should guarantee the future availability of facilities to the Navy well into the future—say 25–50 years, together with the contractual right to change contractors.

The settlement should specify how subcontracts should be handled. Shipbuilders should not be permitted to later bail out subcontractors at Government expense.

The settlement should constitute a one-time permanent solution at that shipyard so that the Government does not again find itself in the dilemma of having to choose between getting ships and enforcing contracts.

That is the end of my testimony, sir.

[The prepared statement of Admiral Rickover follows:]

PREPARED STATEMENT OF ADM. H. G. RICKOVER [1]

Mr. Chairman, you have requested that I testify about shipbuilding claims and possible violations of fraud or false claims statutes contained in claims against the Navy. The views I express are my own, and not necessarily those of the Navy.

The claims problem is not new. There were shipbuilding claims against the Navy even before the *Monitor* and *Merrimack*. In fact, one ship of the *Monitor* class was the subject of a shipbuilding claim.

For many years there have been problems in the way shipbuilding claims have been handled. In 1958, for example, the General Accounting Office reported that claims submitted by shipbuilders were vague and lacked adequate documentation; that Navy claims evaluations were inconclusive; and that claims had been settled without sufficient data to demonstrate Government responsibility.

Until the late 1960's, these claims tended to be small as compared to the amounts of today. For the most part shipbuilders honored the terms of their contracts and confined their claims to legitimate items. During that period one of the largest claim settlements that I recall involved an $8 million Electric Boat claim for a one-year Government-responsible delay in construction of a submarine. The contractor confined his claim largely to Government-responsible actions, and the claim was settled for about $7 million. At the time, $7 million was a large claim settlement; but, by today's standards, a $7 million claim is very small.

It used to be that, if a shipbuilder lost money on a contract, company officials would accept that fact and try to do better the next time. However, the Navy's settlement of the huge Todd Shipbuilding claim in March 1969 introduced a new era in shipbuilding claims.

This claim settlement was the first involving large so-called omnibus shipbuilding claims. Such claims—sometimes called "total cost" claims—do not show a cause-and-effect relationship between alleged Government-responsible actions and the amount claimed. In essence, a shipbuilder, when faced with a projected

[1] This statement reflects the views of the author and does not necessarily reflect the views of the Secretary of the Navy or the Department of the Navy.

cost overrun, makes a large claim based on general allegations that the Government is at fault and therefore should reimburse the shipbuilder for all his costs plus his desired profit—regardless of his own performane.

These large shipbuilding claims seem to be "built backwards." That is, the shipbuilder estimates how much he wants and then assigns people to make up a claim that will yield that amount. Here is an extract from a report of one shipbuilder's internal company meeting in which his people were instructed how to prepare a large shipbuilding claim;

"Division Planning will provide an estimate of man-hours to complete the contract. This estimate will be compared with the original of total manufacturing man-hours to do the contract, and the difference willl be justified in a saleable manner.

* * * * * * *

"Mr. X stated that (the company) would have to use that information and data which would sell. Any data which would not sell would have to be omitted."

If claims prepared in this manner are paid independent of their legal merits, the effect is to convert fixed-price contracts into cost-plus contracts.

I am not certain who invented the omnibus claim concept and peddled it as a way to get out of potentially unprofitable contracts. But the two Washington law firms I most readily identify with this method of doing business are headed by a former Navy General Counsel and a former Chairman of the Defense Department's Armed Services Board of Contract Appeals. I have contempt for federal employees who acquaint themselves with the inner workings of Government and its vulnerabilities, only to switch sides later and profit personally from their inside information.

The Todd claims exceeded $114 million and were settled for $96.5 million—about 84 cents on the dollar. In an April 1971 report, the General Accounting Office was harshly critical of the Todd Settlement, stating:

"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 unrealistically low bid.

"We believe that the Department of Defense should take the necessary steps to ensure that settlements of claims are supported by factual and reliable data relating the specific amount claimed to acts of the Government.

"We believe that in the absence of such information, there is not sufficient assurance that the settlements made were fair and reasonable. The practices presently being followed in settling claims could lead to an erosion of the contractor's incentive to control costs with a corresponding decline in the effectiveness of firm-fixed-price contracting."

These latter remarks by the GAO were prophetic.

Heartened by the greatly inflated Todd settlement, many private shipbuilders and their claims lawyers seized upon vague, unsubstantiated claims as a means of getting well on unprofitable contracts. As a result, the Navy was inundated with omnibus shipbuilding claims. In 1968, outstanding claims totaled $66 million; in 1971, $605 million; in 1974, $1.3 billion; today, $2.7 billion.

In their campaign to have their claims paid, shipbuilders place the blame entirely on the Government. They frequently attribute their problems to inflation, faulty defense procurement policies, improper administration of shipbuilding contracts by the Navy, and a host of other reasons, all of which they contend are beyond their control. Shipbuilder inefficiences, mismanagement, low productivity, and other problems are rarely, if ever, acknowledged in the claims or in public pronouncements by company officials.

Most shipbuilders keep their claims vague and general. In that way they can keep increasing the amount of their claims—as many of them have done—if they encounter further cost overruns.

Some officials of shipbuilding companies would have senior Government officials believe that the Government has an obligation to make their companies profitable, regardless of performance. When Government officials fall for this line of reasoning and make claim settlements in excess of amounts legally owed, they only encourage inefficiency and mismanagement. They also undermine the integrity of Government contracts, making them useless as a vehicle for conducting future business.

The takeover of all our major shipyards by conglomerates has made the situation worse. Conglomerates are staffed with legal, financial, and contract experts who tend to view shipyard oprations as a financial game. Cash flow,

public relations, lobbying, and "creative accounting" are their specialty. Under the conglomerate philosophy, "Managers" are interchangeable and results are measured strictly in financial terms. This tends to divert management attention away from the details of building ships. In general, corporate officials are not interested in building ships; they are interested in financial figures.

Shipbuilders should make a fair profit if their performance warrants it. That is the basis on which fixed-price incentive-fee ship construction contracts are negotiated. But in my opinion it is wrong for corporate officials to use claims, public relations, and political clout to pass on to the Government the results of their own poor management.

I have testified repeatedly about deficiencies in nearly all aspects of shipyard operations: ineffective cost controls and cost reporting systems; costs not related to progress in a manner that identifies potential overruns in time to take corrective action; subcontract procurements not managed in a business-like manner; excessive sole source subcontract procurements; superficial negotiations of subcontracts; poor productivity, including widespread idleness and loafing; inadequate material controls; overtime not properly controlled; ineffective internal audit systems; and excessive overhead costs. In the current environment, however, it is apparently easier to let costs come out where they will and submit claims than it is to establish better controls over the work.

In recent years, both Newport News and Electric Boat have encountered serious productivity problems as they increased their workforces. Both yards have had trouble training and managing an expanding work force. Their productivity problems delayed ships and caused higher coss. But to read the claims submitted by them, one could only conclude that all delays and cost overruns were the Government's fault. This is what I resent—the dishonesty of those who pursue the claims business for a profit, and the unfair burden these invalid claims place on the Government employees who must refute them, and on the taxpayer.

Some shipbuilders, egged on by corporate officials and high-priced claims lawyers, have become proficient in developing, assembling, and prosecuting claims and have the trained specialists to do so. Sometimes the impetus for a claim comes from firms that specialize in this work. In fact, a whole claims industry is sprouting. Here is a promotional letter one company I deal with received from one of these claims specialists:

"Dear Sir: We are specialists in all phases of Government and commercial contracting. Our specialty is the ability to obtain additional funds from fixed price customers. This is done via the constructive change basis. which means that the entire transaction is evaluated from the date of the order or contract to the date of actual delivery. All the extras, such as extra work performance, or delays, or interruptions are transposed into dollars and thus presented to the customer for reimbursement.

"This essentially is collecting for delivering something beyond the bargain. The obvious changes are easy enough, but the subtle or hidden changes that are not apparent; either to buyer or seller are the ones that we can transpose into a dollar recovery.

"Our credentials are available for your review, and our references range from the smallest companies to those appearing on the Fortune 500. A meeting may be beneficial."

The above letter is from a small time operator. The Washington law firms that specialize in claims against the Government are more sophisticated in their marketing efforts. They make companies aware of their services through seminars and publications on Government contracts and claims. At billing rates of up to $100 or more an hour, claims lawyers will develop and promote legal theories to blame the Government for any cost overruns their client incurs, or to contest the validity of a contract.

Many practitioners of the claims trade seem to specialize in obfuscation and harassment. If fact or the law is not with them in a case, some claims lawyers will harass the Government with voluminous claims, unsupported allegations, Freedom of Information Act requests, interrogatories, depositions, and the like. By generating mountains of paper and broadening issues, they hope to bog down Government officials or courts to the point that their clients can negotiate settlements independent of the claim's legal merits.

The strength of the claims lawyers lies in their ability to delay and harass the Government. They well know that with the high rate of personnel turnover in Government, time works to their advantage. They also know that the Government cannot assign anywhere near equivalent resources to the case, and that eventually they can wear the Government down.

Lawyers are supposed to be officers of the court charged with responsibility of searching out the truth. My experience has been that most claims lawyers try to hide or distort the truth.

I now have first-hand experience on how a law firm handles contract disputes. Through the month of December, I have been subjected to a deposition conducted by a Washington law firm that Newport News has retained in connection with the lawsuit between the U.S. Government and Newport News regarding the nuclear cruiser CGN41. The Government contends that the Navy has a valid contract with Newport News for construction of the CGN41. The company, seeking to reprice the contract, has contended it is invalid. But the issue of whether or not there is a valid contract may never be heard in court because Newport News succeeded in getting the District Court to dismiss the case without ever addressing that issue.

The case is now before the Court of Appeals. Since the District Court decision may be reversed, Newport News obtained a District Court order requiring my deposition. This deposition has been an eye-opener for me. Day after day, I face as many as eight experienced lawyers. Three of them take turns interrogating me and the others busily confer with each other and write and pass notes. For over 35 hours so far my inquisitors have barraged me with questions about dates, places, letters, conversations and events spanning a period of six years. They seem incredulous because I do not remem er documents written years ago even though I have pointed out to them that I have probably read close to three-quarters of a million documents and signed 50,000 in this period.

Mr. Chairman, can you imagine anyone expecting you to recall the details of every document you have signed in the past six years; who told you each piece of information in it; exactly what you meant at the time; what you may have said to people about it; and so forth? If I were to remember such information I would have no room in my mind to handle today's problems and plan for the future. Besides, I learned long ago that a written record is much more reliable than memory.

I have no idea how much longer my inquisitors will prolong this deposition. But I think any objective observer reading the deposition record must conclude that there can be no legitimate purpose in dragging this deposition out. As far as I can see, very few of the questions I have been asked have any discernable relationship to whether or not there is a valid CGN41 contract. I can only presume that depositions of this sort are designed to consume time and discourage Government empolyees from ever standing up to a large contractor or from having the temerity to put the interests of the taxpayers above those of a large conglomerate.

The shipbuilding industry has a lobby group—the Shipbuilders Council of America—which provides a forum for arriving at industry-wide positions. The theme of the major shipbuilders is the same—that shipbuilding claims must be the Navy's fault since major shipbuilders have been experiencing cost overruns. They blame Navy procurement policies and they blame Navy personnel for allegedly failing to promote "good relations" with the shipbuilder.

The ultimate leverage these companies have is their control over the facilities needed to build ships the Navy vitally needs. Because partially completed ships cannot be transferred from one shipyard to another, they are sometimes held hostage in contract disputes. Both Litton and Newport News have threatened work stoppages thus forcing the Navy into court in order to require them to continue work. But Federal judges are not able to hear complex shipbuilding contract disputes and render judgments in a short time. In the two cases mentioned, the Navy was ordered to continue to pay the contractor's incurred costs pending resolution of the dispute. This is what both shipbuilders wanted.

Within the Defense Department, contract disputes have been made more difficult by the involvement of senior officials in matters that their subordinates should be handling. Many large and politically influential defense contractors have ready access to Defense Department and Navy officials throughout the chain of command. They use these contacts to their advantage. I suspect that most contractor officials prefer to deal with senior Defense officials because they are not as familiar with contractual details as the working level officials and therefore tend to be more sympathetic to contractor complaints.

In the past there have been far too many private meetings between senior Government and contractor officials on matters involving claims or contract disputes. These meetings undermine the efforts of those responsible for handling contract matters—particularly when they are not in attendance. At times, those responsible have not been informed of the results of the meeting, or even that they were held.

There has been a high turnover of senior Navy and Defense officials. Each new arrival, although not acquainted with details of the claims, wants to apply his own "magic formula" to resolve the problem. Most of these attempts have been futile. Some have actually exacerbated the problem. Here are some ways various officials have tried to deal with the shipbuliding claims problem during the past several years:

In 1971, the then Commander, Naval Ship Systems Command, personally negotiated with officials of Lockheed Corporation and tentatively agreed to pay the company $62 million in settlement of shipbuilding claims totaling about $160 million. This was the infamous "Golden Handshake" made without the benefit of a legal, technical, and financial audit of the claim.

Based on a subsequent audit of the claim, the Navy's contracting officer determined that the Navy owned only about $7 million, not $62 million. Lockheed appealed to the Armed Services Board of Contract Appeals. The Board, without reviewing the merits of the Lockhead claims, ordered the Navy to pay the $62 million on the basis that Deputy Secretary of Defense Packard had made statements which led the company to believe it would be paid that amount.

In October 1969, following the Todd settlement, the Navy established a Contract Claims Control and Surveillance Group, to assure that major claims submitted by Navy contractors would receive an adequate and complete technical, legal and financial review. This Group disapproved some major claims settlements and was subsequently disestablished.

In 1972, responsibility for resolving claims was assigned to a General Board consisting of Navy Admirals and a Claims Board comprised of "procurement executives" of theNaval Systems Commands.

By 1975, the Navy reported that the claims backlog had been drastically reduced as a result of claim settlements and that the problem was well in hand. However, in order to make the claim statistics look better, some Navy officials had resorted to semantic games. They relabeled several large claims "Requests for Equitable Adjustment." When the dollar value of these so-called Requests for Equitable Adjustment was added to claims in-house and appeals before the Armed Services Board of Contract Appeals, the Navy's total claims backlog was actually $1.5 billion, not $300 million as the Navy was then reporting.

In April 1976, former Deputy Secretary of Defense Clements announced he would try to dispose of the Navy's $1.3 billion backlog of shipbuilding claims by providing extra-contractual relief under Public Law 85–804. The plan was to involve Litton, Tenneco, General Dynamics, and National Steel. This effort was abandoned when neither Litton nor Newport News would accept the maximum figure Mr. Clements felt he could offer.

In July 1976, following collapse of the Public Law 85–804 plan, Mr. Clements approved the establishment of an independent, three-man Navy Claims Settlement Board to evaluate shipbuilding claims and try to settle them on their merits. A directive was issued to the effect that no one be permitted to interfere with or give unsolicited advice to the Board, Initially, the Board was assigned all Newport News' shipbuilding claims, which totaled $894 million. In March 1977, the Board was also assigned the Electric Boat SSN 688 Class claim for $544 million.

The Board has settled one of the Newport News' claims, the one against the contract for construction of the nuclear cruisers *USS California* (CGN 36) and *USS South Carolina* (CGN 37). This $151 million claim was settled for $44.3 million—less than one-third the amount claimed. The Board is still negotiating with Newport News to resolve the remaining Newport News' claims.

On 1 December 1977, just as the Navy Claims Settlement Board was about to complete its evaluation of the Electric Boat claim, the Chief of Naval Material directed that the Board terminate its efforts on that claim, and furnish the data they had thus far developed to a special Steering Group under the Assistant Secretary of the Navy.

Grossly inflated claims are becoming accepted as standard operating procedure. Unless something is done to enforce the various Federal Statutes regarding fraud and false claims, we face the prospect of being harassed by such claims indefinitely.

The problem of inflated claims exists at all three private shipbuilders with whom I have dealt: Ingalls Shipbuilding Division of Litton Industries; Newport News Shipbuilding and Dry Dock Company, a subsidiary of Tenneco; and Electric Boat Division of General Dynamics Corporation. In prior hearings I have pointed out the problems I encountered in Ingalls' $40 million claim on their contract for construction of the SSN's 680, 682, and 683. Each time Government analysts refuted a portion of this claim, Litton revised the claim and resubmitted it.

Between November, 1970, and July, 1972, when a Contracting Officer's decision was issued, Litton had submitted five different versions of the claim—but the amount of the claim always remained about the same. The claim was revised a sixth time in the appeal to the Armed Services Board of Contract Appeals (ASBCA) and a seventh during the Board's hearing. Each revision required extensive analysis and evaluation by Government personnel. After a four-month hearing on the matter and lengthy deliberation, the ASBCA—obviously bogged down by the mass of data—awarded Ingalls roughly half the amount claimed.

After reviewing the Litton submarine claim, I reported to my superiors apparent irregularities in the claim. I recommended that the claim be investigated for possible violation of false claims statutes. An 18-month independent review by the Navy came to a similar conclusion and the case was referred to the Department of Justice. A subsequent 2½-year investigation by the Justice Department resulted in Litton being indicted in Federal Court for violation of Federal statutes prohibiting the submission of false claims. However, a Federal judge dismissed the indictment without hearing the case, citing an alleged procedural irregularity. The Justice Department has appealed the judge's decision.

In June, 1976, I testified at length before this committee about Newport News' claims. I cited many examples of grossly exaggerated and inflated items in the claim, including $97 million for "Parkinson's Law" and $32 million for "Navy Recruiting Practices." The record of the June, 1976, hearings explains these and other claim items in detail.

The one claim the Navy Claims Settlement Board has been able to settle shows that the Newport News' claims are greatly inflated. In February, 1977, the Navy Claims Settlement Board was able to settle the $151 million CGN 36 and 37 claim for $44.3 million—only 29 percent of the total amount claimed. This settlement resulted in Newport News recovering all of its costs and a profit despite: (i) the very significant manpower problems Newport News experienced in building these ships; (ii) the 18-month delay in delivery of both ships from the original contract delivery dates during a period of double digit inflation; and (iii) all the difficulties encountered by Newport News during the construction of these ships regardless of cause or responsibility.

Newport News officials contend that it is wrong to characterize this settlement as "29 cents on the dollar." It is true that even if the claim had been determined to be completely valid and the contract ceiling price increased by $151 million, as the company requested in its claim, Newport News would not have actually recovered $151 million in cash. This is due to cost sharing provisions in the contract. However, the Navy had to review every element of the $151 million increase in ceiling price claimed in order to determine how much was vaild and how much the company would be paid. Based on this review, the Board found that over 70 percent of the claim was invalid.

I have no way of knowing what proportion of the remaining $743 million of Newport News' claims are valid. The Navy Claims Settlement Board is still considering them. However, in accordance with Naval directives, I have submitted to appropriate Naval authorities four reports on Newport News' claim items under my technical cognizance which I bleieve warrant investigation for possible violation of fraud or false claims statutes. Since my review of claim items under my technical cognizance is incomplete, there may be more. Further, I understand that other people reviewing the claims have reported additional claim items for investigation.

A similar situation exists with regard to the $544 million claim submitted by Electric Boat under two contracts for construction of 18 SSN 688 Class submarines. The claim was submitted on December 1, 1976. The General Manager of Electric Boat certified this claim as "current, complete and accurate." He also certified the claim as accurately reflecting "the material damages or contract adjustments for which the Navy is allegedly liable."

The Electric Boat claim cites numerous Government actions which the company alleges caused all delyas and increased costs experienced on the SSN 688 Class ships at Electric Boat. Yet, there were many contractor-responsible problems at Electric Boat which adversely affected production. These problems include a shortage of skilled manpower, poor productivity, start-up of new facilities, and a five-month labor strike.

Based on a review of claim elements under my technical cognizance, I have submitted to the appropriate Naval authorities a report on 18 Electric Boat claim elements which I believe should be investigated for possible violation of fraud or false claim statutes.

More than six months have elapsed since I submitted my first report regarding possible fraud in the Newport News' claims. As I understand it, two attorneys in the office of the Navy General Counsel have been given the task, along with their other duties, of reviewing these reports and of determining whether the claims should be forwarded to the Justice Department for formal investigation.

Senior Navy and Defense officials seem reluctant to investigate grossly inflated claims by shipbuilders, some of which involve hundreds of millions of dollars. This reluctance could stem from several reasons. Many of these officials came from industry or from law firms and may see nothing wrong with what these companies are doing to try to enhance their profits. Some may be reluctant to pursue the false claims issue, for fear of being criticized for not promoting "good relations" with contractors, or for scuttling a potential claims settlement, or for not seeing the "big picture." Moreover, corporations can bring great pressure to bear and cause delays so that it might take years to complete an investigation.

Large shipbuilding claims can be important to conglomerates as a means to defer or perhaps avoid having to report losses to their stockholders. The profit projections they use assume a given recovery under the claims. To the extent the figure assumed is greater than the amount the Navy determines it legally owes, the company has a strong incentive to avoid settlement through whatever means are available, including lengthy litigation, while it tries to pressure the Navy into a higher settlement offer.

Inflated claims also increase a shipbuilder's chances of getting paid more than he is contractually owed, or getting a lucrative settlement based on the Government's assessment of "litigative risk" and "litigative cost". "Litigative risk" is the amount Navy lawyers include in claims settlement offers to account for the possibility of losing in the Armed Services Board of Contract Appeals or in court. "Litigative cost" is the amount the Government estimates it will spend to defend itself before the Board or in court. The larger and more complex a claim is, the more costly it is for the Government to litigate and the greater the risk that a shipbuilder, with his high-priced lawyers, can obfuscate the issues and win a favorable decision in litigation. Of course, "litigative risk" and "litigative cost" are highly subjective assessments which can be used to pay off claims while ostensibly settling them only on their so-called "legal" merits.

If Federal statutes covering fraud and false claims are not enforced, contractors will continue inflating their claims. Under these conditions the Government will continue to waste millions of dollars evaluating highly inflated claims which have little or no substance.

In my opinion, the Defense Department and the Justice Department should strictly enforce the False Claims Act and criminal statutes including those pertaining to fraud. Prior to settling a claim, the Contracting Officer should be required to certify that no evidence of fraud or false claims has been uncovered in his review. If such an affidavit cannot be made, all evidence discovered should be thoroughly investigated for possible fraud, with the assistance of the Justice Department.

I have testified previously and at length regarding the need for other improvements in the area of shipbuilding claims. These recommendations are as follows:

1. Authorize the Navy to hire outside counsel and such other assistance as is necessary to help with claims and claims-related matters. These lawyers should be authorized to perform any services in connection with these claims except representing the Government in court, which is properly the function of the Justice Department. We are not presently getting adequate legal support from the Office of Navy General Counsel.

2. Develop a permanent group of outside claims specialists including technical personnel, procurement experts, and attorneys to review and analyze major claims, do legal research, prepare legal documents, interview witnesses, and help prepare the Government's defense under the direction of Government personnel. Presently, the burden of claims analysis is being borne by Government personnel to the detriment of their assigned responsibilities.

3. Require as a matter of law that prior to evaluation of any claim, the Government must obtain and the contractor must submit a signed certificate from a senior contractor official that the claim and its supporting data are current, complete, and accurate. There is presently a Navy requirement to this effect, but it is not always enforced.

4. Costs incurred by the Navy in evaluation of invalid portions of claims should be set off against the amount determined to be legitimately owned. This should discourage shipbuilders from using frivolous items in their claims.

5. Prohibit contractors from changing their claim after it has been finally submitted to the Contracting Officer. Following review by the Government, the contractors should be given an opportunity to furnish additional information needed to support the claim where the Government review indicates weakness. However, new theories of entitlement and new claims submissions should be barred. Often the Navy's claims analysis effort is frustrated by the constant revising of claims.

6. Require litigants and their attorneys to disclose at the outset of any commercial litigation all facts, whether favorable or unfavorable, relating to their lawsuit. In filing a case before the courts or administrative boards, the plaintiff and his attorneys should be required to sign a stringent certificate that the information submitted in support thereof is current, complete, and accurate. Criminal penalties and disbarment proceedings should be invoked for false certifications. Under our present system, some shipbuilders contend that they are not required to disclose facts which would tend to undermine their claims.

7. Change the operation of the Armed Services Board of Contract Appeals as follows:

a. Give the Government the same right as contractors to appeal adverse decisions of the Armed Services Board of Contract Appeals. Presently, the Government has no recourse in the case of a bad Board decision or one in which the Board has exceeded its authority.

b. Until such right of appeal to the Courts is granted, the Departent of Defense should provide for internal review of Armed Services Board of Contract Appeals decisions. Particular attention should be paid to questions of whether the Board is exceeding its authority.

c. Make any material obtained by contractors under the Freedom of Information Act, which is not obtainable by discovery proceedings, inadmissible against the Government before any Contract Board of Appeals or in any litigation. As it now stands, contractors can circumvent Board or Court restrictions on discovery by using the Freedom of Information Act. The Government has no such comparable rights.

d. Discontinue trials *de novo* before the Armed Services Board of Contract Appeals. Only evidence submitted to the Contracting Officer should be allowed before the Armed Services Board of Contract Appeals. Today a shipbuilder can present the Board an entirely different case than he has presented to the Contracting Officer.

e. Promulgate a Board rule that law firms who violate the ABA Code of Professional Responsibility are not allowed to appear before the Board. Require that no one in the Defense Department shall do business with law firms which are in violation of the ABA Code of Professional Responsibility. At present there seems to be no effort by the Department of Defense to ensure that attorneys practicing before the Board comply with the ABA Code.

The above are my recommendations for improving the handling of contract claims. I recognize that some shipbuilders stand to lose considerable sums of money on their Navy shipbuilding contracts if their contracts are enforced. So be it. That is how free enterprise is supposed to work. Some of these losses result from mismanagement; some from unanticipated events which the contractor may not have foreseen, but which under the terms of the contract are not the legal liability of the United States Government. But, the point is that if shipbuilders are excused from their contracts, other Defense contractors will want similar treatment when they experience losses on their Government contracts. I view the problem this way: if contracts are not to be enforced, there is no sense negotiating them.

There has been a tendency for some of our transient Defense and Navy officials to believe the shipbuilding claims problem can be solved if only a way can be found to pay contractors their projected losses. These officials forget that if the Government had picked up the tab for such losses at any time in recent years, we would still have large claims today. For example, five years ago the Litton LHA claim was for about $270 million. By 1976, the claim had grown to over $500 million. Today, the Litton LHA claim totals over $1 billion.

The Electric Boat SSN 688 Class claim is another example. In early 1976, the Navy settled all outstanding claims on the first SSN 688 Class submarine contract through May 20, 1975, for $97 million. Then, General Dynamics officials offered the Navy a total claims release on both the first and second SSN 688 Class contracts for an additional $53 million. The Navy could not accept that offer since it covered a claim which had not yet been presented.

Shortly after the $97 million settlement, Deputy Secretary of Defense Clements introduced his plan to settle shipbuilding claims using Public Law 85–804. Under that plan, General Dynamics and the Defense Department reached tentative agreement to settle all remaining claims on the two SSN 688 Class contracts at Electric Boat for about $170 million—almost $120 million more than the company's previous settlement offer. As late as November, 1976, General Dynamics was still asking the Defense Department to accept the $170 million Public Law 85–804 claims settlement.

By February 1977, however, the company's cost estimates for the SSN 688 Class construction program increased such that even a $170 million settlement would have left the company deeply in the red. Moreover, costs have been overrunning so that even if the Government had in February 1977, paid Electric Boat all losses being projected at that time, the company would again find itself in a substantial loss position by the 1st of December. Had the Government paid off the losses being projected on the 1st of December, the company would again find itself in a projected loss position as of today. To anyone considering a one-time payoff as a solution to the shipbuilding claims problem this should be a sobering thought.

In extraordinary cases where the Government decides to bail out a shipbuilder under Public Law 85–804, the Navy should ensure future access to the shipyard's production facilities. This could be done by buying the shipyard and having a contractor operate it as a Government-owned, Contractor-operated plant. Alternatively, the Navy might be able to enter into a long-term leasing arrangement so that if the contractor subsequently threatened to deny the facilities for Navy work, the Navy could make them available to another contractor.

My proposal to acquire certain shipyards and operate them as Government-owned, contractor-operated plants rather than just to reform contracts in response to shipbuilder threats has been criticized as an attempt to nationalize the shipyards, and as being contrary to the "free enterprise" system and defense procurement policies.

It is not, nor is it meant to be, a punitive measure, as some have suggested, nor a method for the Navy to run private shipyards. What I envision already exists throughout Defense procurement, in the Department of Energy, and elsewhere. In many places, the Government owns the production facilities and a contractor manages them for the Government. That is supposed to give the Government the benefits of private industry in cases where the Government owns the facilities.

Personally, I have always advocated relying on private industry to provide the facilities as well as the management expertise needed to fulfill the Government's needs. But if the Navy excuses a shipbuilder from a contract, it may again find itself faced with threats of work stoppage or refusals to take new business whenever the shipbuilder wants his contracts repriced.

Keep in mind I am only advocating the Government-owned, contractor-operated plant approach in cases where the Government decides it must bail out an essential shipbuilder. Moreover, I advocate the Government paying fair value for any shipyard it would acquire under these circumstances as part of the overall settlement so that the Government would not in any sense be confiscating private property.

The last minute withdrawal of the Electric Boat claim from the Navy Claims Settlement Board and a new agreement to defer litigation on the Litton contract dispute indicate the possibility of another effort to settle the claims at these two yards on other than their legal merits. As I have previously explained, I believe the Government should enforce its contracts. However, I also recognize that senior Defense officials have responsibilities far broader than my own and may, for their own reasons, arrive at different conclusions.

Defense officials have the authority to settle claims by granting extra-contractual relief under Public Law 85–804 whenever they determine this would facilitate national defense. In such cases, however, great care should be taken.

I believe that the following criteria should be applied in resolution of the claims on a basis other than strict legal entitlement:

The true financial condition of the corporation should be determined by Government audit. Corporate officials sometimes tend to exaggerate the severity of their financial situation in dealing with Government officials.

Attempts to reach an overall settlement of shipbuilding claims should in no way prejudice the Government's ability to enforce the terms and conditions of existing Government contracts.

The worth of the claims should be determined. The Navy, the Congress, and the public should know just how much of the amount claimed is valid.

The provision of extra-contractual relief should not in any way excuse a contractor from any legal liability he might have under Federal fraud or false claims statutes.

The settlement should not establish a precedent which the Navy would be unwilling to apply to other claims-troubled contractors if they are essential to national defense and if their continued ability to perform is in jeopardy.

The Government should try to get back, to the greatest extent possible, as much in value as it gives up.

The settlement should guarantee the future availability of facilities to the Navy well into the future—say 25–50 years, together with the contractual right to change contractors. In this way, the Navy will not continue to be vulnerable to threats of work stoppage whenever a shipbuilder encounters financial problems.

The settlement should specify how subcontracts should be handled. Shipbuilders should not be permitted to later bail out subcontractors at Government expense.

The settlement should constitute a one-time permanent solution at that shipyard so that the Government does not again find itself in the dilemma of having to choose between getting ships and enforcing contracts.

Senator PROXMIRE. Admiral, Electric Boat argues that their problems in constructing 688-class submarines are caused by the Government's design.

Has Newport News experienced problems to the same extent as Electric Boat constructing its 688-class submarines?

Admiral RICKOVER. Not to the same extent, sir, although they have problems, too. Newport News happens to be the design contractor for the SSN 688 class, under a completely separate contract.

We made a cost-plus contract with the Newport News design outfit for designing the ship and we made a separate contract with Newport News as a shipbuilding corporation.

However, if there are mistakes in the Government-furnished design made by Newport News, the Government is responsible.

Now, I will give you a specific answer to your question.

Electric Boat incurred substantially greater costs and expended many more man-hours in building their first 688-class submarines, than Newport News did in building the *Los Angeles*, the lead ship.

Current projections for the fourth 688-class ship at each shipyard indicate that Electric Boat is still substantially more costly than Newport News.

Senator PROXMIRE. As I understand it, the Electric Boat contends the Government made 30,000 drawing revisions.

That seems like an awful lot. Would you comment on that?

Admiral RICKOVER. That is a big red herring.

In the 688-class submarines, we expected from the very beginning about six changes per plan. Now, this number of changes, to somebody who doesn't understand it, sounds horrendous. But, the revision might just be a change of a word or a comma or something like that.

We generally figure on a new contract, the Navy does, changes will cause about a 5- to 6-percent increase in the cost of a ship.

Senator PROXMIRE. Were these changes at about the same proportion back in 1967?

Admiral RICKOVER. Yes.

Senator PROXMIRE. When the claims were about 2 percent of what they are now?

Admiral RICKOVER. Yes, just about the same.

Senator PROXMIRE. So, there has been no increase in changes that would account for this enormous increase in claims?

Admiral RICKOVER. No, sir. The same number per drawing. Changes altogether in the cost of a ship run about 5 percent, that is all. Yet you get claims which are almost the same amount as the original contract prices.

That in itself should show you what sort of game this is. The people who testify have statements prepared for them blaming the Government. Actually some probably give orders as I read to you in one case where the senior official says you go ahead and put in any claim you can find until you cover the costs.

Senator PROXMIRE. Now, I know you have had experience with Government-owned, contractor-operated plants for the Department of Energy. You talked about that as kind of a yardstick, I guess. What are the key features of this kind of an arrangement?

Admiral RICKOVER. The key feature is this: The Government owns the plant and the facilities and a commercial contractor operates it. It could be any big company. The Government pays the costs and the fees are pretty low.

I think that the fee we pay in our Energy Department laboratories is about 2.6 percent, something like that. We pay a very low fee. If we see an inefficiency, we have the right to stop it.

With our present shipbuilding contracts, we have no legal authority to do this. Absolutely none.

So, once we make a contract with a shipbuilder, as it has turned out in recent years, there is no incentive for management to worry about the yard. The shipyards are owned by a conglomerate. They go around looking for more business, more profit.

Senator PROXMIRE. So the Government-owned contractor-operated change would give you that authority that you need?

Admiral RICKOVER. Yes, sir. The Army and Air Force make extensive use of Government-owned contractor-operated plants in making their equipment, so GOCO shipyards would not be all that heretical.

Senator PROXMIRE. Now, would converting a shipyard to the Government-owned, contractor-operated operation solve the productivity problem that you mentioned, the shipyard's experience generally?

I realize there is some improvement but do you think it will be a——

Admiral RICKOVER. First, the Government would have to own all land and facilities. The private contractor, as I said, would then be paid a small fee under a cost reimbursement contract with the Government for operating it.

The contractor would be responsible for managing work, providing the personnel, organizing the plant, and so on, subject to review and approval by the Government.

If the contractor failed to perform well, the Government would have the right to replace him with another contractor to operate the facility. While the idea of Government-owned, contractor-operated shipyards is not a panacea for the current shipbuilding contract problems, it would guarantee the Navy access to the facilities and put an end to the claims business.

Do you get that point, Mr. Chairman? This would put an end to the claims business, allowing both the Navy and the shipbuilding personnel to concentrate on the difficult task of building ships.

You would be surprised at the large portion of the technical talent in the Navy that is employed in these claims problems. That is one reason we are going to fall behind in our technical work, so much of this work has to be done by engineers.

We are going to fall behind technically if we keep on with this charade that we are going through. It is just a moneymaking proposition for the shipbuilders and the technical people who are responsible for the military strength of this country have their expert time taken up in this sort of nonsense.

A GOCO shipyard would be better than negotiating a fixed price-type contract, analyzing inflated claims and then having to bail out the shipbuilder anyway just because he is incurring a loss for which the Government is not contractually responsible.

Shifting to a GOCO operation would not in itself solve the present productivity problems. However, it would facilitate their resolution, by allowing personnel to concentrate on shipbuilding instead of contractual financial problems.

It would also eliminate any incentive to try to manipulate the operation for financial advantage rather than producing ships efficiently. I mentioned to you the report we submit concerning shipyard efficiency. If it is a navy yard we can take action with that navy yard to improve the situation.

We cannot interfere with the private shipyard. They make a fixed-price contract with the thought they will perform efficiently but, actually, they do not care; not in this climate.

Senator PROXMIRE. Do you think it would be feasible to have one or two shipyards operated on a GOCO, Government-owned, contractor-operated?

Admiral RICKOVER. Yes.

Senator PROXMIRE. And the rest privately operated, could the Navy have a reliable procurement system that way?

Admiral RICKOVER. Yes, sir; it would not be necessary to make all shipyards GOCO unless we could do better—I am not in favor of converting privately owned shipyards to GOCO as long as the shipbuilders will honor their contracts. I am in favor, as I said previously, of pure capitalism which means integrity and true competitiveness. I am all in favor of that.

I would like to see these goals restored but I believe you find, all over the United States, more and more monopolies are being created by so-called capitalists who are destroying the capitalist system, which in my opinion has made this country great.

Any other system, communism or socialism, is an anathema to me because, ultimately, they must stifle initiative.

But, what difference is there today? We are adopting the Communist system in the way our industry is run. It is really Communistic. If we have some big organization in control, what is the Government's responsibility for protecting the entire people? The taxpayer is not aware of these problems. He never reads testimony on these esoteric matters.

He doesn't realize how he is being ripped off. And my reason is not only to save money. My reason is to get a better job done faster, it is not only a matter of money.

Senator PROXMIRE. Let me get back to that problem you had with your being harassed and held up and the unequal situation with the lawyers of the opposition questioning you at length.

You have testified in past years about the desirability of the Navy being able to hire outside counsel to assist in resolving the claims problems.

Do you still feel there is need for outside counsel?

Admiral RICKOVER. Absolutely, sir. Take the present case, the Justice Department within its own ability is doing an outstanding job in representing the United States. But they don't have enough lawyers to prepare a case the same way their opposition does.

The other lawyers spend days preparing and then I am deposed. After a number of them take plenty of time off to figure out what is the next entrapment question, I am hauled up before them. What we need is an analysis of the claims issue, we don't have the legal talent to do that.

Senator PROXMIRE. You previously testified to the effect that the Government doesn't always get a fair shake in the Armed Services Board of Contract Appeals. What is the basis for your conclusion?

Admiral RICKOVER. The contractor has a right to appeal from a decision of the Armed Services Board of Contract Appeals. The Government does not. However, there has been a recent case decided by the Court of Claims which appears that the Government may have a right. But the Armed Services Board of Contract Appeals is like any other agency, pretty soon they get a life of their own and they start making law.

They are making laws, once they decide a case with new legal principle. Like the laws of the Medes and Persians, it becomes forever engraved on a tablet of stone.

Senator PROXMIRE. I would like to ask you to respond to what seems to me might be some of the logical complaints that the shipbuilders themselves have. They complain, for example, that it takes too long to settle shipbuilding claims and that that is a sore point in their relationship with the Navy. What is your comment on that?

Admiral RICKOVER. I believe I cited, as an example the Electric Boat claim. Electric Boat has complained about the length of time required to settle claims, but their claims were submitted very long after the facts, years after the events happened. That is another sore point. As a result of prodding from Congress, the Navy instituted a system to deal with changes. They claim Government changes are largely responsible, but that is farfetched. As I said, changes on recent contracts are only about 5 percent.

We arranged a procedure which was accepted by the shipyards and is accepted by all contractors with whom I deal. Under this procedure, if the Navy wants to make a change we write a letter to the company and ask them what it will cost and they tell us.

If we consider it reasonable, we go ahead with the work and reimburse the contractor. That reimbursement includes the delay, if any, in the ships they are building.

If we don't think it reasonable, or if we think we could do it cheaper somewhere else, we don't proceed with the change.

Now, the shipbuilders' lawyers are attempting to prove this procedure is "illegal." I make an analogy. Suppose you want to order a new suit of clothes from the tailor. After he starts making it, you would like to have another button added.

You go in and talk with him and ask what it will cost and he tells you. If you don't like the price you tell him not to add the button.

If you accept the price, you pay the extra amount.

What is wrong with this concept? I know you are not a lawyer, sir, but you had to be reasonably intelligent to get elected to Congress. What do you think of that argument?

Now, the shipbuilders are saying many of the work items that they accepted for no increase in contract price several years ago are changes. These items are now the subject of multimillion-dollar claims. How do you like that?

They accept these items at no additional price or told us what it would cost in disruption—what it would cost to do the work and we paid. Now, lawyers are grilling me to destroy a theory which has been accepted by the company and used, grilling me in an attempt to prove that the agreed upon procedure is illegal.

Senator PROXMIRE. What you are saying is this: The contractors by and large are responsible for dragging out this procedure; furthermore, it is to their interests to do so and the system is so structured to encourage them to do so.

Admiral RICKOVER. Yes, sir.

Senator PROXMIRE. The longer they drag it out, the more they get, the higher the profits they get?

Admiral RICKOVER. That is correct, but there is another point to consider. Anyone who knows the facts in these disputes is likely to be gone in a short time. Don't think that is a foolish point.

Senator PROXMIRE. Except you.

Admiral RICKOVER. This is not only a point to consider—it is actually the case.

Senator PROXMIRE. Except you, you have been there since 1918. You outlasted most of the contractors.

Admiral RICKOVER. I have not been in this job since 1918, although——

Senator PROXMIRE. Yes, among official negotiators, there is a turnover.

Admiral RICKOVER. Although dealing with these lawyers has certainly sharpened my wits and given me another concept of how this society works. Let me tell you it has depressed me very much to see as I said——

Senator PROXMIRE. Admiral, with all this depressing testimony, I think that we have to recognize that this country has done pretty well in some ways with shipbuilding. We still have the best Navy ships in the world, most people feel that the one clear reliable deterrent we have against the Soviet Union is our submarines.

There is considerable question about the air part of the Triad and missile part of the Triad but the submarines are considered to be faster, quieter, more efficient in virtually every way.

Our Navy has built great ships.

Admiral RICKOVER. I will not comment on the statement of faster and quieter because of the classified nature of the subject.

Senator PROXMIRE. It is classified, I realize, but that is the general view.

Admiral RICKOVER. But I will comment that the shipyards themselves could never all alone design and build these ships. Recently, or a few months ago, Mr. Diessel, the president of Newport News, during a speech at a launching made essentially this statement: "The Government gives us a blank sheet of paper and we have to go and design the ship."

It occurred to me—if all they get from the Government is a blank sheet of paper—how could they submit $894 million worth of claims based on a blank sheet of paper? It occurs to me that question has never been answered.

There must be a partnership between the Government and the shipyard in order to build ships as complex as today's submarines, aircraft carriers, nearly all vessels.

With a tanker you can build from a standard plan and the consequences of anything going wrong are not anywhere near as serious. But when you consider a complex ship, especially a nuclear-powered ship, there must be complete cooperation between the design and construction people of the yards and the Government and as far as the working people are concerned, this cooperation prevails.

We have no problem with the working people. The real problem is with the financial managers whose objective is not really to build ships, but is to make money. This whole claims situation is made out to be a clash in personalities. It is not. There is one word that describes the problem—money.

I would like to say a few more things and I will be through—may I?

Senator PROXMIRE. Before you finish, may I ask you a couple questions because they relate to what we have just been talking about.

Not only is there an argument that our ships, after all in spite of all the criticism, are of high quality, but they complain that their profits are too low. You say, well, they don't have to get into it. But one of the reasons they get into it is the very reason you are testifying to. They can look forward to claims and pad out their profits. But what I am saying is they would argue that the profits that they can anticipate if they don't file claims are inadequate, and among their arguments on this is the fact that there are so few shipbuilders.

It is not an area where corporations are rushing to get into it. Capital isn't attracted to it. That would argue it is not a very profitable operation basically.

Admiral RICKOVER. I can agree in some cases shipbuilders are not making a profit. But what are the reasons? what about their own inefficiencies? I don't agree that where a firm takes on a job like this, signs a contract, and then pays very little attention to how the work is done—perhaps because he has a feeling in back of his mind that the Government is going to pay whatever it takes—I don't agree the Government should guarantee him a profit.

There isn't any incentive to build ships efficiently. There is not the capitalist incentive. Again, I would like to point out that in the capi-

talist system there is risk. There is no risk in this game if we are just going to pay them off.

Senator PROXMIRE. Well, there certainly isn't a risk when you have this kind of a claims settlement. But I wonder if we cannot balance this out where we work out a system that provides for a substantial profit.

I agree with you that our system is the best but the cornerstone of our system is profit, incentive for profit, so that those who are efficient can make high profits. They should. That is good and I applaud it. I am sure you do, too.

Admiral RICKOVER. I have thought about this a great deal, and I cannot see any other way. I don't know of any other viable method with our system of government, except a GOCO operation, where it is necessary, and then we could step in and point out things that are wrong.

We can give guidance, advice and directions to the men who are running GOCO shipyards. We have done that from time to time under other GOCO operations. We cannot order private shipyards what to do. We can only tell them what we consider to be a problem. But in a GOCO operation if we think management is doing something wrong, we can tell them and they must correct the situation or we will get new managers.

We operate the two laboratories under my jurisdiction under a GOCO arrangement and they make a profit. The parent companies make a profit. It is not large, I believe it is only about 2.6 percent but it is all earned money.

Now, may I read this?

Senator PROXMIRE. Go right ahead, yes, sir.

Admiral RICKOVER. The responsibilities of Government officials involved in the administration of these contracts are twofold:

First, to assure that the work is properly performed in accordance with the contract terms.

Second, to insure that public funds are legally spent.

The evidence presented in the claims is from the viewpoint of the contractors, not from that of those paying the bills.

Shipbuilders have been willing to settle their claims for far less than the amount claimed and this alone should cause one to question the validity of the amounts. This may also explain the reluctance of some company officials to certify their claims.

Theoretically, the burden of proof rests on the contract. In practice it is the Navy or any other Government agency that must construct whatever legal case the contractor may have. This is very time consuming.

Some claimants would have you believe that the whole problem has been created by a conflict of personalities. They have made shipbuilding claims a political and personal matter. In actuality, it is simply a matter of money.

Some say I have no business becoming involved in or criticizing the DOD's contracting or claims settlement practices. They say that any criticism should be left to those whose job it is. But some of them have ceased to be capable of self-criticism.

Although they have great power, they act as if Prometheus had become manager of a match factory.

Although financial dishonesty is of great importance, the real evil that follows general commercial dishonesty is the intellectual dishonesty it generates.

That is a very grave point. This dishonesty permeates much of business today which you know from all the bribery revelations and and many other scandals that have surfaced in recent years. The recording angel may occasionally shed a tear for a sinner but I doubt he will do so for those officials and the shrewd claim lawyers.

A new attempt is now being made by the Defense Department to settle claims. Those involved have implied this will be accomplished in a short time.

What new magic have they developed when all previous quick solutions have not worked and since it has taken the Contract Appeals Board which consists of expert people, such a long time?

I recommend legislation that would make public the records behind company profit calculations. That would help protect the so-called owners of the corporations; I mean the stockholders. You could have the Securities and Exchange Commission report on their profits and what their true financial position is. This would be essential information if a settlement is made.

I strongly urge you to consider that. I think you have some contact with the SEC. I strongly urge, because——

Senator PROXMIRE. Yes, we have jurisdiction over the SEC in the Banking Committee.

Admiral RICKOVER. If senior officials want to help out these conglomerates, let's first see what real profits the conglomerate is making. The SEC has expert people. Perhaps they should get involved before such a settlement is reached.

This is one of the most important suggestions I have offered you for sometime. I hope you will consider it, sir.

History is not wholly a realm of fact. It is also a realm of values. An appeal to principle is, therefore, the condition of any social advancement. Social institutions are the visible expression of the moral values which rule our minds. We cannot alter institutions without altering moral values. Men can make a better society but it will only come from belief in some higher order.

Senator PROXMIRE. Admiral, thank you very, very much for your excellent testimony. It is most useful. I believe you have made a brilliant analysis of his situation and an analysis that will help us to work out solutions.

You have also come out with some very constructive positive ways in which we can make progress. We are very grateful to you for your testimony.

Admiral RICKOVER. I in turn would like to thank you sir, for the privilege and opportunity of appearing before you, and testifying exactly as I believe, which is how I have been testifying, as I think you can tell by the depth of sincerity of my remarks.

The people of the State of Wisconsin should be congratulated for having had the wisdom of electing you and keeping you in your job.

Is that a good campaign pitch for you?

Senator PROXMIRE. That is a great one, yes. I just wish you could vote in Wisconsin.

Admiral RICKOVER. Well, maybe you can get a special law passed establishing a temporary residence for me.

Senator PROXMIRE. We will make you an honorary citizen, instead.

Admiral RICKOVER. Do that, entitled to vote, yes.

Senator PROXMIRE. Very good.

Our next witness is Admiral Manganaro, who I take it is here. He is Chairman of the Navy Claims Settlement Board, the Board we have been discussing.

I don't know if you were here for the testimony of Admiral Rickover.

TESTIMONY OF REAR ADM. F. F. MANGANARO, CHAIRMAN, NAVY CLAIMS SETTLEMENT BOARD, ACCOMPANIED BY RONALD J. LIPMAN, BOARD ATTORNEY; AND CAPT. W. J. RYAN, BOARD MEMBER FOR BUSINESS AND CONTRACTUAL MATTERS

Admiral MANGANARO. I was not.

Senator PROXMIRE. Well, we discussed your Board in some detail. It is central to our concern about Navy claims, of course. I understand that you have no statement, but you are here to answer questions, is that correct?

Admiral MANGANARO. Yes, sir. I brought Mr. Ron Lipman, the Navy Claims Settlement Board attorney; and Captain Ryan, the Board Member for Business and Contractual Matters. I am the contracting officer and Chairman of the Board.

Senator PROXMIRE. Admiral, will you tell us when the Board was established and briefly summarize the charter given to it?

Admiral MANGANARO. The Navy Claims Settlement Board was established in July 1976 by the Chief of Naval Material with the approval of the Deputy Secretary of Defense, then Mr. Clements.

Senator PROXMIRE. I think that followed our hearings that this committee held on Navy claims. Just before that we had had hearings on this and this was one of the responses which I think was very constructive.

Admiral MANGANARO. My Board was delegated the authority for making the Defense Department determinations on the claims assigned to it, at that time only the Newport News claims.

These determinations were to be subject only to the contractors' appellate right to the Armed Services Board of Contract Appeals. In July 1976, the Board was initially assigned all of the shipbuilding claims from Newport News Shipbuilding & Drydock Co., which, at that time, totaled $892 million in claimed ceiling price dollars.

The Board commenced analysis of the claims and entered into negotiations on the first claim with Newport News Shipbuilding & Drydock Co. in November 1976; and on February 11, 1977, the nuclear cruiser 36–37 claim was settled for $44.4 million.

We have conducted the analyses of the Newport News claims in parallel with the objective of achieving the ability to make an offer of settlement sometime prior to the end of this year. Essentially I am ready to do that. At the present time, we are completing our efforts to negotiate a settlement on the nuclear attack submarine 686–687 claim. Unfortunately, I have been advised by the company that our final offer to settle that claim has not been accepted.

The responsibilities of this Board were increased on March 1, 1977, when two claims submitted by the Electric Boat Division of General Dynamics were assigned to the Board for analysis and settlement. These claims had been submitted to the Navy in early December 1976. The total ceiling price of these two claims combined was $544 million. It covered two contracts for the construction and delivery of a total of 18–688 class submarines.

We commenced our work of evaluating that claim and continued until December 1 of this year when our efforts on that analysis were terminated.

Senator PROXMIRE. All right, sir. When the Board was established, there was a Chief of Naval Material memorandum, Admiral Michaelis, dated July 1, 1976. Let me read that to you:

> To be successful, the Board must not be subjected to outside pressures, influences, and unsolicited advice. I expect you to be fully supportive in this regard and to be accountable for the actions of your subordinates as well.
>
> I want you to imbue your organization with the necessity for thorough and rapid responsibilities when called upon for input into the disciplines under your cognizance. At the same time your people must stand apart from claims resolution activities of the Board.
>
> Strict adherence to the guidance contained in enclosure 2 is mandatory for all concerned. The emphasis is that you should be free from outside pressures, influences, and unsolicited advice.

That was part of your charge?

Admiral MANGANARO. Yes, sir.

Senator PROXMIRE. Now, Admiral, the Newport News claims totaled $894 million when you first began working on them. How many people did you assign to that task and how long did it take to complete the review of the Newport News Claims?

Admiral MANGANARO. The number of engineers and attorneys varied over a period of time. I think the best response I can give you is that we have had a number of engineers and attorneys which varied between a low of about 10 to a high of about 40 working on these claims in different areas.

At one time, the Board had a total of about 22 attorneys working on all of the claims.

Senator PROXMIRE. Is the time it has taken to review the claims disproportionate to the time in your judgement that the contractor took to prepare them?

Admiral MANGANARO. That is a difficult question. The time that it takes to prepare the analysis of a claim is directly related to the knowledge that the people evaluating the claim have concerning what took place when the contracts were ongoing. The approach I have taken is to make use of a small number of people drawn from those who worked on the management of the contracts. As a result, we have made significant progress with a relatively small number of people.

It is difficult to say whether the time is disproportionate to the time spent by the contractors because I really don't know how many people and for how long the contractors have had their people working on these claims. There is no question in my mind that if you use people without background and experience, it can take several hundred to analyze these claims. It takes a long time for them to become knowledgeable about what happened when they didn't participate in the events themselves.

Senator PROXMIRE. How long did it take to review the Newport News claims?

Admiral MANGANARO. Approximately 16 months.

Senator PROXMIRE. Sixteen months?

Admiral MANGANARO. Yes; to review all of them. Essentially we are finished.

Senator PROXMIRE. Now the Electric Boat claims were $544 million when you began reviewing them. How many people worked on them and how many did the work before Secretary Hidalgo directed you to stop working on these claims?

Admiral MANGANARO. We commenced our work on those claims in March of this year.

Senator PROXMIRE. 1977?

Admiral MANGANARO. Of this year, yes, sir. The group at Groton was working on this claim from about the 1st of December of last year.

Senator PROXMIRE. Was that 10 to 20 or 30 people again?

Admiral MANGANARO. Yes, sir.

When we began our work in March of this year, we assigned three attorneys here in Washington to work full time. A lead engineer with two people to help him was also assigned. Next, I made the assignments as to which items were to be evaluated in Connecticut and which were to be done in Washington.

We maintained that number of people up until December, dropping a few off as we completed certain items.

Senator PROXMIRE. Were there ever more than six working on it?

Admiral MANGANARO. Yes, sir, most of the time.

Senator PROXMIRE. What was the maximum number at any one time?

Admiral MANGANARO. Twenty to twenty-five.

Senator PROXMIRE. And then how long did they work before Secretary Hidalgo told you to stop working on the claims?

Admiral MANGANARO. They worked up until December 1.

Senator PROXMIRE. The 1st of December. Now did Secretary Hidalgo discuss the Electric Boat claims with you before he took it away and did he explain why he was taking it away?

Admiral MANGANARO. We have discussed the Electric Boat Co. claims on numerous occasions. Secretary Hidalgo has not discussed with me the reasons other than to incidate that additional negotiations were contemplated.

Senator PROXMIRE. Well, did he indicate he would undertake negotiations before review was completed or before your review was completed?

Admiral MANGANARO. He didn't indicate either way to me.

Senator PROXMIRE. In your judgment how long would it have been before you would have been able to complete your review on these claims?

Admiral MANGANARO. Two to four weeks.

Senator PROXMIRE. Two to four weeks?

Admiral MANGANARO. Yes, sir.

Senator PROXMIRE. Based on your experience with the Board, what is the shortest reasonable time it should take for the new team such as the Special Steering Group to fully review the Electric Boat Co. claims?

Admiral MANGANARO. That is difficult to say. I would estimate that within 2 to 4 months they could review the claim itself, the analyses that have been prepared to date, the related decisions, and become knowledgeable enough to proceed from there.

Senator PROXMIRE. But if you had been allowed to continue, you would have been through by now. You say "2 to 4 weeks," that was the 1st of December. Now it is about the 30th—29th rather. You would have been through by now?

Admiral MANGANARO. I would have been through to the point where I would be able to prepare an offer to negotiate a settlement.

Senator PROXMIRE. Since your team took 8 months, how could a new team take only 2 to 4 months to do the job?

Admiral MANGANARO. Because the factfinding for a large portion of the claim has been accomplished, and the information has been developed upon which to base a decision.

Senator PROXMIRE. So they would have to use the work you have already done?

Admiral MANGANARO. Yes, sir.

Senator PROXMIRE. Now if in the course of your review it appears that elements of the claim may violate fraud or false claims statutes, does the Board consider it important to indicate and report them?

Admiral MANGANARO. Yes, sir.

Senator PROXMIRE. What instructions have the Board issued to the claims team working for the Board, to insure that any possibility of violations of fraud or false claims statutes contained in the claims is promptly reported for investigation?

Admiral MANGANARO. Report such items to the executive secretary of the Board.

Senator PROXMIRE. Now, Admiral Rickover said that—let me come back to that in a minute. I have got a further question on fraud.

Whether or not the claims violate the law based on the Board's rereview to date, do you consider the claims as submitted are prepared in a proper manner or do you think that the shipbuilders are abusing the contracting system?

Admiral MANGANARO. The answer to your question about the preparation of the claim is, no, I don't think the claims are prepared in a proper manner. They are frequently referred to as "omnibus claims."

Generally speaking, an omnibus claim is a claim which is unlike the type you and I submit to our insurance companies when we have an automobile accident. An omnibus claim is one which identifies a series of causes and a number of effects, and then attributes those effects to those causes.

I am sure that if you notified your insurance company that you had had an automobile accident on the east coast in one of your cars driven by someone in your family and the cost of putting that car in good condition was $100, you wouldn't get paid. That, to me, is a kind of an omnibus claim.

If you notify your insurance company that you had an accident on a certain day, at a certain place, in a car driven by you, and the specific conditions under which the accident occurred, the insurance company would evaluate the claim and decide whether or not you should be paid, in accordance with the contract it has with you.

Senator PROXMIRE. So you are saying the claims don't describe the cause or effect, it is up to the Navy to ascertain that?

Admiral MANGANARO. Not quite. The claims do describe causes and they do describe effects. However, they do not provide a straightforward cause-and-effect relationship for all items. For the simple ones, usually they do. For complicated items such as delay and disruption—which are also the high-priced items—the cause-and-effect relationship is very difficult to specify clearly—which must be done if we are to pay, based upon entitlement under the terms of the contract.

Senator PROXMIRE. See if I understand this.

Does this mean that it imposes a great burden on the Government to do the work that the contractor might do to be more specific and detailed?

Admiral MANGANARO. Yes, sir.

Senator PROXMIRE. It does require more work on the part of the Government?

Admiral MANGANARO. Yes, sir.

Senator PROXMIRE. Has your Board ever filed any charges of possible fraud?

Admiral MANGANARO. No, sir, I have not filed any charges of possible fraud. Since I am not an attorney, I do not understand completely all aspects of what constitutes fraud. I have notified the General Counsel's office of items which I consider to be significantly inaccurate, potentially false or possibly fraudulent, so that the General Counsel of the Navy can determine whether or not such items should be referred to the Justice Department.

Senator PROXMIRE. Has the General Counsel taken any action on those reports that you have submitted?

Admiral MANGANARO. I don't know what actions he has taken. I do know that there is a General Counsel's staff investigation of those items and others.

Senator PROXMIRE. Admiral Rickover said that the Navy is settling claims not just for what they are worth, but for their value plus other factors that may have nothing to do with the intrinsic value of the claim. He said litigative costs was one such factor.

Can you estimate how much the Navy might allow in a settlement offer for the cost of defending itself and what factors get lumped into that settlement?

Admiral MANGANARO. No, Senator, I cannot estimate that. Let me tell you how the figure that was used in the claim we have settled was obtained.

The Contract Appeals Division, which represents the Government in appeals to the Armed Services Board of Contract Appeals, is asked to provide an estimate of the effort required to conduct the expected litigation. From that estimate of manpower required, a dollar figure is prepared. The application of the anticipated cost of litigation is an item which may or may not be included in the offer to settle.

Senator PROXMIRE. Now, is it fair to say that the Navy has to add a nuisance value to the amount it offers to pay in settlement of the claim?

Admiral MANGANARO. I don't understand what you mean by "nuisance value."

Senator PROXMIRE. Litigative cost has nothing to do with what the Government really owes on the basis of the claims or changes, anything of that kind?

Admiral MANGANARO. No, sir, it doesn't. It is simply the amount that the Government expects to expend in the process of defending itself in litigation if the claim is not settled.

Senator PROXMIRE. That is what I understand the lawyers call "nuisance value."

Admiral MANGANARO. I have never heard any attorney tell me that.

Senator PROXMIRE. What reforms do you recommend be made in preparation of handling of shipbuilding claims?

Admiral MANGANARO. I have given that subject a great deal of consideration over the past 10 or 15 months. There are many recommendations that could be made. Some involve minor actions such as specification improvements. Others are more drastic, such as the use of cost-plus-fixed-fee contracts.

I prefer changes which will get at the core of the problem. I think the concept of a settlement board is good. I think the ability to pursue the claim on a full-time basis with a small number of knowledgeable people to expedite determining what the Government's just debt is and pay it, is really our objective.

I think that a permanent Board of the type I have headed for the last 16 or 17 months is an improvement. The independent nature of the Board helps to expedite its decisions.

I also feel that with a small Board that is relatively independent, there is a better opportunity to hold the chairman, its contracting officer, accountable for the money spent. In short, he would then be the only person you have to look to, to find out if the taxpayers' money is being spent properly.

The Board should be administratively assigned to the Naval Sea Systems Command. That solves many housekeeping problems and provides for manpower. The contracting authority of the Chairman of the Board should come from the Secretary of the Navy.

The Board should operate with a small number of very competent and experienced people. Of course, these are the people that are in high demand for many things, but if we are to handle millions of dollars and do it correctly, I believe we need that type of individual.

The Board ought to have a small permanent cadre of lawyers assigned to it not the number of lawyers it needs when it is working on all of the legal aspects of given claims, but a reduced number so that the experience derived from dealing with an element of one claim can be transferred to another.

The Chairman of the Board, the contracting officer, ought to be the single point of contact for the contractor. If the company is permitted to deal with various——

Senator PROXMIRE. Would you repeat that again?

Admiral MANGANARO. The Chairman of the Board should be the single point of contact with the contractor for a claim. If that is not the case, then should the Chairman of the Board not be responsive in a way the contractor would like other avenues are open to the contractor to press for alternative solutions?

If the Chairman of the Board is to determine the value of the claim, the just debt of the Government, and is authorized to pay it, then I think he is the person that the contractor should deal with.

The matter of clauses in the contract is important. It is also a large subject. As an absolute minimum, the contract should contain a clause that specifies the format of the claim that is to be submitted. If the claim is not submitted in the prescribed form, it should be rejected out of hand.

Senator PROXMIRE. All right, sir, I think those are excellent guidelines and I commend you on them. You have obviously done some very constructive thinking on them. Now would you tell us to what extent you were able to carry out those elements? I notice one element at least, that the Chairman of the Board should be the one who would be the person who would deal with the contractor. Was that standard lived up to?

Admiral MANGANARO. In general, I think that is was.

My dealings have been with Mr. Charles Dart of Newport News since this effort began and I am under the impression that he continues to remain the individual with whom I will negotiate.

I have negotiated the settlement of the CGN 36–37 claim with him and those provisional payments which we have made.

Senator PROXMIRE. Let me ask, what effect was the decision to take the Electric Boat situation away from the Board—to what extent do you think that that was—how does that affect your concept of how the Board should operate and your notion that the Chairman should be the one to deal with the contractor?

Admiral MANGANARO. I don't think that it is counter to my concept. If the claim is to be negotiated to a settlement with the contractor, the Chairman of the Board, who is the contracting officer for that claim, should do it. If other actions are considered or if discussions of other matters are held with the contractor, I don't think that the effort of the Claims Settlement Board should be diluted by becoming involved in those actions.

Senator PROXMIRE. In this particular case, as you say, you were just about finished. You only had 2 to 4 weeks before you would have been able to make a finding and wrap it up. It was taken away and it will now take several more months before this new group could make a finding.

Doesn't that seem to be at the least inefficient, if not subject to very considerable question as to its integrity?

Admiral MANGANARO. Certainly it would appear to be inefficient. I cannot comment about its integrity.

Senator PROXMIRE. In that particular decision, it did not meet your guidelines as to the way in which the claims system should operate?

Admiral MANGANARO. I think it does unless the only intent of the new group is to negotiate a settlement of that claim.

Senator PROXMIRE. Last year the Navy announced your appointment as Chairman of the Navy Claims Settlement Board and said the Newport News and Electric Boat claims were assigned to the Board. Thus far the Navy announced settlement of only one of these claims. The Navy stated the agreement was for $151 million. The claim on the nuclear cruisers U.S.S. *California* and U.S.S. *South Carolina* were settled for $44.4 million.

Would you please give a breakdown of how much that payment was for items for which the contractor was clearly entitled in accordance

with his contract, how much is interest, how much is for profit, how much for litigative risk, how much for litigative cost and how much for other categories that may have been paid?

Admiral MANGANARO. Can I supply those numbers for the record and give you a brief summary of them now?

Senator PROXMIRE. Yes, fine.

[The statistics referred to follow:]

Following is a breakdown of the claim settlement for the U.S.S. *California* and the U.S.S. *South Carolina:*

	Million
Entitlement	$19. 9
Litigative risk	9. 7
Cost of litigation	3. 3
Profit	3. 3
Interest	8. 2
Total	44. 4

Admiral MANGANARO. The total settlement of $44.4 million contained entitlement of approximately $20 million, which was derived from the added work, change orders, and impacts of that added work and the change orders.

The remainder consisted of amounts derived from the payment of interest, payment of profit, adjustments for allowables and nonallowables, litigative risk, and cost of litigation.

Senator PROXMIRE. See if I understand. What you are saying is the claim itself was about 50 percent, that is $20 million of the $44.4 million. Then the remaining amounts—interest, profit, litigative risk, et cetera—account for the difference, which is $19 million. Is that correct?

Admiral MANGANARO. Yes, sir.

Senator PROXMIRE. Can you give us any notion of how much the litigative risk and litigative cost was?

Admiral MANGANARO. I will have to generate that number and supply it to you.

Senator PROXMIRE. All right.

[The statistics referred to follow:]

The litigative risk and the litigative cost portions of the CGN-36/37 claim settlement follow:

	Million
Litigative risk	$9. 7
Cost of litigation	3. 3

Senator PROXMIRE. Then the claim itself was $20 million out of the $44 million. The difference between the settlement and the claimed increase in ceiling price is over $100 million. Does that mean that the Board found no entitlement for more than $100 million of the ceiling price increase claimed?

Admiral MANGANARO. Yes, sir.

Senator PROXMIRE. How near is the Board to completing evaluation of those claims?

Admiral MANGANARO. Which claims, sir? The remaining Newport port News claims?

Senator PROXMIRE. That's right.

Admiral MANGANARO. Essentially we are complete.

Senator PROXMIRE. You say "essentially" you are complete. What does that mean?

Admiral MANGANARO. It means that we have not compiled all of the items that have been through the review process and made decisions concerning items such as profit, interest, and target-to-ceiling spread which is required to complete the evaluation and arrive at a final offer for settlement.

Senator PROXMIRE. Have offers been made on all the remaining claims or are they about to be made?

Admiral MANGANARO. No, sir. I made a decision early in this process to make an offer on each claim in series. To offer the contractor a settlement for each of the claims all at one time would permit him to be selective as to which ones he would accept and which ones he would prefer to litigate.

Senator PROXMIRE. So you are awaiting response to your first offer, then you make the second and so on. Meanwhile, interest runs against the Government?

Admiral MANGANARO. Sir?

Senator PROXMIRE. Time is elapsing as you wait for a response to the first offer?

Admiral MANGANARO. Yes, sir.

Senator PROXMIRE. Meanwhile, interest runs against the Government?

Admiral MANGANARO. In some respects it does; not all the time or cost is considereded interest bearing.

Senator PROXMIRE. When was your last offer made?

Admiral MANGANARO. The last offer was for the SSN 686–687 claim the first week in August.

Senator PROXMIRE. And still no response?

Admiral MANGANARO. We have had several responses and much negotiation since then.

Senator PROXMIRE. But no definitive decision?

Admiral MANGANARO. Yes, sir. Two or three days ago. The final offer made to the company good until the 5th of January was responded to on Tuesday. Newport News declined to accept the offer and requested that the contracting officer's decision be prepared.

Senator PROXMIRE. So they are getting ready to appeal, is that right?

Admiral MANGANARO. Yes, sir.

Senator PROXMIRE. Based on the Board's review of the Electric Boat claims, would you conclude the amount for which there is legal entitlement is substantially less than the increase in ceiling price claimed?

Admiral MANGANARO. Please repeat the question.

Senator PROXMIRE. OK. Based on the Board's review of the Electric Boat claims, would you conclude that the amount for which there is legal entitlement is substantially less than the increase in ceiling price claimed?

Admiral MANGANARO. The increase in ceiling price of the contract, the ceiling price value of the claim?

Senator PROXMIRE. That's right.

Admiral MANGANARO. Yes, sir, that is correct.

Senator PROXMIRE. In evaluating those sections of the claims for which no entitlement was found, did the Board find cases where the shipbuilder was responsible for actions which the Government, in fact, was not responsible for?

Admiral MANGANARO. Yes, sir.

Senator PROXMIRE. In those areas of claims for which no entitlement was found did the Board find instances where the contractor withheld information which was in his possession which would have shown the claim to be incorrect?

Admiral MANGANARO. I can't answer that directly. In the process of evaluating these claim elements we accomplished what is called "factfinding." Whenever the information in the claim is not adequate, in our view, to support the entitlement the contractor claims, we go to the contractor and ask for additional information which the contractor then supplies. I wouldn't categorize that as "withholding" it in the sense I think you mean.

Senator PROXMIRE. But it was not in the original documentation?

Admiral MANGANARO. It was not in the original documentation.

Senator PROXMIRE. Now, if your recommendation for a form would have to be followed and followed rigidly, if that were in effect, would that have provided you with the information before, without going back to the contractor?

Admiral MANGANARO. Not necessarily. I think it is impossible for anyone to submit a claim that is as complicated as these are, and include all of the information that the Government's analysts could possibly want. It depends upon your idea of what constitutes "adequate proof" that the money is owed. I think, however, that there would be some benefit to be gained by requiring a response within a certain time limit so that the contractor will supply the information in a timely manner.

Senator PROXMIRE. In those areas of the claims for which no entitlement was found, did the Board find examples of statements which were misleading or untrue in regard to allegations of Government responsibility?

Admiral MANGANARO. Yes, sir, misleading in the sense that in advocating its position the contractor identified only those items considered to be Government responsible, and then generated the claim element based on those items alone. Often there were significant contractor responsible items which were not even mentioned in the claim but were identified as critical.

Let me give you an example. In one of the claims there was a period of significant delay that was considered by the contractor to be the responsibility of the Government. During that period of delay there was a strike. The company's position was that the strike was not the cause of any delay in the delivery of the ship.

It is very difficult for me to consider such a thing valid. Therefore, it is necessary to factfind, to determine the degree of progress made and balance that against the degree of progress planned so that you can determine whether, in fact, the strike did contribute to the delay.

Strikes are usually handled in the claims as "excusable delay." In other words, if the company has a strike, the period of time that the strike delays the delivery of the ship is excused, but the Navy doesn't pay any compensation for that delay.

Senator PROXMIRE. In those portions of the claims for which no entitlement was found did the Board find any examples which might be a violation of false claims or fraud statutes?

Admiral MANGANARO. I can't say. We did find items that we thought were questionable and those items have been referred to the General Counsel's office.

Senator PROXMIRE. By letter of June 24, 1976, Secretary of the Navy Mittendorf informed me: "By the employment of a detailed multidisciplined time approach the Navy is using, evaluating the claims will uncover any evidence of any fraud."

He assured me if there should be indications of fraud, the matter will be referred to the Department of Justice. Has the Board in its multidisciplined approach identified any possibility of violation of fraud or false claims statutes? And, if so, have they been reported to the Department of Justice?

Admiral MANGANARO. We have reported them, Senator, to the General Counsel's office. I don't know if he has referred them to the Department of Justice. I have reported them to him as the agent that will determine whether such referral will be made.

Senator PROXMIRE. Admiral, you can understand why we are concerned with this situation?

Admiral MANGANARO. Yes.

Senator PROXMIRE. Admiral Rickover in your absence pointed out that you established your operation as a means of preventing the kind of pressure, political pressure, that we get to settle these claims at enormous cost to the taxpayers and in the view of Admiral Rickover gave great injury to an efficient Navy and getting the ships we need badly and getting them on time and getting them the way they should be built.

He contended that the latest decision very greatly concerned him, taking the Electric Boat claims away from your operation just a few days before you were about to conclude your investigation. And as I said, you have indicated that you feel at the very least that this was inefficient, but you are not making any conclusion with respect to what else it might be.

Admiral MANGANARO. That is correct.

Senator PROXMIRE. Captain, did you want to say a word?

Captain RYAN. No.

Senator PROXMIRE. Well, gentlemen, thank you very much.

The subcommittee will resume hearings at 2:30 when we will hear from Edward Hidalgo, Assistant Secretary for Manpower and Research Affairs of the Navy.

[Whereupon, at 12 o'clock noon, the subcommittee recessed, to reconvene at 2:30 p.m. today.]

AFTERNOON SESSION

[The subcommittee reconvened at 2:35 p.m., Hon. William Proxmire (chairman of the subcommittee) presiding.]

Senator PROXMIRE. Mr. Secretary, I apologize for being a little tardy.

Our witness this afternoon is the Honorable Edward Hidalgo, Assistant Secretary of the Navy, accompanied by Togo D. West, Jr., General Counsel of the Navy.

Gentlemen, we heard some very disturbing testimony this morning which casts a large shadow of doubt over the shipbuilding claims issue.

Shipbuilding claims problems have become almost a permanent fixture in the past several years. You may know that this surcommittee held its first hearing on the subject in 1969 when the Navy was criticized for settling a large claim on terms favorable to the shipbuilders without having factual information that substantiated the claim.

Since 1969 a variety of reorganizations have taken place in the Navy over the claims problem, but each time we draw close to an effective solution a new reorganization takes place which seems to halt progress and bring us back to square one.

I have read your prepared statement, Secretary Hidalgo. Frankly, I fail to see the progress you indicate has been made in the past year, in view of the fact that whatever progress has been made occurred mainly as a result of the work of the Manganaro board. It seems to me that your recent action taking the Electric Boat case away from the board has undermined its authority.

There are two fundamental questions in my mind: One, is the Navy protecting the taxpayer's interest in its present handling of shipbuilding claims? Two, is the Navy about to hatch a new shipbuilding bailout scheme?

I hope you will address those questions in the course of your remarks. You may now proceed with your statement and as it is brief, you can read it in full if you would like to do so.

STATEMENT OF HON. EDWARD HIDALGO, ASSISTANT SECRETARY OF THE NAVY FOR MANPOWER RESERVE AFFAIRS AND LOGISTICS, ACCOMPANIED BY TOGO D. WEST, JR., GENERAL COUNSEL; AND JOHN J. McDONNELL, SPECIAL ASSISTANT TO THE ASSISTANT SECRETARY

Mr. HIDALGO. Thank you, Mr. Chairman.

I had the privilege of testifying before you on July 22 on women in the Navy.

Senator PROXMIRE. I recall that very well indeed.

Mr. HIDALGO. We seemed to have a good deal of consensus on that occasion. I hope some of that will rub off today, sir.

Let me say by way of introduction that I will not read my prepared statement, which you already had the kindness to read.

Senator PROXMIRE. All right.

Mr. HIDALGO. I will submit it for the record. It was an attempt to set forth the factual statistical data that your letter to Secretary Claytor called for, and that was our response to your desires.

I would like, however, to make some introductory remarks, if I may. More of a philosophical nature, which I hope will address the points that you have mentioned.

I couldn't agree more, Mr. Chairman, that claims are an absolute calamity created over the last decade by a succession of errors, misjudgments and circumstances beyond everyone's reasonable control.

Attribution of blame to any single cause or source has to be the product of misguided perspective and defeats the imperative objective

of seeking with every effort at our disposal a sensible and expeditious resolution not only of the claims, sir, but of the underlying problems of those claims.

When I took office exactly 8 months ago, it was clearly understood with Secretary Claytor that my priority mission was to search for the resolution of which I speak; to do so, Mr. Chairman, with dispatch because the relationship between the shipbuilding industry and the Navy was in serious disarray and rapidly becoming worse—kindly take my word for this; to seek the resolution with cool objectivity.

This, may I say in a self-serving way, is a very easy aspect for me. Mr. Chairman, at my time in life I have no axe to grind, I have no prior decisions to defend nor, let me hasten to say, do I wish to attack any prior decisions by others. I merely wish to get on with it, sir.

I am not imbued, perhaps I should add, with any concept of big business, whatever that may be, but merely with a deep devotion to the Navy and to my country, and I say this, Mr. Chairman, with profound sincerity. To find the solution within the contours of paramount national interest. This also came to me quite easily as the importance of certain segments of our private shipbuilding industry, precisely those involved in the claims situation, became identified with the construction of combatant ships absolutely essential to our national defense.

I have in mind, of course, the Trident, the SSN attack submarines, the amphibious assault ships, the LHA's, the nuclear carriers, the DD–963 destroyers and the nuclear cruisers, the CGN's. All of those ships—although there are no claims concerning the Trident, but all of these ships are involved with the shipbuilders which have filed the claims which bring us here today. I would like to just talk of claims, Mr. Chairman.

The problem urgently begging for solution is twofold: One, disposition of the $2.7 billion accumulation of claims, about half of which are already scorched with the acrimony and wastefulness of litigation. As I speak, unless we bend every effort, many more may be headed in the same miserable direction.

As a trial lawyer, Mr. Chairman, I view this somber prospect without drama. It is not a frightening thing, but nevertheless with a realistic dismay for everyone concerned—the Navy, the shipbuilding industry and our Nation as a whole. In key situations within the shipbuilding industry, reasonable and expeditious settlement of the claims is linked with the present and future financial stability of shipyards vital to the Navy's needs.

A second and even more important aspect of the problem which I have mentioned to you is how to insure the continued construction of vital combatant ships and their delivery to the fleet at the lowest relative cost to the Navy, and that is where the underlying problems to which I have referred come out.

I have increasingly become deeply involved in an analysis of the Litton and Electric Boat situations in particular. With Litton, we were faced with a proliferation of litigation: In the Mississippi district court, in the circuit court of appeals, the fifth circuit, in the Court of Claims and in the Board of Contract Appeals.

There was a Mississippi court order, as you know, Mr. Chairman, which granted an injunction to the Navy to force continuation of the

construction of the LHA's, which has been extended and—as of the time I am talking to you—effective to July 1, 1978, and the quid for the construction was to pay Litton 91 percent of the costs of construction.

I became involved in discussions with the Litton officials, and this led in October to an informal agreement to reduce the 91 percent—to which I have referred—of costs provided for in the court order to 75 percent; and with this advantage, obvious advantage to the Navy, combined with assurances of continuing construction of the LHA's, which is an aspect of paramount importance.

With Electric Boat I became, I repeat, involved in a series of intensifying discussions and growing knowledge and, for a variety of causes, an increasingly critical situation has developed in the construction of the 18 SSN–688's with 17 yet to be delivered.

In both the Litton and Electric Boat situations, in the absence—and I underscore this—of timely and reasonable resolution of the claims, the shipbuilders have unquestionably incurred, and even seriously, will continue to incur heavy cash shortfalls and losses in the construction of the LHA's and the SSN–688 class.

Very briefly stated then, Mr. Chairman, those are the broad considerations which led to the Navy's decision sometime last October, and I want to be very specific about this, first to undertake discussions with Litton and Electric Boat aimed toward the resolution not only of the claims themselves, because this would leave a lot of unanswered, unfinished business of great importance, but also resolution of the underlying problems. This is a vital point to understand.

Second, to undertake these discussions with Litton and Electric Boat simultaneously, of course separately, but simultaneously.

Now, where do we stand, Mr. Chairman, in this process? You rightly complain that there seems to be no progress judging from my prepared statement, but that is why I wanted to address these thoughts more informally to you now. Where do we stand?

As a result of efforts over the months we have commenced discussions with Electric Boat and Litton. We commenced them on December 1. These are discussions to see what resolution, if we can find jointly a resolution not only, I insist and repeat again and again, of the claims, but of the overall underlying problems so that continued construction of ships essential to the Navy can be counted upon without interruption.

Since it was organizationally vital that these simultaneous discussions and all the intricate supporting preparation they require be carried forward by the Navy with unanimity and singleness of responsibility, authority and judgment, and this replies to certain questions I know you have, Mr. Chairman, a steering group was formed by Secretary Claytor, which I chair and which is composed also of the Assistant Secretary of the Navy for Financial Management, Mr. George Peapples; Mr. Togo West, who accompanies me, General Counsel of the Navy; and Vice Admiral Davis, representing the Chief of Naval Operations, head of OP–09 and Vice Adm. Vince Lascara, whom I am sure you know, Vice Chief of the Naval Material Command. That is the top steering group.

Under that, there is a task group, and under that, there are individual groups to handle the Litton claims and handle the Electric Boat claims.

The EB claims were moved over from the Navy Claims Settlement Board, which was created by my predecessor, the Assistant Secretary for Installations and Logistics, to the steering group and I don't know what all the fuss is about, precisely to achieve important organizational objectives of singleness of authority, responsibility, and judgment in the context not only of claims settlement, Mr. Chairman, but also of resolution of the underlying problems.

Just to mention one aspect to you, it would have been organizationally distorted for the steering group to be analyzing and proceeding with analysis of the Litton claims over here and to have a separate body with a separate set of judgments perhaps, with a separate approach limited narrowly to the entitlement process and not to the broader problems, to which I have referred, to be separately handling the Electric Boat claims.

Organizationally, it seemed to me there was only one path to follow. That is why as a fairly routine thing and with the approval of everyone concerned those claims were moved over from the Settlement Board to the steering group which I chair.

The move officially occurred December 1, but the plan to do so, as I have just stated, and its advisability were discussed with Admiral Manganaro and other interested Navy officials, beginning in late October. In my latest discussions of the matter with Admiral Manganaro in late November I was led to understand that evaluation of the Electric Boat claims was both indefinite and incomplete. He was not specific as to how much more time he needed, but it was very clearly made known to me that the evaluation was incomplete and as yet indefinite.

Now, all of the Electric Boat files were turned over to the steering group on December 1, Mr. Chairman, and the files themselves give me full evidence that there were, on December 1, a number of technical evaluations and appraisals still due. Those have come in since, by the way. Also there were others, some 25, that were still under review, that there were some 25 or 30 legal memorandums—I think, in fact, the number was 48, Mr. Chairman—that were still incomplete.

Now let me make this perfectly clear. In my steering group I have simply taken the same knowledgeable expert people that Admiral Manganaro had, and they are now under the steering group there is no interruption, Mr. Chairman, either of knowledge or of time, and we are going to move right ahead with the process. Anybody who suggests anything else simply does not know the facts.

So the task groups are moving forward——

Senator PROXMIRE. Now wait a minute. At this point, Mr. Secretary, in doing that it seems to me you just destroyed the Board.

Mr. HIDALGO. No, sir, not at all.

Senator PROXMIRE. Furthermore, you see what puzzles and troubles me is that we had testimony from Admiral Manganaro, who impressed me as being a very careful and conservative gentleman, and I am sure you have great esteem for him, too.

Mr. HIDALGO. I do.

Senator PROXMIRE. He told us this morning that he would have concluded this within 2 or 4 weeks of the time you took the Electric Boat case away from him. That was his testimony. He was specific and clear.

I asked him, "Does that mean you would have finished it by now?" He said, "Yes, sir." I asked, "How long would it take a group to finish it?" He said, "2 to 4 months."

Mr. HIDALGO. Well, I don't know what he bases that on. Let me say quickly when you say "destroyed the Board," let's make it perfectly clear that the Board continues to have cognizance of the very, very important Newport News claims. As you know, they are $740 million.

Senator PROXMIRE. I knew that when I said "destroyed the Board," what I was referring to is that you must recognize the attitude you can expect the contractor to take. If the Board is going to have a case removed from it before it can come to conclusions, particularly when it is on the verge, according to testimony, the public testimony of the head of the Board, it seems to me that it is much less likely that contractors are going to be satisfied with their decision. They are going to do their best. If they feel they are going to get an adverse decision, they are going to do their best to have the same thing done in their case.

Mr. HIDALGO. I don't believe that is so, sir, because the circumstances are different from shipbuilder to shipbuilder. You can't compare one with the other. There are certain comparable problems involving Litton and Electric Boat which we felt justified—and only with those two shipyards—that justified simultaneous treatment in these discussions to see what we could do, and I make no promises to anyone about what we are going to be able to find or do, what we could do to resolve the underlying problems.

Senator PROXMIRE. I am sorry I interrupted. You finish your statement and then I have some questions for you.

Mr. HIDALGO. Based on discussions today with both Electric Boat and Litton, I perceive recognition by both sides of the huge difficulties which confront us, but an attitude of earnest dedication to the task that lies ahead, to the need for objective search for solutions that satisfy the demands of our national interest, and insure construction of the ships that are essential to our national defense.

I cannot predict the outcome, Mr. Chairman, should these discussions fail in the immediate future. I can't put a time limit on these things because there is a lot of financial information and so on that has to be analyzed and so forth. Then, of course, if we do not succeed either the steering group with many of the same people that the Settlement Board had would proceed and there would be a contracting officer within the steering group to make offers of settlement, or we could put the thing back into the Settlement Board.

I have not analyzed that, but the process would continue and in the meantime we offer ourselves the hope of a basic solution of this extremely serious problem.

That completes my statement, Mr. Chairman.

[The prepared statement of Mr. Hidalgo follows:]

PREPARED STATEMENT OF HON. EDWARD HIDALGO

Mr. Chairman, members of the subcommittee: I am pleased to have this opportunity to appear before you on the critical subject of shipbuilding claims, accompanied by Togo D. West, Jr., Esq., General Counsel of the Department of the Navy.

Upon taking Office in April of this year, the Secretary of the Navy, Graham Claytor, gave me an umnistakable mandate to urgently concentrate my efforts on the resolution of shipbuilding claims and the reduction of future claims to an unavoidable minimum. I have therefore in a number of ways which will come out in my testimony, increasingly assumed responsibility and direction of efforts concerning the massive claims backlog against the Navy.

Initially, I would like to provide you with an overview of the existing shipbuilding claims. The total claimed value is $2.7 billion—$2.693 to be more exact. Of this total $332 million have been heard by the armed services board of contract appeals and decisions have been rendered on $196 million. Decision is expected in the near future on the remaining $136 million presently before the board.

Also before the ASBCA, although inactive as a result of litigation presently in the courts, is a claim in the amount of $1.076 billion from Litton/Ingalls on the amphibious assault ships (LHA). This amount represents a recent increase of $374 million in the ceiling price of this claim. As you can imagine, given its magnitude, the LHA claim is complex and difficult. Settlement efforts in the past between the Navy and Litton were not fruitful. Litigation is presently pending before the Court of Appeals for the Fifth Circuit, in the District Court for the Southern District of Mississippi, and in the Court of Claims.

Recently, however, the Department of Justice, with Navy participation, succeeded in arriving at a partial settlement with Litton of the litigation in the southern district of Mississippi. Pursuant to negotiations in which I actively participated, Litton accepted a reduction from the 91 percent payment of costs ordered by the court as the condition of enjoining Litton to perform, to 75 percent payment of such costs, and litigation is being stayed while disussions proceed between Navy and Litton to seek an overall resolution not only of the claims but also of the fundamental underlying problems. The Navy will notify Congress at the beginning of the 1978 session of the details of this agreement.

The bulk of the remaining $1.3 billion backlog consists of claims filed by Newport News Shipbuilding and Dry Dock Co., five claims totaling $742 million, and the Electric Boat Division of General Dynamics, two claims totaling $544 million. These claims are not yet but could easily and quickly become the subject of litigation before the ASBCA or the courts. Prolonged years of judicial controversy with the leading shipbuilders of our Nation is a dismal scenario for the construction of essential naval ships.

Cognizance of the Litton and Electric Boat claims is currently with a steering group, chaired by myself, with the support of a task group composed of military and civilian personnel drawn from appropriate disciplines within the Navy. Although the Newport News claims are under the cognizance of the Navy claims settlement board, headed by Rear Admiral Manganaro, my mandated responsibilities regarding claims could not be discharged without proper attention to the problems which pertain to this important shipbuilder.

The progress in analysis and evaluation of the claims is quite impressive since hearings were last held on this subject before this subcommittee in June of 1976. The Litton claims, revised substantially in September of this year, now appear virtually complete; technical analysis and audit of these claims should be completed in the first quarter of 1978 and legal evaluation soon thereafter. Analysis of the Electric Boat claims is proceeding and evaluation should be complete also in the first quarter of the upcoming year.

One Newport News claim for $151 million on the guided missile cruisers, CGN 36 and 37, was settled earlier this year for $44.4 million. Analysis has been completed, or completion is imminent, on the other Newport News claims. No prediction can presently be made regarding the prospects for a negotiated settlement of these claims. No reasonable effort should be spared to achieve this end.

In response to the request contained in your letter inviting me to appear before this committee, the following further detailed breakdown of pending shipbuilding claims is provided:

On the Los Angeles (SSN 688) class attack submarines, claims have been filed by both shipbuilders, Newport News and Electric Boat, on four contracts covering 23 ships. The original program cost estimate for these 23 ships was $4,035.7 million versus a current program cost estimate of $4,226.6 million. All program cost estimates which I present are exclusive of the effects of ultimate claims resolution. Newport News filed claims on the SSN 688 contract and the contract for SSN 689, 691, 693, and 695 on July 2, 1975. These claims were both revised on March 8,

1976 bringing them to their current values of $78,543,149 and $191,567,199 respectively. On December 1, 1976, Electric Boat filed claims on SSN 690, 692, 694, 696–699 valued at $121,310,990 and SSN 700 through 710 valued at $422,568,739. There have thus far been no formal revisions to these two claims.

Three additional ship types under contract with Newport News are the subject of pending claims. A claim was filed under the contract for two nuclear powered aircarft carriers, CVN 68 and 69, on Februrary 19, 1976 in the amount of $221,280,223. There has been no revision to this claim. The original program cost estimate for these two ships was $1,063.2 million and the current program cost estimate is $1,442.1 million.

The three guided missile cruisers, CGN 38, 39, and 40, originally estimated to cost $764.6 million on a program basis and now estimated at $853.0 million are the subject of a $159,774, 936 claim filed August 8, 1975. This claim has not been subsequently revised. The fifth Newport News claim is on the last two attack submarines of the SSN 637 class, SSN 686 and 687. This claim was originally submitted on March 8, 1976, revised August 6, 1976 and presently valued at $90,431,723. Original and current program cost estimates for the two ships are $162.6 million and $188.6 million respectively.

There is one claim pending from Litton on the five amphibious assault ships, LHA 1–5. The original and revised program cost estimates for these five ships are $905.5 million and $1,588.5 million respectively. The revised program cost includes approximately $250 million in payments made or anticipated under court order. The original claim submission was dated March 5, 1973 with upward revisions in March 1973, July 1974, on June 30, 1976 and September 16, 1977, to the current value of $1,076,156,110.

These pending shipbuilding claims plus the appeals that have been heard by the ASBCA on other shipbuilding contracts total $2,693,329,819.

This concludes my statement.

Senator PROXMIRE. Now this morning Admiral Rickover testified that he formally submitted four reports of possible fraud in Newport News claims and a report lising 18 items of possible fraud in the Electric Boat claims.

Do you recall receiving copies of those reports?

Mr. HIDALGO. Sir, I have not to my knowledge received any copies of any fraud reports alleging fraud with regard to Newport News. I did receive a memorandum from Admiral Rickover on December 10, which I promptly turned over to our General Counsel for appropriate action. Anything further on that I would like to refer to the General Counsel.

Senator PROXMIRE. Were you award that Admiral Rickover filed reports indicating possible fraud?

Mr. HIDALGO. Not in any specific way, sir, no.

Senator PROXMIRE. Well, in what way? You said, "Not in any specfic way."

Mr. HIDALGO. Well, in meetings I have had with Admiral Rickover, since I took office, maybe there have been five or six. We have discussed many subjects of interest to him and within my realm of responsibility and he had mentioned that word that you mentioned, these allegations, but it was not within my province to deal with that. So I took absolutely no direct interest in that except to refer anything I might have to the General Counsel and to do so immediately.

Senator PROXMIRE. Before Mr. West responds, let me say that Admiral Rickover's testimony was that consistent to the Secretary of the Navy and, I believe, went to your office, too. That is what his testimony indicates.

Mr. HIDALGO. That is true of his memorandum of December 10. It is not to my knowledge true of the other memorandums with regard to Newport News.

Senator PROXMIRE. He made four reports of possible fraud that he specified.

Mr. HIDALGO. Let me say this: Had they come to me, I would have done the same with them, to immediately turn them over to the General Counsel for appropriate action.

Senator PROXMIRE. Mr. West, did you want to respond?

Mr. WEST. Yes, Mr. Chairman. I believe the four reports you refer to are allegations with respect to the Newport News case. They certainly have been turned over by Admiral Rickover. We have them in the General Counsel's Office. They come through a convoluted chain. Those reports under Navy procedures are made to the Inspector General, who in turn forward them to the Chief of Naval Material and thereafter to the General Counsel. However, they came to our office. We have them, we are looking into them.

Senator PROXMIRE. Do the copies that you get show that copies were sent to Secretary Claytor and Secretary Hidalgo?

Mr. WEST. I don't think so, Mr. Chairman. I think that those particular reports were not copied to any one. I could be wrong, but I think those were simply sent to the addressee; that is from the admiral to the Inspector General.

Senator PROXMIRE. Did you discuss those reports with Secretary Hidalgo?

Mr. WEST. No, sir. I have not discussed those reports with him. I don't think it is appropriate to discuss those fraud reports at this point. Those should be investigated in a professional manner by lawyers at a working level in cooperation with Navy personnel and, incidentally, we also discussed——

Senator PROXMIRE. I want to be sure I understand.

Are you saying that it wouldn't be appropriate to call to the Secretary's attention the fact he may be negotiating claims that could be based on fraud?

Mr. WEST. No, I am not saying that. That would be inappropriate though.

Senator PROXMIRE. Isn't that the case here?

Mr. WEST. I am saying that at a stage at which we are receiving allegations and conducting an inquiry, that I prefer to have the lawyers, who are working the case in accordance with whatever investigators are working it, work it. If at some point we are able to come up with some determination that it is appropriate, then we will send it to the Justice Department.

Senator PROXMIRE. These are not allegations made by some anonymous crank. These were allegations made by the most experienced procurement officials perhaps we have ever had in this Government.

Mr. WEST. I am not sure that is correct.

Senator PROXMIRE. As you know, he has a remarkable record for accuracy and for being sustained by history in his judgments in these matters, and this is where he is particularly expert.

Mr. WEST. Mr. Chairman, he is not a procurement official. Admiral Rickover is in the technical area having to do with nuclear propulsion. The procurement officials are contracting officers and in that line of authority. Nonetheless, you are right in your assessment that the allegation is not just by and crank, as you put it.

Senator PROXMIRE. Didn't Admiral Manganaro also tlak to you about fraud?

Mr. WEST. Not with me, but certainly through his staff passed and allegation or some allegations to a lawyer on our staff, the lawyer incidentally who was in charge of looking into fraud.

Senator PROXMIRE. Wasn't that passed along to Secretary Hidalgo?

Mr. WEST. No, sir, not that I know of. I didn't pass it along.

Senator PROXMIRE. Why shouldn't that be passed along since he is negotiating in this particular area?

Mr. WEST. Mr. Chairman, there are two different efforts going forward in the Office of General Counsel. One of them involves an ongoing attempt to look into allegations of fraud that are being made in increasing numbers, as far as I can determine in my 8 months on the job, with respect to certain Government contracts.

I don't think it either necessary nor appropriate that every time one of these allegations is made to go to a political appointee within the Secretariat and say, "Look, here is an allegation of fraud." I do think it appropriate to carry out a sound and through investigation to coordinate with the Justice Department and find out virtually from the outset what they think about these allegations and to get that underway.

Senator PROXMIRE. I am going to ask the committee counsel, Mr. Kaufman, to pursue this.

Go ahead.

Mr. WEST. May I finish this point, Mr. Chairman?

Senator PROXMIRE. Go ahead.

Mr. WEST. It is not the function of the Navy nor of any officer in the Navy to determine the presence or absence of fraud. It is our function in the Office of General Counsel to look into the inquiry and to see if there is enough evidence that we can accumulate, yea or nay, to pass on to the Justice Department so that they can do their function, which is to decide whether to indict.

Mr. HIDALGO. May I clarify something that may help all of us? I think we have got to keep our timing in mind, Mr. Chairman.

I have been meeting regularly with Admiral Manganaro since I came aboard because of the mandate I had from Secretary Clayton to get on with the claims, to see what I can do about the claims and their underlying causes, and with regard to Newport News keeping in touch, perhaps having observations, talk and so on.

I have made it clear, I thought in my opening remarks here, that the discussions with EB and Litton did not start until December 1, so when the reference was made to the fact that Mr. West should bring something to my attention if negotiations are going on. These have just started and what the outcome is going to be is much too early to tell.

I would just as soon—please correct me, General Counsel—as I go along he is on my steering group, sir. I mentioned that to you. If there was something that he thought that the steering group should know that in any way interfered with the negotiations we were conducting, he would call me aside and tell me so.

Mr. WEST. Excuse me. On that respect we have gotten off onto slightly the wrong track. It is not Mr. Hidalgo who needs to know about alleged Newport News fraud in order to be careful in his negotiations, it is Admiral Manganaro, who is investigating those claims.

Senator PROXMIRE. Well, let me proceed. Maybe Mr. Kaufamn can get into this a little later.

Secretary Hidalgo, Admiral Manganaro testified that he reported to the Navy's General Counsel his concerns of possible fraud in the Newport News claims. Were you aware before today of Admiral Manganaro's concerns?

Mr. HIDALGO. No, sir, he never discussed that with me.

Senator PROXMIRE. I also understand that the Navy's Supervisor of Shipbuilding at Newport News has filed reports of possible fraud in Newport News claims. Are you aware of those reports?

Mr. HIDALGO. No, sir.

Senator PROXMIRE. In view of the fraud reports that have been made, the fact that one shipbuilder, Litton, has already been indicted for filing a fraudulent claim; that another shipbuilder, Lockheed, is under investigation by the Justice Department with regard to possible fraud in a claim; in view of the large proportion of claims for which the Navy has not found any legal entitlement, do you agree that some of the pending claims may contain violations of false claim or fraud statutes?

Mr. HIDALGO. Sir, I would like to defer to the General Counsel on that. I just have no evidence of what you referred to, but I think that requires a technical answer there. For example, the first thing, the indictment of Litton, I think that was dismissed and is on appeal. Would you handle that?

Senator PROXMIRE. I am not talking about a technicality here. I am talking about whether or not it seems distinctly possible that some of the pending claims may contain violations of false claim or fraud statutes.

Mr. HIDALGO. I have no evidence of this, Mr. Chairman.

Mr. WEST. With respect to those two, the Lockheed claim, for example, we have made our investigation and passed it to the Justice Department and they have done their part. With respect to the question of whether there are pending claims still to be resolved that may have substantial false claims or fraud in them, certainly, Senator, the record is now before you that the allegations have been made and we are trying to find out. That is about as much as I can say at this point.

The question of whether there are large amounts of fraud in it, I just can't answer that.

Senator PROXMIRE. Mr. Secretary, what actions have you taken to insure that any violations of the false claim or fraud statutes is detected in shipbuilding claims and referred to the appropriate law enforcement authorities?

Mr. HIDALGO. Sir, as my group goes ahead with the evaluation of the claims in the steering group, they have very clear orders that if they see anything of that type, they should refer it at once to the General Counsel if there is any question about that.

Senator PROXMIRE. Now is it your intention to take any actions in the future to deal with the fraud problem in shipbuilding claims?

Mr. HIDALGO. That is not my province, Mr. Chairman, except to bring to Mr. West's attention anything that indicates that, and then it is up to him to handle it in conjunction with the Department of Justice. I have enough worries of my own, sir.

Senator PROXMIRE. I still don't understand. It is not clear how you can wash your hands of fraud, or possible fraud, I should say, in matters that are before you for negotiation.

Mr. HIDALGO. I couldn't agree with you more, sir, but if you forgive me, I don't agree with the description of "washing my hands." I consider that a matter of greatest concern, having been a lawyer for 42 years. "Fraud" is a very serious word, it is a very serious accusation that should not be made lightly and if made, should be investigated and you can have my absolute commitment that anything I see of that kind would go to Mr. West for whom I have the highest respect.

Senator PROXMIRE. I understand you have responsibility to refer it to Mr. West for action, but don't you also have a responsibility to explore it thoroughly in connection with your negotiations so that your negotiators can be informed on this? It is not as if this is something that has never occurred. It is not as if it is something that is most unlikely.

We have evidence that it has occurred. We know it has occurred in the past in certain cases.

Mr. HIDALGO. Sir, I can only answer that the way I have already, that should I be going ahead with the negotiations, in full knowledge of Mr. West, who sits on my steering group, and there should be some matter of this type that you discussed that he feels I know about, he would be the first to bring it to my attention and I would act accordingly.

Mr. WEST. Mr. Chairman, could I give you an example?

Senator PROXMIRE. Yes, sir.

Mr. WEST. Admiral Manganaro, in resolving the claims he has before his Board, makes it a practice to ask of the General Counsel his opinion of whether he ought to go forward with a decision to settle in light of the presence or absence of allegations of fraud and how much we have been able to determine about those at that point. So when an effort is made to resolve a claim, there is an attempt made to find out if we have some, if we have enough evidence at that point as to presence or absence of fraud, to deal with it.

The fact of the matter is that even if we conclude we don't and we later find that there is enough evidence of fraud there to require a referral to Justice and Justice seeks an indictment and obtains it, of course the interests of the taxpayers and the U.S. Government are protected by statute.

Senator PROXMIRE. Mr. Secretary, you talked in your oral statement about the need to attack the underlying causes of the claims. We heard a great deal this morning about the enormous increase, and we know there has been literally something like a 50-fold increase over the last 10 years in the volume of claims.

According to Admiral Rickover, one underlying cause is that in the past the Navy has been too generous with taxpayers' money. Some settlements have been giveaways, that contracts are not strictly enforced and that it pays in cold, hard cash for contractors to delay settlements and drag out the proceedings, threatening to stop work on Navy ships as they do so.

It seems that the present system encourages claims so that when one is settled, we can expect larger ones to follow. How would you respond?

Mr. HIDALGO. I would respond, first, sir, that in my 8 months I have no evidence of any of the things that you mentioned. While I don't find it easy to disagree with a man of the distinction of Admiral Rickover, I simply have no evidence of what he says there of contractors behaving in that fashion.

The ones I have had conversations with principally, and I visited most of the shipyards in our country, both private and Navy, I believe have real problems, have encountered difficulties that they are seeking to resolve. I don't see any evidences—I repeat—in my 8 months. I am not goint to talk out of history books, Mr. Chairman, and in my 8 months I absolutely have no evidence of what you just mentioned.

Senator PROXMIRE. Well, how do you account then for the fact that we have had this enormous increase in claims, increasing not only by an immense explosion in dollars, but the great increase in the percentage of naval procurement?

Mr. HIDALGO. Well, I wish we had 2 hours, Mr. Chairman, sometime when your time wouldn't be so valuably absorbed but indeed let me mention to you that side by side with seeking to resolve claims and their underlying problems we have been conducting an exercise which I consider of great importance: How shall we reduce claims to a minimum in the future?

It turned out in August, when the first interim report was issued, that there are 26 problem areas contributing to the causes of claims. We sent that to all the shipbuilders in our country. We have conducted between September 26 and November 28 interviews with 11 of the principal shipbuilders and it was really a roll-up-the-sleeves situation, Mr. Chairman, with the top people of each of these companies who came in and for the first time maybe in many a year they talked very freely to each other about what was troubling them, and the Navy as to what was troubling the Navy.

We are in the process now of digesting the results of those interviews and will turn out a final report analyzing the cause of these herculean, monumental claims. I would very much like personally to present you a copy of both the interim report and final report when we have it, Mr. Chairman.

Senator PROXMIRE. I would like to have the report. Will you see that we get a copy when it is available?

Mr. HIDALGO. Yes, sir.

Senator PROXMIRE. I have asked you once about this, but I want to ask in a little more detail. As I said, there was testimony this morning about the effects of taking EB claims again from the Manganaro Board just as the Board was about to complete its review.

You had said that they didn't know when they would complete it. We were told by Admiral Manganaro, who was extraordinarily cautious and careful and not specific in many areas, but here he was as clear as crystal, that he would complete it in 2 to 4 weeks. Now that action of taking the case away from that board is bound to have a demoralizing and discouraging effect on those on the board who have worked on the claims for so long.

It also appears to be a very inefficient procedure that will probably delay the complete review by several months. Admiral Manganaro, who refused to make any judgment about it in most respects, did say it was clearly an inefficient action. How do you justify that action?

Mr. HIDALGO. Well, I have tried to in my oral remarks, sir, but let me rephrase it.

First of all, I would rather stay away from the phrase "taking it away from the board."

Senator PROXMIRE. That is what you did. Isn't that what you did?

Mr. HIDALGO. Well, sir, they were moved to the steering group because organizationally it made a great deal of sense, as I will explain more in a minute.

It was no wrenching away. I discussed this with Admiral Manganaro from October onward. I discussed it with others within the Navy. Needless to say, I also discussed it with Secretary Claytor.

Since Admiral Manganaro's Board by definition, by charter, can deal only with the narrow issues of entitlement, there was no way that he could deal with the bigger problems that we intend to deal with in our discussions that I have several times referred to, so we would be leaving a little piece of something over here. He did not have the Litton claims. The Litton claims actually began to get some individual specific momentum with the task group I organized under Mr. MacDonnell, my special assistant to my left.

So it made total organizational nonsense to leave a piece of Electric Boat over here and to bring a big piece of it over here under the steering group, particularly when I don't agree that we were demoralizing anybody. Admiral Manganaro has never mentioned this to me and I have the highest regard for him. We meet at least twice a week because of my great interest in the claims. He has never mentioned the word "demoralization." I don't know where that comes from, and the inefficiency, sir, if by inefficiency you mean that the transition may mean another 2 or 3 or 4 weeks in reaching an evaluation of the EB claims, there is not that much rush in it, sir, because we wish to combine this, I repeat, with an effort, and a very important effort, to try to——

Senator PROXMIRE. But just a few days in effect before it was to be completed.

Mr. HIDALGO. Sir, we are talking of December 1.

Senator PROXMIRE. Right.

Mr. HIDALGO. At that time, I repeat, I don't mean to engage in any differences of opinion with Admiral Manganaro. I was told that the analysis was incomplete and indefinite at that point.

Senator PROXMIRE. Admiral Manganaro was not indefinite before us. He was indefinite on lots of things, but here he said, "2 to 4 weeks."

Mr. HIDALGO. That is his privilege, sir.

I can neither agree nor disagree with that. I am just saying to you that the same people working for the Board are now working for the steering group. The same exact people were there—Pete deMayo and others were right in there. They are the ones who have been working on these claims.

Remember one thing, Mr. Chairman——

Senator PROXMIRE. Let me make it clear: You said the same people are working on it. Does that mean you took the professional staff away from the Manganaro Board?

Mr. HIDALGO. Yes because he had no further use for them. If they were working on Electric Boat claims, the logical thing would be to send them to the steering group instead of having them sit on their hands somewhere. That's right, yes.

Senator PROXMIRE. You say you cut the staff of those people, that means you cut their capability of action in half?

Mr. HIDALGO. No, sir, not in half at all. I think seven or eight people who had been working on——

Senator PROXMIRE. How many did they have? They didn't have a great deal more than that.

Mr. HIDALGO. As you know, Admiral Manganaro's staff varied a great deal.

Senator PROXMIRE. He told us that, yes, but seven to eight would cut it roughly in half. They said they had from 6 on up, 3 engineers and 3 lawyers minimum up to 20 maximum. If you take seven or eight away, that pretty well—well, it certainly doesn't decimate it, but it comes close to cutting it in half though.

Mr. HIDALGO. Mr. Chairman let me say we are still sort of in an organizational state within the steering group, but there were about six or seven people who were at Groton and who were there, Mr. Chairman, before the Electric Boat claims were assigned to the Board. Remember, Electric Boat claims were not assigned to the Board until the first of March of this year. They were in NAVSEA before that, and that wasn't so disastrous.

Now they have come into the steering group and there are about seven people from the Electric Boat organization at Groton that are now going to be reporting to the steering group, but they are the ones with intimate professional knowledge.

Senator PROXMIRE. Now Admiral Manganaro testified that based on his 10-month review of the Electric Boat claims he concluded there was substantially less legal entitlement than the amount claimed. Now privately I have heard a rumor that the Board would have concluded the claim worth only a small fraction of the face amount.

Would this have anything to do with your decision to prevent the Board from completing its review?

Mr. HIDALGO. Absolutely not, sir. I deny any implication of that absolutely; nothing whatsoever.

Senator PROXMIRE. Now, how many full-time professional persons have you assigned to complete the review of the Electric Boat claim and when do your expect the review to be completed?

Mr. HIDALGO. Well, sir, if you take the whole group, the steering group at the top, the task group underneath which is about 8 or 10 and then within the box of Electric Boat we have around 8 doing nothing but Electric Boat so you really have quite a professional group of multidisciplines within the Navy, the top people in the Navy have been assigned to me for that purpose.

Senator PROXMIRE. Full-time professionals then you have what, 10, 15, 20?

Mr. HIDALGO. Full-time professionals, what would it be, eight, nine?

Mr. MCDONNELL. Yes.

Senator PROXMIRE. When do you expect the review to be completed?

Mr. HIDALGO. I am going to get a report, Mr. Chairman. I wish this were January 16 and I could tell you more precisely—by the head of that box down here in EB, around January 13, because he is going through the files that were turned over to him by the Board.

But I say that within 2 or 3 months would be ample time for us to have moved forward with the discussions of the underlying problems, because these, too, I repeat, have to go together.

Senator PROXMIRE. Within 2 to 3 months of now or of January 16?

Mr. HIDALGO. I would say of now.

Senator PROXMIRE. Now. Do you intend to involve yourself or your office in the negotiations with Newport News in regard to its pending claims?

Mr. HIDALGO. As much as I can be helpful on them I shall, yes, sir, that is part of my responsibility.

Senator PROXMIRE. Do you recognize that one of the main reasons that the claims problem has gotten out of hand in the past 10 years is the tendency for high level officials with no experience in the area to intervene, shoving the professionals aside and negotiating directly with high level contract officials?

Do you see that as a problem?

Mr. HIDALGO. I would hope it would not be, sir. I have worked very well with Admiral Manganaro. I repeat I have the highest regard for him. I wish it would be kept in mind, sir, the historical setting of the organization of that Board.

I think it is very important. You must know that history better than I do. I think that history is different today. The settlement of these claims has been entrusted to Mr. Claytor and he has turned that over to me. That is his responsibility and he has made it mine.

The Board was created at a time when, perhaps, there was a vacuum to be filled. It was after the attempt by Secretary Clements, as you know——

Senator PROXMIRE. Right.

Mr. HIDALGO [continuing]. To solve problems through 85–804. We do not have that situation today, sir, and I tell you with all candor that Mr. Claytor and I on a day-to-day basis will be more directly involved.

Senator PROXMIRE. I am glad to hear that, but as you understand, we thought establishing this Board was a strong step in the right direction and we were moving in the right way and Admiral Rickover did, too. He said so this morning.

But the fact that you have taken action as you have in the Electric Boat case raises very, very considerable questions on our part.

Mr. HIDALGO. I hope it doesn't, Mr. Chairman. There is no implication that should be drawn from that. Perhaps the only thing I would have to admit is that if you just take the business of going ahead with the entitlement we may lose 2 or 3 weeks of sorts in this transition or a month, if you will; and I do not consider that important because just settling the EB claims does not settle the EB problem.

Senator PROXMIRE. Have you discussed the claims or involved yourself in the negotiations with officials of Newport News, Electric Boat or Litton, and, if so, tell us with which contractors you have had discussions.

Mr. HIDALGO. All three. I have had discussions with all three, Newport News, EB, and Litton.

Senator PROXMIRE. Now, we heard this morning that Newport News rejected the Manganaro Board's final offer on the 686 and 687 submission claim, 686 and 687 submarines.

Mr. HIDALGO. Right, sir.

Senator PROXMIRE. Do you now intend to negotiate personally with Newport News over that claim and, if so, won't that be a clear signal to the firm to turn down the Board's offer because they might get a better deal out of you?

Mr. HIDALGO. Sir, I intend only to do what Admiral Manganaro and I will work out together to his satisfaction. I don't want to be a burden, I don't want to in any way impede any progress.

How or who does it is not important.

Now, I may have some thoughts—I have been a lawyer a long time—thoughts that might be helpful. If so, I am going to take a part in it.

Now, the 686–687, you have just pointed out there has been action taken. What can properly be done about that, I really have no present thought.

Senator PROXMIRE. Admiral Manganaro testified this morning very clearly on the guidelines he set forth and they seemed commendable. The fundamental principle was that the chairman, in this case, Admiral Manganaro, should be the man who would have the association with the contractor, work with the contractor, and negotiate with the contractor.

If he is not, he loses control of it; that his bargaining position is undermined and feeble no matter how good the intentions may be of the official who intervenes to act in his place.

Mr. HIDALGO. I think those generalizations, I don't find them helpful, sir. Specifically in the case of Electric Boat the officials of that company chose to come to see others within the Navy Department, specifically myself, specifically Mr. Claytor.

Now, there is no way of telling them you cannot do that.

Senator PROXMIRE. Why not?

Mr. HIDALGO. Well, you do it if you think you can be helpful in having those meetings, sir, you proceed to do it. There are many minds, you know, that can organize themselves usefully.

There has been no conflict in any of this, Mr. Chairman.

Senator PROXMIRE. This is precisely the purpose for establishment of the Board, to insulate the process from interference from very well-intentioned people of the highest integrity, such as you, but people who come in without the backgrounds, without the full-time experience, without the single obligation that Admiral Manganaro has which is to act on claims.

Mr. HIDALGO. Sir, the original purpose of that Board to me is no longer valid today in the sense that it should exclude Secretary Claytor and myself from the deliberations and from the direction of these matters. And we do not intend to permit that.

Senator PROXMIRE. Then you are repealing the charter of the Board? The part that we were particularly impressed by this morning was the third paragraph which indicated that it was vital that the Board be insulated from political influence or political control.

Mr. HIDALGO. I don't consider my influence political, Mr. Chairman. I have dealt with matters of this kind across my whole life as a lawyer.

Senator PROXMIRE. There is nothing wrong with the political aspect, of course. I have great pride in it, I think that is one of the most important offices in our Government. I consider myself a politician and I am proud of it, but you are obviously a political appointee.

Mr. HIDALGO. Yes, sir.

Senator PROXMIRE. I think that is to your great distinction. We believe in civilian control. We believe in that kind of thing.

Let me read what the memorandum describing the said charter and this is by Admiral Michaelis, July 1, 1976:

To be successful, the Board must not be subjected to outside pressures, influence, and unsolicited advice.

I expect you to be fully supportive in this regard and to be accountable for the actions of your subordinates as well. I want you to imbue your organization with the necessity for thorough and rapid response when called upon for input to the Board by the various disciplines under your cognizance.

At the same time your people must stand apart from claims resolution activities of the Board. Strict adherence to the guidance contained in enclosure 1 is mandatory for all concerned.

You must not be subjected to outside pressures, influences, and unsolicited advice.

I submit that is exactly what this Board is getting.

Mr. HIDALGO. Sir, if I thought that my predecessor, Mr. Bowers, intended that charter to mean that neither Mr. Claytor nor I can participate, express views, give direction, I would change that charter tomorrow.

I would, on the other hand, wish to emphasize to you that I have worked very harmoniously with Admiral Manganaro. I hope he feels that I have been helpful to him; he certainly has been helpful to me. So I see nothing to be gained by this theoretical discussion, sir.

Senator PROXMIRE. How many full-time professionals have been assigned to the Litton claim?

Mr. HIDALGO. About the same number as EB, sir.

Senator PROXMIRE. That would be 8 to 10?

Mr. HIDALGO. Eight or ten, is that about right?

Mr. MCDONNELL. Probably more.

Mr. HIDALGO. Probably more on Litton because there is more to be done there.

Senator PROXMIRE. How many more?

Mr. HIDALGO. There was a task force working directly for me which consisted of what, 10 or 15?

I would say that 15—would 15 be misleading the chairman?

Mr. MCDONNELL. No.

Mr. HIDALGO. About 15.

Senator PROXMIRE. You indicated in your statement that the review of this claim will be completed by March.

Mr. HIDALGO. Is this Litton you are talking about?

Senator PROXMIRE. Yes.

Mr. HIDALGO. Those are dangerous predictions for me, sir. Remember, their last claim documentation was——

Senator PROXMIRE. They were not my predictions, they were yours in your prepared statement, if I read your prepared statement correctly.

Mr. HIDALGO. I know, I indicated them with hesitation and with some fear because the last documentation from Litton was submitted in September of this year.

Now, it all depends on how quickly we can move because I want to move side by side with the overall discussions.

Senator PROXMIRE. I raise that question for that very reason. You have anticipated my concern here.

The Litton claim was revised upward by more than $300 million as recently as September of this year, you have referred to that.

It took the Manganaro board 18 months to review the Newport News claim and 10 months for the EB claim, which totaled $554 million.

It seems to me that for you to review a $1 billion claim so quickly would be unlikely even with 15 professionals working on it.

Mr. HIDALGO. I have had this task force at work, Mr. Chairman, since roughly April or May of this year. So we have had that much behind us.

Remember, Mr. Chairman, right at Pascagoula, we must have over 100 people who have been working on this claim for several years so I mean this is not virgin territory. I would like to have the opportunity to come up and inform you, Mr. Chairman, if I could, if you would give me 1 month I will come up and give you more exact figures.

I don't want to mislead you in any way.

Senator PROXMIRE. I would be delighted with that. We will be delighted to have you back.

Mr. Secretary, is it your present intention to propose to Congress a bailout of one or more shipbuilders with the type of proposals Secretary Clements made to Congress, but, then, withdrew last year?

Mr. HIDALGO. I hate cliches, Mr. Chairman, if you would let me sidestep bailout——

Senator PROXMIRE. Let me ask you this: Would you propose an action of the kind that Secretary Clements proposed last year on behalf of one or more of the shipbuilders?

Mr. HIDALGO. I am going to give you a hypothectical answer, Mr. Chairman, to the best of my ability.

If the discussions with Electric Boat and Litton or one of them—while we wanted to start them simultaneously—the destiny of one doesn't depend on the destiny of the other—but if they lead to a consensus as to how not only we can resolve all the pending claims but also the underlying problems, that is, there is continuous cash shortfall, a negative cashflow that these shipbuliders have in the construction of vital Navy ships, that we can resolve the whole thing and if——

Senator PROXMIRE. What if that——

Mr. HIDALGO. May I finish because it is important that I answer your very important question.

Senator PROXMIRE. Yes; go ahead.

Mr. HIDALGO. And if the only way we can resolve the underlying problems is through some modification of the existing contracts, then I say to you that extraordinary relief under Public Law 85–804 may be invoked at that time. I may make that recommendation to Secretary Claytor.

Senator PROXMIRE. Would you invoke it if it is their fault, even if you have these conditions but the conditions are in part or in large part their fault?

Mr. HIDALGO. And that we are faultless, sir? Is that what you are saying?

Senator PROXMIRE. Of course not, but in large part.

Mr. HIDALGO. How I will come out on that, Mr. Chairman, I don't know what these discussions will lead to as to whose fault is

whose and what the degree of it is. What I am interested in is getting these ships at the lowest possible cost to the Navy.

Mr. HIDALGO. How I will come out on that, Mr. Chairman, I

Senator PROXMIRE. I know that. We want to get the ships, but it would seem if you follow that procedure, that you can be expected to follow, in the future, providing an incentive for the shipbuilders to pursue this line, expecting to have that kind of treatment in the future, and that was our concern with the Clements' proposal.

That is why there was such strong opposition to it here in the Congress. That is why it had to be withdrawn.

Mr. HIDALGO. Sir, if our discussions lead us to the point where Public Law 85–804 seems to be the correct path, of course we will come to Congress and I would assure you that we would not be coming to the Congress with a noxious proposal, so that we are not setting a noxious precedent.

But I don't want to do it on an "iffy" basis right now, sir.

Senator PROXMIRE. Can you assure me that the Navy will not take any action that constitutes a giveaway or bailout to the shipbuilders and that the claims will be considered strictly on their merits and settlements made only after they are fully examined and evaluated?

Mr. HIDALGO. Again, sir, I am torn with the semantics. What we will do, sir, is evaluate the claims. We will arrive at a range of values, assess the exposure of the Navy represented by those claims, and, therefore, look into the merits.

We will look into the merits of the entire history of each of the situations. We will look into the merits of what it would mean to the Navy to have to move ships from one yard to another to complete essential ships to the Navy.

We are going to look—if you forgive me—at the whole total package and our criterion will be, how can we get these ships built at the lowest possible cost to the Navy and the national interest.

So, viewed from that perspective, yes, sir, the merits will be our guiding light.

Senator PROXMIRE. Well, I have great sympathy for your position. I would agree wholeheartedly that national defense has to come first and that we need the ships, we have to have them, we have to have then as soon as we can get them and we have to have them, of course, at the lowest possible cost.

But, I am concerned that there is not a system here in which we can achieve that end without having a man as distinguished as you are in the high position you occupy, able to answer in the flat affirmative without qualifications——

Mr. HIDALGO. Because it all depends——

Senator PROXMIRE [continuing]. That you assure me that the Navy will not take any action that would amount to a giveaway or bailout of these shipbuilders' and that the claims will be considered strictly on their merits and settlement achieved only after the claims are fully examined and evaluated.

Mr. HIDALGO. That is too narrow a question, Mr. Chairman, I cannot answer it with honesty to you. That is one aspect of it. We will have to look at the total aspect of it.

Senator PROXMIRE. So you might have to, in order to get the ships, you might have to propose a giveaway or bailout?

Mr. HIDALGO. No, sir, I am not going to call it a giveaway.

Senator PROXMIRE. You won't call it that but it might well be called that most properly.

Mr. HIDALGO. It won't be that, It will be in the Navy's interest to do a particular thing. Whatever plan—if I ever come up here with a plan with the approval of Secretary Claytor, with a petition to Congress to put the stamp of approval on something we are doing, it will be in the overall interests of the Navy and also of the shipbuilding industry, because those two things, Mr. Chairman, are in many ways identical.

There is no——

Senator PROXMIRE. We are getting closer to Charlie Wilson's observations, "What is good for General Motors is good for the country."

Mr. HIDALGO. No, sir, I am not saying that at all. I am saying there is not a shipyard in the country that can build a nuclear carrier except Newport News. There isn't a shipyard in the country that can build the Trident except EB and I can add a lot more things such as the LHA and Litton.

Senator PROXMIRE. One of the proposals that Admiral Rickover suggested this morning to overcome that is a GOCO—Government-owned, contractor-operated—shipyard in which the Government has the authority to move in and to act to prevent inefficient operations.

As a yardstick, he said he was very much opposed to Government operations generally or to Government ownership, I should say, generally, and I agree with him. I think it is grossly inefficient. It is much better to have private shipbuilders.

But, at the same time, if this is one way of establishing an effective yardstick, it is one I think we might well consider. It seems to me that while we have these claims going up and up and up, now it is $2.7 billion, they were $100 million, as we pointed out, just 10 years ago, where are they going to be, $10 billion, or many times the original contract cost of the ships, as time goes on?

It look like there is no end here.

Mr. HIDALGO. That is what we are trying to avoid, Mr. Chairman. That is exactly what we are trying to avoid.

Senator PROXMIRE. Then we ought to do that. It seems to me the situation is getting worse when we say we are going to follow policies that will permit them to file claims that will be honored and give them, in effect, an award for inefficiency.

Mr. HIDALGO. That is not our purpose nor shall we——

Senator PROXMIRE. I know it is not your purpose.

Last year some Government officials were alarmed at the alleged lack of interest in Navy ship programs. They allege that contractors felt Navy contracts were so unprofitable that shipbuilders were reluctant to bid on them.

I understand in fiscal 1976, the Navy requested bids on 38 ships and received responses from 11 different shipbuilders. Can you give us the names of the bidders who wanted to build Navy ships and your comments on whether there is sufficient interest in Navy programs in the shipbuilding industry to satisfy the Navy's needs?

Mr. HIDALGO. For the specifics, I will have to submit them for the record, sir.

[The following information was subsequently supplied for the record:]

Type of Ship	Number of ships	Offerors	Award
AD	2	NASSCO, Ingalls, Todd	NASSCO.
AO	2	Avondale, Ingalls, Bethlehem	Avondale.
T-ATF	4	Marinette Marine, Halter Marine (nonresponsive)	Marinette.
FFG	[1] 11	Bath, Todd	Bath, 5; Todd, 6.
MSC	[2] 4	Peterson Builders	Peterson.
PGG	[2] 9	Peterson Builders, Tacoma Boat	Do.
SSBN	1	Electric Boat	Electric Boat.
SSN	5	Electric Boat, Newport News	Newport News.

[1] 2 FMS.
[2] All FMS.

Mr. HIDALGO. But I know that many shipbuilders have declined to bid because they have found Navy work burdensome, completely unprofitable; and they have been nonresponsive to certain bids because they have said cost-plus instead of fixed-price incentive.

Yes, there has been a broad range of discouragement among the shipbuilding industry.

Senator PROXMIRE. See the facts I gave in my question suggest that that isn't necessarily the case. As I said, the Navy requested bids on 38 ships and didn't get responses from 1 or 2 shipyards, they got responses from 11; 11 different shipbuilders.

Mr. HIDALGO. I don't know what those responses were, Mr. Chairman, but I know the history that I have gathered——

Senator PROXMIRE. These are the figures the Navy gave Congress this year.

Mr. HIDALGO. Well, sir, I will check on that and give you the response. But I still think that my broad response is going to be correct, that increasingly there has been disenchantment in the shipbuilding industry in bidding.

I know, for example, on the last SSN flight 4, at first Newport News did not wish to bid because of past experiences and, then, they did change their mind and they came in and bid on SSN 688, three of those ships.

In general, and certainly based on the interviews with 11 of the shipbuilders, Mr. Chairman, I can assure you that most of them said that doing business with the Navy was simply the most adventurous, unrewarding thing they have ever done in their lives with one or two exceptions.

The FFG programs seem to be going to the satisfaction of both Bath and Todd in general, but I hope this is one——

Senator PROXMIRE. They may have a point. I just don't know. You know far more about it than I do.

But the admiral pointed out this morning that nobody is holding a gun to their temple and saying you have got to build ships. The fact is they come in, make these contracts, they are free to do it.

He feels they are doing very well and you have a situation where if they don't do well, they file claims and get well on them. At any rate, you do have a situation where there were, as a matter of cold hard fact, we are told 11 shipbuilders who did bid.

They didn't have to but they bid on 38 ships and made those responses.

Mr. HIDALGO. Was that in the testimony by one of the witnesses this morning, the 38?

Senator PROXMIRE. No, that was testimony before an appropriations subcommittee.

Mr. HIDALGO. We will get that.

Senator PROXMIRE. It was the Armed Services Appropriations Subcommittee earlier this year. So we would like to know from you for the record, the names of the shipbuilders and whether in your judgment having gone over that, do you feel there is sufficient interest in the Navy programs in the shipbuilding industry to satisfy the Navy's needs?

Mr. HIDALGO. I will stand on my statement that interviews we have had in the past 2 or 3 months indicated a tremendous disenchantment. The fact there is $2.7 billion indicates few have been settled so I don't think anybody is getting rich on those.

Senator PROXMIRE. You and I are big boys, Mr. Secretary. We know these shipbuilders are not going to come in and say we are doing beautifully, our profits are up—after all, they are making claims, they have to plead poverty, they have to say their "heart is breaking" and they are in tears and wearing ashes and sackcloths. They won't say they are doing well.

Mr. HIDALGO. I know, but we know the facts of what their profits or losses have been.

Senator PROXMIRE. Maybe we do and maybe we don't. These are by and large conglomorates and it is very hard to know. We cannot break it out and know what their overall profits have been.

Mr. HIDALGO. I think we have a fairly good bit of knowledge on that.

Senator PROXMIRE. Some people have expressed concern about the capacity of the shipbuilding industry to produce the ships required by the Navy. Others believe there are too many shipyards as a result of the drop in demand for commercial ships in recent years.

As far as the Navy is concerned, is there overcapacity, undercapacity or adequate capacity in the shipbuilding industry?

Mr. HIDALGO. We are talking now of the private shipbuilding industry, aren't we, without the Navy's facilities?

Senator PROXMIRE. That is right.

Mr. HIDALGO. There is right now some concern as we look down the path, Senator, let's say into 1980–81, where certainly these shipyards—well, as to how they will be able to keep their work forces at a level which will be acceptable in terms of overhead and so on.

That is true of some, not true of all. Of course, the Navy's shipbuilding program——

Senator PROXMIRE. So there is concern there may be overcapacity along about 1980 or 1981. Have there been any studies done by the Navy to determine whether or not the capacity is there or likely to be there?

Mr. HIDALGO. There certainly are projections that NAVSEA is constantly making on that.

Senator PROXMIRE. Would you make those available to us for the record?

Mr. HIDALGO. Yes.

[The following information was subsequently supplied for the record:]

SHIPBUILDING CAPACITY PROJECTIONS

Projections of workload for the shipbuilding industry and testimony regarding the capacity of the industry to accomplish the forecast workload are provided to the Congress each year by the Commander, Naval Sea Systems Command in hearings held by the Armed Services Committees. The following information reflects current status, but will be updated for the coming year's hearings.

SHIPBUILDING RESOURCES IN THE PRIVATE SECTOR

- 117 CONTRACTORS ON BIDDERS LIST FOR NAVY NEW CONSTRUCTION
- 11 ACTIVE SHIPYARDS WITH CURRENT AND PREVIOUS MAJOR NEW CONSTRUCTION EXPERIENCE
- THESE 11 LARGE SHIPYARDS HAVE 61% OF TOTAL EMPLOYMENT OF 176,000

CHART 1

Within the private shipbuilding industry, 117 contractors are on our bidders list for new construction and conversion programs. However, the number reduces only 11 when we talk of those active shipyards with current and previous major new construction ship experience. These 11 shipyards represent 61% of the total industry employment of approximately 176,000.

The 11 major private yards are shown by geographical location on Chart #2. Nine of these currently hold all the contracts for Navy new construction ships. Chart #3 shows the geographical location of representative "Other Than Major Shipyards". Displayed are yards which have held Navy shipbuilding contracts in the last five years. They are important in satisfying Navy requirements for construction and maintenance of smaller ships and craft. There are over 100 shipyards in this category, employing about 20% of the total industry workforce.

THE SHIPBUILDING ENVIRONMENT
(MAJOR PRIVATE YARDS)

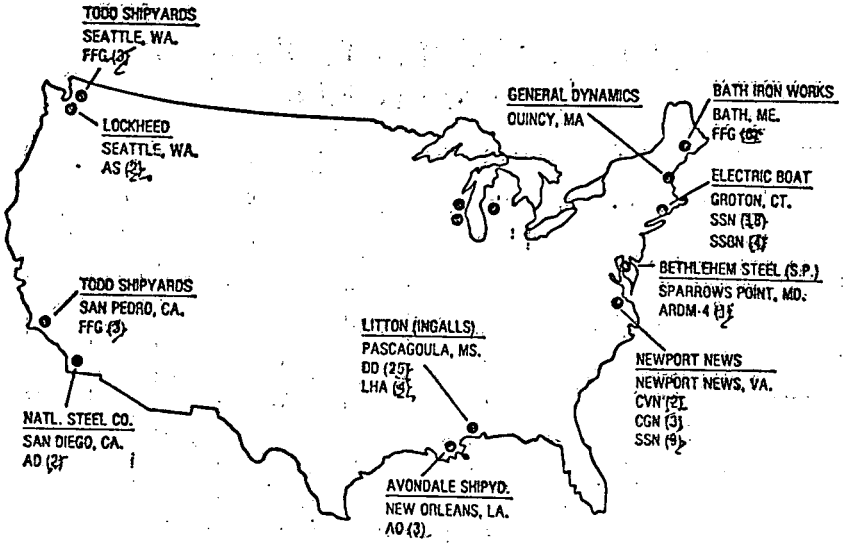

CHART 2

THE SHIPBUILDING ENVIRONMENT
(OTHER THAN MAJOR YARDS)

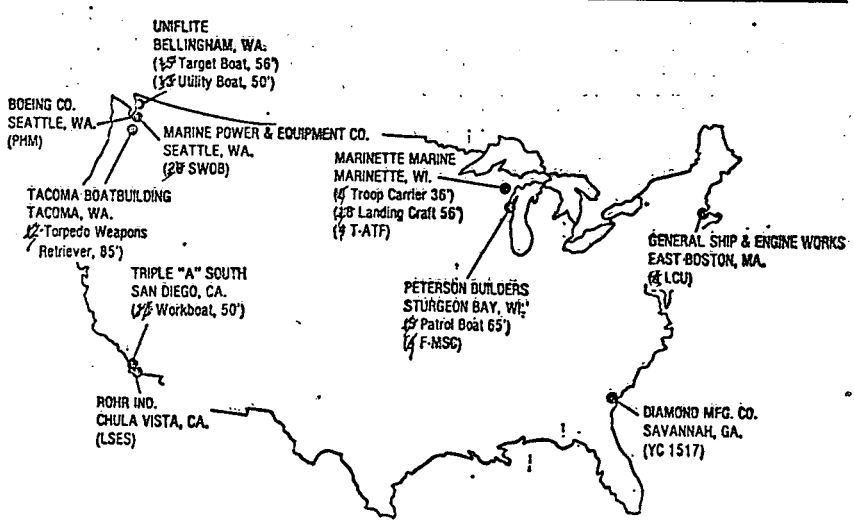

CHART 3

The capabilities of major shipyards to construct complex Naval ships are listed on Chart #4. Additionally, throughout the country, there are major industries and smaller companies supplying to the shipbuilders equipment and components for these complex programs. Apparent from this display is the fact that the construction of our large surface combatant ships and submarines is limited to a few yards, while for destroyers, frigates and auxiliaries there is a wider range of shipyard capability.

SHIPYARD CAPABILITY FOR PROJECTED SHIPBUILDING PROGRAM

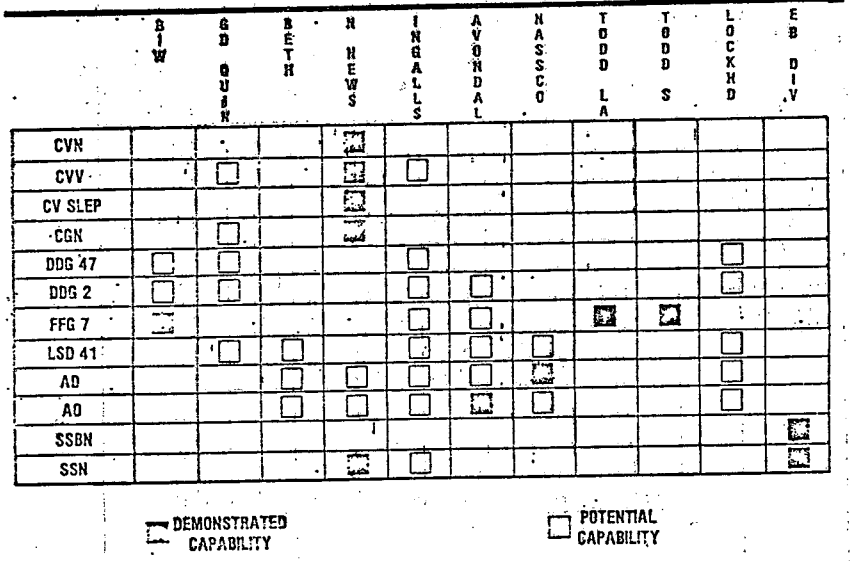

CHART 4

Now let us consider the ability of the U.S. Shipyards to absorb the workload involved in the Navy's shipbuilding program. Chart #5 shows the total workload projected for the shipbuilding industry through CY 84. In the near term, commercial new construction current or projected work represents only about 16% of the total workload. Navy new construction, both near term and projected, will absorb about 40 to 45% of the total manpower. Commercial workload beyond calendar 80 is being reassessed.

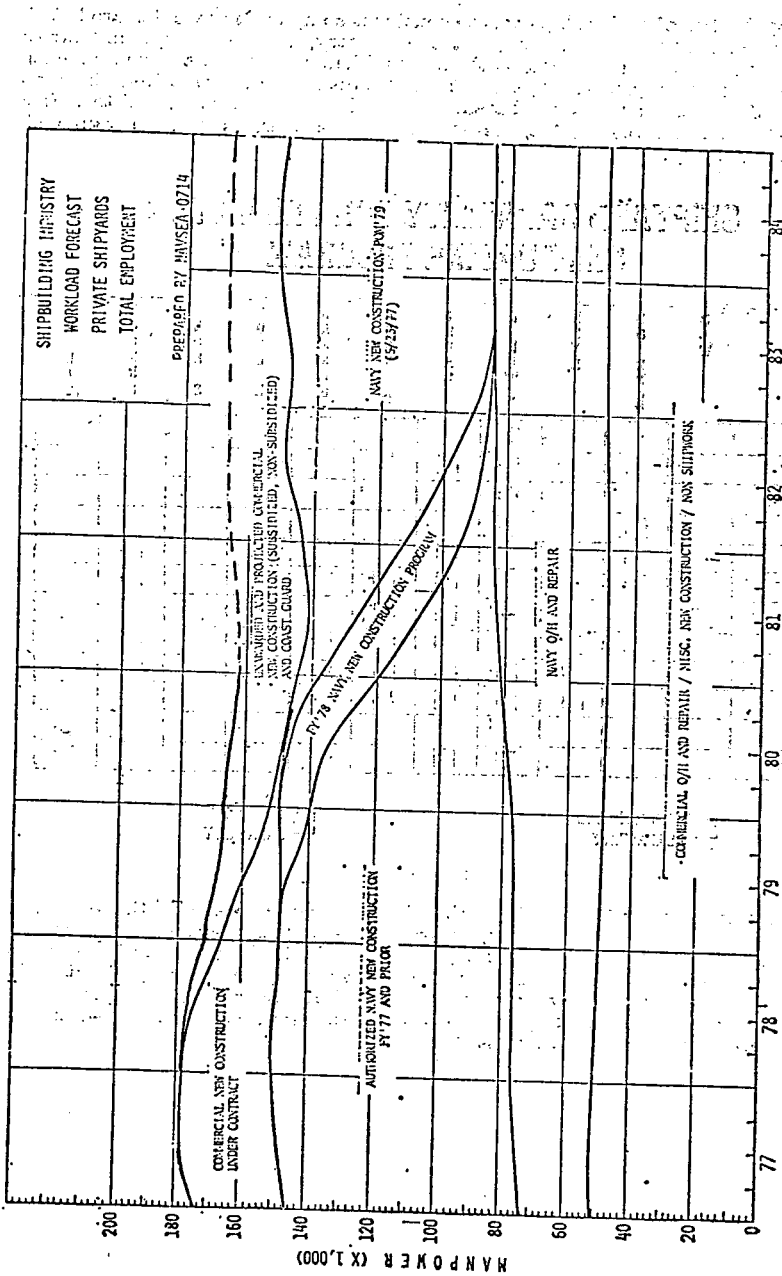
SHIPBUILDING INDUSTRY
WORKLOAD FORECAST
PRIVATE SHIPYARDS
TOTAL EMPLOYMENT
PREPARED BY NAVSEA-0714
COMMERCIAL NEW CONSTRUCTION UNDER CONTRACT
AUTHORIZED NAVY NEW CONSTRUCTION FY'77 AND PRIOR
FY'78 NAVY NEW CONSTRUCTION PROGRAM
NAVY NEW CONSTRUCTION FY'79 (5/25/77)
NAVY O/H AND REPAIR
COMMERCIAL O/H AND REPAIR / MISC. NEW CONSTRUCTION / NON SHIPWORK
MANPOWER (X 1,000)
CALENDAR YEAR
0
20
40
60
80
100
120
140
160
180
200
77
78
79
80
81
82
83
84

CHART 5

Senator PROXMIRE. Newport News Shipbuilding and Drydock at one time threatened to stop work on Navy ships and indicated it might not complete the nuclear carrier under construction. I understand that after making those threats it asked the Navy for permission to bid on fiscal 1977 nuclear submarine contracts.

How many ships has Newport News indicated it would like to submit bids on in the past year, and has it carried out any of the threats to stop work?

Mr. HIDALGO. I, in my time, sir, have known of no threats to stop work and I only knew indirectly that at first, as I mentioned earlier, that they did not seem inclined to bid on the SSN 688's and later on, they asked for time to do so, they did and they won the award.

Senator PROXMIRE. In spite of the talk in this case at least——

Mr. HIDALGO. The CGN–41, of course, was involved in litigation.

Senator PROXMIRE. But in spite of the talk about the shipbuilders being reluctant to work, that there is no profit in it, there is a lot of uncertainty, a lot of grief, nevertheless in this case you don't know of an instance where Newport News refused to bid?

Mr. HIDALGO. No, sir, not in my time, except for this SSN 688 situation which they finally bid on.

Senator PROXMIRE. So, Newport News is really up to its neck in claims, they are involved in very heated controversy but they still are anxious to bid on new contracts; it doesn't look as if the situation is that unattractive for them.

Mr. HILDAGO. I think they feel, for instance, the new contracts on the 688's, sir, are more realistic in their escalation clauses, give them a better chance to find an acceptable result from the building of these ships.

I don't want to speak for them, sir, I think they should be asked on this.

Senator PROXMIRE. When the chips are down they seem to be interested in bidding.

Early in 1976, the Navy announced it reached an agreement with Litton whereby Litton agreed to take up the LHA claim at the ASBCA and supply the Navy with documentation of the claim in accordance with the schedule so that the full documentation would be before the Navy by the end of 1976.

Now, did Litton comply with the agreement to provide documentation and, if so, was there full compliance, and if not, why not?

Mr. HIDALGO. Sir all I know is that the final documentation—I ask Mr. McDonnell to correct me on this—on delay and disruption was put into the Mississippi court in September of this year.

Now, that is all I know about the subject. And that, apparently, is all of their documentation, they had a lot of work and rework to be done on that and it was finally put in in September of this year.

Senator PROXMIRE. As of this date, has Litton supplied the Navy with the full documentation for the LHA claim?

Mr. HIDALGO. It appears so.

Senator PROXMIRE. Is it correct that the LHA claim is once again pending before the Armed Services Board of Contract Appeals?

Mr. HIDALGO. It has been there, sir, but in a state of suspension; is that correct, Mr. West?

Mr. WEST. That is right, basically it is not before the Board presently. The whole issue has been down in the U.S. District Court in Jackson. Litton served us with a notice of intention not to continue production on the LHA's. We sought an injunction from the U.S. District Court in Mississippi to compel them to perform. We got that injunction but the court also tacked on a requirement that we pay 91 percent on a weekly basis of invoice costs and it is out of that scenario that Mr. Hidalgo's earlier description of where we stand with respect to the LHA program goes.

Presently, the matter is pending before the Armed Services Board of Contract Appeals but is in suspension. There is no activity going forward there.

Senator PROXMIRE. As of March of this year the amount of the LHA claim was $701 million. Can you state briefly the originial amount of the claim; when it was first filed; and the new amounts and dates each time it was revised by Litton?

Mr. HIDALGO. It was first filed in March 1973, there were revisions in 1974 and 1976, and I don't have the exact figures but we can supply those for the record.

[The following information was subsequently supplied for the record:]

The Litton/Ingalls shipbuilding claim was first submitted to the Armed Services Board of Contract Appeals in March 1973 in the amount of $270 million, and revised upward that month to $376 million. Subsequent to that time the claim has been revised four times as follows:

July 1974 (million)	$400
April 1975 (million)	504.8
June 1976 (million)	701.7
September 1977 (billion)	1.076

All of the revisions to the claim were accompanied by additional documentation to substantiate the new amounts.

Senator PROXMIRE. Is it correct that the total amount of the present LHA claim is about $1.1 billion?

Mr. HIDALGO. $1.07 billion.

Senator PROXMIRE. How does the amount of the claim compare with the estimated current program cost of the LHA?

Mr. HIDALGO. The program cost—estimated program cost, Mr. Chairman?

I think it is $1.5 billion—$1,558 million.

Senator PROXMIRE. So the amount claimed is about 70 percent as high of the current estimate cost; and it is substantially higher than the original estimated cost of the entire program?

Mr. HIDALGO. Yes; a little bit higher, yes. The original estimate was $905 million.

Senator PROXMIRE. The amount claimed is $1.07 billion which is higher?

Mr. HIDALGO. That is right.

Senator PROXMIRE. Now, as I understand the facts, Litton brought its claim to the ASBCA before providing the Navy with full documentation. In effect, Litton used a procedure for appealing a Navy decision on a claim before the Navy had an opportunity to fully examine the claim.

Do you agree that this is a peculiar procedure to file a claim, withhold documentation and then appeal it before it has been audited or examined by the agency with which it was filed?

Mr. HIDALGO. I would rather our general counsel answer that.

Mr. WEST. Let me say, they cannot appeal a decision to the Armed Services Board of Contract Appeals until the final contracting officer decision comes out of the Navy; unless the contracting officer is unreasonably late in issuing a final decision.

In this case, the Navy was apparently tardy at giving them a final contracting officer's decision and they appealed.

From the Navy's point of view, we would prefer to have them supply everything that is necessary for us to be able to assess their claim obviously, and to be able to audit it fully. Certainly, before the Armed Services Board of——

Senator PROXMIRE. If they filed the claim in 1973 and they didn't meet the documentation until this year—is that correct?

Mr. WEST. That is correct. That is what Mr. Hidalgo just said.

Mr. HIDALGO. Well, now, there was documentation, wasn't there, Mr. McDonnell?

Senator PROXMIRE. I am talking about complete documentation.

Mr. HIDALGO. Oh, complete.

Mr. WEST. We have taken that position, yes.

Senator PROXMIRE. You have what, sir?

Mr. WEST. We have taken that position in various responses in court documents.

Senator PROXMIRE. That they shouldn't do that?

Mr. WEST. That is right.

Senator PROXMIRE. Why shouldn't it be required that a claim be fully documented and a reasonable time allowed for auditing and examination before it can be appealed to the Armed Services Board of Contract Appeals?

Mr. WEST. I missed that.

Senator PROXMIRE. Why shouldn't it be required that a claim be fully documented and a reasonable time allowed for auditing and examination before it can be appealed to the Armed Services Board of Contract Appeals?

Mr. WEST. The Navy couldn't disagree with that statement, Senator; that is the argument we have been making in various forms in which we have had to contest this particular claim.

Senator PROXMIRE. All right, you are contesting it, OK.

Mr. West, how many Navy lawyers are working full time and investigating the shipbuilding claims for violation of false claim or fraud statutes?

Mr. WEST. We are not working in an affirmative context. We don't have lawyers carrying out an investigation to find out whether there is fraud in various contracts. What we have, Senator, is that when allegations are made by those personnel who are involved in evaluating claims that are submitted, which normally are technical personnel, contracting office personnel, when those allegations are forwarded to us, we undertake to do an inquiry. In that respect there are presently, I think, two attorneys, maybe three attorneys in the Office of General Counsel who are looking into various allegations of fraud that have been sent to us.

Senator PROXMIRE. How many attorneys are working full time on these cases?

Mr. WEST. Excuse me, there are none working full time.

Senator PROXMIRE. How many are working part time, two?

Mr. WEST. Two.

Senator PROXMIRE. What are your responsibilities in regard to violation of false claim and fraud statutes in Navy shipbuilding contracts?

Mr. WEST. The responsibilities are these: When an allegation that a claim is either intentionally false or fraudulent is made by some person in the Navy or some person and brought to the attention of the Navy, that allegation as it applies to Government contracts eventually finds its way to the Office of General Counsel. At that point it is our duty, depending on the circumstances of the case, to do either one of two things: If it is an investigation that is being undertaken by a purely investigative service, such as the Naval Investigative Service or the FBI, or the Bureau in the Justice Department, we provide advice on matters of contract law.

After all, it is our office that is best equipped to give that kind of contract law advice. If, on the other hand, it is a matter in which, quite frankly, the issues are fairly complex, then the Office of General Counsel will attempt to carry out the first stages of the inquiry itself as the major actor in the inquiry.

It has been our practice, at least since I arrived in the last 8 months, that at an early stage of this kind of an inquiry, and at the working attorney level, we will alert the Justice Department to the existence of the allegations and from time to time seek their view as to progress. The whole point is somewhere the Justice Department must be in a position to be able to make a decision on it.

Senator PROXMIRE. How long do you expect your investigation to take of possible fraud in the Newport News and Electric Boat cases?

Mr. WEST. Well, I couldn't rightly say as to the latter, Senator. We have just received the allegations in the EB case in the last month or so, to my knowledge. I believe the testimony you have from Admiral Rickover is that he forwarded 18 allegations or so on the tenth of December. He didn't forward them to me. They were forwarded to the Inspector General and to the Assistant Secretary, each of whom eventually forwarded their copies to me.

We did not receive the attachments to his memorandum that support his allegations until the 21st of December. So our inquiry in the EB fraud question has only just commenced.

With respect to your first one, as to Newport News, those allegations quite frankly are still coming in. You mentioned at least four fraud reports that the admiral mentioned this morning. The fourth of those was forwarded to us this month.

Senator PROXMIRE. I am not faulting you. I just wondered if you could answer the question how long do you expect it to take?

Mr. WEST. I really can't answer it and those are the reasons why. I just don't know when we will be through with it.

Senator PROXMIRE. So the claims might be settled before you are able to make the fraud investigation?

Mr. WEST. That is absolutely correct, Mr. Chairman, and no interests of the United States will be jeopardized if that happens.

Senator PROXMIRE. Why not?

Mr. WEST. Well, because the False Claims Act, and the statute for fraud that governs fraud in Government contracts, provide us

means to recover where we uncover fraud. We will be able to recover that money. As a matter of fact, if a civil suit is brought under the False Claims Act, we will be able to recover double the amount.

The contractor is severely penalized for that, Indeed, if we don't pay out before, if we discover fraud and we don't pay out, then we don't have a fraud action at all. We will not have suffered any damage.

So in either case the U.S. interests are protected.

Senator PROXMIRE. Now, Mr. Secretary, I am about finished, but let me just point out that the Navy is inconsistent here. I can understand the temptation not to be consistent, but when the Navy appears before the Appropriations Committee asking for more ships, they make the case that they have all the capacity they need and they have shipbuilders anxious to build it.

This testimony by Admiral Michaelis, Chief of Naval Material, in March of 1977—here is what he said in this connection:

> I would like to note that there is sufficient productive capacity in the U.S. shipbuilding industry for all of our projected Navy shipbuilding. In fact, under planned shipbuilding programs some private yards will soon be forced to reduce employment.
>
> Finally, for U.S. Navy ships during fiscal 1976 we requested industry bids of eight different ship types, involving a total of 38 ships. Sixteen responses were received from 11 shipbuilders and recently Newport News Shipbuilding and Drydock requested an opportunity to bid on the fiscal year 1977 688 submarine procurement, although they had previously declined to bid.

Let me conclude by saying that if the purpose of a congressional hearing is to raise questions, this hearing has been eminently successful. We have raised a lot questions. Unfortunately for the public these questions seem to be at the present time without answers.

I cannot for the life of me understand why information about possible fraud, including formal allegations by high-ranking naval officials, is not communicated quickly to the Navy hierarchy. I cannot understand why the Electric Boat claims were taken away from the Claim Review Board shortly before the review would have been completed.

After all these years we seem to be back to where high level Presidential appointees are trying to solve through personal involvement what professionals have been struggling with at length. We seem to be back at square one.

If there is a renewed determination within the Navy to strictly enforce its contracts, it was not demonstrated here today. I have come away from this hearing with the same reaction Alice had after talking with Humpty Dumpty: "It was a very unsatisfactory experience."

The official Navy spokesman would not even give me his assurance that the Navy would not take any action that would constitute a giveaway or bailout. As a Senator, as a member of the Appropriations Committee, I will oppose any plan that amounts to a giveaway or bailout.

I am confident the majority of my colleagues would be of the same opinion should the Navy be so unwise as to propose such a plan.

I want to thank you, Mr. Secretary, Mr. West and gentlemen, for your responsive and intelligent presentation here today. We are very grateful to you for it.

The subcommittee will stand adjourned.

Mr. HIDALGO. Thank you, Senator.

[Whereupon, at 3.57 p:m., the subcommittee adjourned, subject to the call of the Chair.]

[The following questions and answers were subsequently supplied for the record:]

RESPONSE OF ADM. H. G. RICKOVER TO ADDITIONAL WRITTEN QUESTIONS POSED BY SENATOR PROXMIRE

Question 1. Admiral, when you testified before this Committee in June 1976, you gave us examples of inflated elements contained in the Newport News claims such as Parkinson's Law, Naval shipyard recruiting practices, and misallocation of environmental costs, Have you uncovered any more examples of inflated claim elements which you can describe for the record?

Answer. Yes, sir. Analysis of the Newport News claims after my June 1976 testimony has identified many other examples of inflated claim items. In my testimony before the Subcommittee on the Department of Defense of the House Appropriations Committee on March 24, 1977, I discussed some examples. Excerpts of my remarks are reproduced below. The first example is the "financing costs" element of Newport News' claim on the contract for construction of CGN's 36 and 37. The second example is a claim for the cost of allegedly adding valves to ships for which the valves were provided on the original contract.

"HOUSE APPROPRIATIONS COMMITTEE, SUBCOMMITTEE ON THE DEPARTMENT OF DEFENSE, HEARINGS ON DEPARTMENT OF DEFENSE APPROPRIATIONS FOR 1978 (PAGES 572–573)

ANALYSIS OF MAJOR CLAIM ITEM

"I will give you an example of one major item in this Newport News claim: then you can decide for yourself whether this shows that the claim was exaggerated and inflated.

"One-fourth of the $151 million ceiling price adjustment requested in the 12 volumes, specifically $37.1 million. is attributed to "financing costs required as a result of the Government's failure to make progress payments that provided adequate compensation to cover the contractor's costs, including profit pursuant to the contract." Since this item is such a major portion of the claim, and the method of calculation is so questionable, I think it will be worth your while for you to understand it.

"According to the provisions of this contract, Newport News was to be paid periodically in accordance with the progress made on the contract, except that the total Government payments were not to exceed 105 percent of costs certified by the contractor to have been incurred by him in the performance of the contract at any given time. In the claim Newport News tabulated 105 percent of the total costs accumulated through each month. The claim then subtracted from this amount the cumulative "actual Government payments" through that month, and labeled the difference as "loss in revenue." The claim then calculated an imputed interest in two categories: (1) imputed interest on financing necessary to support loss in revenue and cumulative prior interest; and (2) imputed interest on lost investment opportunity for loss in revenue and cumulative prior interest not assigned to the financing category.

"The imputed interest for the financing category was based on the assumption that to finance each $1 in loss in revenue and cumulative prior interest allocated to the financing category it was necessary to borrow $1.15, leaving 15 cents in the bank to preserve credit. The imputed interest was calculated on the amount financed, using the prime interest rate existing at the time for each month of the contract.

"For each dollar of lost revenue and cumulative prior interest allocated to the "lost investment" category, the savings interest rate in effect at the time, which was generally less than the prime interest rate applicable to financing, was used to calculate the imputed interest.

"Thus, each dollar of lost revenue allocated to the financing category generated more imputed interest than a dollar allocated to the lost savings category.

"A detailed review of the calculations in this claim revealed that for many months Newport News allocated more amounts to the financing category for this claim alone than the total yard-wide actual borrowings. In addition, when the dollars allocated to the financing category for this claim were added to those of

the other claims, it was found that during some periods Newport News included in their claims nearly five times as much total borrowings in the financing category as the total yard-wide actual borrowings. The difference between the total borrowings allocated to the financing category in the Newport News claims and the actual yard-wide borrowings was as much as $120 million.

"The total cumulative imputed interest calculated up to June 1976 for the claim on the *California* and *South Carolina* contract was $26.9 million. In the claim, Newport News reserved the right to calculate a higher amount if the claim was not settled by June 1976.

"A detailed analysis on a month by month basis of the data supplied by Newport News in this claim reveals that prior to tabulating the 'actual Government payments' Newport News subtracted the escalation payments actually made by the Government. By improperly excluding these escalation payments from the calculations, Newport News nearly doubled the cumulative 'loss in revenue' claimed.

"In the claim, Newport News alleges that the target cost should be adjusted by the imputed interest they calculated of $26.9 million and that the ceiling price should be adjusted by 1.378 times this amount, for a total claimed ceiling price adjustment of $37.1 million for imputed interests. Since the loss of revenue to Newport News could not possibly exceed the difference between Government payments and 105 percent of actual costs, multiplying the calculated imputed interest by 1.378 appears to have no valid basis whatsoever.

"I thoroughly understand that money paid several years ago would have a higher value than the same amount paid today. It is for that reason that in settling this claim the Navy included $8.2 million in the $44.3 million settlement to pay for interests on the delayed payment for work for which the Navy accepted responsibility. But how can it be valid to claim an increase in ceiling price for: (a) imputed interest on escalation payments the Government actually made; (b) borrowings much greater than the actual Newport News borrowings; and (c) 37.8 percent more than the financing costs based on the maximum possible 'loss in revenue'?

"Admiral RICKOVER. Here is an example of one item from a Newport News claim. The contractor claims entitlement to a contract price increase of over $200,000 on the basis that the Government's design agent—in this case Newport News was the Government's design agent, on a separate cost plus contract—issued revised drawings which required the addition of 124 valves in seven systems for the ships in question. The shipbuilder alleges about 15,000 man-hours were required to comply with the changed drawing and that nothing in the contract specifications could be interpreted as a requirement for these valves.

"The Navy's detailed technical review revealed the following:

"(*a*) The revisions cited by the shipbuilder added only 4 valves, not 124 as alleged. Most of the remaining 120 valves has been required by the original drawings developed by the shipbuilder and in effect at the time the contract was definitized.

"(*b*) The contract specifications expressly required valves to perform the function these valves provide.

"(*c*) The revisions in question were issued by the shipbuilder himself and not by the Government's design agent, as claimed.

"(*d*) The shipbuilder had repeatedly assured the Government that implementation of these drawing revisions would not involve a contract change.

"The Navy's review required several hundred man-hours to be expended by experienced personnel who were diverted from their normal duties only to discover that there was no factual basis for the shipbuilder's allegations. The Navy should not have to be subjected to this sort of treatment."

These are just examples of claim elements which I consider to be inflated. Actually, the vast majority of the items from the claims which concern matters under my cognizance have been determined to have little, if any, merit. Analysis of both the Newport News and Electric Boat claims indicates that numerous items were apparently contrived to get the Government to pay money it does not owe. Subsequent to my appearance before the House Appropriations Committee, I submitted several reports to appropriate Naval officials describing in detail many claim items which I believe warrant investigation for possible violation of fraud or false claims statutes.

Some idea of the extent to which Newport News has inflated its claims can be gleaned from the Company's financial reports. Mr. John P. Diesel, Chairman of the Board of Newport News and Executive Vice President of Tenneco, testified

to the House Appropriations Defense Subcommittee in March 1977 that if the Newport News claims were accepted as valid at face value, Newport News would recover $460 million. The Tenneco 1976 financial report to its stockholders stated that the estimated revenue from the claims carried on the company's books was $222 million—less than half the amount that would be recovered if the claim were completely valid. It is my understanding that the Navy Claims Settlement Board has concluded that the amount Newport News is contractually entitled to is substantially less even than the $222 million booked by Newport News.

In my opinion, Newport News has resorted to many dubious techniques in presenting their claims. Numerous specific examples have been reported by others as well as myself which may well constitute violations of fraud or false claims statutes. These items have common features of faulty and misleading reliance on prior ship construction experience; omission of facts; statements that are demonstrably untrue; and so forth. Taken together, these items appear to have been carefully coordinated, possibly with the advice of legal counsel, thus raising the question of whether techniques were developed and provided to personnel preparing claims for the specific purpose of portraying Government responsibility for Contractor responsible items in such a way that fraudulent or false intent would be difficult to prove. This raises the further question whether such coordination of the claims, if it were found to exist, would not itself violate applicable statutes. Whether or not the Newport News claims violate fraud or false claims statutes cannot be determined until they are investigated by the Justice Department.

Question 2. In your opening statement you have a list of recommendations to improve the Navy's processing of claims and another list of criteria you recommend be considered in any attempt to settle claims independent of their merits. Can you explain in detail the basis for these recommendations?

Answer. The overall objective of my recommendations is for the Navy to be able to conduct its business with contractors without the burden of frivolous or inflated claims. This can only be achieved if contractors become convinced that it is to their financial advantage to conduct their business with the Government in an efficient straightforward manner. Efficient contract performance must be perceived by contractor management as being more profitable than the prosecution of inflated claims.

To achieve this proper business framework, there are two basic prerequisites. One is that existing fraud and false claims statutes be strictly enforced. The other is that the Navy be both willing and able to strictly enforce the terms of its contracts. My recommendations are made to achieve these goals.

My first recommendation is that the Navy be authorized to hire outside counsel and such other assistance as is necessary to help with claims and claims-related matters. Frankly, this is an area where the Navy is greatly outgunned. It is commonly thought that the Government has virtually unlimited financial and legal resources with which to defend itself. Actually there is a drastic imbalance in legal resources which favors the large contractor. One large corporation has retained five law firms to work on its shipbuilding claims. In contrast, the Navy rarely has more than one attorney working full-time on a large claim. The Government has difficulty finding sufficient resources to respond to opposition demands and rarely has the resources to launch an affirmative defense. With the Government at such a disadvantage, the traditional adversary system of justice fails.

To deal effectively with the shipbuilding claims problem and to discourage unfounded and inflated claims, the Navy needs to be able to hire outside legal counsel to assist in evaluating and processing claims, Present Navy legal resources are inadequate to do the job. Many of the lawyers upon whom the Navy must depend are inexperienced and overloaded with work. Yet, they are up against experienced, highly skilled, and highly paid outside counsel retained by shipbuilders specifically to prepare and prosecute claims against the Navy.

In the current environment, contract litigation has become a lucrative business for law firms and their clients. Companies, particularly large corporations, have found that litigation, or the threat of litigation, is an easier way to ensure a profit than actually performing their contracts efficiently. Claims have proven to be profitable and claims lawyers are gaining acceptance of the claims approach as a respectable means of doing business; these lawyers appear frequently at symposiums and seminars to explain how to prosecute contract claims against the Government.

These claims firms are also active and well represented in the American Bar Association (ABA), especially in the public contract law section. Their influence

is seen in positions taken by the ABA. For example, the ABA has failed to strictly enforce its code of ethics in regards to a ruling which would have required a prominent Washington claims firm to withdraw from cases in which one of its attorneys had been involved in behalf of the Government. Apparently, it did not matter to the ABA that this attorney had served as Deputy Counsel in charge of claims for the Naval Sea Systems Command and as such had intimate knowledge of the Government's defense in virtually every then existing shipbuilding claim. After considering the issue for almost eight months, the ABA held that the Government could waive the required disqualification.

If the ABA is unwilling to stand behind its code of ethics then the Justice Department should establish its own rules for preventing Government attorneys from switching sides. As I stated in my prepared statement, I have nothing but contempt for these lawyers and other Federal officials who use their Government positions to gain an insight of the Government's vulnerabilities only to profit personally from the experience by switching sides later.

The public law section of the ABA has promoted the idea that the Government should reimburse contractors for their legal expenses in prosecuting claims against the Government. Large corporations can afford to pay the high costs of top flight law firms through years of litigation. As time passes, a company's chances for a settlement without regard to the mertis of its claim improve because the Government employees have generally left for work in other places and the original files are no longer available. In this climate, the administrative and judicial processes for resolving claims disputes are a shambles.

In the Defense Department, the Armed Services Board of Contract Appeals was established as a simple administrative forum for settling contract disputes quickly and cheaply. However, the contractors' claims lawyers have effectively subverted this process by broadening and obfuscating issues, thus stretching out the judicial process and frustrating the search for the actual facts. Massive interrogatories and other forms of legal maneuvering are commonplace, especially when large sums are involved.

In this environment, it is essential that the operation of the Armed Services Board of Contract Appeals be changed. The Government should be given the same right as contractors to appeal adverse decisions of the Armed Services Board of Contract Appeals. Presently, the Government has no right of appeal—even in cases in which the Board has exceeded its authority. Until the right of appeal is extended to the Government, the Department of Defense needs to provide for internal review of Armed Services Board of Contract Appeals decisions. Particular attention should be focused on whether the Board is exceeding its authority.

Any material against the Government obtained by contractors under the Freedom of Information Act, but not obtainable by discovery proceedings, should be inadmissible in any litigation. Presently, contractors can use the Freedom of Information Act to circumvent Board or Court restrictions on discovery. I am sure that this was not the intent of that legislation.

Trials *de novo* before the Armed Services Board of Contract Appeals should be discontinued. Only evidence submitted to the Contracting Officer should be allowed before the Armed Services Board of Contract Appeals. This would preclude shipbuilders from presenting the Board an entirely different case than was presented to the Contracting Officer. I also believe there should be a Board rule that law firms who violate the ABA Code of Professional Responsibility cannot appear before the Board. It should also be required that no one in the Defense Department shall do business with law firms which violate the ABA Code of Professional Responsibility. At present, there seems to be no effort by the Department of Defense to ensure that attorneys practicing before the Board comply with the ABA Code.

The Navy should develop a permanent group of outside claims specialists comprised of technical personnel, procurement experts, and attorneys to review major claims. This review should include claims analysis, legal research, preparation of legal documents, interviewing witnesses, and helping to prepare the Government's defense under the direction of Government personnel. Presently, the burden of claims analysis is borne by Government personnel to the detriment of their assigned responsibilities. The problem is that the Navy does not have enough resources to handle all of its shipbuilding claims, particularly when they are so exaggerated. The Newport News claim on the contract for construction of CGN's 36 and 37 is a good example. It was settled for 29 cents of each dollar claimed. It took many people a lot of time to evaluate that one claim and arrive at a settlement. There are only three members on the Claims Board, but it probably

took 50 to 75 people in the Navy—technical people—whose time was taken away from their work to analyze the 71-percent part of the claimed amount which was not allowed.

It should be required as a matter of law that prior to evaluation of any claim, the contractor must submit to the Government a signed affidavit from the senior responsible contractor official authorized to commit the company with respect to its claim that the claim and its supporting data are current, complete and accurate. There already is a Navy requirement to this effect, but it is not always enforced. To date, Newport News officials have refused to certify that their claims are current, complete, and accurate. If this requirement were strictly enforced, frivolous lawsuits and unfounded claims would be discouraged.

Similarly, in any commercial litigation, litigants and their attorneys should be required to disclose at the outset all pertinent facts, whether favorable or unfavorable. Under present procedures, some shipbuilders maintain that they do not have to disclose information which could undermine their claims. In filing a case before the courts or administrative boards, the plantiff and his lawyers should be required to sign a certificate attesting that the information submitted in support thereof is current, complete, and accurate. Stiff criminal penalties and disbarment proceedings should be invoked for false certifications.

Contractors should be prohibited from changing their claims after final submission to the Contracting Officer. Following review by the Government, the contractors should be allowed to furnish additional supportive information needed when the Government's review indicates a particular weakness with the contractor's case. However, new theories of entitlement and new claims submissions should not be permitted. The Navy's claims analysis effort is frustrated by the constant revising of claims. This should be prohibited.

After the Navy's review is complete and the amount legitimately owed is determined, the costs incurred by the Navy to evaluate any invalid portion of the claims should be set off against the amount determined to be legitimately owed. This would discourage shipbuilders from using frivolous items in their claims.

I believe the Government should enforce its contracts and that claims should be settled on their merits. However, I also realize that senior Defense officials have broader responsibilities than my own and may, for their own reasons, arrive at different conclusions. Moreover, in view of the financial problems some shipbuilders are experiencing it is unlikely they will accept a claim settlement strictly on the merits of their claims. To do so would require reporting large losses to their stockholders. Apparently, some shipbuilders actually prefer to contest the claims for many years through litigation. In that way they can defer reporting losses and perhaps even avoid them by convincing someone in Government, as has happended in the past, to agree to a settlement for more than the claims are worth. In this situation, senior Government officials may determine that, in order, to facilitate national defense, the Navy must grant extra-contractual relief in accordance with Public Law 85–804.

It is important that any such settlement will not undermine the basis of future Government contracts by encouraging inflated and exaggerated claims. If Government contractors believe that they can prosper by submitting grossly inflated claims and then negotiating lump sum settlements with the Government, contractors will continue to submit inflated and unwarranted claims in the future.

Therefore, the following considerations should be taken into account in the event of a negotiated settlement of shipbuilding claims which is independent of the merits of the claims:

(*a*) Attempts to reach an overall settlement of the shipbuilding claims should be done in such a manner as not to impair the Government's ability to enforce the terms and conditions of existing Government contracts. In the previous effort to settle shipbuilder claims under Public Law 85–804, Navy and Defense officials tried to justify the granting of extra-contractual relief by making public statements to the effect that the escalation provisions of Navy shipbuilding contract were unfair or inequitable. Although untrue, these statements have subsequently been used against the Navy in various judicial forums.

(*b*) The settlement should constitute a one-time, permanent solution. Unless precautions are taken, simply "paying off" shipbuilders today will leave the Navy with similar problems tomorrow. As explained in my prepared statement, the Litton LHA claim and the Electric Boat SSN 688 Class claim are both good examples of why a one-time payoff would not solve the shipbuilding claims problems.

(c) The settlement should not establish a precedent which the Navy could not, in principle, apply to other claims-troubled contractors who are essential to national defense and whose projected losses are sufficiently large that their continued ability to perform is in question. In the previous attempt to settle claims under P.L. 85–804 with four specific shipbuilders, other defense contractors expressed an interest in receiving the same deal.

(d) The settlement should not permit shipbuilders to bail out their subcontractors at Government expense.

(e) The settlement should be a two-way street. The Government should make a concerted effort to get back as much in value as it gives up. This will help protect the taxpayer's interests and help discourage other contractors from seeking extra-contractual relief.

(f) The settlement should guarantee the future availability of facilities to the Navy 25 to 50 years into the future together with the contractual right to change contractors. This would protect the Navy from threats of work stoppage whenever a shipbuilder encounters financial problems. In this regard a Government-owned, Contractor-operated plant could offer considerable advantages.

(g) The granting of extra-contractual relief should not excuse a contractor from any legal liability he might have under Federal fraud or false claims statutes. Similarly the granting of extra-contractual relief should not be done in a way which prejudices the Government's ability to enforce such statutes. These statutes should be strictly enforced.

(h) The true financial condition of the corporation should be ascertained by Government audit. Corporate officials sometimes tend to exaggerate their financial problems, expecially in dealing with Government officials. In this regard, it is worth noting that the conglomerate parents of the Navy's three largest shipbuilders are still reporting profits in spite of the financial problems at their shipyards.

(i) The worth of the claims should be determined. The Navy, the Congress, and the public have a right to know just how much of the amount claimed is valid and also the value of the extra-contractual relief which is granted.

Question 3. In addition to Electric Boat's complaint that 30,000 drawing revisions influenced their ability to produce the SSN 688 Class submarines, I understand complaints have also been made about the effects of designing and building the ships concurrently. Would you please comment on these matters?

Answer. As I previously stated, Electric Boat's complaint concerning drawing revisions is largely a red herring. It is unfair to imply that 30,000 drawing revisions represents an unexpected or unreasonable number of drawing revisions. The figure is consistent with our past experience with respect to drawing revisions for previous classes of submatines. On one such class, the SSN 637 designed by Electric Boat, each drawing was revised an average of about 5 times—a total of about 45,000 revisions for about 8,500 drawings. For the SSN 688 class, there have been about 5 revisions per drawing—about 30,000 revisions for about 6,000 drawings.

The impact of a drawing revision depends on when it is issued in relation to when it is needed for construction. The impact also depends on how much the revision affects construction work already performed or being performed. The fact that a drawing may have been revised six times may be of no consequence if the drawing revisions do not require rework or the use of more expensive construction methods. Moreover, the number of drawing revisions do not necessarily reflect the extent of design changes. The bulk of drawing revisions do not affect work already performed and do not make ship construction more costly. In fact, many drawing revisions reduce the amount of work to be performed and are frequently made for the convenience and benefit of the shipbuilder. Revisions of detailed ship construction drawings are issued for many reasons. For example:

(a) Authorize alternate and potentially less costly construction techniques recommended by the shipbuilders.

(b) Accommodate shipbuilder requests to use equipment or material different than that shown in the drawings.

(c) Provide construction details on drawings previously issued early in construction to facilitate material ordering.

(d) Incorporate design improvement changes prior to bidding for follow ships

(e) Accommodate differences in ship construction practics among the building. shipyards.

(f) Reflect changes in suppliers of shipbuilder or Goverenment-furnished equipment.

(g) To correct administrative and clerical errors.

The other matter you mentioned—complaints about the effects of designing and building the ships concurrently—requires a brief review of the SSN 688 Class design history in order to be properly addressed.

Design work for the propulsion plant was started in October, 1946 and preliminary design of the submarine was completed in March, 1969. The contract design, which includes drawings and specifications specifically prepared for use by the shipbuilder in preparing fixed priced proposals for construction of the submarines, was completed in January, 1970. Use of the contract design for obtaining fixed-priced proposals is a longstanding Navy contracting procedure. The information contained in the SSN 688 Class contract design was equivalent in detail to that provided in the contract design for the previous class of attack submarines, the SSN 637 Class. The solicitation of bids for follow ship construction of the SSN 688 Class submarines was issued on March 31, 1970, using the contract design as a base.

The contract for the detailed class design was awarded in November, 1969. This detailed design provides all of the specific details necessary to completely build the ship. For the propulsion plant, this includes such details as where to run each pipe and each electrical cable in the plant. Although information from this detailed design work is not needed by the shipbuilders in order to bid on construction of the submarines, the detail design information was provided to Electric Boat as it was developed during the bidding period.

There are other indicators of the advanced state of design of the propulsion plant for the SSN 688 Class by Newport News at the time of solicitation for construction of follow ships. By March, 1970, when the solicitation was made, the full-scale mockup of the reactor compartment had been essentially completed and about 90 percent of the steam plant mockup was completed. These mockups include every component, valve, pipe, and cable, and are used to draw the detailed plans required for ship construction. The Navy made arrangements for Electric Boat design and construction personnel to make numerous inspections of the mockups at Newport News during the bidding period. In addition, Electric Boat assisted in several areas in developing the contract and detail design of the submarine. Certainly by the time the contracts were awarded for the first follow ships on January 8, 1971, Electric Boat had been afforded every opportunity to become familiar with the basis for bidding on these ships.

Most of EB's $544 million claim, specifically $423 million, is against the second flight of ships. At the time Electric Boat bid on the second flight of ships, the detailed design was essentially complete and EB was well along in their construction of the earlier ships.

As recently as April 1974, the then general manager of Electric Boat informed me his many years of shipbuilding experience showed that construction of submarines should start when less than 5 percent of the detailed design drawings are available, with 20 percent available at keel laying and 80 percent available at launch. He further noted that over a period of years, Electric Boat had worked in this fashion without excessive contract changes and that it had proven to be the most cost-effective program.

Question 4. Admiral, you say that shipbuilders are not inveigled to take contracts. How many of these massive claims are on contracts which were awarded competitively without negotiating a price with the Government's contracting officers? Are shipbuilders justified in alleging that Government contracts are unfair and unprofitable?

Answer. Of the outstanding claims on nuclear shipbuilding contracts, three have been submitted on contracts which were awarded as a result of competition between three shipbuilders—Newport News, Electric Boat, and Ingalls. Newport News has filed claims totalling $90.4 million on its SSN 686/687 contract and $191.6 million on its first follow-ship contract for four SSN 688 Class submarines. In addition, Electric Boat has claimed $121.3 million on its first contract for seven SSN 688 Class submarines. For these contracts, the Government simply accepted the price bid by the shipbuilder without negotiations. While these contracts may have turned out to be unprofitable at the prices submitted by the shipbuilder, it is hard to understand how they can be unfair.

Although there were price negotiations for subsequent SSN 688 Class contracts, Electric Boat and Newport News were in competition against each other. These contracts include Electric Boat's second contract for 11 SSN 688 Class submarines under which the shipyard has submitted a $423 million claim.

When some shipbuilders fail to meet expected profit margins they quickly allege that Navy shipbuilding contracts are unfair. Shipbuilding contracts are not unfair. In many regards shipbuilders get preferential treatment, particularly when it comes to matters like progress payments and escalation payments. I do not deny that shipbuilders may be losing money on some Navy contracts. On the others, they are making or starting to make good profits. The shipbuilder personnel who prepare the bids and negotiate these contracts are trained contract people with many years of experience and are free to accept or reject a contract.

Further, shipbuilders don't have to be losing money before they decide to submit a claim. For example, consider the contract for the nuclear carriers *Nimitz* and *Dwight D. Eisenhower*. The latest Newport News cost reports submitted to the Navy project that Newport News will recover all their costs for these two ships plus a profit of about $26 million without a claim. Even so, the largest claim on any one contract at Newport News is for this contract, a claim for $221 million increase in ceiling price.

Newport News appears to be losing more money on their contract for the construction of three commercial liquified natural gas carriers than they stand to lose on any Navy contract. That commercial contract has far less favorable payment and escalation provisions than the Navy contracts, yet I have heard no public allegations from Newport News officials about how unfair their commercial customers are to them.

Question 5. You discussed a shipbuilding official who delivered a speech to the effect that the Government gives him a blank sheet of paper and he has to go design the ship. Explain whether this statement was consistent with the facts about the claims filed by his firm. Do you have any other examples where the public pronouncements of shipbuilding officials are inconsistent with their claims?

Answer. The statement that the Government only provides a blank sheet of paper and the shipbuilder has to design the ship was made by Mr. John P. Diesel, Chief Executive Officer of Newport News, at the launching of the nuclear attack submarine *Memphis*. Mr. Diesel stated, "What really makes ours a special industry is the shipbuilder. He starts with nothing more than a blank sheet of paper and an idea—and, in my opinion, often an inadequately financed Government contract."

Mr. Diesel, of course, knows full well that before Newport News agrees to the price of a shipbuilding contract his people prepare a detailed cost estimate based on a complete set of contract plans and specifications. He also knows that Newport News designed the *Los Angeles* class submarines, which includes the *Memphis*, on a separate cost-plus contract. Further, he has been most vociferous in insisting that the Government is totally responsible for any costs resulting from deficiencies in that design, even when the deficiencies result from errors by Newport News design personnel.

In actuality, large portions of the Newport News claims are based on allegations that Government furnished design information prepared by Newport News under cost-plus-design contracts was defective—not absent; that it required shipbuilder effort beyond the terms of the contract; or it exceeded the requirements of previous shipbuilding contracts.

Mr. Diesel has made many public statements which are inconsistent with the claims. In a speech before a Virginia civic group Mr. Diesel asserted: "Some of the instant experts have characterized these claims as 'cost overruns.' This is not the case. Sometimes we make mistakes. But our claims against the Navy do not reflect our own errors. They include only the cost impact of Government actions, including changes in ship design and construction ordered by the Navy and late and defective Government-furnished equipment and information."

In a widely publicized letter to all Newport News employees dated June 11, 1976, Mr. Diesel said: "The allegations that have been made are without foundation. I can assure you that our claims are reasonable and well-documented. These claims represent sizable sums of money owed us by the Navy for work that you have already performed over the last 10 years."

In a television interview broadcast in the Newport News area, Mr. Diesel reiterated his position that the claims were for costs incurred due to Government actions. He said the claims came about: "As a result of changes made in ships, of late delivery of Government furnished equipment and late delivery of Government furnished information and faulty information. One of the misnomers that I think arises in the claims area is overruns, there are inefficiencies, that have occurred that are our responsibility for the moneys that we are asking for are only related to those issues or items that I specified at the beginning." He then went

on to blame the reduction in employment level at Newport News on the Navy. He said: "I am gravely concerned about the layoffs that have been necessary in our company. More than 4,500 men and women have lost their jobs in the last 4 years. I realize the personal hardships that have resulted and I deeply regret these actions. But when the Navy refuses to pay its bills, reductions in force become necessary."

In fact, Newport News decided to reduce the employment level because of the runaway overhead and loss in productivity they experienced during their attempts to expand their employment to the level they considered necessary to meet their commitments on Navy contracts. It is interesting to note that Mr. Diesel made this statement in the same year that Newport News reported to its stockholders that it had made the largest profits in the history of the company, despite also incurring a $36 million loss on the first liquefied natural gas carrier being built in the new commercial yard.

Mr. Diesel has also alleged that Navy contracts are deliberately underpriced. In testimony before the Seapower Subcommittee of the House Armed Services Committee Mr. Diesel stated: "Unrealistic target prices are responsible in large part for the dire situation now facing the Navy's shipbuilding program. The Navy has not requested from Congress and thus never received adequate funds to pay the full costs of these new ships. The shipbuilders and their suppliers have been left holding the bill."

He continued:

"The Navy's ten year pattern of coaxing, cajoling, bullying and arm-twisting shipbuilders and suppliers to take marginal high risk and frequently unprofitable business—all with promises of future rainbows if they acquiesce and economic disaster if they refuse—is just about over."

Mr. Diesel's various allegations that the Navy deliberately underpriced the original contracts and that the claims include only costs for which the Government is responsible contradict the allegations made in the claims themselves. The claims allege that actions by the Government subsequent to the pricing of the contracts and defects in the original specifications caused the increases in costs. In the claims, Newport News alleges that the Government is responsible to pay for all costs that have occurred, plus a substantial profit. On four of the six contracts, the claims allege that for the scope of work covered by the original contracts, Newport News' performance was so good that they underran the target costs. If the total claims were accepted as valid at face value, Newport News would recover all of their costs, including interest, on the six contracts involved, and a profit after interest greater than the original total target profit. In fact, the overall pretax profit after interest would be much larger than the profit objective set by Tenneco of 7 percent of total costs after paying interest.

Take, for example, the one Newport News claim for which a settlement was reached. In February 1977 the Navy Claims Settlement Board settled Newport News claims totaling $155 million on the contract for the nuclear cruisers U.S.S. *California* (CGN 36) and U.S.S. *South Carolina* (CGN 37) for $44.3 million—only 29 percent of the total amount claimed. Nevertheless, this settlement results in Newport News recovering all its costs and a profit despite: (1) the very significant manpower problems Newport News experienced in building these ships; (ii) the 18-month delay in delivery of both ships from the original contract delivery dates during a period of double-digit inflation; and (iii) all the difficulties encountered in constructing these ships regardless of cause or responsibility.

In addition, Mr. Diesel's continued refusal to certify that his company's claims are "current, complete, and accurate", as is required by Navy regulations, casts serious doubts upon his public pronouncements that his company's claims contain only Government responsible items. If that were the case, why did Mr. Diesel repeatedly refuse to certify the accuracy of Newport News' claims as required by Naval procurement regulations?

Question 6. In your testimony you indicated that you are a firm believer in capitalism and expressed concern that some capitalists who are profiting from the system may be wrecking it. What did you mean?

Answer. By this statement I meant that capitalism in America should be practiced within a strict moral code. Businessmen or capitalists need to exercise self-restraint. In failing to exercise self-restraint, some capitalists are stretching the rubber band until it is near breaking. If they continue on this course, they will inevitably be faced with again being called "malefactors of great wealth", as President Theodore Roosevelt called them, and risk having their empires broken up.

As a more complete response to your question, Mr. Chairman, I would like to submit a copy of a speech I gave to the Economic Club of Indianapolis entitled: "Business and Freedom."

Business and Freedom[1]

(By Admiral H. G. Rickover,[2] U.S. Navy, at the Economic Club of Indianapolis, Inc., Indianapolis, Indiana, Friday, November 7, 1975)

Over a period of many years I have spoken and written about such issues as education, freedom, science, engineering, and technology—all of concern to many Americans.

But since this audience is especially interested in business and economics, I thought I would share with you some of my thoughts on these, based on my experience in dealing with many segments of American industry for more than 35 years. Part of my work has involved the procurement from private business organizations of billions of dollars worth of machinery, electrical equipment, and nuclear components for ship propulsion and for civilian power plants.

This experience, combined with a lifelong interest in government, philosophy, and history have given me a unique vantage point to observe many aspects of business conduct.

I feel especially indebted to our country for the opportunities it has given me—education, a profession, observing other cultures, and a variety of experiences. In every respect America has been good to me.

I am deeply concerned, however, that the opportunities we have had in the past may not exist in the future. As a nation, we are burdened by internal problems unparalleled since the Civil War: the energy crisis, the threat to the environment, the problems of the cities, the abuse of and consequent loss of respect for traditional institutions and values.

Compounding these problems and exacerbating them is a condition of increasing moral decay which seems to be spreading throughout our society. This exists in many areas, but I will focus on business, and the state of business ethics.

Although I shall be critical of certain business practices, I am not hostile to business, to free enterprise, or to capitalism. I believe in the capitalist system. No other system offers as much opportunity for individual freedom. I criticize only because I do not want to see this system destroyed.

Business is an essential part of society. Throughout history, societies have recognized its importance and have established standards for its conduct. The code of Hammurabi 4000 years ago governed contracts, loans, debts, deposits, and other areas of commerce in ancient Babylon. The Old Testament forbade stealing—one of the Ten Commandments—also bribery, short measure, false dealing, lying, fraud. During the Middle Ages, the Church prohibited usury. From the Protestant Reformation emerged the idea of business as a Godly calling in which the businessman conducted his affairs as a public service, of benefit to himself and to his neighbors. From the earliest days of recorded history man has struggled to reconcile the pursuit of profit with honest dealing and useful service, to balance self-interest with the common good.

Because of industrialization and urbanization, the effect of business on society is now greater than it ever was. A half century ago Calvin Coolidge said: "The business of America is business." Its influence is no less pervasive today. Our society honors those who excel in business. Labor leaders, doctors, lawyers, accountants, engineers emulate them. Business leaders, as much as anyone, set the moral tone of society.

Yet the image business leaders convey has not always been flattering. In 1912, Charles Francis Adams, Jr., descendant of two Presidents, said of business in the United States: "I have known, and known tolerably well, a good many 'successful' men—'big' financially—men famous during the last half-century; and a less interesting crowd I do not care to encounter. * * * A set of mere money getters and traders, they were essentially unattractive and uninteresting. * * *" This quotation from Adams is as important as that from Coolidge, for Adams warns that business leaders may lack the vision to see their obligation to the society which nourishes them.

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[2] This speech reflects the views of the author and does not necessarily reflect the views of the Secretary of the Navy or the Department of the Navy.

What example are businessmen setting today? Can you remember a single week in recent months when the press was not filled with accounts of business wrongdoing? Here are a few recent ones: 19 companies convicted of making illegal political contributions; the fertilizer industry investigated for price-fixing and other anti-trust violations; a well-known ice cream manufacturer indicted on charges of knowingly marketing tainted ice cream; a major oil company making unlawful payments to foreign officials; six securities firms disciplined for stock manipulation; prominent bankers indicted for unauthorized speculation in foreign currencies; a leading truck manufacturer found guilty of conspiring to evade taxes.

In the area of defense contracting where I have first hand experience, the problems are similar. The Justice Department is investigating the possibility of fraud in contract claims; Congress held hearings on the refusal of one of America's largest corporations to comply with Defense procurement regulations; some contractors have refused to honor Government contracts; there were charges of conflict of interest involving former military officers working for defense contractors.

Because unlawful actions are more newsworthy than lawful ones, one might contend that news accounts are not an accurate measure of the prevailing moral climate in American business. On the other hand, unethical, though not illegal conduct goes unreported. I have observed such unethical practices first-hand: use of deceptive accounting techniques, refusal to honor contracts, attempts to subvert laws and regulations. Such practices are commonplace; I doubt they are confined to the defense industry.

The business community has evidenced little concern about transgressions within its ranks. Criticism of business conduct typically comes from outside. Even ethical businessmen appear to feel no obligation to speak out against less scrupulous colleagues. Nor is this silence broken by so-called experts in ethics. A recent survey of theologians and professors of business ethics about bribery and political meddling overseas by American corporations resulted in inconclusive answers. One professor called foreign bribery a "semantic" rather than an ethical problem. Some prominent clergymen with close ties to business declined to comment at all.

But the public is not indifferent. Another recent poll reported that eighty-two percent of the American people believe that, if left alone, big corporations will be greedy and selfish and make profits at the expense of the public. Proliferation of consumer interest groups confirms this growing public concern.

Too often business has reacted to public criticism with more and larger public relations campaigns. Companies contend they have been misunderstood; they emphasize the benefits they claim to be providing the public, stockholders, employees, customers and to the free enterprise system. Press releases and advertisements portray businessmen as rugged individualists who believe in free markets, price competition, and concern for our society. Unfortunately, too few of them act in accordance with these high ideals.

Some argue that illegal or unethical practices which do come to light are not typical; that the ones who survive in the marketplace are ethical; that those who fail to meet minimum ethical standards lose out in our competitive system. This is the classic concept of the self-regulating economy articulated by Adam Smith 200 years ago. Unfortunately, in our modern economy, buyers and sellers are seldom equal; competition frequently is not adequate to insure ethical conduct.

Many businessmen are, of course, ethical. Many firms, particularly small ones, act in the finest tradition of the free enterprise system. A typical example of how the small company operates is one that has an important contract for my program. Its outlook is refreshing. Its owners do not spend nearly all of their time, as do the officials of large companies, on public relations, lobbying, and exerting political influence. Instead, they understand it is up to them to please the customer and make a success of the work. This they do by paying close attention to the work itself. When confronted with problems, they do not seek bail-outs or subsidies or use influence in high places to get special privileges.

I have found that small and medium size companies take a more responsible view toward their contractual obligations than the large ones. One reason for this is that market forces generally are more effective in restraining their behavior. They are also better able to perform a back-up role of providing new and alternative products when larger firms fail to do so.

I have also observed that larger firms expect to be insulated from risk of business failure. When a small firm becomes inefficient for otherwise unable to compete, it fails. But many large companies act as if the Government has an obligation to protect them from failure. And within Government, there are policy makers who are loathe to allow large firms to fail because much is at stake for the owners, customers, employees and creditors.

I disagree with this point of view. Rather, I agree with the sentiments expressed by Mr. Donald T. Regan, chairman of one of the largest and most prominent Wall Street brokerage houses. Here is what he said of stockbrokers who faced financial ruin: "So what if they go bust? What God-given right do they have to stay in business? That is what the country and capitalism are supposed to be all about." If we gave the matter adequate thought, we would realize that we are really protecting the managers who have been responsible for the failure. The facilities and actual working people are still there and in many cases could continue to produce under different ownership or management.

Another way large companies have tried to escape the workings of the self-regulating economy is to produce what they want to sell, rather than what the consumer needs to buy. Sale of these products is induced through skillful advertising, and the price set without regard to demand. Large conglomerate and multinational corporations are particularly effective in avoiding market forces because of their size, diversity, and ability to muster great financial resources to pay for advertising, public relations and lobbying.

Large corporations are often able to escape the traditional safeguards of the marketplace. This is especially disturbing because of their ever-increasing accumulation of economic power. One hundred corporations control over 50 percent of our entire industrial output. Four corporations, in their respective industries, control over 99 percent of vehicle output, 90 percent of aluminum fabrication, 80 percent of cigarette production, and 72 percent of the detergent market.

Often the largest businesses—those not subject to most of the restraints of free enterprise—are the most outspoken advocates of the capitalist, free enterprise system as an effective safeguard against business excesses. They want the public to believe that the free enterprise system regulates their behavior, when in fact they are escaping the restraints of that system. Time and again, they lobby against new Government regulations, and herald the virtues of competition and the marketplace as if they were small businessmen subject to these forces. Simultaneously, they lobby for assistance in the form of tax loopholes, protected markets, subsidies, guaranteed loans, contract bailouts, and so on. They take no chances; they light one candle for Christ and one for the devil.

Apparently, they want subsidized free enterprise or capitalism with a guaranteed return—a contradiction in terms. So long as they make profit, they want the benefits of the free enterprise system. Once profits turn to losses, they look to Government for help.

Freedom is not a license to avoid responsibility. If men expect to reap the benefits of our system, they should be willing to accept its responsibilities and risks.

Many in the United States are troubled by the pervasive influence of big business on our economy. Reinhold Niebuhr, the theologian, observed that the imposition of ethical standards on large organizations is one of the major problems of our time. Ordinary citizens, and some national leaders recognize this problem.

Some perceive the solution in the classic concept of a self-regulating, free market economy, free of all, or nearly all Government regulation and control. Others advocate an economy regulated and controlled in large part by Government.

I subscribe to neither of these views. As a student of history, I do not believe that free market forces automatically restrain excesses of the profit motive or impose a standard of ethical conduct on big business. It is questionable whether market forces ever were truly effective in restraining their conduct. When there was an essentially free market in this country—during the late 19th century before antitrust legislation and during the laissez-faire period of the 1920's—there was much business misconduct. Those were the days of the Robber Barons and manipulated stock prices. The free market of those periods failed to restrain big business. The inevitable result was increased Government regulation, most of which had its origin in the abuse of the free market.

The factors which have made the free market ineffective—the rise of large corporations, the sheer size of our economy, the complexities of modern industrial production—will continue. Under these circumstances, a free market economy of small, autonomous businesses roughly equal in economic power, is a naive notion born of nostaligia for what never was.

By contending that the current marketplace can effectively regulate business conduct, businessmen unwittingly do a disservice to the capitalist system; they play into the hands of advocates of a strictly regulated economy. When market forces fail to regulate business conduct and wrongdoing results, public pressure for regulation mounts. In effect, those most committed to an unregulated capitalist system end up overwhelmed by regulation because the free market they advocate does not by itself exert sufficient restraint on their conduct.

At the other extreme are those who favor Government regulation and control. In their view, business cannot be trusted to keep its house in order. Their belief, to paraphrase Clemenceau, is that business is too important to be left entirely to businessmen. Their thesis is that capitalism can only result in a rich society, not a just one; therefore, it cannot or should not survive.

I do not support this view. I believe in capitalism and in competition. I believe that business has a right to pursue reasonable profit. I am convinced our capitalist system must survive in order for our fundamental freedoms to survive. In this respect, I am a conservative in the literal sense of that word, which means "to save," to respect established values.

The essence of our capitalist system is spontaneity and freedom of choice. Businessmen, at their own risk, may choose which products to produce, at what prices to offer them, from whom to buy materials. Entrepreneurs are free to try to fill perceived economic needs.

Contrast this with a system in which the economy is under complete state regulation and control. Industrial activity is planned by the state. There are no entrepreneurs as we know them. By and large, businessmen can not enter fields of their choice but are told by the bureaucracy what products to produce, at what price to sell them, from whom to buy.

The material well-being under our system can be traced to fundamental differences. In the United States there is a free business community in conflict with itself and with Government regulation and control. From this conflict and tension comes progress. In the state-controlled system is conflict minimized. But without conflict there is little criticism and without criticism, there is less chance for progress.

More important than material well-being is the dergee of individual freedom under the two systems. Because economic and business activity is central to a modern society, the form of economic organization has a great impact on freedom. This is particularly important for freedom in large, industrialized nations. Communism and socialism generally give lip service to individual liberty, but do not always practice it. State control places a premium on material well-being at the expense of freedom. Some visitors to communist and fascist countries have praised what they see, pointing to clean streets and the absence of stray dogs. Many do not note also the absence of freedom in the streets. It is a striking coincidence of history that all utopias, from the Guardians of Sparta onward, inevitably developed into some form of dictatorship.

Capitalism, based as it is on freedom of choice, helps preserve our other freedoms. For all its imperfections, it is the best system yet devised by man to foster a high level of economic well-being together with individual freedom. Should our capitalist system be destroyed, its destruction will be accompanied by the loss of most of our other liberties as well.

Let me summarize where I think we are: the clasic concept of a self-regulating, free market economy in a complex modern society no longer enforces the required high standard of ethical business conduct. Those who advocate exclusive reliance on the market do disservice to capitalism, since the result often is increased Government intervention, the very antithesis of their goal. On the other hand, the destruction of capitalism and the establishment of complete state control are inimical to economic and political freedom.

I advocate a middle ground between these two extremes, I am concerned with the survival of our capitalist system. Here are some steps I believe should be taken to preserve it.

First, I believe that businessmen must treat Government regulation realistically rather than with instinctive opposition as well as manipulation through public relations and political influence. Much of Government regulation is necessary to protect the public against the recurrence of past abuses, and because it is unrealistic to expect any group to truly police itself. Businessmen should face the fact that regulation is inevitable. Blind opposition to all regulation detracts from the valid complaints business may have about the excesses of regulation.

But they undermine public confidence in their integrity when, to protect themselves from normal market forces they publicly oppose regulation while privately exploiting the regulatory process. For example, according to the Chairman of the Federal Trade Commission, the Civil Aeronautics Board has, by controlling the entry of new airlines into the air transportation market, eliminated all competition in air routes and rates. When the Administration recently proposed reducing economic controls on the domestic airline industry, the chief executive of a major airline opposed this move. It is obvious the airlines oppose deregulation.

Second, I believe businessmen must vigorously advocate respect for law. Law is the foundation of our society. Few areas of society are as dependent upon law as is business. It is law that protects such essential rights of business as integrity of contracts. When businessmen break the law, ignore its spirit, or use its absence to justify unethical conduct, they undermine business itself as well as their own welfare.

They should be concerned with the poor record of law enforcement as it relates to them, and be willing to reexamine an idea if an intellectually responsible attack is made against it. They should be concerned about the double standard where an ordinary citizen is punished more severely for a petty crime than corporate officials convicted of white collar crimes involving millions of dollars. In the recent cases of illegal corporate campaign contributions, only two of 21 executives convicted of violating the law received jail sentences. Most continued in their high level jobs or stayed on as highly paid consultants. Corporate fines averaged $5,000 and individual fines less than $2,000. The lightness of these penalties should be of concern. Some may take comfort in the traditionally light sentences imposed for white collar crime. But the more thoughtful should recognize it is not to their advantage to operate in an environment where those who violate or skirt the law make out better than those who respect and honor it, in letter and spirit.

They should take note of the recent Supreme Court decision in the *Parks* case. This decision may herald a new era of individual accountability for businessmen if its logic is applied widely by legislative bodies and courts. In that case, the Supreme Court ruled that corporate officials as individuals may be liable for the illegal acts of their companies. The Court said: "The only way in which a corporation can act is through the individuals who act on its behalf."

The *Parks* decision may balance the 1886 decision of the Court in the case of *Santa Clara County* vs. *Southern Pacific Railroad* in which the Court held that the Fourteenth Amendment applied to corporations. The *Santa Clara* decision thus gave corporations the same rights of protection as a "natural person." Although corporations had now won the rights of persons, the officials acting in their behalf were not held to the obligations required of persons. Instead, they were able to disclaim personal responsibility and shift the blame for their illegal acts onto the corporation.

I have long held the view that if a corporation is to be considered a person for purposes of protection under the Fourteenth Amendment, then all the obligations incumbent on a person ought to be binding on the corporation. And, since the corporation acts through its officials, they should be held personally liable for illegal corporate acts. The *Parks* case appears to be a step in this direction.

Although I have been speaking of compliance with the law, there is more to respect for law than merely observing its letter. No law, however strong, will suffice if men lack the inner will to act legally. Each of us is his own lawmaker; he is daily making decisions of right and wrong. If we break our personal laws of morality and integrity, then statutory laws can have no meaning for us.

Respect for law and realistic treatment of regulation are important steps that can be taken to preserve our system. But these steps involve accommodation to external forces and, as such, will never be wholly effective. External constraints such as law or regulation cannot entirely overcome man's inner motivations. Man has free will. Because of this, a third step is necessary—a moral approach that must begin by taking a hard look at ourselves.

This should start with the executives of large corporations—the ones most favored by capitalism. Many of them benefit from the system in which they risk little personally. They are given handsome salaries as well as other economic benefits. They are powerful and influential and have the most at stake in preserving our form of Government and our free society. They, above all, should be concerned with preserving our freedoms. This is best expressed in the Biblical injunction: "For unto whomsoever much is given, of him shall much be required."

Businessmen must do more than merely seek to preserve the freedom to make money. The unrestrained pursuit of profit is the heart of the problem; it cannot form a part of the solution. They should seek a higher purpose. They should restore ethical behavior to business practice.

In recent years there has been much talk about the need for businessmen to accept "social responsibility" and help solve critical national problems. Too often, however, they appear to conceive of social "projects" as substitutes for legal and moral practice. Often these projects are not substantive but only the familiar panoply of public relations, and the public has become skeptical of such gimmicks. They would be far more sympathetic if more businessmen demonstrated by their actions the determination to conduct their affairs ethically.

Businessmen need to exercise self-restraint. Capitalism in America should be practiced within a strict moral code. Morality benefits business, those who operate illegally or unethically threaten it. In failing to exercise self-restraint, they are stretching the rubber band until it is near breaking. If they so continue, they will inevitably be faced with being called "malefactors of great wealth" and having their large empires broken up as was done by Theodore Roosevelt. Many today see this as the basic way to remedy the excesses that pervade business. Besides this, there will also follow, as in the administrations of Woodrow Wilson and Franklin Roosevelt the establishment of powerful Regulatory Commissions to replace today's toothless ones.

Trust and good faith facilitate business. The underpinning of the capitalist system is to a large extent trust—the faith that men will deal fairly and honestly with the customer; with the general public; with each other; and with the stockholder.

There is another reason to adopt a strict code of moral and ethical conduct. As heirs to the ideas and accomplishments of all men who have ever lived, it is the responsibility of all of us to preserve a free society, where knowledge, truth and justice flourish, so that our inheritance can be passed on to posterity. Our responsibility involves dedication to an ideal higher than self. This means love of country and love of one's fellow man—present and future. It is marked by excellence, courage, honesty, selflessness, and many other terms which for millenia have represented the best traits of man.

Few would dispute that men should live morally and ethically according to these higher ideals. Why do we then not pursue this alternative? Primarily because it is the most difficult of all paths. Men have tried for thousands of years to be ethical and moral, with differing degrees of success. The duty to uphold the rights and interests of others often succumbs to selfishness. Then, when chaos threatens, many find it easier to accept the discipline of strict laws, regulations, and even curtailed freedoms than to exercise self-discipline. That is why, for a basic change to be made, it is necessary that men change their way of thinking. Change which is significant manifests itself more "in intellectual and moral conceptions than in material things." As difficult as this appears, such changes have occurred in the past.

The Hebrew concept of one God was one of these; it ultimately replaced the many gods of the pagan world.

The ancient Greeks adopted the attitude that reason must prevail among men and that the citizens themselves should govern.

The English Revolution of 1688 and the French Revolution of 1789 did away with the concept of divine right of monarchs; this led to greater democracy and freedom.

The ideas and works of Copernicus, Galileo, Kepler, Newton, and Darwin entirely changed man's concept of his place in the universe.

But men do not change their thinking overnight. For that reason we will continue to need laws and regulations to govern our personal lives and our business activities. I do believe, however, that individuals can change and can make a difference. People are eager for leaders who will give of themselves for the good of their communities. They are sick of platitudes, of high talking and low living, of fine words and selfish deeds. They want and will follow those who live by higher values.

Our Bicentennial should remind us that the leaders of our Revolutionary period showed that the individual can make a difference. These men, properly honored by the title "Founding Fathers," valued freedom and culture more than wealth. They brought fundamental honesty to the business of government, and dealt with their countrymen on frank and open terms. They lived by the ideals they propounded. The Declaration of Independence was no idle statement for them. In support of it they pledged, and some lost, their lives, their fortunes, and their sacred honor. Through their beliefs and individual deeds our Revolutionary leaders stirred their fellow countryment to struggle and sacrifice for independence. More important, they set a moral tone and example for their age and ours.

To set an example, an individual starts with himself. He puts his family and his community above his own desires. He puts high moral and ethical principles into his personal and business dealings. He accepts as his personal responsibility the duty of restoring the concepts of honesty, truth and morality.

As a nation, we can choose one of two ways to bring about the changes needed in our country: we can use the power of the state or we can entrust the task to our capitalist system. In my opinion, to use the state will result—as it has in other

parts of the world—in a loss of freedom. I believe the job can best be done by our capitalist system provided those who lead it understand that the methods used must be legal, must be supported by our government and people, and must transcend some of the current ways of conducting business. While capitalism must be based on the opportunity to make profit, those in charge must not use their special position to gain advantage over our country and our citizens.

The great problems facing us today—energy, population, the environment—demand the highest degree of ability and initiative. Solutions require basic changes in thinking and a willingness to question past practices. Although these problems are national in scope, the search for solutions can begin with day-to-day activities. For example, businessmen would be well advised to question their effect on our society by creating, through advertising, artificial demand for products of questionable value. They would also do well to consider the implications for the future of capitalism of a recent study which shows that misleading television advertising may permanently distort children's values of morality, society and business. And they should examine whether their practices exploit the fact, reported by another study, that 62% of adult Americans are rated either incompetent or barely competent on consumer economic questions.

Businessmen have a special opportunity and responsibility to effect beneficial change in our society. To do so they must set demanding goals for themselves. They should ask what will be their contribution to the legacy which American civilization leaves to the world? The Hebrews endowed mankind with concepts of morality; the Ancient Greeks left concepts of democracy and self-government. The legacy of the Roman Empire was law.

It is my hope the American legacy will be more than a business structure whose major objective is attainment of wealth; more than a facility for self-serving public relations; more than a highly developed advertising industry with its propensity to "image-making." I hope America's legacy will be the accommodation of the forces of capitalism, democracy and morality in a highly industrialized society. Such a rich legacy would be worthy of a great nation.

Question 7. You testified previously to Congress about percentage-of-completion accounting having an adverse impact on the ability of the Navy to settle claims on their legal merits. Would you please explain this?

Answer. The percentage-of-completion method of accounting used by shipbuilders for financial reporting on long-term contracts, gives a contractor's management the accounting flexibility to report sizable losses as respectable profits or vice versa on an annual basis, simply by changing management estimates of progress which has been made in performance of the contract, contract revenues expected to be received and costs expected to be incurred under the contract. These management judgments are not subject to strict audit verification by a company's independent auditor. The result is that a company's reported profits or losses on a contract can be "managed" up until the year in which the contract is completed and all final payments, including any revenues from claims, have been made. In that year the profit which is calculated is auditable and must be reconciled with the cumulative prior year profits that were booked against the contract based on the unauditable management judgments. Then, if the final net profit on the contract is less than the sum of the profits that the contractor may have elected to book against the contract in prior years, the contractor would have to report a loss in the year the contract was settled. Thus, a shipbuilder who has reported profits based on expectations of receiving revenue from contract claims is extremely reluctant to settle a claim for less than his expectations. However, shipbuilders can mitigate the impact of undesired profits or losses on completed contracts simply by adjusting profit estimates on other work yet uncompleted and avoid reporting an overall loss on their consolidated income statements.

In some cases, contractors predicate their profit figures on the favorable outcome of claims pending with the Government. Yet, the reader of the financial report has no way of knowing whether management's estimate of the expected amount from claims is conservative or wildly optimistic. If expected recovery from a claim is included in the contractor's financial statement and the claim is grossly inflated, then the contractor's financial report will be similarly inaccurate.

A senior official of one of our shipbuilders once demonstrated how inflated claims can be used to the shipbuilder's advantage. He showed a member of my staff a draft copy of a letter that he was about to send to the Navy in which he took the position we owed the company large amounts of money for various items. When the shipbuilder official was told, "This letter is a lot of baloney. There are a lot of items that are not correct"; he said that he was far better off

to submit the letter to the Navy, even if the Navy said that the claim was all wrong. He said in effect that he could include this claim as an asset in his financial statements and postpone a loss, as long as he could demonstrate to his auditor that he had told the Navy that the Government owed him so much additional money against the ships. He stated that if the auditor asked for the basis of this item, he could be shown the shipbuilder's letter to the Navy. Apparently, the shipbuilder does not have to tell the auditor that the Navy thinks the claim is unfounded.

Now, a shipbuilder cannot continue this charade once he settles his claim. But if he is in a loss position on a contract, or has overstated prior performance, it may be to his advantage with this kind of accounting to delay settlement of claims until a more advantageous time in the future. It is one way he can be reporting profits to stockholders at the same time he is complaining to the Navy that he is losing money. Once a shipbuilder reports a profit by including a certain amount for anticipated return on his claim, he will be far more unwilling to settle the claim at less than the amount he stated he had expected—even if so settling the claim would result in a profit on the contract. In this way, claims settlement becomes a difficult, drawn-out process.

An interesting specific example is the current situation at Newport News. The Tenneco 1976 report to stockholders stated that Tenneco had included as revenue $222 million as its estimate of the minimum amount to be recovered from the Newport News shipbuilding claims against the Navy. By booking this amount as revenue from the claims, Newport News has been able to report the highest profits in its history each year since 1975 while at the same time incurring losses on commercial shipbuilding. I understand that the Navy Claims Settlement Board, based on its detailed analysis of the claims, has concluded that the actual value of the claims in accordance with the terms of the contracts is much less than the $222 million booked by Newport News. However, if Newport News were to accept the Navy's offers for settlement, they would have to reduce the amount booked for the claims and reduce their recorded profits by the difference. This would require Newport News to report reduced profits to the Tenneco stockholders. If the remaining profits on Navy work were not sufficient to cover the large commercial shipbuilding losses, then they would have to report a net loss. That would inevitably focus more attention on the large losses Newport News is experiencing on its commercial shipbuilding. However, by rejecting the Navy's claim settlement offers, Newport News can force the claims into litigation which will doubtless take several years. While the claims are being litigated the Company can keep carrying the higher figure for income from claims on its books. In this manner top Company officials continue to take credit for high profits. They can always settle the Navy claims for a lower figure at some future date if it appears desirable to do so, long after the commercial shipbuilding losses have been quietly forgotten. Further, they can hope that in the meantime they can get some Navy official, or the Armed Services Board of Contract Appeals, or the Court of Claims to pay them more to settle the claims.

Question 8. You have mentioned that a large part of the Defense Department operates with Government-owned, contractor-operated plants. Is what you envision for ship procurement similar to the manner in which the Air Force and Army procure their equipment?

Answer. What I envision for ship procurement is a Government Owned-Contractor Operated (GOCO) shipyard where the Government owns, or controls through a long term lease, all of the plant assets. These assets would be made available to an operating contractor to build Navy ships. Under the operating contractor to build Navy ships. Under the operating contract, the Contractor would be reimbused all of his costs for building ships plu a small, guaranteed profit, while the Government would retain the right to change operating contractors in the event of unsatisfactory performance. This would be a significant improvement over the GOCO plants which the Army and Air Force currently use to produce a variety of defense hardware including munitions, planes, missiles, engines, and tanks.

Many of the current Army and Air Force GOCO plants have intermingled Government and Contractor owned assets such that the plant cannot be operated without the consent and participation of both the Government and the contractor. This arrangement enables the contractor to use the plant for as along as he wishes and to deny use of the plant by any competitor. For example, there is an Air Force plant producing jet engines where the contractor owns the boiler house and power distribution systems which are essential to the plant's operation.

Intermingled assets can prevent the Government from changing operating contractors even in situations where the contractor's investment is small.

The primary difference between what I envision for GOCO ship procurement and current Army and Air Force GOCO practice is that the Government would control all of the plant assets and therefore be able to change contractors if management turned out to be unsatisfactory.

RESPONSE OF REAR ADM. F. F. MANGANARO TO ADDITIONAL WRITTEN QUESTIONS POSED BY SENATOR PROXMIRE

Question 1. As of 1 December 1977 when Secretary Hidalgo directed you to stop work on the Electric Boat claim:

(*a*) What portion of the claim had been evaluated by the Board with respect to technical merits? With respect to legal merits? With respect to a financial audit?

(*b*) What is the ceiling price of the Electric Boat claim? The target cost? The requested profit? And the so-called target to ceiling spread?

(*c*) With regard to the target cost what proportion of the claimed amount had been technically evaluated?

Answer: (*a*) In terms of the number of items in the Electric Boat claim which was evaluated by the Navy Claims Settlement Board, the portion of the analysis completed as of 1 December 1977 was as follows:

[In percent]

	688I	688II	Total
Technical	94	98	97.6
Legal	74	84	82.7
Financial	94	98	97.6

(*b*) The following table summarizes the Electric Boat claim as submitted:

Claimed amount	Contract N00024-71-C-0268 688I		Contract N00024-74-C-0206 688II		Total
	Amount	Percent	Amount	Percent	
Target cost	77,809,300	11.9	313,415,953	11.9	391,225,253
Target profit	9,259,307		37,296,498		46,555,805
Target price	87,068,607	130.0	350,712,451	130.0	437,781,058
Ceiling price	101,152,090		407,440,739		508,592,829
Financing costs	20,158,900		15,128,000		35,286,900
Total	121,310,990		422,568,739		543,879,729

(*c*) With regard to Target Cost, the following percent of the claim in terms of dollars had been technically evaluated as of 1 December 1977:

	Percent
688 I	99.9
688 II	98.6
Total	98.9

Question 2. Although interest has always been an unallowable cost, I understand that some factors have been included in previous claims settlement offers to reflect interest cost. What is the basis for allowing interest? Would interest be allowed in the case of the Electric Boat claim? If so, what would be the maximum interest the Board would include?

Answer. Although there is a statute (28 U.S.C. 2516(a)) prohibiting the payment of interest unless such payment is provided for under a contract or by another statute, the Court of Claims has ruled as allowable the payment of interest as a cost of performance under certain circumstances. *Bell* v. *United States* 186 Ct. Cl. 189 (1968). The inclusion by the Navy of interest in the settlement of claims has resulted from a line of decisions of the Court of Claims and the Armed Services Board of Contract Appeals (ASBCA) following the *Bell* decision. These decisions deal with interest both in terms of cost and equity capital.

Interest would not be allowed by the Navy Claims Settlement Board in settlement of the Electric Boat claim as a result of (*a*) a specific contractual provision which invokes ASPR Sec. 15 which results in interest being disallowed as a cost; and (*b*) a 14 December 1977 decision of the Court of Claims (*Framlau Corp.* v. *United States* No. 274–74) which appears to limit the circumstances previously applied by the ASBCA under which interest can be recovered. Further, the *Framlau* decision thus far has had a substantial impact on the body of case law relating to interest payments, and it has been considered in the Navy Claims Settlement Board evaluation of the financing elements in pending Newport News, claims assigned to it.

Question 3. You were directed to turn over to a special Steering Group chaired by Mr. Hidalgo the work that the Board had already completed regarding the Electric Boat claim. Did you or any member of your staff summarize the status and results of your evaluation of the claim? Was the Steering Group provided a status report of where you stood in evaluating the claim and how much work remained to be done? If so, please provide a copy.

Answer. The status of the claim analysis on 1 December was summarized and forwarded to the Chairman of the Steering Group. Additional response is contained in separate correspondence.

Question 4. Approximately how many people and manhours have been utilized in analyzing the Electric Boat claims? The Newport News claims?

Answer. The Navy Claims Settlement Board (NCSB) was established in July of 1976. At that time only Newport News Shipbuilding and Dry Dock Company claims were assigned to the NCSB.

The Electric Boat (EB) claims were assigned to the NCSB on 1 March 1977, three months after their submission on 1 December 1976. Preliminary effort was expended by the Naval Sea Systems Command and the Office of the Supervisor of Shipbuilding, Groton, prior to assignment of the EB claims to the NCSB. The personnel and manhour figures provided below include analysis effort expended prior to assignment of the EB claims to the NCSB.

The number of people assigned to individual claims varied considerably during the 20-month period the NCSB has been involved in the analysis of the Newport News claims and during the 10 months the NCSB was involved in the analysis of the EB claims.

With respect to manpower utilized in the claim analysis effort, approximately 43 people (full or part time) have expended approximately 44,000 manhours in the evaluation of the EB claims. In addition, 126 people, full or part time, have expended about 220,000 manhours on the Newport News claims.

Question 5. Provide for the record an approximate dollar figure on the cost incurred by the Government for the Navy Claims Settlement Board's partial analysis of the Electric Boat claims? Make a similar estimate of the cost to date of the Government's analysis of the Newport News claims.

Answer. An estimate of the cost incurred to date which includes direct labor, material (supplies), computer charges, travel costs, and certain fringe benefits is approximately $635,000 for the Electric Boat claim and approximately $3,300,000 for the Newport News claims.

Question 6. Do the figures you furnished in your testimony concerning the number of people who worked on reviewing the Newport News and Electric Boat claims include the effort expended by Naval Sea Systems Command technical groups and the Supervisor of Shipbuilding, as well as all other Government personnel who have worked on the claims? Do your figures also include personnel who may have been contracted by the Government to assist in the claims evaluation? If not, please provide an estimate of the amount of effort expended by these other personnel.

Answer. The estimates given in the answers to questions 4 and 5 include all Government and Contractor personnel, both from the technical groups in the Naval Sea Systems Command and from the Supervisor of Shipbuilding Offices in Newport News, Va., and Groton, Conn.

Question 7. You testified that in regard to Newport News' claims your Board was delegated the authority for making Defense Department determinations on the claims and that: "This determination was to be subject only to the contractor's appellate right to the Armed Services Board of Contract Appeals."

In view of Secretary Hidalgo's testimony that he intends to involve himself in the negotiation of the Newport News claims, I want to know whether the Board's authority has been changed and if so, to what extent. Please be specific in stating

what limitations, if any, formal or informal, oral or written, have been placed on the Board's authority to make and issue determinations on claims before the Board.

Answer. The Board's authority for making the Defense Department's determinations for claims assigned to it has not been changed. There have been no limitations placed on the Board's authority to evaluate the assigned claims.

As stated in his testimony on 29 December, Assistant Secretary of the Navy (Manpower, Reserve Affairs & Logistics) has "increasingly assumed responsibility and direction of efforts" concerning resolution of the large shipbuilding claims. As a consequence, offers of settlement and other negotiation actions concerning the Newport News claims are being coordinated with the ongoing discussions between the ASN(MRA&L) and corporate/company officials. Accordingly, issue of determinations on claims before the Board will be as directed by ASN (MRA&L).

Question 8. You testified that Newport News has rejected the Board's final offer to settle the SSN 686/687 claim. When will the Board be ready to issue a Contracting Officer decision on that claim? Do you expect to do so? If not, why not?

Answer. The Board prepared a Contracting Officer's Decision after determination of its final position on the SSN 686/687 claim. The appropriate document has been completed and is ready for issue. Further actions concerning the SSN 686/687 claim will be taken as determined by the ongoing discussions between ASN(MRA&L) and corporate/company officials.

Question 9. How does the amount of the Board's final offer on the SSN 686/687 compare to the amount requested in the claim and to the amount of the Contracting Officer decision, if one is planned? Please identify the specific reasons for each increment of difference between the two amounts.

Answer. The amount of the Board's final offer on the SSN 686/687 claim was considerably less than the ceiling price of the claim. Additional response is contained in separate correspondence.

Question 10. You testified that you are ready to make offers to Newport News on the remainder of the Newport News claims. Are you required to obtain approval from higher authority for the amount of these offers before you make them? If so, what person or persons have to approve them?

Answer. I am not required to obtain approval from higher authority for the amount of any settlement offer to Newport News.

Question 11. If you are ready to make the offers, why have they not been made? When do you expect to make them on each of the remaining Newport News claims?

Answer. An initial offer to settle can be prepared for each of the Newport News claims assigned to the Navy Claims Settlement Board. Such offers will be made in accordance with the results of ongoing discussions with corporate/company officials.

Question 12. If Newport News will not accept your offers do you expect to issue Contracting Officer decisions? If not, why not? If so, how soon after Newport News' rejection of the offer do you expect to issue the decision?

Answer. Contracting Officer decisions will be issued for each claim for which Newport News advises that the Navy's final offer is unacceptable. The decisions will be forwarded within two weeks of receipt of notice as to the unacceptability of the final offer.

Question 13. Before deciding on your offer, do you personally read each claim item and the Government's analysis of that claim? Do the other two members of the Navy Claims Settlement Board read the claims and the Government's analysis?

Answer. Before deciding on an offer, each item in a claim is reviewed by the Chairman and all Board members. This review includes the reading of the technical analysis and legal memorandum containing each claim item. Items requiring discussion or clarification are reviewed by the Board in executive sessions in which the technical analysts and assigned attorneys participate.

In carrying out this process, I and the members of the Navy Claims Settlement Board have read each item and the applicable Government analysis.

Question 14. According to press accounts, the Navy Claims Settlement Board offered Electric Boat a $20 million provisional payment several months ago but the company turned it down. Is this true? If so, why would the company turn down a $20 million provisional payment when this would not in any way jeopardize the amount they might receive in a final settlement?

Answer. A contract modification for a $20 million provisional increase in contract price was offered Electric Board on September 29, 1977. On October 26, 1977, General Dynamics Corporation requested that the Government withdraw the modification. The document was withdrawn on October 28, 1977.

The Company did not discuss with the Board its reasons for requesting the withdrawal of the modification.

Question 15. By what authority did you reimburse Newport News for items such as interest, litigative risk and litigative cost on the CGN 36/37 claim settlement? Do contracting officers normally have authority to pay for such subjective items? What are the applicable legal precedents for paying interest on shipbuilding claims?

Answer. A discussion of the precendential basis for paying interest is included in the answer to question No. 2.

Litigative risk is merely the recognition that, although certain claim items do not result in a determination of clear entitlement, there is a significant risk that the Government will not prevail if the matter proceeds to litigation. The method which the NCSB has utilized to assess litigative risk has been developed by the Navy's Office of General Counsel, and has been included in prior claim settlements which have been audited by the General Accounting Office. The risk of losing in litigation has also been recognized by the Court of Claims as a valid form of consideration. *Penn Ohio Steel Corporation* v. *United States* 173 Ct. Cl. 1064 (1965).

Cost of litigation represents the pontential costs saved by the Government if a claim is settled rather than litigated. The costs are estimated by attorneys in the Navy's Office of General Counsel having substantial experience in the litigation of Government contract claims. The Comptroller General has recognized this kind of cost avoidance as a valid form of consideration. 40 Comp Gen 309.

Contracting Officers normally include these items in the Navy's maximum position to be used in negotiations for the settlement of claims, as long as the amount included is founded upon a proper analysis. The basis for their inclusion has been their acceptance as a recoverable cost or as a valid form of consideration, as pointed out above.

Question 16. What are the procedures that the Navy Claims Settlement Board uses in determining amounts to be offered for litigative risk and for litigative costs? Who establishes the amount and what assumptions are made? What are they based on?

Answer. (a) *Litigative risk.*—Amounts paid for litigative risk are determined by the NCSB after separate determinations of litigative risk factors and the values of the claim items in which there is risk.

Litigative risk factors are determined by attorneys from the Navy's Office of General Counsel assigned to the Navy Claims Settlement Board. These factors, expressed as percentages, represent studied legal opinions of the Contractor's chances for success in litigation on any given issue of entitlement. The magnitude of each factor, i.e., the extent of the risk, is determined by an attorney after a thorough investigation of the facts and an analysis of applicable legal precedent.

The value of each claim item is derived from the Navy's technical analysis of the cost of the "extra work" in both manhours and material required to accomplish the tasks, and the audited dollar value of that extra work.

In some cases, this amount is increased by application of a "jury verdict" factor to the difference, if any, between the claimed amount and the Navy's valuation. This factor is determined by an attorney and is based on his assessment of how a judge might view the relative strengths of two quantification positions in light of the treatment of Quantum in Board and Court cases.

(b) *Cost of litigation.*—The amount for cost of litigation for each claim is an experienced attorney's estimate of the costs that the Government would have to bear if an appeal were to be taken by the Contractor to the Armed Services Board of Contract Appeals. After an examination of the magnitude and complexity of the claim items and issues, the attorney estimates the amount of time and resources needed for the pre-trial phase, the actual trial, and the post-trial briefings. Needed resources include, but are not limited to, attorneys, production analysts, auditors, contracting officers and specialists, computer services, and various administrative services. The cost of these efforts is calculated using GS rates (for Government employees) and data from previous contracts (for contracted services).

Question 17. For items such as interest, litigative risk and litigative cost it would appear that prior settlements including amounts for such factors would qualify

as extra-contractual relief and require application of the procedures required by P.L. 85–804. What is the rationale for failing to comply with the statutory requirements of Public Law 85–804?

Answer. Public Law 85–804 permits the President to enter into or amend contracts, without regard to other provisions of law, when it would facilitate the national defense. By Executive Order 10789 this authority was delegated to the Service Secretaries, to act under uniform DOD procedures. The Armed Services Procurement Regulations, which contain those procedure include three major types of actions under Public Law 85–804: (1) making amendments without consideration, (2) correcting mistakes, and (3) formalizing informal commitments.

As indicated to the answers to questions #2 and 15, interest, litigative risk, and cost of litigation have been either paid pursuant to legal precedent or have been found to be valid forms of consideration. As such, extra-contractual relief under Public Law 85–804 would not be necessary.

Question 18. You testified that in your review of the Newport News claims for the cruisers *California* and *South Carolina* you found more than 2/3 of the claimed amount was invalid. For each of the remaining Newport News claims, did you find a higher degree of validity in any of them? If so, which ones? Did you find a lesser degree of validity in any of them? If so, which ones? For that portion of the Electric Boat claims for which the Board has completed its analysis did you find the validity of the claimed amount was greater percentage or a lesser percentage than what you found in the CALIFORNIA/SOUTH CAROLINA claim?

Answer. I testified that on 11 February 1977, the CGN 36/37 claim was settled for $44.4 million, and that the Board found no entitlement for more than $100 million of the ceiling price increase claimed. Additional response is contained in separate correspondence.

Question 19. Based on your review to date of the Newport News and Electric Boat claims, does it appear that there may be any general patterns in the manner in which those portions of the claims the Board found to be invalid were prepared? If so, please explain.

Answer. As I stated in my testimony, both Newport News and Electric Boat claims are essentially "omnibus" claims, i.e., they allege a number of causes and effects, and attribute the effects to the causes without establishing specific relationships between the two in many of the items. In my opinion, they rely to a large extent on generalities, and do not present a good, demonstrable audit trail between alleged government actions and the impact or consequences of those alleged actions.

Certain general patterns seem to characterize the omnibus nature of these claims:

(1) A relatively small percentage in the dollar value of the claim is derived directly from labor and material costs for so called "hard core/added work" Government responsible changes.

(2) A major percentage of the claims dollar value stems from relatively few claim items. Five or six claim items account for about 90 percent of the claim value.

(3) The claims contain several items which are derived based upon arguable legal theories concerning Government responsibilities and liabilities.

Question 20. Taking into consideration the large fraction of the amount claimed by Newport News on the CGN contract which your Board has found to be invalid, don't you think the manner in which the claims are prepared should be thoroughly investigated to determine whether or not the methods used by the shipbuilders to prepare the claims constitutes a violation of false claims or fraud statutes? If not, why not?

Answer. As I stated in my testimony I do not believe that "omnibus" claims are proper. Claims against the Government should be detailed and documented. They should state what it was that the Government did or failed to do, and then reasonably demonstrate the effects of the Government responsible causes in a manner which can be evaluated and verified.

During the evaluation of these claims, the Office of General Counsel was advised of items which the Board considered to be significantly inaccurate, potentially false, or possibly fraudulent.

Question 21. You have testified that you have reported items to the Office of the Navy General Counsel which you think may violate false claims or fraud statutes. What guidance or criteria has the General Counsel given to you to promulgate to

the claims analysts working for the Board to ensure that they are reporting all items which they consider may constitute a violation of the statutes?

Answer. Appropriate instructions by the Secretary of the Navy (e.g. SECNAV INSTRUCTION 4385.1B) provide guidance to all members and employees of the Navy as to the actions to be taken in the event that matters of possible fraud are discovered. The Navy Claims Settlement Board has compiled with these instructions. Analysts and attorneys assigned to the NCSB have been instructed to bring to the attention of the NCSB members all misstatements of fact and misrepresentations found in the claims. Additional fact finding has been accomplished for such items and where appropriate they have been both formally and informally reported to the Office of General Counsel.

Question 22. Have you considered asking each claims analyst to certify that he or she has reported all items the analyst has observed in the claims which may be possible violations of the statutes? If you have not done so, will you do so? If not, why not?

Answer. The claims analysts and attorneys assigned to the NCSB have been instructed to bring to the attention of the NCSB members all misstatements of fact and misrepresentations found in the claims. Each analyst and attorney sign the memoranda which constitute his or her work product. The signatures of these experienced people on memoranda which make up the official Government analysis which supports the settlement offer is considered to be sufficient certification to this Board of the correctness of the analysis.

Further, the procedures given in the answer to the previous question provides assurance that misstatements, omissions, and misrepresentations will be reported and result in proper factfinding and investigation. I consider further certification by individual claims analysts unnecessary.

Question 23. In reviewing the Electric Boat claim did you find many items that were without merit? What is the approximate percentage? Please provide the same information for Newport News. In reviewing the claims did you find areas where the company did not provide information which would tend to discredit their case? Did you find "errors" in a claim which would tend to benefit the company? If so, please identify the company and provide details.

Answer. There were several items in both the Electric Boat and Newport News claims which were determined to be without technical merit based on the Navy Claims Settlement Board analysis. Additional response is contained in separate correspondence.

Question 24. Based on your previous testimony on the settlement of a Newport News claim, there appears to be a large discrepancy between the ceiling price value of the claim submitted by the shipbuilder and the amount to which the shipbuilder is found to be entitled. How do you account for this discrepancy?

Answer. There was a large difference between the ceiling price claimed and the amount of the settlement of the *California* and *South Carolina* claim. This difference derives from certain items which were considered to lack adequate evidence or substantiation of a demonstrated cause and effect relations. In addition, there were other items where the quantification of the items by the Navy technical analysts during the fact finding process and the review of the items by auditors from the Defense Contract Audit Agency resulted in an amount of entitlement which was less than the amount claimed.

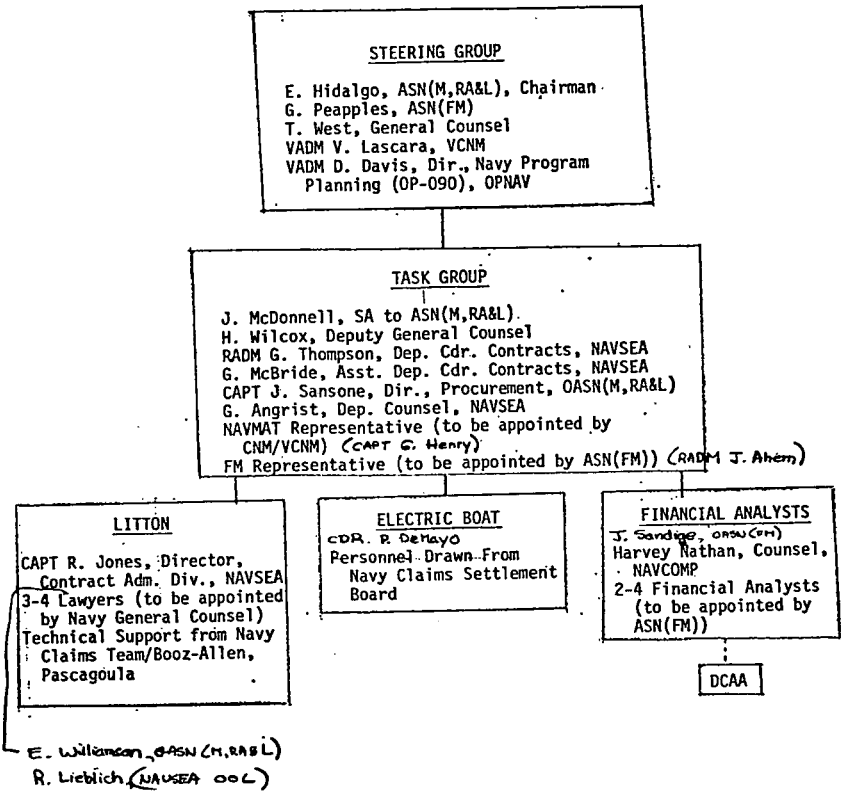
Question 25. You testified that your Board has referred to the General Counsel's office items from Newport News claims which you felt to be questionable or which might be possible violations of false claim and fraud statutes. How many different instances have you reported to date? What is the total ceiling price value of the claim items involved in these items referred? Please provide similar information for the Electric Boat claim.

Answer. I testified that "I have notified the General Counsel's office of items which I consider to be significantly inaccurate, potentially false, or possibly fraudulent * * *." Additional response is contained in separate correspondence.

RESPONSE OF HON. EDWARD HIDALGO TO ADDITIONAL WRITTEN QUESTIONS POSED BY SENATOR PROXMIRE

Question 1. You testified that you have set up a Steering Group and a Task Group to handle shipbuilding claims, and that you will be Chairman of the Steering Group. Provide any documents pertaining to the organization and responsibilities of these groups.

Answer. The relevant documents follows:



Question 2. Explain the working relationship between the Navy Claims Settlement Board and the Steering Group and Task Group.

Answer. The Navy Claims Settlement Board (NCSB) has provided the results of its analysis of the Electric Boat claims as well as backup material to me, as the Chairman of the Steering Group. Personnel who previously aided the NCSB in this analysis, and who are no longer needed by the NCSB in connection with its other responsibilities, will conduct or support other analytical efforts at the direction of Steering or Task Group members.

Question 3. Which group will be responsible for reviewing the claims filed for Newport News, Electric Boat and Litton?

Answer. The Steering and Task Groups have no responsibilities with regard to the Newport News claims, which are presently being reviewed by the NCSB. The NCSB has finished its review of the Electric Boat claims. The Litton claims are being reviewed and analyzed by a NAVSEA claims team.

Question 4. With regard to the Steering Group, are the members autonomous, each with one vote, or are they subordinate to the Chairman and their views only advisory?

Answer. No formal rules of procedure for the Steering Group have been promulgated. Since the Steering Group is composed of top members form the Navy's procurement, legal, financial, and operational communities, each member sits on the Group with the responsibilities and authorities of his office. Accordingly, actions decided upon by the Steering Group are the product of discussion and consensus.

Question 5. Identify the names of each member of the Steering Group and the Task Groups.

Answer. The Steering Group is composed of:

Hon. Edward Hidalgo, Chairman, Assistant Secretary of the Navy (Manpower, Reserve Affairs, and Logistics).

Hon. George Peapples, Assistant Secretary of the Navy (Financial Management).

Togo D. West, Jr., Esq., General Counsel, Department of the Navy.

Vice Adm. Vincent A. Lascara, SC, USN, Vice Chief of Naval Material.

Vice Adm. Donald C. Davis, USN, Director, Navy Program Planning, Office of Chief of Naval Operations.

The Task Group is composed of:

Rear Adm. James R. Ahern, SC, USN, Deputy Comptroller of the Navy.

Rear Adm. Gerald J. Thompson, SC, USN, Deputy Commander for Contracts, Naval Sea Systems Command.

Harvey J. Wilcox, Esq., Deputy General Counsel, Department of the Navy.

Capt. Joseph S. Sansone, Jr., SC, USN, Director of Procurement, Office of Assistant Secretary of the Navy (Manpower, Reserve Affairs and Logistics).

Capt. Gerald R. Henry, SC, USN, Assistant Deputy Chief of Naval Material (Contracts and Business Management).

Mr. Gerald McBride, Assistant Deputy Commander for Contracts, Naval Sea Systems Command.

Mr. John J. McDonnell, Special Assistant to Assistant Secretary of the Navy (Manpower, Reserve Affairs and Logistics).

Eugene P. Angrist, Esq., Deputy Counsel, Naval Sea Systems Command.

In addition, Captain Ronald A. Jones, SC, USN, LHA Claims Manager, Naval Sea Systems Command; Commander Peter DeMayo, Assistant to the Director of Procurement, Office of the Assistant Secretary of the Navy (Manpower, Reserve Affairs and Logistics); and Mr. James B. Sandidge, Assistant Director, Banking and Contract Financing, Office of Navy Comptroller, attend Task Group meetings and act as members thereof in their areas of responsibility (see organizational chart provided in response to question No. 1).

Question 6. For each member of the Steering Group and Task Groups please state specifically his or her qualifications in relation to experience in handling shipbuilding claim matters and their technical and legal knowledge in shipbuilding matters.

Answer. As reflected in the following individual notes, the members of the Steering Group and Task Group lend experience in various disciplines to the group as a whole in its handling of shipbuilding claims and contracting matters and represent cumulatively the finest expertise available in the Navy.

STEERING GROUP

Hon. Edward Hidalgo, Assistant Secretary of the Navy (Manpower, Reserve Affairs and Logistics): I have had a long law career in both public and private practice and in both domestic and foreign fields. The Naval portion of my career began with my assignment as an officer on the carrier U.S.S. *Enterprise* during World War II and continued with my subsequent service as a member of the Eberstadt Committee which reported to the Secretary of the Navy on Unification of the Military Services, as Special Assistant to the Secretary of the Navy James Forrestal, and as Special Assistant to the Secretary of the Navy Paul H. Nitze.

Hon. George A. Peapples, Assistant Secretary of the Navy (Financial Management): Mr. Peapples has both a Bachelor's degree and a Master of Business Administration from the University of Michigan with majors in economics and finance, respectively. He has held various financial positions in General Motors Corporation with increasing responsibilities covering capital requirements and short-term investments and, for the last 2 years, served as Assistant Treasurer—Bank Relations.

Togo D. West, Jr., Esq., General Counsel of the Navy: Mr. West received an undergraduate degree in electrical engineering and a Doctor of Jurisprudence degree from Howard University. He has previously served as an officer in the Army Judge Advocate Corps, as an attorney-advisor to the Assistant Secretary of the Army (Manpower and Reserve Affairs), and as an Associate Deputy Attorney General in the U.S. Department of Justice.

Vice Adm. Donald C. Davis, USN, Director, Navy Program Planning: VADM Davis is a graduate of the U.S. Naval Academy and has attended the Naval War College. A highly qualified Naval Aviator with numerous awards and decorations from World War II, Korea, and Vietnam, he has held many challenging operational and staff billets during his distinguished career.

Vice Adm. Vincent A. Lascara, Supply Corps, USN, Vice Chief of Naval Material: VADM Lascara received a Bachelor of Arts degree in economics and

accounting from the College of William and Mary and a Master of Business Administration degree from Stanford University. Having begun his career as a line officer, he transferred to the Supply Corps after World War II, served in increasingly responsible positions, including Director, Nuclear Supply and Comptroller Department, Naval Reactors Department of the Atomic Energy Commission and as Supply Officer aboard the nuclear-powered aircraft carrier U.S.S. *Enterprise*. He has received a number of awards, including a Distinguished Service Medal for significant contributions toward the solution of shipyard claims problems while serving in his present position.

TASK GROUP

Rear Adm. James R. Ahern, Supply Corps, USN, Deputy Comptroller of the Navy: RADM Ahern received his undergraduate degree from the U.S. Naval Academy. He is also a graduate of the Industrial College of the Armed Forces, holds a Master of Business Administration Degree from Harvard University, and has an LLD degree from National University. He also has professorial appointments from The George Washington University and National University. RADM Ahern has held various responsible management and staff assignments during his Naval career for which he has received numerous decorations.

Rear Adm. Gerald J. Thompson, Supply Corps, USN, Deputy Commander for Contracts, Naval Sea Systems Command: RADM Thompson received his undergraduate degree from the U.S. Naval Academy and his Masters Degree in Business Administration from Stanford University. His various Naval assignments have included serving as Contracting Officer, Division of Naval Reactors, Atomic Energy Commission; Director, Purchase Division, Navy Ships Parts Control Center; and Deputy Chief of Naval Material (Procurement and Production).

Mr. Gerald McBride, Assistant Deputy Commander for Contracts, Naval Sea Systems Command: Mr. McBride holds a Bachelor of Commercial Science degree from the Benjamin Franklin University. He began his career as a cost analyst in the Department of the Air Force and later became a contract negotiator in the Navy Bureau of Aeronautics and has served in a business advisory and a cost analyst capacity on the staff of the Chief of Naval Material. Following his subsequent position as Director of the Weapons System Purchase Division in the Naval Air Systems Command, he was selected for his present job in 1970. Mr. McBride has received numerous performance awards and letters of commendation as well as the Navy Distinguished Civilian Service Award in 1975.

John J. McDonnell, Esq., Special Assistant to the Assistant Secretary of the Navy (Manpower, Reserve Affairs and Logistics). Mr. McDonnell received his Bachelor of Arts degree from Boston College and his law degree from Fordham University. He was in private practice in both New York and Washington prior to accepting his present position.

Capt. Ronald A. Jones, Supply Corps, USN, Special Assistant, Office of the Deputy Director for Contracts, Naval Sea Systems Command: Captain Jones received an Associate of Arts degree in Business from Chaffee College and a Bachelor of Arts in Business from San Jose State College. He has also completed a number of Department of Defense professional courses in contracting and acquisition management. Among the many challenging positions he has held during the course of his career are: Contracting Officer and Director Contract Administration Branch, Defense Construction Supply Center; Director Purchasing Division, Naval Supply Center, Norfolk; Chief, Contract Administration Division, Defense Contract Administration Services District, Birmingham; head of a Navy shipbuilding claim settlement team; Director of Procurement Management and Production Division, Headquarters, Naval Material Command; and Director of Contract Administration, Claims and Appeals Division, Naval Sea Systems Command.

Capt. Gerald R. Henry, Supply Corps, USN, Assistant Deputy Chief of Naval Material: Captain Henry received his Bachelor of Science degree in Industrial Management from the University of Kansas and his Master of Business Administration degree from the University of Michigan. His career is highlighted by assignments as Contracting Officer, Director of Purchasing, and Executive Officer of the Aviation Supply Office, and as District Commander of the Defense Contract Administration Services District, Reading, Pa.

Harvey J. Wilcox, Esq., Deputy General Counsel of the Navy: Mr. Wilcox received his Bachelor of Arts degree from Amherst College and his Bachelor of Laws degree from Yale Law School. Following short period of private practice, Mr. Wilcox was commissioned into the Navy and served with the Office of the

Judge Advocate General. Following this, he joined the Navy Office of the General Counsel as a civilian where he has concentrated on procurement and contracting matters. Prior to his present position, he served as Counsel, Naval Air Systems Command and has been a member of the Navy Contract Adjustment Board, legal representative to the Navy Procurement Policy Advisory Group and guest lecturer at the Army Logistics Management Center.

Capt. Joseph S. Sansone, Jr., Supply Corps, USN, Director of Procurement, Office of the Assistant Secretary of the Navy (Manpower, Reserve Affairs and Logistics): Captain Sansone received his Bachelor of Science degree from LeMoyne College and subsequently attended the Army Logistic Management Center for Defense Procurement Management, the Industrial College of the Armed Forces, and the Massachusetts Institute of Technology's Senior Executive Program. Notable achievements in a distinguished career include assignments in procurement planning, U.S. Naval Communications System Headquarters; procurement policy at the Defense Industrial Supply Center; weapons systems acquisition policy and procurement operations in the Office of the Deputy Assistant to the Director of Contracts, Naval Electronic Systems Command; and as Deputy Commander for Procurement Management, Naval Supply Systems Command.

Edward J. Williamson, Jr., Deputy Director of Procurement, Office of the Assistant Secretary of the Navy (Manpower, Reserve Affairs and Logistics): Mr. Williamson holds a Bachelor of Arts Degree from Brown University, a Master of Business Administration in Procurement and Contracting from The George Washington University, and a Certificate of Achievement in General Procurement Management from Rensselaer Polytechnic Institute. Following two shipboard tours and one staff tour as a Naval Officer, Mr. Williamson joined the Navy as a civilian and handled various claims as a contract termination specialist. His career has progressed with increasingly challenging assignments as a senior negotiator, as a contract specialist, the last at the Naval Sea Systems Command. He has received an Outstanding Performance Award, a Navy Procurement Fellowship for graduate study, and is a Certified Professional Contracts Manager.

Comdr. Peter DeMayo, Supply Corps, USN, Assistant to the Director of Procurement, Office of the Assistant Secretary of the Navy (Manpower, Reserve Affairs and Logistics): CDR DeMayo is a graduate of Hofstra University where he received his Bachelor of Science Degree with a major in economics and received his Master of Business Administration Degree from the University of Michigan. He has completed with honors several professional courses in procurement. Assignments of note include those in procurement and systems analysis at the Electronic Supply Office and in procurement planning and policy at the Headquarters, Naval Material Command; and as Assistant Professor and Director of the Systems Acquisition Management Program at the Naval Postgraduate School. CDR DeMayo is currently on the faculty of The George Washington University, the University of Maryland, and the Northern Virginia Community College where he teaches courses in procurement, economics, and management.

Question 7. For each of the persons on the Steering Group and Task Groups, state whether that person will be expected to read the claim items and the Government's analysis of the claim items for each claim item on which that person is expected to give advice.

Answer. All persons who give advice on a claim item will be expected to read the claim item (or a Government-prepared summary thereof) and the Government's analysis of the claim item. The Steering Group and the Task Group will be furnished an executive summary of the claims and the Navy analysis to read. In addition, it is anticipated that the Claims Team members will present a brief to these two bodies and be prepared to answer their questions concerning the claim.

Question 8. Which members of the Steering Group and the Task Groups are expected to establish and/or approve amounts for litigative risks and litigative costs?

Answer. As to the Litton claims, Captain Ronald A. Jones, SC, USN, the Litton Claims Team Manager, upon appropriate advice of counsel, will establish amounts for litigative risks and litigative costs. The NCSB has already established these amounts for the EB claims.

Question 9. For each of the three major shipbuilders, who will be the Contracting Officer who signs the settlement agreement for the Government?

Answer. Rear Admiral Frank Manganaro, Chairman of the NCSB (with Contracting Officer authority), would sign any settlement agreement of Newport News claims. Since the possibility and form of any settlement with Litton or

EB are uncertain, this question cannot be answered at this time; however, if settlement is achieved by means other than extraordinary relief, it is presently anticipated that the Contracting Officers responsible for the analysis of the claims would sign any such settlement agreement.

Question 10. Will that Contracting Officer be responsible to carry out the directions of the Steering Group and the Task Group or will the Steering Group and Task Group merely be advisors to the Contracting Officer?

Answer. The Contracting Officer will be responsive to the Steering Group consistent with the duties and responsibilities attendant to his warrant.

Question 11. Will the Contracting Officer be responsible for justifying the amounts offered?

Answer. In accordance with the Armed Services Procurement Regulation and the Navy Procurement Directives, the Contracting Officer will be responsible for justifying any amounts offered to the contractor based upon the analysis of the claims.

Question 12. What are the rules and criteria used for determining amounts to be offered for litigative risks and litigative costs?

Answer. The amount to be offered for litigative risks is a matter of the Contracting Officer's judgment based on the Government exposure to loss in litigation and legal advice as to the risks in connection with that exposure. The amount to be offered for litigative costs is also determined by the Contracting Officer based on an estimate of costs to defend the claims in the ASBCA provided by the Navy lawyers charged with that responsibility. In both instances such amounts are included in offers consistent with the paramount concern and duty of the Contracting Officer to protect the Navy's interests, a practice recognized and approved by both the federal judiciary and the General Accounting Office.

Question 13. Will the person or persons proposing and/or deciding on the amounts to be offered for litigative risks and litigative costs have read the specific claim items and the Government's analysis of these claim items? Will the person or persons deciding amounts for litigative risk be personally familiar with current Government contract law?

Answer. The Contracting Officer who will make these decisions will do so upon the basis of the claims items analysis of the claim items and legal advice as to the risks, in light of current Government contract law, in connection with such items.

Question 14. Will that person or persons also be intimately familiar with the potential for the specific claim items containing false or fraudulent material?

Answer. There will be full familiarity with the details of the claim items.

Question 15. Are litigative risks and litigative costs determined against each element of the claim or are they determined against the claim as a whole?

Answer. The potential of Government loss is analyzed and presented to the Contracting Officer as to each element of the claim. Litigative costs represent the cost of a trial of all issues and claim items at the Armed Services Board of Contract Appeals.

Question 16. If payments for entitlement, litigative risks, or litigative costs are made against a claim which subsequently is found to contain false or fraudulent matter, what are the Government's rights to recover funds thus expended?

Answer. If payments are made to a contractor for entitlement, litigative risks or litigative costs based on fraudulent or false statements the Government's right to recover in a civil action is based upon 31 USC 231 and 28 USC 2514 giving the Government the right to seek double damages plus a penalty and forfeiture of payment. The criminal statutes are 18 USC 1001, false statement, 18 USC 287, false claim, 18 USC 371 and 18 USC 286, conspiracy. These statutes sanction both a fine and/or a penalty.

Question 17. If any portion of a claim is found to be false or fraudulent, is the Government then entitled to recover for payments made against any portion of that claim, or is the Government's right of recovery restricted solely to those elements of the claim which are found to be fraudulent or false?

Answer. The Government's right to recovery would in most cases be limited to the items paid to the contractor that were based upon the false or fraudulent representations.

Question 18. You testified that should you or other members of the Steering Group find anything in the claims which would indicate a possible violation of fraud or false claim statutes, you would immediately turn it over to the Navy General Counsel. What criteria have you issued to the Steering Group or the Task

Groups and claim analysts working for you to use as the basis for determining what items should be reported to the General Counsel?

Answer. The lawyers and analyst assigned to the Steering Group are apprised of their responsibility to submit any possible violation of fraud or the false claim statutes to the General Counsel through the Contracting Officer.

Question 19. When the Government's analysis of a shipbuilding claim reveals that a substantial portion of the claim analysis is invalid, do you believe that the manner in which the claim was prepared should be investigated to determine if the claim violates false claims or fraud statutes? If not, why not?

Answer. If the circumstances surrounding the claim involved a substantial umber of false or fraudulent statements then I believe the whole claim should be investigated. Government allegations that a contractor has engaged in criminal conduct are most serious and are not to be taken lightly. However, a disagreement between the contractor and the Government over legal principles should not occasion the commencement of an investigation.

Question 20. You testified that attribution of blame (for shipbuilding claims) to any single cause or source has to be the prodict of misguided perspective and defeats the imperative objective of seeking "a sensible and expeditious resolution not only of the claims, but of the underlying problems of those claims." Please provide the following information:

Who has attributed claims to a single source or cause? When was this done?

Define a "sensible and expeditious" claims resolution.

Answer. Over the years many commentators, both from the public and private sectors, have sought to reduce the complexities behind the present claims backlog to a single or overriding cause. I believe this is a commonly understood fact. This sort of simplistic notion, regardless of source, clouds a clear and objective view of past responsibilities and present problems and impacts adversely on a sensible and expeditious claims resolution. By the latter, I refer to a settlement which fairly addresses both those past responsibilities and present problems in light of the paramount concern of procuring ships needed for national defense objectives in a manner consistent with the national interest.

Question 21. In your remarks you refer to "resolving the underlying problems." Identify the underlying problems about which you testified. Do you believe that the Navy is responsible for paying for the effects of these "underlying problems" regardless of the legal entitlement of the claims?

Answer. It is my belief that resolution of the outstanding claims would be only a transient achievement if we were not to come to grips with what I have referred to as "underlying problems." Without cataloging them in their entirety, I have in mind matters such as form of contract, escalation coverage, change order administration and the large number of other factors that play in the naval ship procurement process. As to the contracts for which present claims exist, this requires a full analysis of all contributing causes of the claims and their magnitude as well as their impact on present and future shipbuilding programs, followed by appropriate decisions in light of such analysis. In regard to future contracts and actions, as I mentioned in my testimony of December 29, 1977, we are addressing through a Navy Ship Procurement Process Study, areas in which change in present policies and practice may properly minimize claims in the future. In further response to your question, the "legal entitlement of the claims" is obviously an essential consideration in defining the Navy's responsibility.

Question 22. You stated that claims are "an absolute calamity created over the past decade by a succession of errors, misjudgments, and circumstances beyond everyone's control." Please provide the following information:

Specify the "errors and misjudgments" you have in mind, who committed them, when, and the amount of cost overruns and delays caused thereby.

Explain why these "errors and misjudgments" were beyond "everyone's reasonable control."

Explain who is responsible to pay for these errors and misjudgments under the terms of the contracts.

Were the "errors, misjudgments, and circumstances" you have in mind the exclusive cause of shipbuilding claims? If not, what were the other causes, when did they occur, who is responsible for them, and how extensive were the cost overruns and delays caused thereby.

Answer. There is no meaningful, definitive answer to this question I am able conscientiously to provide for the record. The comment quoted from my testimony (incorrectly with respect to "circumstances beyond everyone's control") was a broad, abstract reflection on my part which should be read and understood in that context.

Question 23. In your testimony you indicated you would not rule out the possibility of settling the claims independent of their legal merit. This can be done under the provisions of Public Law 85–804 if it is in the interest of the national defense. In his testimony Admiral Rickover described several criteria that he would recommend be used if it was determined necessary to attempt to settle the shipbuilding claims independent of their merits. Would you please provide specific comments on each of these criteria, and state whether or not you agree?

Answer. In testifying before the Subcommittee on Priorities and Economy in Government on 29 December 1977, Admiral Rickover stated that certain criteria should be applied if claims are to be resolved on a basis other than strict legal entitlement. The following are the criteria stated, as well as appropriate comments:

Criteria	*Comment*
"The true financial condition of the corporation should be determined by Government audit. Corporate officials sometimes tend to exaggerate the severity of their financial situation in dealing with Government officials."	No action predicated on the financial condition of a contractor should be taken without a thorough and objective analysis of the contractor's financial condition.
"Attempts to reach an overall settlement of shipbuilding claims should in no way prejudice the Government's ability to enforce the terms and conditions of existing Government contracts."	If claims are to be resolved on a basis other than strict legal entitlement the terms and conditions of existing Government contracts will most likely need be reformed or modified.
"The worth of the claims should be determined. The Navy, the Congress, and the public should know just how much of the amount claimed is valid."	Agree that a thorough evaluation of the claims must be performed and the Navy, the Congress, and the public should be fully informed of the results. The "worth" of the claims needs careful delineation. The evaluation of the claim must be realistic. Rather than attempting to measure precisely its value as past efforts have tended to do, it is more appropriate to analyze the minimum and maximum Navy exposure.
"The provision of extracontractual relief should not in any way excuse a contractor from any legal liability he might have under Federal fraud or false claims statutes."	Agree.
"The settlement should not establish a precedent which the Navy would be unwilling to apply to other claims troubled contractors if they are essential to national defense and if their continued ability to perform is in jeopardy."	Agree. Each case, of course, must be determined on its own facts.
"The settlement should guarantee the future availability of facilities to the Navy well into the future—say 25–50 years, together with the contractual right to change contractors. In this way, the Navy will continue to be vulnerable to threats of work stoppage whenever a shipbuilder encounters financial problems."	Agree that the settlement should insure that facilities be available for future shipbuilding programs.
"The settlement should specify how subcontracts should be handled. Shipbuilders should not be permitted to later bail out subcontractors at Government expense."	As a general principle, Navy deals with the problems of prime contractors, not subcontractors.
"The settlement should constitute a one-time permanent solution at that shipyard so that the Government does not again find itself in the dilemma of having to choose between getting ships and enforcing contracts."	Agree that this is an objective earnestly to be pursued.

Question 24. In your discussion of profits made by conglomerates and shipyards you stated you knew the facts of what their profits and losses have been and that you think you have a fairly good bit of knowledge on that. Provide for the record whatever information you have on the profits and losses reported by each of the three major shipyards and their conglomerate parents for the past ten years. In the case of Newport News can you reconcile their complaints about financial conditions resulting from their Naval ship contracts and the record profits that both Tenneco and Newport News have been reporting for the past several years, despite reported losses on commercial shipbuilding contracts?

Answer. In my discussion of profits, I was referring to the profitability or loss of present shipbuilding contracts, and not the financial status of the conglomerate parent. All of the major contracts subject to claims, save one, are estimated by the Navy to be in a loss posture absent any claims recovery. In regard to your question about Newport News, the profits to which you refer are based on anticipated claims recovery.

Question 25. Have you received a formal legal opinion from the General Counsel of the Navy advising you to remain uninvolved in potential fraud investigations or is this an action you have taken on your own accord?

Answer. I have received no formal legal opinion from the General Counsel on this matter. He and I have discussed this matter and we are in agreement on the course I have followed.

Question 26. Could you please provide for the record a time schedule of actions you contemplate taking in your endeavor to resolve the underlying problems at Ingalls, Electric Boat, and Newport News.

Answer. No specific time schedule exists.

Question 27. You stated that you have had discussions with Newport News, Electric Boat and Litton. Explain why you feel your discussions with Newport News have not undermined Admiral Manganaro's authority as the person in charge of negotiating claim settlements with Newport News?

Answer. I believe Admiral Manganaro, with whom I communicate on a continuing basis, would advise me if he believed I was "undermining" his efforts with Newport News. I have kept him currently advised of my plans or actions which might bear upon his own so as to avoid potential conflict or confusion.

Question 28. At the outset the Navy Claims Settlement Board was advertised as an independent Board. I understand former Deputy Secretary of Defense Clements issued instructions that no one was to interfere with the Board. If this is correct, provide a copy of the instructions for the record. Have these instructions been modified or revoked since he left office? If so, why?

Answer. At the time of the creation of the NCSB, then Deputy Secretary of Defense Clements addressed a memorandum to other officials of the Office of the Secretary of Defense directing their non-interference in the actions of the NCSB.

At that time, the Office of the Secretary of Defense had assumed direct authority for the resolution of outstanding claims. At the inception of the new Secretariats of the Defense and Navy Departments, the direct responsibility and authority to resolve the outstanding claims were entrusted to the Secretary of the Navy, subject, of course, to the oversight authority of the Office of the Secretary of Defense. The Secretary of the Navy has in turn directed me to handle the claims and related problems subject to his oversight authority.

Question 29. In your testimony you state that the original purpose of that Board to you is no lnger valid today in the sense that it should exclude Secretary Claytor and yourself from the deliberations and from the direction of these matters. Please describe what has happened to invalidate the original purpose of the Navy Claims Settlement Board which was to isolate claim settlement actions from outside interference. Please be specific as to each of the shipbuilders involved.

Answer. I cannot conceive that the original purpose of the Board was or should have been to disqualify all Defense Department officials from discharging their statutory responsibilities in the vital areas of claims and their impact upon the Navy's shipbuilding program. The charter of the Board was issued by the Chief of Naval Material who had neither the authority nor intention to preclude his superiors, uniformed or civilian, from fulfilling their responsibilities.

Question 30. Is it your policy to have the responsible contracting officer present when you discuss matters with contractors within the contracting officer's responsibility? If not, why not?

Answer. I have established no such policy nor indeed has there been any fixed instruction to include or exclude anyone from any meeting. I choose those participants for individual meetings as I deem appropriate on the basis of the identity of those who do participate and the subject matter to be discussed.

Question 31. Please comment on Admiral Manganaro's testimony concerning the need for a permanent Navy Claims Settlement Board under the auspices of the Naval Sea Systems Command.

Answer. I have not discussed with Admiral Manganaro his view of the need to establish a permanent Navy Claims Settlement Board. On the other hand, I have hopes that our Navy Ship Procurement Process Study will identify some of the fundamental causes that have led to the present shipbuilding claims and that armed with this knowledge we will be better able to minimize future claims. The need for a permanent Board of Navy Claims Settlement should be judged in that context.

Question 32. You stated that the last documentation received from Litton in regards to its LHA claim was submitted in September, 1977. Since this claim has been in existence for at least five years, doesn't this seem to be somewhat unusual? What action do you think is necessary to prevent the situation where a shipbuilder can submit a claim and not completely document it until five years later?

Answer. The Litton claim was the subject of a Contracting Officer's decision in 1973 and the claim was appealed to the Armed Services Board of Contract Appeals. As you pointed out, Litton's final documentation was submitted in September 1977, While the Navy rejects undocumented claims submitted for consideration of a Contracting Officer, the Navy cannot unilaterally prevent a Contractor from filing and amending claims in an ASBCA or other adjudicative proceeding.

Question 33. Has Litton completed the documentation of its LHA claim? Supply for the record information concerning the cost of shipbuidling claims analysis incurred by the Navy over the past several years. Please provide a breakdown by individual shipyard and individual claim. If actual cost figures cannot be given, please provide an estimate and the basis for the estimate for each shipyard and each claim.

Answer. Litton has completed their documentation of the claim. Admiral Manganaro has addressed in his answers the costs of analysis connected with the Newport News and Electric Boat claims. The total cumulative cost since 31 December 1972 on all claims processing is approximatley $55 million.

Question 34. Have any members of your Task Group or other Navy officials been charged with studying the concept of Government-owned, contractor-operated shipyards as recommended by Admiral Rickover as a last resort action in case the Government is going to give extra-contractual relief to the shipbuilders. If not, why not? If so, describe the status of their efforts.

Answer. Neither the Task Group, nor any other Navy official to my knowledge, has been specifically charged to study the concept to which you refer, although the ldea has been discussed on several occasions. I have heard Admiral Rickover's broad suggestions on this subject but it is my understanding that the idea has never been developed in detailed fashion for circulation and comment within the Naval Material Command and the Office of the Chief of Naval Operations. Certainly any concrete proposal should and would be given careful consideration.

Question 35. Please provide for the record a list of Public Law 85–804 actions that has the Navy approved in the last ten years indicating the contractor and the approximate amount of money involved and a brief description of the circumstances.

Answer. Pursuant to 50 U.S.C. § 1434, this information is reported to Congress each year on March 15th. Those reports for the last ten years would stand four to five feet high. Because this information is already in the public record, I am confident you would not wish us to incur the large reproduction costs involved in this duplication endeavor.

Question 36. Provide for the record any information concerning ships which Newport News has refused to bid on, and ships that it has bid on in the past three years.

Answer. I am unaware of any ships that Newport News has in the final analysis refused to bid on, which they were qualified to build, While it is true that Newport News stated in the past that they would not accept any more work from the Navy, and did not initially bid on the FY 77 SSN contract, it is also true that they subsequently submitted a proposal for the SSN 688 Submarine and were awarded a contract as the low offeror. Over the past three years, they have submitted proposals for FY 75/76 SSN 688 (Hulls 711–715) and FY 77 SSN 688 (Hulls 716–718) and were awarded contracts for both.

Question 37. You noted that Secretary Claytor had made you responsible for claims matters in the Navy. Have you personally read any of the claims submitted by Electric Boat, Newport News or Litton and/or the Government's detailed analysis of claim items? If so, please state which items you have read.

Answer. No.

Question 38. You stated that you reached an agreement with Litton to pay for 75 percent of the LHA's cost while obtaining an assurance of continued construction. How long is this agreement effective? Were there any provisions associated with this agreement? If so, provide copies for the record. If this agreement ends prior to delivery of the last LHA please describe why it is advantageous to the Navy.

Answer. This agreement modifies the contract until completion. I an enclosing the letters from the Secretary of the Navy to the Chairman of relevant Committees of the Congress to which are attached appropriate documents.

[The letters and attached appropriate documents follow:]

DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., January 18, 1978.

Hon. JOHN C. STENNIS,
Acting Chairman, Defense Subcommittee, Senate Appropriations Committee, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Attached is a copy of a letter I have forwarded to the Chairmen of the House and Senate Armed Services Committees to inform them, in compliance with 50 U.S.C. 1431 (Supp. 1977), of the Navy's plans to make a narrow and limited amendment to the LHA contract with Litton Systems, Inc. The action proposed to the Congress will establish a rate of government provisional payment for the LHA construction work while affording the government and Litton an opportunity to seek an orderly resolution of their differences.

My staff and I are prepared to brief you and your Committee members and staff at your convenience.

Sincerely,

W. GRAHAM CLAYTOR, Jr.,
Secretary of the Navy.

DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., January 18, 1978.

Hon. GEORGE H. MAHON,
Chairman, House Appropriations Committee,
U.S. House of Representatives, Washington, D.C.

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Secretary of the Navy.

DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., January 18, 1978.

Hon. MELVIN PRICE,
Chairman, House Armed Services Committee,
U.S. House of Representatives,
Washington, D.C.,

DEAR MR. CHAIRMAN: This is to notify you of the Navy's plans to make a narrow and limited amendment to its contract with the Ingalls Shipbuilding Division of Litton Systems, Inc. for the construction of LHA class ships.

Numerous controversies surrounding this contract have drawn the government into litigation which has threatened successful completion of the LHA program. The proposed action, described in more detail in the attached Memorandum of Decision (Annex A), will establish a rate of government provisional payment for continuing LHA construction work significantly more favorable to the Navy than that previously imposed by court order (75% of costs in lieu of 91%) and will afford the parties an opportunity to seek an orderly resolution of their differences. Such provisional payments, of course, will be subject to recoupment by the government in the event they exceed the total amount finally determined to be due by settlement or judicial decision. The foregoing developments are the result of closely coordinated efforts by the Navy and the Department of Justice which actively participated in the agreement with Litton which underlies the proposed contract modification.

This letter and an identical letter addressed today to the Chairman of the Senate Armed Services Committee, are furnished in compliance with the notification requirements of 50 U.S.C. 1431 (Supp. 1977). Information copies are being forwarded to the Chairmen of the Senate and House Appropriations Committees. Upon expiration of the period provided therein for Congressional review, the parties would execute a contract modification in the form of the attachment (Annex B).

Please do not hesitate to call upon me or members of my staff for such assistance as you may desire in the course of your review.

Sincerely,

W. GRAHAM CLAYTOR, Jr.,
Secretary of the Navy.

DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., January 18, 1978.

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Chairman, Senate Armed Services Committee,
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Please do not hesitate to call upon me or members of my staff for such assistance as you may desire in the course of your review.

Sincerely,

W. GRAHAM CLAYTOR, Jr.,
Secretary of the Navy.

Attachments.

Annex A

Memorandum of Decision

1. BACKGROUND OF LHA CONTRACT

On 1 May 1969 the Navy awarded Contract N00024–69–C–0283 to the Ingalls Shipbuilding Division of Litton Systems, Inc., for the construction of an entirely new class of general purpose amphibious assault ships—the LHAs. The performance of this contract has been fraught with difficulty from the outset resulting in massive claims and complex litigation. The Government, through the Department of Justice, has recently reached an agreement with Litton in connection with current litigation which ensures continued construction of the ships while the Navy and Litton seek a resolution of the underlying problems. This decision implements a portion of that settlement in a manner incontrovertibly favorable to the Navy since it reduces a court ordered payment of 91% of costs to 75%.

The LHAs have the capability to carry almost a complete Marine Amphibious Unit, along with the supplies and equipment needed in an assault, and land them ashore by either helicopter or small amphibious craft or a combination of both, thus enhancing the Navy/Marine Corps team's capability to carry out its present day missions. With this almost autonomous capability in conducting a total landing force operation, an LHA will carry the payload and perform functions now requiring four separate amphibious force ships. The LHAs offer the Navy/Marine amphibious forces the largest, fastest, and most versatile vessel in the history of American amphibious warfare. The Navy's assigned amphibious lift, in terms of capability to meet national strategic objectives, is well below the stated by the Joint Chiefs of Staff. Without the five LHAs, the Navy's amphibious lift capability, now at the lowest level since 1950, is below even this established minimum and all five LHAs presently under contract are required to attain the capability to maintain four forward afloat deployments (with helicopter platforms) in the Western Pacific, Mediterranean, or Caribbean.

The LHA contract was awarded to Litton following a competition with two other firms. It is a multi-year, fixed-price incentive contract, and initially called for the construction of nine ships. In January of 1971, however, pursuant to contractual rights, the Navy canceled the last four ships under contract. The LHA contract was unusual in many respects. Most notably the contractor assumed Total System Responsibility, that is, it agreed and represented to the Navy that it could build ships, as designed, without fear of impossibility of performance and assumed virtually full responsibility for delivering ships which met particular performance requirements/capabilities.

Litton planned to perform the contract at a new shipyard it was constructing in Mississippi, which was designed to use a high-technology modular technique and thereby gain some of the advantages of assembly-line production.[1] Even before actual construction of the LHA's began, Litton found itself in financial difficulties in regard to the west bank yard. Substantial start-up costs in connection with ship construction at the new facility, reported by Litton to be approximately $150,000,000, were capitalized as "manufacturing process development" costs. The design effort under the LHA contract proved to be far more difficult, and the time necessary to construct the ships much greater, than anticipated when the contract was awarded. The cost of performance, actual and projected, has increased more or less in proportion to the delay; however, the payment and escalation provisions of the contract do not compensate the contractor for this cost growth. The present contract value, which consists of the current contract price, including all adjustments to date, plus the escalation costs paid the contractor under the terms of the contract, is almost exactly $1 billion. Litton projects costs to complete the contract of approximately $1.4 billion (not including the $43,000,000 of manufacturing process development allocated by Litton to the LHA contract), and the Navy estimates that these costs may be as high as $1.45 billion.

2. CLAIMS AND LITIGATION

Litton asserted in 1972 that, as a result of Government actions, there should be a price increase of $246,600,000 in the contract. The parties tried but failed to

[1] On June 23, 1970 the Naval Sea Systems Command awarded Contract N00024–70–C–0275 to Ingalls for the construction of 30 destroyers of the DD–963 class, also to be performed at this new facility.

negotiate an agreement, and the contracting officer reset the contract by unilateral decision on 28 February 1973. He raised the contract price to ceiling, including $19,000,000 on account of changes, and the maximum charge allowed in the contract for cancellation of the four ships. The contracting officer also concluded that the contractor had received payments some $55,000,000 in excess of actual progress on the contract, which he demanded the contractor return as required by the terms of the contract.

Litton filed an appeal from the entire decision to the Armed Services Board of Contract Appeals (ASBCA), incorporating not only its various specific grievances with the final decision but also its entire claim for contract price adjustment on account of alleged defective specifications, constructive changes and late and defective Government-furnished material. Litton also sued the United States in the Southern District of Mississippi seeking judicial review of the contracting officer's decision. The District Court enjoined the Navy from recouping the $55,000,000 overpayment, but, on appeal, the Court of Appeals for the Fifth Circuit reversed in the case of *Warner* v. *Cox*, 487 F. 2d 1301 (5th Cir. 1974). The Navy then withheld further progress payments until the $55,000,000 had been recouped.

For nearly three years Litton pursued its claims before the ASBCA. It also pursued various informal avenues of settlement at higher Navy levels but no resolution between Litton and the Navy was reached. By 1976, Litton's claims had grown to $505,000,000. On June 1976, Litton notified the Navy of its intention to stop work on account of alleged Navy breaches of contract. By this time, under the contract, progress payments to Litton entitled it to reimbursement of only about 25% of costs being incurred on LHA construction.

The Navy responded to the threatened work stoppage by joining with the Department of Justice in suing Litton for specific performance of the contract and a permanent injunction requiring Litton to complete the work on the ships. The case was brought in the Southern District of Mississippi where the court awarded the Navy a preliminary injunction but conditioned its order of continued performance upon a requirement that the Navy pay Litton 91% of the actual costs of construction.

In September 1977, the total amount claimed by Litton, including alleged impact on the DD–963 contract of Government actions on the LHA contract, was raised to $1,076,000,000. The ASBCA case, suspended as part of a negotiation effort in January 1976, has not been reinstated. Despite Navy efforts to reinstate, the ASBCA has declined to do so in deference to the desires of the District Court. An action has also been filed by Litton in the Court of Claims, which raises in affirmative fashion substantially the same issues that constitute defenses in the District Court case and claims in the ASBCA proceeding, but this action has been in a state of suspension from the outset.

3. COST REIMBURSEMENT BY NAVY

To date, the enormous Navy and Department of Justice effort in connection with the action brought by the Government has yielded only an order that requires Litton to continue construction if the Navy pays 91% of its costs. The Government has opposed the continuation of the 91% cost reimbursement provision but its efforts have met with failure. On 26 October 1977, the Court ordered the continuance of both the preliminary injunction and the condition that Litton receive 91% of cost incurred until 31 July 1978. An appeal of the propriety of the cost reimbursement provision has been filed. Should the Government lose on that issue, the loss would confirm a District Court's power to require cost reimbursement as a condition of specific performance of a Government contract, regardless of the contract terms. Victory on that issue would give rise to the possibility of the Court's denying a permanent injunction if it concluded that performance entirely at the contractor's expense would be inequitable.

The Navy recognizes that, without some cost reimbursement, Litton would face severe financial strains in the completion of the LHAs. Progress payments to Litton on the DD–963 contract, on terms similar to that of the LHA contract, are gradually falling behind costs incurred on that program, and the combined cash shortfall on the two west bank contracts is projected to reach in excess of $100 million by July 31, 1978, even if court-ordered LHA reimbursement continued at 91 percent. This shortfall would increase rapidly thereafter, even with 91 percent reimbursement on the LHA, with an anticipated total cash shortfall on the two contracts as of delivery of the last ships, in the range of $200 to $300 million.

A complete cut-off of cost reimbursement on the LHA, as a result of a Government victory in the appeal, would represent judicial recognition of a significant contract principle, but the practical result would be an immense cash drain on Litton. The position of the parties would revert to the present terms of the contract, resulting in an immediate indeptedness to the Navy from Litton, as of June 1978, of approximately $180 million in LHA overpayments which would include approximately $100 million in payments to Litton over the present contract ceiling. In addition, victory in the appeal would impose upon Litton a cash requirement of approximately $4 million a week in excess of progress payments to continue the present Navy contracts. Navy estimates show that the indebtedness and continued cash requirements would result, in the absence of substantial claims recovery, in a combined cash shortfall at the completion of the LHA and DD contracts in the range of $500–$600 million.

4. NEGOTIATION OF CONTRACT MODIFICATION

In light of the uncertainties facing both parties, Navy initiatives led to negotiations with Litton and the Department of Justice which resulted in an agreement, dated 14 November 1977, to postpone argument of the appeal of the payment condition in the District Court's order until after 1 April 1978. Further, the parties agreed upon and obtained from the District Court a reduction until 1 April 1978 of the payments under the outstanding court order from 91 percent to 75 percent of costs. The premise of this agreement was that Navy and Litton would enter into a financing arrangement at 75 percent of cost incurred on the LHA contract which is not contingent upon the outcome of the pending appeal or the continued granting of temporary injunctions by the District Court. It was further agreed that all such payments would be provisional in nature and subject to recoupment upon final settlement of the contract. The parties agreed that this arrangement, coupled with a stay of litigation, would allow Navy and Litton to seek a resolution of the underlying contractual difficulties in an environment unencumbered by litigation. In order to ease the cash shortfall impact on both the LHA and the DD–963 construction of the reduction from 91 percent to 75 percent, the Navy acceded, to a limited extent, to Litton's request for the accelerated release of accumulated earned retentions on the DD–963 ships.

The Navy has concluded that such a financing arrangement ensures continued construction of the LHAs while the underlying contract disputes are analyzed and hopefully resolved. While such a financing arrangement provides significant cash to continue construction, reduction of the reimbursement percentage from 91% to 75% gives Litton a substantial incentive for timely and economical performance of the LHA contract and for constructive negotiation of the underlying complex problems. It represents, at the current expenditure rate of almost $3 million per week, an additional $400 thousand a week that Litton must invest in the LHA program, or approximately $50 million over the life of the contract.

* * * * * * *

Accordingly, in the exercise of my residual powers under Public Law 85–804, 50 U.S.C. SS1431 *et seq.*, I find that the proposed modification to Contract N00024–69–0283, providing for payments to the contractor, Litton Systems, Inc., at the rate of 75 percent of costs (in lieu of the 91 percent previously stipulated in the court order) incurred in construction of the LHA ships provided for in the contract and subject to recoupment upon final settlement of the contract and without regard to other provisions of the contract concerning payments to the contractor, will facilitate the national defense, and I hereby authorize the execution of such modification by the Contracting Officer.

W. GRAHAM CLAYTOR,
The Secretary of the Navy.

Annex B

DRAFT

CONTRACT MODIFICATION

WHEREAS the parties to this contract modification are also parties to lawsuits and administrative proceedings concerning the performance of this contract; and

WHEREAS this contract modification is considered essential to the orderly performance of the contract in the interest of the national defense; and

WHEREAS this contract modification has been submitted to both Houses of the Congress in compliance with applicable law and neither House has passed a resolution of disapproval within the time provided by law for consideration and disapproval of such a contract modification;

NOW, THEREFORE, under the authority of applicable statute law and regulation, and in order to facilitate the national defense and in consideration of the mutual covenants of the parties, it is agreed as follows:

1. Notwithstanding any other provision of this contract concerning payments from the Government to the contractor in exchange for performance hereunder, it is agreed that from and after the date of this contract modification, the Government will pay to the contractor, upon the receipt of invoices from the contractor that reflect on a weekly basis those actual costs incurred by the contractor in the performance of the contract, seventy-five percent (75%) of such invoiced costs. The costs to be invoiced shall be determined by the methods used by the parties as of November 1, 1977, to implement the orders of the United States District Court for the Southern District of Mississippi in the case of United States v. Litton Systems, Inc. Civil Action No. S–76–197(c).

2. The payments to the contractor pursuant to the foregoing paragraph 1 shall be in lieu of any and all payments otherwise due to the contractor and/or to Litton Industries, Inc. under the provisions of this contract governing payment and/or compensation, and all such payment and compensation provisions shall be deemed to have been suspended since August 3, 1976, and to remain suspended for the duration of any period during which the contractor is paid a stated percentage of the costs of performance of this contract, whether pursuant to this modification or pursuant to court order; provided, however, that the foregoing limitation on payments shall not apply to the following:

a. Any recovery in favor of Litton Systems, Inc. appellant, in ASBCA 18214, on the issue of interest on alleged late material progress payments, which issue has already been heard by the Board and briefed by the parties (the SACAM Appeal); any such recovery shall be paid promptly in full, in accordance with usual procedures.

b. Any recovery in favor of Litton Systems, Inc., on the issue of a ceiling on the cancellation charge, now pending before the United States Court of Claims in Docket No. 203–76; any such recovery shall be paid promptly in full, in accordance with usual procedures.

c. Payments to the contractor on account of change orders issued pursuant to the Changes clause of the contract after the date of this contract modification; such payments shall be made in accordance with procedures followed by the parties for change orders as of November 1, 1977, except that payments for such changes prior to delivery of any ship shall be at the rate of seventy-five percent (75%) rather than ninety-one percent (91%) as is currently the practice.

3. Except as expressly provided by this Modification all rights and remedies of the parties hereto set forth in LHA Contract No. N00024–69–C–0283, including any and all amendments thereto, or in applicable statute, regulation or case law, as such rights and remedies existed on June 29, 1976, shall remain unaffected and unimpaired by execution of this Modification or the exercise of any right conferred hereby, and no waiver of the rights or remedies of any party hereto shall be deemed to have occurred except as explicitly set forth herein.

4. Any payments made pursuant to this modification as in the case of any payments made pursuant to prior orders in the case of *United States of America* v. *Litton Systems, Inc.*, are provisional in nature and are subject to recoupment on the part of the government upon final settlement of the contract in the event that payments then made exceed the amount due the contractor under the contract as determined by the final settlement or disposition. Any such amounts subject to recoupment shall be repaid, with interest calculated in accordance with the procedures set out in ASPR E–619.

Question 39. During your testimony you said you have little specific knowledge of possible fraud reported by Admiral Rickover and others. Since you have been given a mandate to handle the claims how can you take the position that fraud allegations are not within your province? Isn't a complete understanding of the nature of the claims essential to working out a solution to the claims problem?

Answer. I believe Mr. West, General Counsel of the Department of the Navy, will fully address your inquiry in his answers to your letter of January 24, 1978.

Question 40. You stated that, "In key situations within the shipbuilding industry reasonable and expeditious settlement of the claims is linked with the present and future financial stability of shipyards vital to the Navy's needs." Identify

the shipyards whose financial stability is dependent on an expeditious claim resolution. Identify the conglomerate parent of each shipyard identified and the extent to which its financial stability is dependent on its subsidiary's claims. What will happen to these corporations if these claims are found to be grossly inflated or possibly fraudulent?

Answer. Resolution of the claims and related problems is obviously relevant to the financial situation of the three major shipyards. Tenneco Inc. is the parent of Newport News Shipbuilding and Dry Dock Company; Litton Industries, Inc. is the parent of Litton Systems, Inc.; and General Dynamics Corporation is the parent of Electric Boat Division. It would be inappropriate to speculate on "What would happen" to these companies "if these claims are found to be grossly inflated or possibly fraudulent."

Question 41. Has each shipyard and conglomerate parent allowed the Navy free and unencumbered access to its books and records in order to determine their true financial condition? If not, why not?

Answer. To the extent relevant to our efforts to seek a resolution of the claims and underlying problems, the Navy has received the fullest cooperation from the shipyards and parent corporations in obtaining financial information.

Question 42. During the early 1960s, I understand General Dynamics wrote off hundreds of millions of dollars in losses connected with a commercial aircraft produced at their Convair Aircraft Plant in San Diego. With inflation the equivalent figure today would, of course, be much greater. General Dynamics survived that write-off and today it is a much larger corporation than it was then. Is it your belief that the potential losses the company faces from its Electric Boat Division would exceed today's equivalent of the amount General Dynamics has demonstrated it can absorb? If corporations are required to absorb such losses in their commercial ventures, why is it that the Government is expected to step in and save them from losses on their Government work?

Answer. Your question calls for difficult and inappropriate speculations as to the amount of "potential losses" General Dynamics "can absorb" which require a variety of basic assumptions and detailed financial information and analysis which is not presently available to me. In response to the final part of your question, I would never advocate that "the Government (should be) expected to step in and save them (corporations) from losses on their Government work."

Question 43. You indicated that you have met with representatives from Newport News Shipbuilding and Dry Dock Company and Tenneco. Identify the different occasions when you met and whom you met. For which occasions were claims under the jurisdiction of the Navy Claims Settlement Board discussed? Was Admiral Manganaro or one of his representatives present for these discussions? How are such meetings consistent with the underlying concept of the Navy Claims Settlement Board's independence from outside interference?

Answer. I have met with representatives of Newport News Shipbuilding and Dry Dock Company or Tenneco on approximately nine occasions. These representatives include Messrs. Diesel, Sapp and Dart. Certain of these meetings were introductory in nature; at most of these meetings discussion occurred concerning the outstanding claims of Newport News. Admiral Manganaro was not present at these meetings but was made full aware of such meetings in advance and there was coordination after the meetings.

Question 44. Has Newport News or Electric Boat or their parent firms ever complained to you about the Navy Claims Settlement Board or any of its personnel? If so, please provide details concerning each complaint and the action taken by you in response.

Answer. No.

Question 45. To your knowledge, did representatives of Electric Boat or Newport News ever indicate to you or to anyone else in the Department of Defense that negotiations and evaluation separate and distinct from the efforts of the Navy Claims Settlement Board were necessary or desirable? If so, please state the circumstances.

Answer. No, although it is clear and obvious that the shipbuilders would welcome any avenue of investigation which might lead to a resolution of the claims and their underlying causes.

Question 46. Do you agree that the affidavit by Mr. Gordon McDonald, formerly General Manager of Electric Boat, that his company's SSN 688 Class construction claim is "accurate, complete, and current" is an accurate representation? If not, why not? If so, does this mean you consider Electric Boat is entitled to the $544 million claimed? If not, why not?

Answer. It is not for me to agree nor disagree with Mr. MacDonald's affidavit and his assertion that it is "accurate, complete, and current." My answer in no way implies that I consider Electric Boat is entitled to the $544 million claim.

Question 47. The General Counsel, Mr. West, has indicated that only two attorneys in his office are working part-time to investigate the shipbuilding claims for violations of false claim or fraud statutes but that no investigation is being carried out "in an affirmative context." In your opinion, is adequate attention being devoted to the possibility that the existing claims are false or fraudulent? Have you discussed these matters with the Secretary of the Navy? If so, what directions did he give you?

Answer. I am confident that the General Counsel is devoting adequate attention to the existing claims and the possibility that they might be false or fraudulent. I have discussed the claims situation on repeated occasions with the Secretary of the Navy and I have systematically sought and received his approval of the courses of action I have taken. This includes the posture I have taken vis a vis allegations of fraud and false claims and the manner in which they are being handled.

Question 48. We have heard testimony that the outstanding shipbuilding claims are improperly prepared and, in general, do not show a direct cause and effect relationship. How will your approach to settling the outstanding claims persuade shipbuilders that submitting such claims is not to their advantage? In your opinion, do such claims place an unfair burden on the Government?

Answer. Without doubt the effort to resolve outstanding shipbuilding claims will be a difficult learning experience for all concerned. The shipbuilders must surely recognize that their claims will not be considered unless they are complete to the maximum possible extent. Inadequate claim preparation does impose an unfair burden on the Government.

Question 49. Based on your understanding of the claims from your discussions with Admiral Manganaro and other officials and on your awareness of the claims evaluation performed to date, are shipbuilders submitting inflated claims—claims that overstate the shipbuilders' case that the Government owes them money? Are you aware of any claim items for which, following the Government's review, no entitlement was found?

Answer. On the basis of discussions with Navy officials responsible for evaluating claims it is clear that in many cases the shipbuilders have not borne their burden of proof. I am aware that government analysts have recommended to the contracting officer in many cases that a finding of no entitlement was indicated.

RESPONSE OF TOGO D. WEST, JR., TO ADDITIONAL WRITTEN QUESTIONS POSED BY SENATOR PROXMIRE

Question 1. In your testimony concerning allegations of fraud, you said you think it is appropriate to carry out "a sound and thorough investigation to coordinate with the Justice Department and find out virtually from the oustet what they think about these allegations and to get that underway," and you mentioned the possibility of an investigation by the Naval Investigative Service or the Federal Bureau of Investigation.

To the best of your knowledge has anyone in the Navy requested the Naval Investigative Service or the Federal Bureau of Investigation to invetsigate any of the allegations of possible violation of fraud or false claim statutes in shipbuilding claims? Without formal investigation by investigators how can you gather the evidence necessary to allow the Justice Department to decide on prosecution?

Answer. The Office of the General Counsel has on occasion turned over allegations regarding fraud and false claims to the Justice Department. Some of these allegations have required an FBI investigation, others have been investigated by the Naval Investigative Service.

Question 2. Does your office have subpoena power?

Answer. The Office of the General Counsel, Department of the Navy, does not have subpoena power.

Question 3. Does your office have complete access to company records?

Answer. The Office of the General Counsel has access to Company records during a trial before the ASBCA through discovery proceedings. This Office also has access to the voluntary submissions by Companies of their records during

claims evaluation and during the application of progress payments throughout the life of the contract.

Question 4. Does your office have the authority to interview present or former company employees concerning matters affecting the allegations of possible fraud or false claims?

Answer. Company employees can be interviewed only on a voluntary basis unless the Navy is involved in ASBCA proceedings.

Question 5. What steps have you taken to protect the preservation of evidence that may exist concerning these allegations?

Answer. Preservation of evidence is handled in the same manner as in preparation for trial.

Question 6. Do you consider your office is capable of conducting an inquiry into the allegations in sufficient depth to decide whether or not a violation of Federal statutes has occurred in the shipbuilding clams?

Answer. This Office can properly evaluate the allegations based on the existing Navy evidence in order to determine whether the facts relied on in forming the allegations are accurate and complete.

Question 7. If so, how long do you expect it will be before you reach such a determination? If not, isn't the time it takes for your inquiry simply delaying the start of a formal inquiry by the Justice Department?

Answer. All evidence in these matters has been shared with the Department of Justice.

Question. 8. Considering the importance of this matter, do you consider it to be an adequate allocation of resources to have only two attorneys working part time on this issue?

Answer. From time to time the assignment of attorneys has been from one to six and their time was properly distributed with the other ongoing legal problems that this office handles.

Question 9. What criteria is your office using to evaluate the allegations or possible fraud or false claims and to determine whether or not to refer them to to the Justice Department?

Answer. This Office, as does the Justice Department, relies on the applicable statutes and precedents relating to these offenses.

Question 10. Have you personally read the reports of possible violation of fraud or false claim statutes made by Admiral Rickover, Admiral Manganaro or others?

Answer. I have all of the reports and have read them.

Question 11. You testified that Admiral Rickover's reports of possible fraud came to the General Counsel's Office through a convoluted chain. What steps are you taking to expedite the processing of fraud reports? In your opinion should this convoluted chain be changed?

Answer. The process for referrals of this type is not unusually burdensome and I believe that it has not unduly affected the speed or accuracy of our deliberations. It is true, however, that the reports in question were not made directly to the Office of General Counsel.

Question 12. You stated you have not discussed the potential fraud reports with Mr. Hildalgo and that you did not think it appropriate to discuss those fraud reports with him. Since Mr. Hidalgo has been put in charge of claims for the Navy, don't you think it would have been appropriate to mention this problem to him?

Answer. I stated that I did not mention NN fraud to Assistant Secretary Hidalgo. That matter was under the responsibility of ADM Manganaro. If and when the NN claims come before Secretary Hidalgo, I wil discuss with him each of the fraud or false claims analyses which, in my view, warrant his attention. It is, of course, necessary for Assistant Secretary Hidalgo or anyone else who is working out a solution to the claims problem to have a complete understanding of the nature of the claims. To that end, OGC attorneys are assigned the responsibility to investigate each claim and to communicate with those individuals seeking to resolve these claims. In that way, proper consideration is given to all alllegations of fraud and/or false claims which may arise.

Question 13. You testified you have two lawyers working on a part-time basis on reports of possible fraud in connection with the Newport News and Electric Boat claims. Could you please give us a brief description of the lawyers' backgrounds; specifically, identify their experience in terms of fraud or criminal matters as opposed to their experience in civil matters.

Answer. The Office of the General Counsel's attorneys assigned to these matters have about 30 combined years of shipbuilding claims experience.

Question 14. Could you give us a brief resume of your experience in criminal and civil law; what is your experience in contract law?

Answer. Prior to my appointment, I was neither a government contracts practitioner, nor a criminal lawyer.

Question 15. Identify for the record the number of potentially fraudulent elements contained in the Newport News and Electric Boat claims which have been alleged.

Answer. I believe that the release of this type of information at this time could be prejudicial to any affirmative action the government might determine to be necessary.

Question 16. Identify the date by which you expect to be finished with your preliminary investigation of the allegations of fraud.

Answer. All materials concerning the Navy inquiry have been made available to the Department of Justice.

Question 17. As previously mentioned, you stated that it is not the function of the Navy nor of any officer in the Navy to determine the presence or absence of fraud. Is this statement consistent with U.S. Naval Regulations? Is it consistent with instructions issued by the Secretary of the Navy? What is the responsibility of personnel in the Navy with regards to fraud they suspect may have occurred?

Answer. (a) The statement is consistent with U.S. Naval Regulations. See SECNAV INSTRUCTION 4385.1B. (b) The statement is consistent with SecNav Instructions. See SECNAV INSTRUCTION 4385.1B. (c) The responsibility of naval personnel is to report allegations to the Inspector General or the General Counsel. See SECNAV INSTRUCTION 4385.1B.

Question 18. Is the General Counsel's office authorized by statute to investigate possible violations of Federal statutes?

Answer. The General Counsel's office is authorized to investigate allegations of fraud under Navy regulations/instructions. See SECNAV INSTRUCTION 4385.1B.

Question 19. Why are you investigating the potential fraud reports prior to submitting them to the Justice Department?

Answer. It is my duty under Navy regulations/instructions (SECNAV INSTRUCTURE 4385.1B). Furthermore, the Office of the General Counsel can assist that agency in our specialized area of Government Contract Law.

Question 20. You implied that the False Claims Act and statutes for fraud provide you a means to recover any monies paid for a false claim whenever you uncover fraud. Is this just your personal understanding of the Act, the opinion of the Justice Department, or a formal opinion by your office? What happens in cases where the Contracting Officer has made an independent determination of the amount owed and did not rely on the claim itself? Can the Government still pursue a false claim prosecution in that case? If not, why are independent determinations of a claim's merit not prohibited?

Answer. (a) It is this office's understanding of the law. It is not contained in an opinion of the Justice Department or of this office. (b) The Government can pursue a false claim even if not relied on in the Contracting Officer's decision. This view is based on the express terms of two civil statutes and four criminal statutes. These six statutes are: 31 U.S.C. §231 which permits a suit by the Government for $2,000 plus double damages plus costs against anyone presenting a false claim; 28 U.S.C. §2514 which provides for forfeiture of fraudulent claims against the United States; 18 U.S.C. §§286 and 371 providing for up to a $10,000 fine and 10 year imprisonment for anyone conspiring to defraud the Government; 18 U.S.C. §287 providing for up to a $10,000 fine and five years imprisonment for presenting a false or fraudulent claim to the Government; and 18 U.S.C. §1001 providing for up to a $10,000 fine and five year imprisonment for knowingly making a false statement to the Government.

Question 21. In your testimony you stated that "If we discover fraud and we don't pay out then we don't have a fraud action at all. We will not have suffered any damage." Why do you not consider the Government's cost of analyzing the false claim to represent damages?

Answer. This item can be asked for under the civil statutes previously described in response to question 20.b.

Question 22. Is it not an offense just to make a false statement to a Government agency regardless of any monetary damages which might result?

Answer. Yes, if the statement was made knowingly and willfully it would be a violation of 18 U.S.C. §1001.

Question 23. Admiral Rickover testified that his first report of possible fraud in the Newport News claims was submitted more than six months ago. What was the result of your office's investigation of this report? What is the current status of this item?

Answer. All materials concerning the Navy inquiry have been made available to the Justice Department.

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