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 2

APPENDIXES

Printed for the use of the Joint Economic Committee

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APPENDIX A

Documents relating to the Newport News Shipbuilding claims and Deputy Secretary of Defense Clements' efforts to settle outstanding Navy shipbuilding claims under Public Law 85-804

CONTENTS

ITEM 1.—*Oct. 25, 1974—Newport News Vice President F. H. Creech letter to the Supervisor of Shipbuilding notifying the Navy of the company's plans for submittal of additional claims under Navy shipbuilding contracts. Attached to the letter is a matrix showing currently identified claims areas and applicable contracts*

NEWPORT NEWS SHIPBUILDING AND DRY DOCK CO.,
Newport News, Va., October 25, 1974.

Subject: Status of Claims Under Navy Shipbuilding Contracts.
Enclosures: (1) Matrix Showing Currently Identified Claim Areas and Applicable Contracts.

Capt. R. J. EUSTACE,
Supervisor of Shipbuilding, Conversion and Repair, U.S. Navy, Newport News Shipbuilding and Dry Dock Co., Newport News, Va.

DEAR SIR: As you will recall, both you and Rear Admiral E. E. Renfro have asked to be advised of the Company's plans for submittal of additional claims under our Navy shipbuilding contracts. We have not yet completed our analysis of the many issues which have given rise to increased time and cost under our Navy contracts, but our investigation has proceeded to a stage where we have identified several significant claim items under each ship construction contract. Enclosure (1) graphically displays the major claim areas, and the ships to which they apply, which we have identified to date.

We have assigned teams of experienced shipbuilders, contract administration personnel, and others skilled in the management of the shipbuilding design and construction process to carry out this investigation and develop such claims as may be necessary to enable negotiation of appropriate equitable adjustments. This organization is supplemented by knowledgeable shipbuilding personnel throughout the Company as required to provide proper documentation of specific claim items.

We have been assured by responsible officials of the Department of Defense and the Navy Department that we will receive prompt and equitable consideration of our contract claims. These officials have repeatedly stressed the need to identify and submit such claims as soon as possible so as to permit early resolution of our differences and enhance the orderly completion of the work now under contract. Accordingly, we are treating the work of developing and submitting the claims discussed herein as a matter of utmost importance, and it is receiving the personal attention of the Company's top level management. The level of detail of the claims and supporting data will of course be consistent with the amount of information which exists and the time available for developing the facts and correlating the masses of data. In addition, the day-to-day operations and observations of the Government's several hundred auditors, cost analysts, inspectors, engineers and other busi-

ness management personnel who are resident in our plant, provides the Government a full and complete knowledge of our business methods and practices. As a result, the need for extensive data will be minimized. We plan to submit claims which are reasonably supported by facts and analyses, and we fully expect that such claims will provide an ample basis for evaluation and negotiation of equitable adjustments under the contracts involved.

The overall schedule is still being prepared. However, we do expect to have all supplemental claim items on the DLGN36 and 37 in the Government's hands by the Christmas holidays. Section 8 of the current DLGN36/37 claim was not ready at the time of submittal. This section covers interest and financing costs, and will be submitted the week of October 28, 1974. We have scheduled initial submittal of the remaining major claims for the Carriers and DLGN38 Class Frigates by January 31, 1975. Also in the final development stages is the delay claim on SSBN617. We plan to complete and submit this claim before year-end.

I trust the information summarized herein and in the enclosure will enable the Government to make preliminary plans for prompt resolution of these matters. Further, it should be evident from the subject matter of the claims we are evaluating that we expect to properly demonstrate the obligation of the Government to compensate the Company, and that we are not merely asking the Government to pay the difference betwen the current contract prices and the expected costs of performance—an allegation we encounter frequently in discussions with the Government and most recently in your 11 page letter responding to my request for equitable relief under the Carrier contract. Let me stress however that I believe it is entirely reasonable to expect that costs incurred in excess of the current ceiling prices of our contracts will prove to be the responsibility of the Government. One principal reason for this belief is that the parties have mutually negotiated a ceiling price which they believed would cover the full range of costs which could reasonably be required to cover the basic contract work.

Yours very truly,

F. H. CREECH,
Vice President.

Enclosure.

Hull	Ship	Acceleration	Untimely/improper GFE	Untimely/improper/inadequate GFI	Excessive inspection	Defective/impossible specifications and/or drawings	Formal change orders and contract modifications	Interest	Navy recruiting practices	Crew interference and inspection activities	Development of documentation and estimating	Abuse of discretion	Deferred and out-of-sequence work	Letters of direction	Excessive tests and trials	Directions to follow erroneous contract interpretations	Limitation of work methods, sequences, and operations	Delays	Constructive change orders	Unilateral revisions of acceptance standards, specification interpretations and contract administrative practices	Underabsorbed overhead	Impact disruption and inefficient utilization of resources (facilities, labor, and material)	Increased general and service costs	Increased overhead and other indirect costs due to Government imposed management systems	Security	Cumulative impact	Ripple or cascade effect	Escalation
594	CVAN68	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x
595	DLGN36	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x
596	DLGN37	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x
597	SSN686	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x
598	SSN687	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x
599	CVAU69	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x
600	SSN68	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x
601	DLAN68	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x
602	SSN689	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x
603	SSN691	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x
604	SSN693	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x
605	SSN695	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x
606	DLGN39	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x
607	DLGN40	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x
	MARF	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x
	SSBN617	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x

ITEM 2.—*June 2, 1975—Newport News letter forwarding the initial submission of SSN 688 Class claim by Newport News. This initial submission does not provide pricing details*

NEWPORT NEWS SHIPBUILDING AND DRY DOCK CO.,
Newport News, Va., June 2, 1975.

Attention: Contracting Officer.
Subject: Proposal for Equitable Adjustment of Contracts N00024–70–C–0269 and N00024–71–C–0270, SSN688 Class Submarines.

SUPERVISOR OF SHIPBUILDING, CONVERSION AND REPAIR,
U.S. Navy, Newport News Shipbuilding and Dry Dock Co.,
Newport News, Va.

DEAR SIR: The subject proposal for equitable adjustment of the subject contracts is submitted pursuant to the Articles entitled "Working Drawings and Other Data." It is also instituted under the "Changes" clause of the General Provisions of each contract.

We have developed this proposal for the sole purpose of serving as a basis for negotiation of an equitable adjustment of subject contracts for time and cost increases caused by, or incident to, untimely, unsuitable, and/or deficient data. A narrative discussion of these matters is attached as enclosure (1).

Pricing details are contained in another volume which is undergoing final review. We will forward such details under separate cover. A Contract Pricing Proposal (Change Orders), DD Form 633–5, will be forwarded with the pricing details.

We are willing to meet with you at any time and conduct negotiations to develop mutually acceptable contract modifications to dispose of the data related problems identified in the attached material.

Yours very truly,

F. H. CREECH,
Vice President.

ITEM 3.—*June 19, 1975—Letter from Captain R. J. Eustace, Supervisor of Shipbuilding, Newport News, to Newport News President Diesel noting that the company's proposal for equitable adjustment of SSN 688 construction contracts did not contain the required certification that facts described therein are current, complete, and accurate*

SUPERVISOR OF SHIPBUILDING, CONVERSION AND REPAIR, USN
Newport News, Va., June 19, 1975.

Subject: Proposal for Equitable Adjustment of Contracts N00024–70–C–0269 and N00024–71–C–0270.
Reference: (a) NNS ltr 600/C1–1–1, 600/1024–979.01 of 2 Jun 75; (b) SUPSHIP–NN GEN/4330, Ser 100–217 of 20 Nov 74.
Enclosure: (1) Format of Affidavit.

Mr. JOHN P. DIESEL,
President and Chief Executive Officer, Newport News Shipbuilding and Dry Dock Company, Newport News, Va.

DEAR MR. DIESEL:

1. Receipt of reference (a), which was delivered to this Command on 10 June 1975, is acknowledged. It is noted that the proposal, as submitted, does not contain the affidavit requested by reference (b), however, this may be so because it is not yet complete in that pricing details will be forthcoming in the near future.

2. It is recognized that the proposal is presented as a request for equitable adjustment pursuant to the terms of the contract. This fact may have led the Company to believe that an affidavit would not be required. To avoid a potential misunderstanding in the future, I am taking this opportunity to make it clear that the Government expects to receive an affidavit in the format requested by reference (b) when the remainder of the proposal is submitted. A copy of the sample affidavit is attached for your convenience.

3. In the interim, please be advised that the Government intends to take no action with regard to reference (a) until the affidavit and the complete pricing details are received.

Sincerely,

R. J. EUSTACE.

Enclosure.

CERTIFICATION

I, J. P. Diesel, President and Chief Executive Officer of Newport News Shipbuilding and Dry Dock Company, the responsible senior Company official authorized to commit Newport News Shipbuilding and Dry Dock Company with respect to its Proposal for Equitable Adjustment, dated 2 June 1975, under Contracts N00024–70–C–0269 and N00024–71–C–0270, being duly sworn, do hereby depose and say, to the best of my knowledge and belief that: (i) the facts described in the Proposal for Equitable Adjustment are current, complete and accurate; and (ii) the conclusions in the Proposal accurately reflect the material damages or contract adjustments for which the Navy is allegedly liable.

J. P. DIESEL.

STATE OF VIRGINIA,
City of Newport News, ss:

Subscribed and sworn to before me on this _____ day of _____, 1975.

_____
(Notary Public)

ITEM 4.—*July 2, 1975—Submission of $142.4 million SSN 688 Class Claim by Newport News. This claim was subsequently increased in March 1976 to $270 million*

NEWPORT NEWS SHIPBUILDING,
Newport News, Va., July 2, 1975.

Attention: Contracting Officer.
Subject: Proposal for Equitable Adjustment of Contracts N00024–70–C–0269 and N00024–71–C–0270, SSN688 Class Submarines.
References: (a) Mr. F. H. Creech's letter, File No. 600/1024–979.01, same subject, dated June 2, 1975. (b) Mr. F. H. Creech's letter, subject: "Compensation Adjustments for Government-Responsible Causes under Navy Contracts" dated June 9, 1975.
Enclosure: (1) Three copies, Pricing Details, Volume II of Proposal for Equitable Adjustment of Contracts N00024–70–C–0269 and N00024–71–C–0270 for SSN688, 689, 693, and 695 (Copies 1, 2, and 3).

SUPERVISOR OF SHIPBUILDING, CONVERSION AND REPAIR,
U.S. Navy, Newport News Shipbuilding and Dry Dock Co.,
Newport News, Va.

DEAR SIR: A proposal for equitable adjustment of the subject contracts pursuant to the Articles entitled "Working Drawings and Other Data" and the "Changes" clause of the General Provisions was forwarded by reference (a).

Consistent with the goal expressed in reference (b), enclosure (1) [1] is furnished in connection with the submission made by the Company by reference (a). Although we are continuing to define enclosure (1), we do not expect this refinement to cause any significant variance. In any event, any variance can readily be considered during negotiations.

Yours very truly,

F. H. CREECH,
Vice President.

ITEM 5.—*Aug. 8, 1975—Submission of $159 million CGN, 38, 39, 40 claim by Newport News*

NEWPORT NEWS SHIPBUILDING,
Newport News, Va., August 8, 1975.

Subject: Proposal for Equitable Adjustment of Contract N00024–70–C–0252, DLGN38 Class, for Government Responsible Matters.
References: (a) Newport News Shipbuilding letter CONTRACTS/GEN, 601/C1–1–1 dated June 23, 1975; (b) Newport News Shipbuilding letter 601/C1–1–2 dated July 18, 1973; (c) Newport News Shipbuilding letter 601/

[1] Enclosures may be found in Navy Department files.

C–1–1–2 dated September 12, 1973; (d) Newport News Shipbuilding letter 601/C1–1–2, 601/1024–105 dated November 7, 1973.
Enclosures:
(1) DD Form 633, Contract Pricing Proposal
(2) Proposal for Equitable Adjustment of Contract N00024–70–C–0252

SUPERVISOR OF SHIPBUILDING, CONVERSION AND REPAIR,
U.S. Navy, Newport News Shipbuilding and Dry Dock Co.
Newport News, Va.

DEAR SIR: Our letter, reference (a), asserted the subject proposal for equitable adjustment of the contract. Reference (a) also transmitted a preliminary Management Summary describing the proposal as it then stood along with other data which identified the scope and contents of the proposal.

This letter and its enclosures constitute our finalized request for equitable adjustment of the contract. Enclosure (1) [1] is the Contract Pricing Proposal, DD Form 631 Enclosure (2) [1] is our proposal. The proposal presents information supporting the proposed adjustment and establishes entitlement with facts and elements of proof which support the amounts requested.

A finalized Management Summary is included as a part of Volume 1 of the proposal. It supersedes the preliminary issue transmitted with reference (a). As there are substantial differences between the preliminary and final issues of the Management Summary the preliminary issue should be taken out of circulation.

One element of this proposal is Government responsible delay. To expedite review and negotiation, our analysis of all known Government responsible delay under the contract, including the 28 week delay originally submitted by references (b), (c), and (d), is consolidated in this single presentation. Therefore, Government responsible delay periods and the costs identified in enclosure (2) include all Government responsible delay known to us at the time the analysis was made.

Yours very truly,

C. L. WILLIS,
Director of Contract Controls.

ITEM 6.—*Oct. 1, 1975—Letter from Vice Admiral Gooding, Commander, Naval Sea Systems Command to Newport News President Diesel reiterating requirements that Newport News certify its claims for equitable adjustment under Navy shipbuilding contracts. The letter forwards a standard certification statement, modified in an effort to reach an agreement with Newport News*

DEPARTMENT OF THE NAVY, NAVAL SEA SYSTEMS COMMAND,
Washington, D.C.

Mr. JOHN P. DIESEL,
President and Chief Executive Officer, Newport News Shipbuilding and Dry Dock Co., Newport News, Va.

DEAR SIR: On 24 July 1975, in conjunction with the Navy/Newport News negotiations for construction of SSN's 711–715, you expressed your desire for prompt settlement of the Newport News claim under the contracts for construction of SSN's 688, 689, 691, 693, and 695. I assured you that NAVSEA would act promptly on the claim and that my plan was to negotiate a settlement by 31 December 1975, and if that proved impractical, to provide Newport News a provisional payment by that date on the merits of the case.

Prior to the above assurances, you had been informed by the Supervisor of Shipbuilding letter of 19 June 1975 that NAVSEA would take no action with regard to your claim until receipt of your affidavit certifying it.

In view of the Company's acceptance of the affidavit requirement in the contract for SSN's 711–713 with options for SSN's 714–15, and your statement to my SSN 688 Class Deputy Project Manager, Mr. Wakefield, that an affidavit would be submitted for the SSN 688 Claim claim, it appeared that the affidavit posed no problem. This enhanced my confidence of being able to start the NAVSEA review of the SSN 688 Class claim in time to meet the 31 December 1975 date.

[1] May be found in company files.

On 29 August 1975, the Supervisor of Shipbuilding requested that an affidavit also be submitted on your claim under the contract for construction of DLGN's 38–40.

However, Newport News (Mr. Creech) in a letter to the Supervisor of Shipbuilding dated 15 September 1975 denied NAVSEA's right to require the affidavit and issued an ultimatum. He stated:

"If past is prologue, we can now expect NAVSEA to dissect our submissions and subject them to the most intensive scrutiny. This process will result in questions being asked and answered, information requested and furnished, errors noted and corrected, etc. It may even result in NAVSEA bringing to our attention information or approaches which we had not considered, possibly requiring our submission to be updated or revised. In short, there is a tremendous amount of work now facing both parties, and unnecessary delay by NAVSEA in bringing its shoulder to the wheel is an outright breach of its duty under our contracts. Irreparable harm to this Company will result.

Your demand for an affidavit is ultra vires and in complete disregard of your contract obligations. The Government, in the absence of a statute, regulation or mutual agreement, has no authority to demand an affidavit. Even if it did have such power, constitutionally it can do so only prospectively and not retroactively so as to impair existing vested contractual rights. We cannot permit the Navy to dictate or coerce us into abrogating contract rights when, as in this case, there is not even the slightest suggestion that Navy's position is consistent with contract requirements. We demand that you proceed with your responsibilities in connection with our June 2, 1975 submission and confirm to us that you have done so. If you will not do this, please issue a final decision immediately. If neither a final decision nor a confirmation as requested is received by this Company within thirty (30) days from the date of this letter we reserve our right to interpret the failure to be an adverse and appealable determination and take appropriate action."

I consider that Mr. Creech's letter is counter-productive to a good business relationship between the Company and the Navy and his ultimatum should be withdrawn. In any event, NAVSEA does not intend to accede to Mr. Creech's ultimatum.

The NAVSEA request is both reasonable and in accord with Navy policy As explained to your representatives, including Mr. Creech, during the negotiations for construction of SSN's 711–715, the major purpose of the requested affidavit is to ensure that the data submitted in support of any claim or a request for equitable adjustment is current, complete, and accurate and that it accurately reflects the damages for which the Navy is allegedly liable. With such an affidavit, the Government may evaluate the total claim expeditiously and with confidence that all the facts are being considered and that the request will not be repeatedly revised during the evaluation/negotiation period, with the attendant expenditure of additional evaluation effort and delay of resolution.

Since contractors are required by the Truth-in-Negotiations Act to so certify prior to the award of non-competitive procurements over $100,000, the requirement for similar assurances prior to devoting the large Government resources required to evaluate a claim is appropriate.

The DLGN 38–40 claim states that "we do not represent this proposal as being a balanced portrayal of both sides of the picture; however, we believe that it contains sufficient information for the Navy to develop a negotiating position and to recognize that it has a duty to equitably adjust the contract." Your submission should not be limited only to those facts that favor Newport News. The Navy does not expect you to make the Navy's case, but the Navy does expect you to submit all facts within the knowledge of your Company that are material to the issues raised in your submission.

The Newport News SSN 688 Class claim states that "we reserve the right to adjust any or all of the estimates or allocations, either upward or downward as may become necessary when further facts become known, *or as may be necessary to ensure an equitable resolution.*" (emphasis added) Such caveats must either be withdrawn or countermanded by language in the affidavit such as that in the introductory phrase in enclosure (1). Either you have presented your claim fully or you have not. If you wish to add other theories or facts now known, you should do so before the Navy begins its

evaluation. NAVSEA has no intention of trying to deal with a vacillating claim.

Mr. Creech's letter of 12 September states that Newport News will provide NAVSEA with an affidavit but with certain qualifications which are unacceptable. While I prefer an affidavit identical to that contained in NPD 1-401.55, I will accept an affidavit containing the qualifier "to the best of my knowledge and belief" to be consistent with language contained in the Truth-in-Negotiations Act. Your Company agreed to such an affidavit regarding requests for equitable adjustments under the SSN's 711-715 contract. Enclosure (1) reflects this wording.

I have given you my assurances regarding the timing for resolving your SSN 688 Class claim. Of course, this timing depends upon your cooperation in promptly providing the affidavit and all subsequent information necessary to evaluate your claim. Accordingly, I request that you review your claim and make whatever adjustments you believe are necessary to enable you to submit the enclosure (1) affidavit.

Sincerely yours,

R. C. GOODING,
Vice Admiral, USN,
Commander, Naval Sea Systems Command.

Enclosure: (1) Certification.

CERTIFICATION

Notwithstanding anything to the contrary in the Proposal for Equitable Adjustment cited below, I, J. P. Diesel, President and Chief Executive Officer of Newport News Shipbuilding and Dry Dock Company, the responsible senior Company official authorized to commit Newport News Shipbuilding and Dry Dock Company with respect to its Proposal for Equitable Adjustment, dated 2 June 1975, under Contracts N00024-70-C-0269 and N00024-71-C-0270, being duly sworn, do hereby depose and say to the best of my knowledge and belief that: (i) the facts described in the Proposal for Equitable Adjustment are current, complete and accurate; and (ii) the conclusions in the Proposal accurately reflect the material damages or contract adjustments for which the Navy is allegedly liable.

J. P. DIESEL.

STATE OF VIRGINIA,
City of Newport News, ss:

Subscribed and sworn to before me on this _____ day of _____, 1975.

_____
(Notary Public)

ITEM 7.—*Feb. 2, 1976—Letter from Newport News President Diesel to Vice Admiral Gooding, Commander, Naval Sea Systems Command stating a willingness to provide an affidavit certifying Newport News' claims conditionally. However, Mr. Diesel rejects the Navy's compromise affidavit.*

NEWPORT NEWS SHIPBUILDING AND DRY DOCK CO.,
Newport News, Va., February 2, 1976.

R. C. GOODING,
Vice Admiral, USN, Commander, Naval Sea Systems Command, Department of the Navy, Washington, D.C.

DEAR ADMIRAL GOODING: Since receiving your letter of January 2, File 028 Ser 689, I have again reviewed the matter of an affidavit for DLGN38 Class ships. I reviewed the record of the extensive discussions between our representatives with regard to the affidavit issue under several contracts, including the significant amount of correspondence which has been exchanged dating back to November 13, 1973. I have listed the formal correspondence on this matter, and the summary is enclosed for your benefit in reviewing the overall situation.

I have been, and I am now, willing to give you an affidavit. In our letter to the Supervisor of Shipbuilding on September 12, 1975, we offered to provide an affidavit based upon the following:

1. We believe it is inappropriate to swear to the accuracy of a conclusion or opinion.

2. If a senior official of this company executes an affidavit, it must be clearly understood that he does so based upon information and belief, and not necessarily personal knowledge. The official will have been briefed on the proposal, but it is unlikely that he will have read the proposal in its entirety.

3. We attempted to assure ourselves that all statements of fact contained in the proposal are true. But the proposal describes the bases of our entitlement and does not attempt to state potential Navy defenses. There are facts not contained in the proposal. They are not presented because we did not consider those facts to be relevant to our entitlement, or determinative of the ultimate issues, or because we have overlooked them, or because we did not consider further research in a particular area to be practical.

4. We do not consider our proposals to be frivolous, but we know that some legal issues presented may not agree with the Navy's assessment of legal authority. We reserve the right to disagree.

The factors mentioned above serve to illustrate my dilemma. I would like to accommodate you by providing an affidavit—just as I did on the SSN688 Class in the expectation of expediting payment. Nonetheless, your repeated requests for an express form of affidavit—when considered in light of our different understandings of what the proposal says—clearly indicate to me that more problems may be generated than would be solved. I have tried very hard to overcome this problem. I am convinced that you have sincerely tried to solve it too. Nonetheless, no mutually acceptable solution is in sight, and I must respectfully decline to execute the affidavit which you forwarded with your last letter.

As you know, we have offered on several occasions to present a detailed briefing to Government personnel on the subject proposal. That briefing would help you and your representatives to understand how the proposal was compiled, and I believe it would alleviate your concerns to a major degree—if not completely. If it is your final decision that we must submit an affidavit in the particular form appended to your letter of January 2, please have that decision issued as a Final Decision of the Contracting Officer so that we may take the necessary steps to have this issue formally decided. We remain ready to meet with you at any time and develop a mutually acceptable plan to proceed on this most urgent Proposal for Equitable Adjustment.

Yours very truly,

J. P. DIESEL,
President.

Enclosure.

LIST OF CORRESPONDENCE RELATING TO AFFIDAVITS

January 2, 1976—NAVSEA letter, 028 Ser 689, on DLGN38 Class.
November 10, 1975—NNS&DDCo. letter (FHC) on DLGN38 Class.
October 3, 1975—NNS&DDCo. letter (JPD) on SSN688 Class (Affidavit).
October 1, 1975—NAVSEA letter (RCG) on SSN688 Class.
August 29, 1975—SUPSHIP-NN letter, Ser 400-140, on DLGN38 Class.
August 8, 1975—NNS&DDCo. letter, 601/C1-1-1, on DLGN38 Class (Proposal).
July 16, 1975—NNS&DDCo. letter (FHC) on SSN688 Class.
June 23, 1975—NNS&DDCo. letter, 601/C1-1-1, on DLGN38 Class.
June 19, 1975—SUPSHIP-NN letter, Ser 401-137, on SSN688 Class.
June 19, 1975—SUPSHIP-NN letter, Ser 400-130, on DLGN38 Class.
June 10, 1975—NNS&DDCo. letter, 601/C1-1-1, on DLGN38 Class.
June 9, 1975—NNS&DDCo. letter, CONTRACTS/GEN, on all Contracts.
November 20, 1974—SUPSHIP-NN letter, Ser 100-217, on all Contracts and form of Affidavit.
June 14, 1974—NNS&DDCo. letter, 583/C102-C, on LKA Ships (Affidavit).
November 13, 1973—Sullivan, Beauregard letter on LKA Ships.

ITEM 8.—*Feb. 19, 1976—Submission of $221 million CVN 68/69 (Nimitz and Eisenhower aircraft carriers) claim by Newport News*

NEWPORT NEWS SHIPBUILDING,
Newport News, February 19, 1976.

Subject: Proposal for Equitable Adjustment of Contract N00024-67-C-0325, CVAN68 Class, for Government Responsible Matters.

Enclosures: (1) DD Form 633, Contract Pricing Proposal; (2) Proposal for Equitable Adjustment of Contract N00024-67-C-0325.

SUPERVISOR OF SHIPBUILDING, CONVERSION AND REPAIR,
U.S. Navy, Newport News Shipbuilding and Dry Dock Co.,
Newport News, Va.

DEAR SIR: This letter and its enclosures constitute our request for equitable adjustment of the subject contract. Enclosure (1) [1] is the Contract Pricing Proposal, DD Form 633. Enclosure (2) [1] is our proposal. The proposal presents information supporting the proposed adjustment and establishes entitlement with facts and elements of proof which support the amounts requested.

Ten copies of the proposal, numbered 2 through 11 are being provided for use by the U.S. Navy. One copy, Copy No. 12, together with a copy of DD Form 633, Contract Pricing Proposal, is being provided to the Defense Contract Audit Agency with their copy of this letter.

Included as a part of Volume 1 of the proposal is a separately removable Management Summary. This summary was utilized as a part of our final review process. We believe it provides an excellent vehicle for describing the composition and contents of the proposal. It also provides an immediate insight into its magnitude. We believe it would be in our mutual best interest for us to review this summary with Navy management personnel. If you desire such a briefing, please advise me and I will make the arrangements. In the meantime, if you have any questions or if we can provide any additional information, please contact me.

Yours very truly,

C. L. WILLIS,
Director of Contract Controls.

ITEM 9.—*Feb. 20, 1976—Letter from Diesel to Chief of Naval Operations Holloway referring to the outstanding issues with the Navy. Mr. Diesel states that he must reevaluate whether or not to allow the company to embark on new Navy shipbuilding programs, particularly "one of the magnitude of the CVN 70 without solid evidence that we are going to be working with the Navy in a far different atmosphere than the one that exists today."*

NEWPORT NEWS SHIPBUILDING AND DRY DOCK CO.,
Newport News, Va., February 20, 1976.

Adm. JAMES L. HOLLOWAY III,
USN, Chief of Naval Operations, Navy Department,
Washington, D.C.

DEAR ADMIRAL: I believe that you know that I met in Washington with Deputy Secretary of Defense Clements on January 30, 1976 to discuss contractual and financial problems that exist between the Navy and Newport News Shipbuilding and Dry Dock Company. The problems I outlined to him are of long standing, are chronic and are becoming worse. Underlying the failure to reach an equitable solution to the problems is what I see as the Navy's unyielding attitude that it shares no responsibility for their creation.

On February 17, 1976 I met in Washington with Mr. Bowers and Admiral Michaelis and we reviewed these same issues.

The purpose of this letter is to ensure that you know how seriously I view these problems and to let you know that I believe that the Navy and my Company are going to have to work together in a more constructive way than we have up until now if we are going to solve them.

In recent months I have seen no progress at all toward settlement of our current Requests for Equitable Adjustment ("claims"), a factor bearing critically on the financial soundness of the Company. Beyond that we have been unable to reach agreement with the Navy on the cost and impact of a number of major change orders, particularly those involving delay and disruption.

I have concluded that I must re-evaluate whether or not I can in good conscience allow the Company to embark on new Navy shipbuilding programs, particularly one of the magnitude of the CVN70 without solid evidence that we are going to be working with the Navy in a far different atmosphere than the one that exists today. With that in mind I am having a careful review

[1] Enclosures may be found in company files.

made of the Company's legal and contractual position with respect to building CVN70. Where this will take us is not clear but the implications are obviously far-reaching.

I believe that our shipyard is truly an important national asset and one that the Navy should not put in jeopardy without considering carefully what is at stake. The Company is anxious to build ships for the Navy and proud of the ships that we deliver to the Navy. Moreover I am convinced, as I believe you are, that the Navy needs good ships today more than at any time in recent history.

I am ready to talk with you about these matters whenever you desire.

With all best wishes.

Sincerely,

J. P. DIESEL,
President.

ITEM 10.—*Feb. 20, 1976—Letter from Diesel to RADM L. E. Hopkins, Naval Sea Systems Command, Director of Contracts. Mr. Diesel states: "we are making a careful review of our legal and contractual position with respect to CVN 70*

NEWPORT NEWS SHIPBUILDING,
Newport News, Va., February 20, 1976.

Attention: Rear Admiral L. E. Hopkins, Code 02.

Subject: Proposal for Definitization of Contract N00024-67-0325 for Construction of CVN70.

References: (a) NAVSEA Letter PMS392/TJN, CVN6Sc1/9020, Ser 6 Dated 19 January 1976; (b) NNS Letter to SUPSHIP Dated February 19, 1976, 594/C1-1-1; (c) NAVSEA Letter to NNS Dated April 5, 1974.

NAVAL SEA SYSTEMS COMMAND,
Department of the Navy,
Washington, D.C.

GENTLEMEN: Thank you for your letter (reference a) asking for a specific date by which we will be submitting another proposal for definitization of Contract N00024-67-C-0325 to cover construction of the CVN70. Since the submittal of our proposal in 1974, on which we were unable to negotiate a mutually satisfactory definitive contract for the CVN70, we have significantly more cost, performance, and delivery experience concerning CVN68 and 69, the first two ships under the contract.

There has been a delay in delivery of CVN68 and 69. The first ship has been finally accepted by the Navy and the delivery of the second ship is now in sight. The Company considers that the delays are Government responsible, although the Navy has declined to accept any responsibility other than that covered by its interpretation of HMRS1. The Company has completed an extensive evaluation, which is contained in several volumes, of the impact of Government actions to date on CVN68 and 69. Those documents were filed with the Navy yesterday as a request for equitable adjustment (reference b).

The problems on the Carrier program have been adversely affected by unfavorable developments in our relations with the Navy and other contracts. These are combining to hinder our performance on all of our current work and to increase our apprehension of performing a program of the magnitude of CVN70 without solid evidence that we are going to be working with the Navy in a far different atmosphere than the one that exists today. With this in mind, we are making a careful review of our legal and contractual position with respect to CVN70. It would be tremendously helpful if we could mutually devise a way to resolve the problems represented in the requests for equitable adjustment in reference (b).

Reference (c) requested us to provide prompt notification at the time that our expenditures are expected to reach 75% of the Government's maximum liability, which is currently $130,044,000. This is to advise that our expenditures through February 1, 1976 are as follows: Cumulative NNS incurred costs, $51,945,000; 5% Fee, 2,597,000; total, $54,542,000.

In addition, our unpaid purchase order commitments are $56,555,000. The fee on this will be $2,827,000. Thus our total liability as of February 1, 1976 is $113,924,000. We estimate that the amount of our expenditures (incurred cost plus fee) when added to the reasonable potential termination costs will

exhaust the $130,044,000 of funds provided as the maximum obligation of the Government before May 1, 1976. Because of the contractual uncertainties indicated above, we are unable to estimate the requirement for additional funding to be added to the contract at this time. We point out to you that the current funding under the contract expires in May of this year and requires bilateral agreement to be further extended.

Very truly yours,

J. P. DIESEL,
President.

ITEM 11.—*Feb. 20, 1976—Memorandum from Jack L. Bowers, Assistant Secretary of the Navy (Installations and Logistics), to the Secretary of the Navy recommending a program to provide immediate relief of the problems currently being encountered with Newport News and "to offer patterns for extensions to all other firms"*

THE ASSISTANT SECRETARY OF THE NAVY,
INSTALLATIONS AND LOGISTICS,
Washington, D.C., February 20, 1976.

MEMORANDUM FOR THE SECRETARY OF THE NAVY

Via: The Under Secretary of the Navy.
Subject: Program for Solution of Problems of Business Relationships with the Shipbuilding Industry.

The program recommended herein is intended to provide immediate relief to the problems currently being encountered with Newport News Shipbuilding and Dry Dock Company and to offer patterns for extension to all other firms. In addition to near term solutions, plans for the study of long range solution are recommended.

RECOMMENDATIONS

A. Meet with Newport News Shipbuilding & Dry Dock Company and upon mutual agreement proceed with the following actions:

1. Within 30 days negotiate contract completion dates for all programs where such satisfactory dates do not exist. Subsidiary issues need not be negotiated. If bilateral agreement cannot be reached in any case, Contracting Officer decision will be issued after approval by the Chief of Naval Material.

2. Within two weeks develop procedures to allow negotiation of changes to be accomplished on a timely basis. Primary agreement is required in area of how to handle delay and disruption. Standard formulas may be considered or extended but specific analysis periods may be allowed for final resolution. The plan must provide for complete understanding before work starts or, at worst, a reasonable previously agreed period for negotiation while work is in process. The plan may be accomplished in one step or in two phases, an interim and a final solution.

3. The parties will continue to negotiate the DLGN–41 issues in good faith. Emphasis will continue to be placed on issues which offer greatest promise for resolution, large or small.

4. Within 30 days negotiations will be concluded on severable segments of at least two claims currently at issue and payments made.

5. The Chief of Naval Material will thoroughly discuss issues of proper application of Newport News Shipbuilding & Dry Dock Company resources to Navy programs. He will develop an understanding of this issue and receive proper assurances from company management.

B. Develop improved long term solution for negotiation of claims.

1. Consider the formation of an outside consultant group to study issue and report.

2. Whether study is accomplished internally or by above outside group, consideration will be given to the following:

a. Navy organizational approach to claims settlement—roles and missions of all participants—question need for each action.

b. Improved guidelines for contractors.

c. Necessary legislation.

d. Changes in ASPR or other regulations.

e. Consider arbitration as a solution.
i. Contract changes required.
ii. Available arbitrators.

I recommend all of the above be discussed with the Chief of Naval Operations and the Chief of Naval Material, and this or an alternative plan be immediately discussed with Newport News Shipbuilding & Dry Dock Company and put into effect.

JACK L. BOWERS.

ITEM 12.—*Mar. 18, 1976—ADM Rickover Memorandum for the Chief of Naval Material concerning certification of claims. The memorandum recommends the Navy "stand firm on its requirement for this affidavit and the other safeguards it has instituted to protect the public from unwarranted expenditures"*

DEPARTMENT OF THE NAVY,
NAVAL SEA SYSTEMS COMMAND,
Washington, D.C., March 18, 1976.

MEMORANDUM FOR THE CHIEF OF NAVAL MATERIAL

Subject: Certification of shipyard (b) claims.
Enclosure: (1) My memo for the Deputy Commander for Contracts, Naval Ship Systems Command dtd 30 Jun 72.[1]

1. I understand that you plan to meet with the President of shipyard (b) on March 19, 1976 to discuss shipbuilding claims. I recommend you take up the subject of claims certification as the first item of business at that meeting.

2. Navy Procurement Directives (NPD 1-401.55) require that, prior to evaluating contractor claim submittals, Contracting Officers must obtain an affidavit from the responsible senior company official certifying that, to the best of his knowledge and belief ". . . (i) the facts in the claim are current, complete, and accurate and, (ii) the conclusions in the claim accurately reflect the material damages or contract adjustments for which the Navy is allegedly liable." Shipyard (b) provided such an affidavit on its initial claim under the SSN 688 Class contracts but has refused to provide affidavits on its other claims.

3. This requirement was implemented because prior experience indicated that contractors often submitted grossly inflated claims and then revised and resubmitted them whenever the Government's evaluation of amounts actually owed did not turn out to be enough to satisfy the contractor. Enclosure (1) presents an example of one specific case and is similar to what the Navy is facing with shipyard (b) today. A possible fraud action in this case is still being investigated by a grand jury.

4. In addition to refusing to provide the required affidavits on its subsequent claims, now it appears that shipyard (b) is even trying to nullify the one affidavit it did provide. The situation is this:

On July 2, 1975, shipyard (b) submitted a $142.5 million claim on its SSN 688 Class submarine contracts.

On October 3, 1975, shipyard (b), at Naval Sea Systems Command (NAVSEA) request, provided the required affidavit for the above claim; NAVSEA began evaluating the claim.

In February 1976, NAVSEA, based on a preliminary analysis, concluded that a provisional price increase of about $10 million could be made on the claim.

On March 3, 1976, you met with shipyard (b) officials and informed them that the company would shortly be receiving a provisional payment of about $10 million.

On March 8, 1976, shipyard (b) submitted a revised claim, now totaling $270.1 million, covering these same ships; the required affidavit was not submitted, and has not yet been requested.

Although the revised claim is voluminous, comprising 15 books, a cursory review by NAVSEA personnel indicates that the revisions are not confined to additional items of alleged Government responsibility arising after submission of the first claim. Many of the elements of the first claim, which the company certified as being "current, complete, and accurate" have also been revised substantially.

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[1] Enclosures may be found in company files.

5. I believe it is now essential for the Navy to stand firm on its requirement for this affidavit and the other safeguards it has instituted to protect the public from unwarranted expenditures. If the Navy makes a provisional payment on the revised and uncertified SSN 688 claim or if it proceeds to evaluate other uncertified shipyard (b) claims in the face of pressure from shipyard (b), the Navy will have set a precedent for all other contractors to push for higher settlements than the legal merits of their claims would justify. The Navy can then look forward to years of wasted effort evaluating exaggerated and constantly changing claims.

6. I know you are being urged to "improve relations" with shipbuilders. However, the problem is not one of human relations; it is strictly a matter of money. Shipyard (b) appears to want the Navy to ensure the company's profitability. This could well require a payment of more than the amount they are entitled to under their contracts. The Navy, however, can only pay claims on their legal merits. Payments on any other basis would require the Secretary of the Navy to exercise his authority to grant extra-contractual relief under P.L. 85–804.

7. By applying pressure and threatening not to build ships, the company apparently believes it can get paid more on its claims than it could otherwise get. Until contractors are convinced that the Navy intends to handle claims properly and in accordance with established safeguards, they will continue to submit inflated claims and attempt to negotiate settlements with senior Defense officials for more than they are legally entitled.

8. In summary, the Navy policy should be to expedite claim settlements on the basis of legal entitlement. However, this cannot be accomplished until shipyard (b) submits realistic claims and certifies that the claims and supporting data are current, complete, and accurate. I recommend you relate this to the President. If he refuses to submit such realistic certified data, I recommend the Navy suspend its evaluation of shipyard (b) claims and not grant provisional price increases against their claims until the matter is resolved to the Navy's satisfaction. In the long run this will expedite resolution of the claims problem.

9. I would appreciate being informed of what action you take in this regard.

H. G. RICKOVER.

ITEM 13.—*Mar. 18, 1976.—Memorandum from Adm. R. C. Gooding, Commander, Naval Sea Systems Command, to the Chief of Naval Material recommending that no provisional payment be made to Newport News in view of their submission of a revised claim on their SSN 688 Class submarine contracts*

MARCH 18, 1976.

MEMORANDUM FOR THE CHIEF OF NAVAL MATERIAL

Subject: SSN 688 Class Provisional Payment to Newport News.

1. On 2 July 1975, Newport News submitted a claim on its SSN 688 Class submarine contracts totalling $142.5 million (ceiling price). On 3 October 1975, Newport News provided the affidavit required by the Naval Procurement Directives. In February 1976, NAVSEA completed its analysis of the SSN 688 delay portion of the claim and concluded that a provisional payment of about $10.6 million could be paid Newport News on the claim. On 8 March 1976, NAVSEA obtained NAVMAT approval to make the provisional payment.

2. However, on 8 March 1976, Newport News submitted a revised claim for these ships totallying $270.1 million. The SSN 688 delay element, which was previously analyzed, and which was to be used as the basis for the provisional payment was revised from $17.8 million to $26.1 million at cost. A comparison of the common elements of the two claims cannot be completed until the week of 22 March 1976. This should permit NAVSEA to determine whether the information used as the basis of the proposed provisional has been modified or altered by Newport News. If that has occurred, the supporting analysis will have to be redone. You should be aware that based on a cursory review to date, it appears that many of the elements of the claim have been revised and at least two technical elements have been added.

3. A new affidavit was not submitted with the revised claim. In addition, it appears that the revised claim makes the original affidavit invalid.

4. Based on the above, it is NAVSEA's position that no provisional payment should be made until (1) the required affidavit for the new claim is submitted and (2) NAVSEA can complete a detailed review of the revised claim to determine if a valid basis exists upon which to make such a payment.

R. C. GOODING,
Commander, Naval Sea Systems Command.

ITEM 14.—*Mar. 24, 1976—ADM Rickover Memorandum for Assistant Secretary of the Navy Bowers regarding relations with Newport News Shipbuilding and Dry Dock Company. This letter provides background information regarding contractual problems with Newport News and recommends that senior officials make it clear to Newport News and Tenneco management that the Navy will process their claims on their legal merits*

DEPARTMENT OF THE NAVY,
NAVAL SEA SYSTEMS COMMAND,
Washington, D.C., March 24, 1976.

MEMORANDUM FOR THE ASSISTANT SECRETARY OF THE NAVY, INSTALLATIONS AND LOGISTICS

Subject: Relations with Newport News Shipbuilding and Dry Dock Company.

1. I understand that you and other senior Navy officials are to meet with the Deputy Secretary of Defense this week to discuss how the Navy might improve relations with Newport News. In view of our past discussion I thought you might like to have my views on this subject. Therefore I have summarized them in this memorandum.

2. The basic question in the Newport News situation is whether the Navy will take responsibility for financial problems at Newport News regardless of the company's responsibility and performance under its Navy shipbuilding contracts.

3. Most of the financial problem on Newport News Navy shipbuilding contracts is the outgrowth of company actions taken several years ago. In 1971, Newport News projected a need to build up manpower from 18,200 early in 1971 to over 30,000 employees in 1973 to meet its commitments on existing Navy contracts. In the fall of 1972, Newport News signed a contract for three Liquified Natural Gas Carriers (LNG's) and announced plans to build a new yard for construction of these and other merchant ships. At that time, Newport News had an employment level of about 27,000 people and was still building up its manpower. Newport News and Tenneco officials stated at the time that they expected to make manpower for the commercial work available within their expected 30,000 employment level due to a projected decline in Navy work starting in mid-1974.

4. To assuage Navy concern over the potential impact of the commercial work on Navy work, the Chairman of the Board of Tenneco in a letter dated February 12, 1973 assured the Navy that:

"Tenneco will not allow performance of work on non-Navy contracts to interfere with the performance of work necessary to meet Newport News commitments on Navy contracts."

5. In early 1973, shipyard productivity decreased and there was a large increase in fabrication errors—apparently caused by the lower skill level of the new hires. In 1973, Newport News announced that it had abandoned its plans to build up to the 30,000 employees which it had projected were necessary to meet commitments on Navy contracts. Since that time the employment level has decreased to the present level of about 22,000.

6. The decline in productivity and increase in rework during the work force expansion caused an increase in the number of manhours required to complete present Navy contracts. To accommodate this increase in manhours and the shortfall in manning, Newport News stretched out Navy ship construction schedules. Under the contract terms these manpower problems and the costs of escalation on the deferred work are the responsibility of the shipyard.

7. The shipyard still does not have sufficient trained manpower to meet existing commitments on Navy contracts, and is currently faced with having to build up the manpower assigned to commercial contracts or delay the commercial ships. Newport News is claiming that the Navy is responsible for all the delays and higher costs which accrue on Navy work.

8. Newport News assembled a large team to prepare claims on Navy shipbuilding contracts. To generate bases for these large omnibus claims, employees have been encouraged to search out and report actions and events that might be used as a basis for a claim against the Navy. Even minor technical details or problems are now treated as contractual matters.

9. Settlement of contract changes has also become increasingly difficult. Often the company either refuses to price the changes in advance, quotes an excessive and unsupported price, or demands the right to reopen contract pricing later for other reasons such as the "cumulative impact of contract changes."

10. Recently Newport News has accelerated its efforts to have the Navy accept responsibility for financial problems at Newport News. For example, during the past year:

Newport News stopped work on the CGN 41, claiming that the contract option for construction of CGN 41 is invalid. A U.S. District Court directed that the company continue construction while the parties attempted to negotiate their differences and while several issues in dispute were submitted to the Comptroller General for rulings. When the Comptroller General ruled in the Navy's favor the company disagreed and returned the dispute to court.

Newport News continued to refuse to accept most contract changes without reserving rights to "cumulative impact" thus making it impossible to preprice most changes. This created the large backlog of unpriced changes about which Newport News repeatedly complains.

Newport News stated, in a February 20, 1976 letter to the Chief of Naval Operations, that it was considering stopping work on the CVN 70 and not entering into new Navy shipbuilding contracts. The company repeated that statement in a March 15, 1976 letter to Congressman T. N. Downing which has been published in the Congressional Record.

11. Newport News has now submitted to the Navy the large omnibus claims it has been assembling for over a year. These shipbuilding claims now total over $894 million in requested ceiling price adjustments and cover every active Navy shipbuilding contract at the shipyard in addition to several completed contracts. Newport News has been utilizing these claims as the basis for getting the Navy to accept responsibility for the financial problems at the shipyard. However:

a. Newport News refuses to certify these claims as being current, complete, and accurate as required by Navy Procurement Directives. From preliminary Navy review it appears that claims are inflated.

b. Newport News typically does not show a relationship in these claims between alleged Government actions and increased costs and delays. It simply lists a series of alleged Government actions, and then claims that the Government is responsible for all increased costs and delays.

12. While Newport News is owed some money on its claims, the company, by the nature of its claims submissions, has made it very difficult and time consuming to sort out the items for which legal entitlement exists. It is reasonable to conclude from the manner in which the claims have been presented that the company believes that actual entitlement under these claims is considerably less than the amount the company is seeking.

13. In his March 15, 1976 letter to Congressman Downing, the President of Newport News 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." Yet, over $665 million (three-fourths of the total) of Newport News' claims were submitted or revised within the last two months. Moreover, it was Newport News' decision to store up small changes and other items for use in large omnibus claims rather than adjudicate them on their merits at the time they arose.

14. The problem with Newport News is strictly one of money. Relations between the shipyard and the Navy will continue to be poor until the company is paid what it wants or until company officials are convinced that the Navy will pay only what it legally owes. In this regard, you should recognize

that the Newport News parent, Tenneco, is not in any financial trouble—the corporation is reporting record profits.

15. Under P.L. 85–804, the Secretary of the Navy has authority to make payments to contractors regardless of contract terms. In this regard, various possibilities have been discussed. For example, it has been suggested that Newport News contracts be reformed to extend contract delivery dates and apply revised escalation provisions on the basis that escalation provisions on current contracts are inadequate. Actually current contracts adequately protect shipbuilders against inflation if the contractors meet contract schedules or if all delays are Government-responsible. Extending contract delivery dates and providing escalation coverage to current Newport News schedules, however, would result in the Government financing contractor-responsible delays.

16. Granting extra-contractual relief in the current circumstances would create problems. Even if Congress were to approve such relief and appropriate the necessary funds, the Navy would be left with the problem of fending off requests from other contractors for similar treatment. It would become increasingly difficult to enforce Government contracts or settle claims on their legal merits.

17. Assuming that the Navy intends to resolve claims on their legal merits rather than grant extra-contractual relief, I recommend the following actions be taken:

a. Make it clear to Newport News and Tennaco management that the Navy will process their claims and settle them based only on the legal merit of the claims.

b. Return responsibility for settling these claims to the Naval Sea Systems Command and discourage company officials from seeking settlements at higher levels.

c. Enforce the Navy requirement that the senior responsible company official certify that the claims are current, complete, and accurate.

d. Provide the Naval Sea Systems Command sufficient resources to review claims expeditiously. Current Navy legal support is inadequate and too much of the burden falls upon technical people, who are becoming increasingly unable to carry out their primary duties because of the claims workload. The Navy needs to hire, or have the Department of Justice hire for the Navy, outside legal counsel and such other assistance as is necessary to assist in the evaluation of claims and claims related matters.

H. G. RICKOVER.

ITEM 15.—*Mar. 29, 1976—Memorandum from Gordon W. Rule to Chief of Naval Material Michaelis endorsing Mr. Clements' decision to utilize the extracontractual provisions of Public Law 85–804 to settle the shipbuilding claims. This letter sets forth Mr. Rule's thoughts and suggestions in connection with Navy implementation of Mr. Clements' decision*

[Memorandum]

MARCH 29, 1976.

To: ADM F. H. Michaelis, Chief of Naval Material.
From: Gordon W. Rule, MAT–022.
Subject: The Use of P.L. 85–804 to Remedy the Situation Existing in Three Shipbuilding Yards in the United States, Which Adversely Affects the National Defense of the United States—Thoughts Concerning.

1. On Wednesday, 24 March 1976, Mr. Clements, Deputy SECDEF, was given a presentation by the Chief of Naval Material in response to his request for recommendations of what the Navy proposed to do to eliminate the $1.7 billion in Requests for Equitable Adjustments (REA's) under Navy shipbuilding contracts at Electric Boat Division of General Dynamics, Newport News and Litton. The presentation was made by RADM Hopkins who heads the contract division of the Naval Sea Systems Command.

2. Of the $1.7 billion of pending REA's, $1,097.2 million are for nuclear surface ships and submarines under contracts at Electric Boat and Newport News which have been submitted since 1 January 1975.

3. At the conclusion of the presentation, Mr. Clements made the decision to utilize the provisions of Public Law 85–804 to settle the pending REA's at these three shipbuilding yards so vital to the present and future shipbuilding

requirements of the United States. Mr. Clements directed Admiral Michaelis, the Chief of Naval Material, to set up a small group to determine ways and means of implementing his decision.

4. I agree wholeheartedly with Mr. Clements' decision to utilize the extra legal provisions of P.L. 85–804 to settle the present shipbuilding REA's which, in my opinion, amount to a national emergency. I do however, have several thoughts and suggestions in connection with the Navy implementation of Mr. Clements' decision and will set them out for the consideration of those working the problem. They are not necessarily in the order of their importance.

a. Mr. Clements' decision takes guts and as I understand it, he is prepared to go to the Congress and advise them of the emergency facing Navy combatant shipbuilding and how he intends to cope with it. This is certainly the proper way to proceed and I would advise requesting the cognizant committee or committees to hold hearings on his proposal to avoid slanted and biased opposition from those not wishing to testify at hearings. Let any and all opposition go on the record. There is no use anyone trying to kid themselves—this entire P.L. 85–804 exercise to put Navy combatant—especially nuclear—shipbuilding back on course will most likely result in a head-on collision with NAVSEA–08.

I suggest however, we all remember that there are two sides to every question and the $1,097.2 million REA's resulting from nuclear ship contracts cannot be all the fault of EB and/or Newport News and if a head-on collision eventuates, I suggest the time has come when the Navy and the United States' need for ships far outweighs any cause for concern about the bruised feelings of any one person. Mr. Clements' decision is right and it must be successfully supported.

b. What it is the Navy plans to do in order to implement Mr. Clements' decision should be well thought out prior to discussion with the three yards involved. On Thursday, 25 March 1976, a meeting was called by RADM Evans, MAT 02, to discuss with a small group how the Navy would proceed to carry out Mr. Clements' decision. VADM Eli Reich was in attendance. We were informed by RADM Hopkins that the yards involved had already been called and alerted to the P.L. 85–804 decision and they were requested to start preparing certain information for the Navy.

Whoever authorized these contracts at that time apparently doesn't comprehend orderly proceeding or in the vernacular, getting our ducks in a row before moving out. There should be one quarterback for this exercise but apparently there are more than one, with the result that the contractors involved must wonder if we know what we're doing.

c. Since the meeting called by RADM Evans for 2:05 p.m. Thursday, 25 March 1976, there have been protracted meetings in ADM Michaelis' office, VADM Gooding's office, and RADM Evans' office without the presence of a lawyer from OGC. This is a mistake. Whenever P.L. 85–804 is being used, especially to the extent it is here to be used, no meeting should be held without an assigned lawyer being in attendance.

d. It is planned to utilize the residual powers of the Secretary of the Navy under P.L. 85–804 or put this case through the Navy Contract Adjustment Board, or both? (I do not believe that DOD has a Board it can run this case through.)

e. I think it most unwise to have the implementing group in the Navy chaired by a flag officer or any other officer. The military should be available for such assistance as they can provide, but the quarterback should be a civilian of stature, not subject to the vicissitudes of Navy channels and who will sit on whose selection board.

f. If maximum objectivity and results are to be obtained, no officer or civilian who in the past has had any connection with those parts of the Naval Sea Systems Command that are responsible for the existing REA situation should be permitted to have any major part in implementing Mr. Clements' decision. When SECDEF McNamara and DEPSECDEF Nitze directed that a "should cost" team be assembled to study Pratt and Whitney engine costs in 1967, they gave strict instructions that no one from NAVAIR who had worked on the Pratt and Whitney engine account could partake in the "should cost" study. That instruction got noses out of joint, but it stuck and it was wise. By analogy, it is difficult to believe that the same people who have contributed to the track record of shipbuilding in recent years will now contribute to a solution of that track record, which in effect is saying the Navy has been wrong in the past.

g. It appears to me that one of my basic recommendations in the 4 March 1976 document, to the effect that we needed new faces and new ideas is not being adhered to. The same old faces are still there even though all but one of them have either applied for other jobs outside the Navy or are known to be leaving shortly. The effort Mr. Clements is undertaking will be with us for quite some time and it doesn't make much sense to have people now trying to develop an implementing plan, leave it to others to implement and then shove off. That is another reason why a top flight lawyer should be a part of every detail of the planning now underway.

h. What precisely is the basis for P.L. 85–804 in this shipbuilding emergency?

(i) Navy misjudging the economic impact of normal and abnormal inflation on our ship contracts.

(ii) Use of unrealistic delivery dates.

(iii) Wrong type of contract.

(iv) Unfair matrix in contracts, i.e., share, ceiling, target cost, etc.

(v) Unfair or wrong escalation clauses.

(vi) Contracting to meet budget.

(vii) Late GFE and GFI.

(viii) Price competition and forward pricing of both basic contract and options.

(ix) Number of changes involved in concurrent development and production.

(x) Dictating by SEA–08 of number of labor hours.

(xi) Other Government actions, i.e., EEO effect on production, labor negotiations (over 40% increase in latest EB negotiations), lifting of wage and price controls precipitously in about 1974, EPA, etc.

(xii) Failure of Navy to recognize shortage of shipbuilding labor force.

The use of any or all of these factors should be very clearly outlined and documented.

i. How will the use of P.L. 85–804 in this situation affect subcontractors?

j. To what extent should GAO be apprised of our intent to use P.L. 85–804 for this shipbuilding emergency. Obviously, if hearings are held they should be invited to attend and testify, but should we communicate our intentions to them? I recommend we do so.

k. How do we treat other shipbuilders who, while important parts of the industry, are not a part of the emergency situation that exists with respect to our nuclear building yards?

5. When Mr. Clements goes to the Congress he must be prepared to answer two obvious questions:

(i) "If we approve at this time your general plan to proceed under P.L. 85–804, Mr. Secretary, will the committee staffs have the opportunity of reviewing the implementation actions and results by the Navy?"

I suggest that question be answered in the affirmative. If the Navy Contract Adjustment Board is to review and approve the actions taken, their decision could be reviewed, but not changed, by the committee staffs.

(ii) The most important question Mr. Clements will be asked is: "Mr. Secretary, if we approve your plan to settle the $1.7 billion REA's that are pending, what assurance can you give us that the Navy won't be faced with the same situation two, three, four, or five years from now?" A very fair and necessary question, I submit.

The only way Mr. Clements can answer that question to the satisfaction of the Congress and the Committees involved is for the Navy to tell Mr. Clements what their answer to this question is. Is the Navy prepared to change their shipbuilding contracting practices? Will they make fair contracts in the future? Will they allocate combatant ships under an approved mobilization plan rather than price compete and fully forward price? Will they continue to contract to meet their budget estimates or will they ask for more money if they have guessed wrong? Will they continue to permit SEA–08 to dictate labor hours in nuclear ship contracts or will the contracting officer make his own judgment, subject to NAVMAT review?

6. It is respectfully suggested that Mr. Clements not go to the Congress with his P.L. 85–804 proposal until he gets Navy assurance of what will be done differently in the future and who will see that it is done, etc. Mr. Clements realizes the urgent need to get the Navy out of the hole it has dug itself and his decision to do so under P.L. 85–804 is clearly looking to the defense needs of the United States. What does the Navy plan to do—precisely, not

generalities—to assure him that his efforts are not just spinning his wheels?

7. The shipyards involved in this emergency effort by Mr. Clements to settle the existing REA problems must realize they have a very real obligation to fully cooperate in this effort and not expect to obtain benefits beyond what is reasonably determined to be Navy's responsibility. If they adopt and pursue this course of action, and in so doing fairly recognize their own responsibilities and contribution to the existence of the situation, genuine progress can and will be made. One way or the other, this problem must and will be settled, for the United States, the Navy and the shipbuilding industry. Any attempt, by either side to benefit unfairly can abort the objective of Mr. Clements. This must not be permitted to occur.

Very respectfully,

GORDON W. RULE,
Director, Procurement Control and Clearance Division.

ITEM 16.—*Mar. 30, 1976—Memorandum from Deputy Secretary of Defense Clements to the Assistant Secretary of Defense (Installations & Logistics) establishing an executive committee to guide and monitor all Navy Department actions necessary to implement the Public Law 85–804 decision*

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 Depatment 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.

W. P. CLEMENTS, Jr.

ITEM 17.—*Mar. 31, 1976—Memorandum from Secretary of the Navy J. William Middendorf to the Chief of Naval Operations on the Defense Department's plan of execution of the decision by Deputy Secretary of Defense Clements to reform the escalation provisions of certain Navy shipbuilding contracts under the authority of Public Law 85–804*

THE SECRETARY OF THE NAVY,
Washington, D.C., March 31, 1976.

Memorandum for the Chief of Naval Operations.

Subject: Navy Department execution of the decision of the Deputy Secretary of Defense of 24 March 1976 to reform the escalation provisions of certain Navy shipbuilding contracts under the authority of Public Law 85–804.

1. On 24 March 1976, the Deputy Secretary of Defense determined that certain existing contracts between the Department of the Navy and private shipbuilding firms will be reformed as appropriate to permit escalation recovery in these contracts to be in accordance with current Navy shipbuilding policy, notwithstanding the existing provisions of the contracts. This decision will be ratified by the Deputy Secretary of Defense at the earliest date by a Memorandum of Decision under the authority of Public Law 85–804. The Department of the Navy has been directed to take such actions as are necessary to carry out this decision.

2. By memorandum of 30 March 1976, the Deputy Secretary of Defense has designated the Assistant Secretary of Defense (Installations and Logistics) as Chairman of an Executive Committee to guide and monitor all such Navy Department actions. 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 have been designated as members of this committee.

The Executive Committee will consider and determine all matters of policy implicit in executing this decision, and conduct liaison as necessary with the Deputy Secretary of Defense to assure that actions by the Navy Department are consistent with and responsive to the decision of the Deputy Secretary of Defense.

3. In order to support the Committee, I hereby establish a Working Group to report to the Executive Committee and carry out all direction and tasks assigned by the Committee to implement the decision of the Deputy Secretary of Defense.

It is proposed that this Working Group consist of the following members:

RADM L. E. Hopkins, SC, USN, Chairman.
CAPT W. Ryan, SC, USN, Vice Chairman.
CDR J. B. Whittaker, SC, USN, Secretary.
Mr. Gordon W. Rule, Special Advisor.
VADM Eli T. Reich, USN (Ret.), DEPSECDEF, Observer.
CAPT T. Shaver, USN—Fiscal Matters.
Mr. H. Wilcox—Legal Matters.
CAPT R. Gilmore, SC, USN—Claims.
Mr. S. Kzirian—Litton Contracts.
Mr. M. Ward—Newport News Contracts.
CDR F. Fournier, SC, USN—EB Contracts.

4. I request you make these members available for such assignments as may be necessary to carry out the requirement of the Executive Committee.

J. William Middendorf II.

Item 18.—*Apr. 2, 1976—Letter from Deputy Secretary of Defense Clements to Senator Stennis, Chairman of the Senate Armed Services Committee. In this letter Mr. Clements criticizes the management of the Navy shipbuilding program and announces his intention to take action under Public Law 85–804*

The Deputy Secretary of Defense,
Washington, D.C., April 2, 1976.

Hon. John C. Stennis,
Chairman, 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 FY 75 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, programming

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 1977–1985.

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 P.L. 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,

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,

W. P. CLEMENTS, Jr.

ITEM 19.—*April 8, 1976—Washington Post article entitled "U.S. to Settle With Shipbuilders"*

(By George C. Wilson)

The Pentagon has made a major policy decision to pay shipbuilders $1.7 billion they claim the Navy owes them, it was learned yesterday.

The Pentagon wants to wipe the slate clean rather than continue disputes that have made a number of yards reluctant to bid on Navy ships.

William P. Clements Jr., deputy secretary of defense, has decided to settle the disputes at his level rather than wait any longer for the Navy and shipyards to reach agreement.

He has been contacting congressional leaders over the last several days to inform them of the Pentagon's intent to use Public Law 804, passed in the 85th Congress, to pay the shipbuilders' claims.

Members of Congress could object to paying off the yards. But several lawmakers, including Chairman John C. Stennis (D-Miss.) of the Senate Armed Services Committee, have asked Pentagon leaders to take some direct action on the claims.

Principal beneficiaries of the Clements plan would be the two yards that build nuclear-powered warships—Electric Boat Division of General Dynamics and Newport News Shipbuilding and Drydock Co., owned by Tenneco, Inc.

Those two yards, if Clements' plan is implemented, would get about $1 billion of the total $1.7 billion.

Another $500 million would go to the Litton Industries shipyard in Pascagoula, Miss. The remainder of the total would be scattered among smaller yards that claim the Navy owes them money.

Clements has become angry with some of the Navy executives dealing with the shipyards and has made breaking the impasse one of his top priorities. Both Pentagon and shipyard executives have been complaining for the last several months that Adm. H. G. Rickover has gone too far in trying to manage the privately owned yards.

Clements has served notice within the Pentagon that he intends to shake up the Navy's shipyard management so that the industry and the government can work more amicably together.

ITEM 20.—*Apr. 9, 1976—Senator Proxmire letter to Deputy Secretary of Defense Clements registering opposition to providing shipbuilders extracontractual relief under Public Law 85–804. The letter points out that the Justice Department is presently investigating for possible fraud at least two shipbuilding claims, one filed by Lockheed and the other by Litton*

APRIL 9, 1976.

Hon. WILLIAM CLEMENTS,
Deputy Secretary of Defense, Department of Defense,
Washington, D.C.

DEAR MR. SECRETARY: I have noticed press reports concerning your intent to exercise the authority under PL. 84–804 in order to settle the huge backlog of shipbuilding claims against the Navy, and I have also read your letter of April 2, 1976 to Senator John Stennis concerning the same matter.

I very much oppose any such proposals because it would be bad procurement policy, it would reward shipbuilders who have been demonstrably inefficient, it would be a signal to Navy procurement officials to rubber-stamp all such claims in the future, it would be a giveaway of taxpayers' money, and it would be a backdoor form of spending that would tend to exceed the President's budget request and have an inflationary impact on the economy.

As you know, a shipbuilding claim is essentially a request by a shipbuilder that the Navy pay to it more than was agreed upon in the original contract. Sometimes the shipbuilders' request may be justified because of actions taken by the government or circumstances beyond his control. But every claim must be rigorously examined to determine whether the shipbuilder is legally entitled to the extra money.

To simply decide to pay all pending claims in order to "wipe the slate clean" risks giving away public funds for the bad and unsupported claims along with those that are justified.

You are aware that the Justice Deparment is presently investigating at least two shipbuilding claims, one filed by Lockheed and the other by Litton, for possible fraud. The Navy itself has rejected a number of claims because they were not supported by the facts. An action to "settle" all pending claims, or many of them, in one fell swoop would inevitably require the payment of fraudulent, phoney, and baseless claims.

As the author of the provision of PL. 85–804 which requires notification to Congress of an intent to pay any contractor in excess of $25 million above his contract price, I can say that it was the intent of this legislation to discourage and deny backdoor bail outs of defense contractors.

I would appreciate being personally informed of when you intend to submit formal notification of your intent to invoke PL. 85–804 and I would also like to have a copy of the notification when it is transmitted to Congress.

In addition, I would appreciate having a complete up-to-date breakdown of all pending shipbuilding claims showing the amount of each claim, the name of the shipbuilder, a description of the contract on which the claim is based including the types of ships being built under the contract, and the contract price. For each pending claim also show the status of the ship construction for the contracts that are the subject of the claim, including the numbers of the ships completed and the number still under construction.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 21.—*Apr. 9, 1976—Wall Street Journal article entitled, "Pentagon Plans to Invoke Special Powers to Settle $1.5 Billion Shipbuilder Claims"*

WASHINGTON.—The Defense Department said it plans to invoke special legal powers to resolve a series of bitter disputes involving $1.5 billion of claims by two shipbuilders against the Navy.

The claims, which won't be settled at full value were filed to cover inflationary cost increases in contracts written prior to 1970. Newport News Shipbuilding & Drydock Co., a unit of Tenneco Inc., is claiming $892 million; the Ingalls Shipbuilding division of Litton Industries Inc., is claiming $644 million.

Separately, the Navy said it has agreed to pay the Electric Boat division of General Dynamics Corp. $97 million against a company claim of $199.6 million on a contract to build seven nuclear attack submarines. The settlement increases the cost of the contract to $534.9 million.

Newport News Shipbuilding said it was "encouraged" by the move; Litton declined comment.

David S. Lewis, chairman, president and chief executive officer of General Dynamics, said: "We have previously assumed that the negotiated contract price increases would insure that this major program will be completed by Electric Boat without incurring a loss. We see no reason to change that position at this time and we plan to continue our policy of accruing no earnings on this program for the foreseeable future."

Letter to Committee

In a letter to the Senate Armed Services Committee, Deputy Defense Secretary William Clements said the prolonged disputes over how much, if anything, the government should pay contractors to cover inflationary cost increases in long-term shipbuilding pacts have become so bitter that "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 1977–1985."

Thus operating under a law that allows the Secretary of Defense to modify contracts unilaterally in the interest of national security. Mr. Clements said the Pentagon plans to settle the claims and rewrite 11 major shipbuilding contracts to insure that the companies are fairly compensated for their work. Defense officials made it clear that in doing this they hope to forge a better relationship with shipbuilders at a time when the Navy is expanding its ship purchases and trying to instill more competition in its shipbuilding program.

However, the use of the extraordinary powers the Pentagon plans to invoke requires congressional approval, and this is likely to come only after a fight. The settlements could involve payments of hundreds of millions of dollars to the contractors, and would likely require the pentagon to seek a supplemental appropriation from Congress.

Yesterday, Sen. William Proxmire and Rep. Les Aspin, two Wisconsin Democrats who are frequent Pentagon critics, called the settlement plans "bailouts." Said Sen. Proxmire: "The Proposal is nothing less than a bailout, handout and sellout to shipbuilding firms that have been demonstrably inefficient."

Major Cost Overruns

In fact, the Navy's shipbuilding program, with its multi-billion dollar cost overruns and long production delays, has been a Pentagon problem for years. It has been the target of several long congressional reviews. In addition, the Justice Department is investigating charges that shipbuilding units of Lockheed Aircraft Corp. and Litton have filed fradulent cost claims with the Navy.

Because it takes years to build a ship, construction contracts contain cost-escalation clauses. But the 11 major contracts the Pentagon wants to change contain outmoded escalation clauses that didn't allow any recovery for inflation in cases where the contract was extended beyond its initial deadline.

The contracts cover 70 ships—three giant aircraft carriers, five new assault ships, six nuclear cruisers, 30 destroyers, 25 attack submarines and one oiler—and were all written before 1970. Since then the Navy has devised new escalation provisions that "provide significantly more protection to the contractor against unforeseen economic events," according to Mr. Clements.

In addition, many of the contracts were so-called "total package procurement" contracts, under which the Pentagon agreed to pay a maximum price for a full weapons system. The program turned out to be disastrous during the early 1970s, a period of high inflation, and hasn't been used on recent shipbuilding contracts.

Special Committee

Mr. Clements has set up a special committee to resolve the disputes and work with shipbuilders to develop an easier relationship for future transactions.

Frank Shrontz, assistant Secretary of Defense for installations and logistics, said that major shipbuilders had indicated a reluctance to bid on new work "in the absence of a claims-settling process" and that disputes were hindering current production as well. "We'd like to improve that climate and get back to a more businesslike relationship," he said. He added that the Pentagon plans to act quickly, but he didn't set a target.

In his letter to Congress, Mr. Clements criticized the Navy for poor management, and there were indications that he acted over the Navy's objections. Navy officers noted that they have already settled through normal procedures nearly $1.2 billion of claims for about $500 million.

The top Navy brass reportedly believed that the use of extraordinary powers would draw congressional fire, encourage other contractors to come forward with claims and perhaps lead to the payment of improper claims.

ITEM 22.—*Apr. 15, 1976—Senator Proxmire letter to Deputy Secretary of Defense Clements inviting him to testify before the Joint Economic Committee to explain his proposal to eliminate the backlog of shipbuilding claims under Public Law 85-804*

APRIL 15, 1976.

HON. WILLIAM CLEMENTS,
Deputy Secretary of Defense, Department of Defense
Washington, D.C.

DEAR MR. SECRETARY: This is to invite you to testify before the Subcommittee on Priorities and Economy in Government on the subject "Government —Contractor Relations." Your appearance is scheduled for Wednesday, May 12, 1976 at 10:00 a.m.

This hearing is the latest in a series on government procurement begun many years ago by this Subcommittee.

We are particularly interested in your proposal concerning the backlog of shipbuilding claims and in the role of the Department of Defense in the foreign military sales program.

As you know, this Subcommittee has received testimony in the past on both shipbuilding claims and foreign military assistance.

By the way, I am hopeful that the information requested in my letter of April 9, 1976 will be provided within the next few days so that it might be used in our preparation for the forthcoming hearings. In addition, on April 12 my staff requested from the Navy a copy of the memorandum of Admiral H. G. Rickover on the subject of shipbuilding claims which was described in an article in the *Washington Post* by Mr. George Wilson, April 11, 1976. I would appreciate being provided with a copy of this memo at your earlies convenience.

It would aid the Committee if we could have 100 copies of your statement by noon, Monday, May 10, 1976. Please send them to Mr. Michael Runde, Joint Economic Committee, Room G-133 Dirksen Senate Office Building, Washington, D.C. 20510. Mr. Richard Kaufman, 224-0377, can answer any questions concerning the hearing.

Sincerely,

WILLIAM PROXMIRE,
Subcommittee on Priorities and Economy in Government.

ITEM 23.—*Apr. 15, 1976—Letter from Adm. Gooding, Commander, Naval Sea Systems Command to the President and Chief Executive Officer of Newport News, J. P. Diesel, requesting the Company to submit the required affidavit for the CGN 36/37, CGN 38 Class, CVAN 68/69, SSN 686/687, and SSN 688 Class claims so NAVSEA can proceed with its analysis of the claims*

DEPARTMENT OF THE NAVY,
NAVAL SEA SYSTEMS COMMAND,
Washington, D.C., April 15, 1976.

MR. JOHN P. DIESEL,
President and Chief Executive Officer, Newport News Shipbuilding and Dry Dock Co., Newport News, Va.

DEAR SIR: On June 2, 1975, Newport News submitted a proposal for equitable adjustment under contracts for construction of SSN's 688, 689, 691, 693, and 695 requesting a combined ceiling price increase for these contracts of $142.5 million. You forwarded an affidavit for this submission on October 3, 1975 and stated that:

"I assure you that we have no intention of presenting to you a vacillating claim; we seek merely an equitable adjustment for the matters set forth in the proposal previously forwarded to you."

Based on the affidavit which you provided on October 3, 1975, NAVSEA commenced to evaluate your claim in order to meet my commitment of a provisional payment on the claim. As a result of its review, NAVSEA was prepared to make this provisional payment in early March.

On March 8, 1976, Newport News submitted a new claim for these ships. The letter which forwarded the new claim states that the claim includes all the elements of the June 2, 1975 claim plus several additional items that are

alleged to be Government responsible. In the new claim, Newport News requests a total ceiling price increase of $270.1 million. No affidavit was submitted with the new claim.

Before NAVSEA devotes scarce resources to analysis of the new SSN 688 Class claim, we must have assurances that this new claim and its supporting data are in fact current, complete, and accurate. Therefore, it is essential that you submit an affidavit, identical to the one you submitted on October 3, 1975, to cover your new claim. We can then proceed with our analysis.

In this regard, I would also like to point out that you have not yet submitted the required affidavit for the CGN 36/37, CGN 38 Class, CVAN 68/69, or SSN 686/687 claims. Accordingly, I request that you also provide an affidavit for each of these claims so that the Navy can proceed to process and resolve them.

R. C. GOODING,
Vice Admiral, USN,
Commander, Naval Sea Systems Command.

ITEM 24.—*Apr. 20, 1976—Memorandum from Navy General Counsel E. Grey Lewis to the Chief of Naval Material pointing out the need for the Navy to use Public Law 85–804 to reform contracts*

DEPARTMENT OF THE NAVY, OFFICE OF THE GENERAL COUNSEL,
Washington, D.C., April 20, 1976.

MEMORANDUM FOR THE CHIEF OF NAVAL MATERIAL

Subject: Equity in Claims Settlements.

1. I know you have been asked many times about the role of "equity" in the Navy's claims evaluations. In addition, there has been, in the context of recent activities regarding the shipbuilding claims matters, criticism of the Navy's policies in settling claims.

2. Though a recent GAO report generally gave the Navy good marks for its claim settlement procedures, contractors continue to criticise the Navy's handling of claims as unfair and as failing to take into account such factors as the essentiality of the shipbuilding industry as a national defense resource. Moreover, they suggest that the Navy should emulate courts of equity which, they argue, would dispense with the Navy's detailed *legal* requirements of entitlement and quantum proofs.

3. The short answer to the shipbuilders' suggestion is that (except under P.L. 85–804) the Navy simply has no authority to operate as a court of equity. It is bound to administer its contracts within the framework of the contract terms as written and as interpreted under prevailing law. In the case of a claim or request for an equitable adjustment (REA), for example, the subject matter must be found to be embraced by some specific contract provision, such as the "changes" clause, in order to be compensable. This is the essence of the search for "legal entitlement." If entitlement is found, under the "changes" clause, then by the terms of that clause the contractor is entitled to an "equitable adjustment" in price or delivery schedule. Determining what is "equitable" or fair is essentially the process of arriving at the "quantum" of the claim. Whether this entire process occurs at the negotiating table, at the ASBCA, or in a court of law, it is always fundamentally the same—ascertaining and enforcing the legal rights and obligations of the parties under the terms of their written contract.

4. In the evaluation of shipbuilding claims, the Navy seeks to do "equity" in the sense that it tries to be fair to the contractor. Navy counsel assists the other members of the multi-disciplinary claims team by helping them apply the principles of law to the facts ascertained in the exhaustive review of the contractor's claim presentation. Then, in negotiating with the contractor, the Navy presents its strongest adversary position in expectation that the contractor will counter with his strongest arguments. As usual when the parties act as adversaries, the hope and expectation is that the clash of competing arguments will result in a settlement fair to both sides. By taking into account gray areas and questions of litigative risk, Navy negotiations

are given the flexibility to reach such *fair* settlements; thus equity, in the sense of fairness, is achieved.

5. A court of equity, on the other hand, can go further and can change or refuse to enforce the terms of a contract. It can, for example, correct a mistake if it finds that the contract as written fails to express the intentions of the parties. Or if it finds that a contract has become unconscionably unfair or impossible for one party to perform, it could excuse performance altogether. Newport News is seeking this sort of relief in the DLGN–41 suit.

6. Only by exercising the extraordinary authority of P.L. 85–804 can the Navy "do equity" in this latter sense. In the Grumman case, Navy had priced options for three additional production quantities of aircraft, but even though it was satisfied that Grumman's performance of those options would bankrupt the company, the Navy was powerless to abandon those contract rights without using P.L. 85–804. The same is true in the claims arena. The Navy and the contractor have agreed upon procedures for handling changes, delays, and other "equitable adjustments" within the terms of their contract, including an ASBCA hearing for disputes which cannot be resolved. The Navy has a right to insist that the contractor comply with those procedures and cannot simply give up that or any other contract right. Under P.L. 85–804 on the other hand, it could make claim settlements on grounds other than demonstrated cause-and-effect entitlement if it could be found that such action would "facilitate the national defense." Only under that authority, however, could it "do equity" in the fashion the shipbuilders suggest.

7. Should you desire, I would be happy to discuss the above comments with you in more detail.

E. GREY LEWIS,
General Counsel.

ITEM 25.—*Apr. 22, 1976—Deputy Secretary of Defense Clements letter to Senator Proxmire accepting his invitation to testify before the Joint Economic Committee. Attached are, (a) Admiral Rickover's notes for discussion with Deputy Secretary of Defense Clements, dated 7 April 1976; April 17, 1976 letter from Mr. Lloyd Bergusion to Deputy Secretary of Defense Clements; April 13, 1976 letter from President of Sun Shipbuilding to Deputy Secretary of Defense Clements; April 12, 1976 letter from Boland Marine to Deputy Secretary of Defense Clements; March 4, 1976 views of Gordon W. Rule regarding "Navy Shipbuilding in the United States"; March 18, 1976 Congressional Record, page E–1382 containing comments by Congressman Downing (VA.) and including Newport News President Diesel March 15, 1976 letter to Congressman Downing.*

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C., April 22, 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: I write to acknowledge your letters of 9 and 15 April and to accept your invitation to appear and testify before your Subcommittee at 10 a.m. on Wednesday, May 12, 1976 on matters concerning the backlog of shipbuilding claims and the role of DoD in the Foreign Military Sales program. As you know, I recently responded to a letter from Senator Stennis, Chairman, Senate Armed Services Committee in which he expressed his Committee's serious concern about the management problems in the Navy's Shipbuilding program and emphasized "the ultimate responsibility for approval, management, and program execution lies with the Secretary of Defense." On Thursday, 29 April, I expect to testify before the Senate Armed Services Committee on the matter of the Navy's shipbuilding claims problem and the unsatisfactory business relations which exist between the Navy and the shipbuilding industry. The Secretary of Defense and I believe that this situation constitutes a serious problem for our national defense and we recognize our responsibility to initiate corrective action on a timely and prudent basis.

Following the recent press reports concerning the Navy's shipbuilding claims problems and my 2 April letter to Chairman Stennis, I have received several interesting and constructive memoranda and letters which I believe

you will find of value in preparation for the hearings of your Subcommittee. One of these is Admiral Rickover's notes for his discussion with me on 7 April which you requested. In addition, I have letters from Mr. Lloyd Bergeson, former executive of Ingalls Shipbuilding Corp. Pascagoula, Mississippi and General Dynamics Corp., Quincy, Massachusetts; from Mr. P. E. Atkinson, President, Sun Shipbuilding and Dry Dock Co., Chester, Pennsylvania; and from Mr. Joseph P. Ruppel, President, Boland Marine and Manufacturing Company, Inc., New Orleans, Louisiana. Mr. Gordon Rule, the Director, Procurement Control and Clearance Division, Navy Material Command, has recently written several very cogent memos which specifically address the many facets of the serious problems which beset the Navy's shipbuilding program. I, philosophically, agree with the thrust of Mr. Rule's ideas and recommendations. I believe we are beginning already to implement some of these, but much needs to be done.

As enclosures I have included copies of the memos and letters referred to above. I think there is a common theme in all of these which may be summarized as:

(a) There is a serious problem facing the Navy, the DoD, and the national defense.

(b) There is a need for immediate and forthright action.

(c) The Government's (and the people's) interest are paramount—there shouldn't be, and there cannot be, a "bail out" for inefficiency and mismanagement on the part of shipbuilders involved in major Government ship acquisition contracts.

(d) It is not in the Government's interest to persist in attempting to enforce such contracts of such importance to the national defense when their terms have proven to be unworkable or inequitable and more particularly where there is mutual fault.

Concerning DoD's role in the foreign military sales program, much review activity of the DoD program has been underway under my immediate supervision in the past year. I will be pleased to discuss this activity with your committee, but I would prefer to address this issue at a subsequent hearing.

Mr. Chairman, I think it most appropriate that your subcommittee will inquire into the background, the problem (and the remedies thereto), of DoD's shipbuilding program. While I am happy to formally appear before the Committee on 12 May, I would also like to meet informally with you prior to that time either in your office or perhaps, if you could find it convenient, at lunch with me here in my office at the Pentagon.

Sincerely,

W. P. CLEMENTS, Jr.

Enclosures.

ENCLOSURE 1

APRIL 7, 1976.

NOTES FOR DISCUSSION WITH SECRETARY CLEMENTS

Subject: Shipbuilding claims

1. I understand that you have decided to provide shipbuilders extra-contractual relief under Public Law 85–804 in an effort to improve relations with shipbuilders and dispose of the backlog of shipbuilding claims.

2. I have always advocated strict enforcement of defense contracts and settlement of claims on their legal merits. However, I have also testified to Congress that if senior defense officials decide that claims should be settled on other than their legal merits, they have the authority to provide extra-contractual relief under P.L. 85–804.

3. The application of P.L. 85–804 relief in this area will, of course, create new problems: e.g. how to handle other defense contractors and subcontractors when they request extra-contractual relief; how to get Congressional support for extra-contractual payments to large conglomerates who are reporting high profits; how to negotiate P.L. 85–804 settlements if one contractor demands a profit regardless of circumstances or financial need, and another is willing to absorb a loss; how to determine the form and amount of what is to be given to the contractors in order to get them to drop their claims. I presume the Shipbuilding Executive Committee which you have appointed to guide and monitor such settlements is considering these problems.

4. I believe that the contemplated, one-time granting of extra-contractual relief will not eliminate the basic problem. In fact, it may be more difficult to conduct future Defense business because contractors may believe the Navy will henceforth ensure their future profitability regardless of their contract performance. Specifically:

a. Shipbuilders may conclude that their present approach of accumulating large backlogs of unpriced changes and alleged constructive changes to serve as a basis for claims is highly effective. Even after they have been given extra-contractual relief on present contracts, when present or future contracts turn out to be less profitable than anticipated, new claims can be expected. One major factor in the Navy's relations with Newport News, for example, has been the company's refusal to pre-price changes or to conduct other day-to-day business in a normal manner. I am not optimistic that paying off all present claims will eliminate this problem in the future. The yards manpower availability problem is still acute. The financial incentive to divert manpower from Navy work to the expanding commercial work will increase if the Navy pays for the delays on Navy work while delays on commercial work are subject to delivery penalties.

b. Since the Navy is presently dependent upon a few private shipyards and the decision has been made not to enforce the present contracts, the Navy will continue to be vulnerable to shipbuilder assertions that they will not perform Navy shipbuilding contracts unless claims are settled to their satisfaction. For example, Newport News has refused to honor the DLGN 41 contract; announced that it was considering stopping work on the CVN 70 and not entering into new Navy shipbuilding contracts. Such actions underline the Navy's vulnerability to threats of work stoppage, regardless of the legal merits of the shipbuilder's contentions.

c. Navy personnel will still have to devote considerable time and manpower to negotiating and administering fixed price shipbuilding contracts, trying to pre-price changes, and contesting unwarranted claims—all the while knowing that if the contract overruns, the contractor has a good chance of again getting financial relief by appealing to higher authority.

5. Providing financial relief by reforming escalation clauses on shipbuilding contracts is only a temporary remedy. Although the current claims backlog may be eliminated, similar future problems will not be eliminated. It is not that the escalation clauses on Navy shipbuilding contracts were inequitable. They provided better protection during the period of high inflation than the vast majority of defense contracts which contained no escalation clauses. The only time the Navy's shipbuilding contracts did not protect shipbuilders against the effects of inflation was in cases where delays or increased costs were the responsibility of the contractor. The fundamental problem is that some shipbuilders upon whom we must depend apparently will honor contracts only to the extent they are satisfied with the financial outcome.

6. For the above reasons, where extra-contractual relief is provided to one or more of the major shipbuilders, I recommend the following:

a. The Government should acquire title to the shipyard as a condition of the P.L. 85–804 settlement. This would ensure adequate facilities for Navy shipbuilding requirements regardless of market demands for commercial ships, and eliminate contractor threats of diverting these resources to other work. In the case of Newport News, special arrangements could be made to complete existing non-defense work. Several shipbuilders have complained that profits are too low on Navy shipbuilding contracts in relation to their investment. They may be willing to liquidate this investment in settlement of their shipbuilding claims. In addition, more members of Congress might support the Public Law 85–804 approach if the Government ends up owning the shipyard.

b. Once title vests in the Government, operate these shipyards as government-owned, contractor-operated plants along the lines the Atomic Energy Commission and its successor, the Energy Research and Development Administration have used successfully for 30 years to operate its facilities and laboratories. Award long term operating contracts, with provisions for replacement of the operating contractor at the Government's discretion. The operating contract should be on a cost reimbursement basis with a sliding fee scale based on volume of work. By providing a guaranteed profit for little or no investment, such an arrangement should make shipbuilding work finan-

cially attractive to contractors. It would enable the contractor and government personnel to devote their entire efforts to the difficult task of building ships, instead of the situation at present where far too much of the time of contractor and Government personnel is engaged in contracting disputes.

7. In the past I have opposed the use of cost-plus contracts for shipbuilding because they tend to destroy contractor incentive to control costs. However, much of the contractor's incentive to control costs under fixed price contracts is negated when extra-contractual relief is granted. Moreover, it appears we are unable or unwilling to enforce fixed priced contracts with much of the shipbuilding industry. If the Government owns the shipyards; if they are devoted solely to Government work; and if the Government exercises close surveillance I believe that they could be operated at no greater cost to the Government; probably at a lower cost. As a minimum we would eliminate the overhead currently expended in contract disputes between shipbuilders and the Navy. The comparison will, of course, be made with Navy yards. But it must be recognized that these yards have functions which are not performed by private yards. Also, they are bound by Civil Service rules.

8. I continue to advocate strict enforcement of contract terms and settlement of claims on their legal merits. However, on the basis that a decision has been made to grant P.L. 85–804 relief, I recommend that the contemplated extra-contractual settlements with shipbuilders provide for future operation of the shipyards involved on a Government-owned, contractor-operated basis. Under the circumstances this approach offers the best possibility of a permanent solution to the shipbuilding claims problem and has the greatest likelihood of winning Congressional support.

H. G. RICKOVER.

ENCLOSURE 2

LLOYD BERGESON,
Norwell, Mass., April 17, 1976.

Hon. WILLIAM P. CLEMENTS, Jr.,
Deputy Secretary of Defense,
Washington, D.C.

DEAR SECRETARY CLEMENTS: I am writing to you on the subject of the "extraordinary action" announced April 8th with the objective of resolving $1.7 billion outstanding claims on Navy shipbuilding contracts. I do this as a concerned citizen and based on a 40 year involvement in naval shipbuilding—most of it in an executive capacity in private shipbuilding firms, both conglomerate and non-conglomerate. During this time I have directed the planning and or building and timely delivery of well over 100 naval ships of all types including the various nuclear attack submarine prototypes starting with USS NAUTILUS, the POLARIS missile prototype USS GEORGE WASHINGTON, and many follow ships. I have had intimate knowledge of the constructive change phenomena both from the point of view of the shipbuilder and most recently as a witness before the ASBCA for the Navy in their defense against what in my opinion is an improper claim, without merit (Project X), and for the Justice Department before a federal grand jury on a claim alleged to be fraudulent—which allegation has in my opinion considerable merit.

I am in agreement with the expressed need for extraordinary action and would offer to you the following thoughts and suggestion:

1. Correction of "escalation" inequities should not include those aspects of overruns in basic costs which are the responsibility of the shipyard(s) and stem from lack of management effectiveness on their part.

2. Whatever settlements are made should be done in such a way that they do not preclude:

The reforms in procurement regulations and procedures.

The incentives to shipbuilders to do the job right.

The reestablishment of moral and ethical standards for doing business.

These must prevail if the present accelerating trend toward a "paper" navy is to be reversed.

It is a simple fact that a virtual guarantee of 100% recovery never has and never will contribute to an efficient industry (shipbuilding or any other) which has the capability of producing quality products on time.

3. In the Litton picture the two East Bank claims with which I have become familiar attempt to recover full cost. I understand that they are not included in the proposed settlement—nor should they be. While I was not involved with the LHA contract and have no knowledge of the details of the LHA claim, I am familiar with the ship procurement climate, Litton corporate philosophy and actions which won the contract for Litton and laid the groundwork for the present claim. The only rationale of which I can conceive that would justify settling the LHA claim would be that of continuing Litton in business just to get the ships out. This I would not recommend. There are in my opinion viable alternatives which would insure delivery of the backlogged ships, enhance the potential for a moral rebirth in government/industry contracting relationships and help in the rebuilding of a strong shipbuilding industry of integrity.

4. Based on success in substantial recovery of costs on Navy claims it is becoming fashionable for shipyards to attempt to recover 100% of costs on commercial contracts for ships. The FMC Corporation claim for recovery of excess costs on tanker construction from the owner, Chevron Shipping Company, is one example. The Navy's actions in settling claims should in no way encourage further infection of the private sector. If this "infection" proliferates it will destroy the possibility of continuing commercial shipbuilding in the U.S. Owners will simply place their ship orders elsewhere—where contract obligations are honored.

5. Reforms in the Navy's procurement system are long overdue, are technically and practically possible and should in my opinion be a combination of:

Restored Naval technical capability and therefore perceptive cognizance over that which is contracted to private industry.

Optimum standards (wall within the state of the art) for management of shipbuilding programs based on identification of the items which control time and cost.

Revised procurement regulations and procedures.

6. The Naval procurement "establishment" cannot in the heat of battle be expected to reform itself. This is not practical or "in the cards" for many reasons. Yet settling of claims without overtly initiating fundamental reforms in both the Navy and industry will accomplish nothing but temporary relief to corporate financial statements.

7. The pending ONR sponsored program of research into the procurement process can provide a basis for objective analysis leading to sound reforms—independent of and without interfering with current operations.

8. The claims specifically referred to above smack of Watergate type mentalities and modis operandi. Thus concurrent with any settlement announcement, it would be prudent for the administration to be able to point to a serious and objective effort, including ONR's, leading to reform and more ship per $ expended. The defense budget is vulnerable as long as substandard performance by private contractors on large defense programs is possible, condoned or rewarded.

In conclusion, whatever actions DOD takes on shipbuilding claims should give no comfort to the amoral corporate mentalities who cannot see the merit of doing the job right from the outset (planning and hard work on management's part) which would net both profits and a sound foundation for a satisfactory, continuing business relationship with the Navy—as opposed to degrading, after the fact attempts to justify their own mismanagement and be fully reimbursed for it.

I verbally outlined the above views to V/Adm Eli Reich on Thursday, April 15th and stand ready to reiterate and expand thereon if such would be useful to you.

Sincerely yours,

LLOYD BERGESON.

SUMMARY OF PROFESSIONAL RECORD

(LLOYD BERGESON)

Current—Consultant, Marine & Industrial Management.

November 1973–1975, President, Boston Shipbuilding Corporation, Boston, Mass.

In cooperation with the City of Boston, founded and organized the Boston Shipbuilding Corporation with the intent of creating a major commercial

shipyard in the premises of the former Boston Naval Shipyard. This project had the financial backing of thirteen business and professional leaders and Boston's four leading banks. Feasibility of building ships, slow speed diesels and off-shore equipment was proved. Contingent ship orders and financing were obtained. While long range prospects remain good, the combination of adverse world economies, political events, the President's veto of cargo preference legislation and tax legislation unfavorable to oil company interests has caused a moratorium on the financial commitments necessary before the company can go forward.

1973.—Consulting.

Examined in depth for two U.S. utilities their own and their engineer/contractors' organization, engineering, planning, financial and construction control systems for the design and construction of a 600MW fossil plant and a 1000 MW nuclear plant. My recommendations for major changes in management philosophy, organization and procedure were put into effect with positive results in both cases.

Oct. 1969–Jan. 1973.—Vice President, General Dynamics Corporation and General Manager, Quincy Shipbuilding Division, Quincy, Mass.

Quincy was in October, 1969, a "stalled out" shipyard. $200 million in losses had been declared. The yard was written off by those knowledgeable in the industry. It was unable to make deliveries on a large backlog of underpriced naval and commercial ships. It was slated for closure or spin-off by GD's controlling stockholders.

Under my direction the division was completely turned around. A record for timely deliveries of highly complex naval and commercial ships was established. The unprofitable backlog was eliminated and effective controls established. Simultaneously I identified a proprietary product in an untapped market. I directed its development, engineering, design and costing. I proved its outstanding merit and marketed it with perfect timing. This product, 125,000 Cubic Meter Liquified Natural Gas Tankers, gives Quincy, according to GD Chairman, David Lewis, undisputed leadership in the field and the highest profit potential of all General Dynamics divisions.

Unique in U.S. shipbuilding annals, the LNG ships were completely engineered and designed in detail for serial production before they were priced and marketed. I then directed the complete revamping of the yard's production facilities and layout for highly automated manufacture of the ships. Despite the world-wide slump in shipbuilding, the yard currently enjoys a backlog of eight of these ships.

Jan. 1967–Aug. 1969.—Vice President, Litton Systems, Inc. and General Manager, Ingalls Shipbuilding Corporation, Pascagoula, Miss.

By delivering a substantial backlog of commercial ships, naval surface ships and nuclear attack submarines, while simultaneously upgrading facilities, engineering and production capabilities, reorganizing, restaffing and training I restored the reputation of this yard. Specifically:

The yard was returned to the Navy's qualified products list.

New nuclear submarine and commercial ship contracts were captured.

Litton was given shipbuilding credibility—importantly contributing to the capture of three total package procurements (FDL, LHA, DD963) and thus the creation of the largest backlog in shipbuilding history—for the new yard.

After Litton decided to locate the new shipyard at Pascagoula, across the river from the existing (East Bank) shipyard, I was additionally designated as Executive Vice President of Ingalls and slated to take over the new yard also. In early 1969 a Litton policy change gave the West Bank yard over exclusively to aircraft and space industry experts. (Mid-1972 in another complete policy reversal, the management of the West Bank was given over to the team of shipbuilders that I had assembled and trained and which, left intact, had managed the East Bank with great success since 1969.)

May 1962–Jan. 1967: Industrial Management Consultant—self employed.

Typical Assignments Completed (normal consulting): Management Audits. Corporate reorganizations and staffing. Installation and optimization of integrated corporate profit plans, budgets and controls covering R&D, engineering, materials, manufacturing and ship or new plant construction. Organization for major shifts in product and nature of the business and revamping of operations and controls to suit. Manufacturing plan for winning proposal on Navy first total package procurement of ships (FDL).

Typical Management Services provided: Chief executive officer—aerospace component manufacturer.

Direction of: Engineering and development of a classified submarine system. Eng'g and commercial development of a family of solid state devices. Major chemical research and development project thru proof of process, determination of engineering and economic feasibility and decision to commercialization. Corporate Director. Chairman & Chief Executive Officer of cryogenic equipment manufacturer.

Some Clients: Aerojet General Corporation, Electric Boat/General Dynamics, Arthur D. Little, Inc., American Messer Corporation, Hydro-Space Technology, Inc., Lithium Corporation of America, Salzdetfurth AG with LCA, American Shipbuilding, KPT Manufacturing Co., New York Shipbuilding Corp., Vacuum Barrier Corp., Litton Industries.

Prior Business Record Record: 1938–1962: 1951–1962— Planning Manager & Mgr of Manufacturing Services, Electric Boat/General Dynamics, Groton, Connecticut

Directed planning of engineering and construction of the first eight prototype nuclear submarines built in the world as well as follow on production. Also cost estimating, cost engineering, procurement, manufacturing engineering and manufacturing control. Chaired company funded submarine development program. Directed long range planning.

Coordinated all Electric Boat work resulting in the engineering development, design, construction and integration of several unique ship and weapon systems and inertial navigation into the first POLARIS submarine, USS GEORGE WASHINGTON. This immensely complex system was ready to fire missiles "in anger" 30 months from the definition of systems concepts.

During the above period Electric Boat grew by more than 20 fold and was GD's most profitable division.

1950–1951: Ass't to Gen'l Manager—Aircraft Gas Turbines Division, General Electric. Developed and installed a planning and control system to enhance meeting of performance, time and cost commitments by the several jet engine development projects. This was so successful that the President of GE ordered it adopted in every GE division. The disciplined planning of dependent sequences (critical paths) later became PERT after Admiral Raborn adopted this and other aspects of the system as the basis for the POLARIS management control system. Organized and staffed an "Operations Analysis" group to insure all operations in terms of goals and budgets; the concept of which was also adopted as standard throughout GE. Developed first integrated 5-year plan in GE's history.

1948–1950: Ass't to Manager of Hanford Directed Operations, U.S. Atomic Energy Commission. Helped to bring major post war expansion of nuclear production facilities under control. Developed a reorganization plan and definition of interfaces that enabled AEC to keep proper cognizance and control over subsequent engineering and construction projects including their costs.

1946–1948: Executive Ass't to VP-Manufacturing, American Machine & Foundry Co., New York. Supervised complete reorganization and retooling of AMF's five manufacturing plants.

1946: International Business Machines Corporation—on assignment by T. J. Watson, Sr. at Endicott, N.Y. Analysed IBM's new product development, engineering, tooling and manufacturing policies, procedures, methods. Recommended specific improvements to insure product availability to suit desired market schedules.

1940–1946: Assistant to President & Head of Production Department, Cramp Shipbuilding Company, Philadelphia, Pa. Laid out steel fabrication shop and assisted in overall yard layout. Then took over and reorganized a chaotic production situation in this large private shipyard so fast and thoroughly that instead of being taken over by the Navy the yard set records for light cruisers at competitive costs and with weapons systems in combat readiness on delivery. The yard was also able to earn contract bonuses based on cost and delivery.

1938–1940: Product Sponsor, Research Division, United Shoe Machinery Corp., Boston, Mass. Programmed, budgeted, monitored and evaluated all R&D for affiliated companies. Developed and introduced effective budgetary control over $1 million annual expenditures for research and product development.

1936/37 (Summers): Shipfitters Helper, Bath Iron Works Corporation, Bath, Maine.

General Data: Address: 241 River St., Norwell, Mass. 02061 Telephone 617–659–7520.

Personal: Born March 22, 1917 in Newton Centre, Mass. Married—4 children. Health—excellent. Weight—155 lbs. H't 5'10".

Education: Mass. Institute of Technology, SB in NA&ME—1938.

Thesis: Layout of a Shipyard for Serial Production of all Welded Ships.

Professional Memberships: Society of Naval Architects & Marine Engineers, American Bureau of Shipping.

Technical/Advisory Panels: Past Member SNAME Ship Production Panel, M.I.T. Sea Grant Advisory Council.

Lecturer: Current—M.I.T.—Shipyard Management. Past—A.M.A.—Program Management & Project Control.

References: On request.

ENCLOSURE 3

SUN SHIPBUILDING & DRY DOCK CO.,
Chester, Pa., April 18, 1976.

Mr. W. P. CLEMENTS,
The Deputy Secretary of Defense,
Washington, D.C.

DEAR MR. SECRETARY: Your decision to take action on the shipbuilding claims issue is most welcome news from the standpoint of the national defense of the United States. As an observer of this problem over the last few years, I have been most disappointed with the incredible performance of so-called "responsible" administration officials regarding this important phase of our national interest. The poisonous contracting atmosphere among the parties involved has contributed markedly to the decline of U.S. seapower. In this connection, you may be interested in my comments in this regard as outlined in the attached copy of my letter to you of November 29, 1973.

Our company is one of the larger, and I hope more capable, shipyards in the United States. We have not found the Navy contracting climate attractive in the past and accordingly have declined to participate in the Navy shipbuilding program. Your actions have caused us to reexamine our basic thinking and to this end we would welcome the opportunity to lay in front of you and your associates our capabilities and philosophy.

We have been most concerned with the sealift capability of the United States and believe that we can contribute substantially in this area.

Very truly yours,

P. E. ATKINSON, *President.*

SUN SHIPBUILDING & DRY DOCK CO.,
Chester, Pa., November 29, 1973.

Mr. W. P. CLEMENTS,
The Deputy Secretary of Defense,
Washington, D.C.

DEAR MR. SECRETARY: Your meeting and the discussion yesterday were most stimulating and provocative. I certainly appreciated the opportunity to participate. The range of topics discussed was extremely broad, and the implications are obviously vital to the interests of the United States.

I would like to take this opportunity to set forth my views on two points which I would hope you would find useful and constructive in your deliberations concerning the operations of the Department of Defense.

First, I am sure you will recall my rather outspoken comment concerning the management effectiveness of the Department. This comment stemmed from my association with a narrow part of the Department's responsibilities, namely the shipbuilding, ship repairing, and ship operating procedures of the Navy. It may well be that when viewing the enormous scope of the Department's responsibilities as a whole, that my negative view of this narrow area may not justify the generalization made. If this be the case, please accept my apologies.

Secondly, the overall seapower posture of our Country seems to have deteriorated substantially in the last several years. My views of the role of the shipbuilding industry in the seapower equation were set forth in Congres-

sional testimony a few years ago on this subject. My view then and my view today was—"The root of our present seapower problem lies in the failure of the Government to create an industry atmosphere conducive to innovation, outstanding performance, and technological superiority." So much for the problem. As you can readily see, I have not hazarded a solution.

Please accept my congratulations for the initiative you have brought to the Department as exemplified by the meeting we had yesterday. Thank you again for your courtesy. If there is any way in which we can assist your efforts, please do not hesitate to call on us.

Very truly yours,

P. E. ATKINSON, *President.*

ENCLOSURE 4

BOLAND MARINE & MANUFACTURING CO., INC.,
New Orleans, La., April 12, 1976.

Hon. WILLIAM P. CLEMENTS, Jr.,
Deputy Secretary of Defense,
Washington, D.C.

DEAR MR. CLEMENTS: It was with great interest that I read the article in the Washington Post on Thursday, April 8, 1976. Your personal attention to attempt to bring about amicable dealings between the Navy Department and private shipyards, in lieu of the present position of antagonism, is most commendable.

I am taking the liberty of sending you a copy of a Navy letter sent to us in connection with a claim we presented many months ago. This is representative of many letters that we have received that defy answering due to lack of specifics. I am also enclosing a copy of our answer to this letter which tends to illustrate the general problems and coercion and duress private shipyards are exposed to in an attempt to settle claims with the Navy. Our Company has performed many contracts for the Navy prior to the contract referenced in these two letters and have never been subjected to tactics in the instant case.

We eagerly await your success in carrying out your goal of restoring once again the ability of private shipyards to deal with the Navy Department in a business like manner, without emotion, in the attempt to strengthen the United States Fleet.

If I can personally assist you in any way to accomplish this mission, do not hesitate to contact me.

Very truly yours,

JOS. P. RUPPEL, *President.*

SUPERVISOR OF SHIPBUILDING, CONVERSION AND REPAIR, USN.
New Orleans, La., March 31, 1976.

From: Supervisor of Shipbuilding, Conversion and Repair, USN
New Orleans, La.
To: Boland Marine and Manufacturing Company, Inc.
Subject: Contract N00024-74-C-0241, Request for Equitable Adjustment Government Furnished Information.
Ref: (a) Boland letter PSO 8401-76 of 10 March 1976; (b) SUNSHIP letter Ser 00X-5481 of 16 December 1975.

1. A preliminary review of your responses in reference (a) has disclosed that in many important instances the specific questions we have asked remain unanswered.

2. In reference (a) you maintain that, by Modification A00210 to the contract, the Supervisor of Shipbuilding has "negotiated" and agreed to the 18 week extension as constituting Government responsible delay. However, this modification while providing for a time extension, specifically provides that it was not determining responsibility for the delay and costs of delay as manifested in the new delivery date of 16 May 1976. It remains Boland's obligation to provide the detailed, cause and effect presentation with documentation showing that Government responsible delays incurred by its subcontractors during their engineering effort resulted in delays in the production effort and in 18 weeks slippage in the delivery date. Your failure to provide this information to date adversely affects the Government's ability to conduct a complete and expeditious review and analysis of your claim.

3. It is requested that you expeditiously provide replies to those questions in reference (b) related to the delay issue identified above in order that this office may proceed with the evaluation of your claim in the manner most prudent and beneficial to both parties.

4. Your failure to provide specific and detailed answers transcends the delay issue discussed above. In many instances, rather than substantiating estimates by a showing of the rationale and methodology behind those estimates, Boland and the subcontractors have used words like "experience" and "expertise" as a substitute for a factual basis for cost estimates. The absence of the rationale and methodology for those costs makes analysis by the Government all the more difficult.

5. As we have already indicated, Section 1-401.55(f) of the Navy Procurement Directives sets forth the requirements which must be met before a provisional payment can be made. Such a payment can not be made until the Government has determined that the contractor is entitled to at least the amount of the provisional payment. Your attention is also directed to the provision of the same NPD subsection which requires the contractor to demonstrate the necessity for the provisional price increase or provisional payment in relation to overall corporate financial requirements. Because of the provisions cited above, the nature of your original claim submissions, and the amount of time that the continuing analysis will take, largely due to the deficiencies in your response to our questions, we are not in a position in which the provisional payment you request can be made.

DAVID FULDA.

BOLAND MARINE & MANUFACTURING COMPANY, INC.,
New Orleans, La., April 6, 1976.

File PSO 8774-76
SUPERVISOR OF SHIPBUILDING
Conversion and Repair, USN, Eighth Naval District, New Orleans, La.
Subject: U.S.S. King—DLG-10—Contract N00024-74-C-0241. Claim—Government Furnished Information.
Reference: (a) SOS letter to Boland Ser 400-1369 of March 31, 1976.

GENTLEMEN: Paragraph one (1) of Reference (a) advised that your Command had made a preliminary review of our responses to your questions relative to the subject matter and that many questions remain unanswered. We answered every question posed by you. If the answers are, in your opinion, nonresponsive, please make a final review, address each question and answer specifically, and advise what you require. The approximate twenty-four inches of data submitted to your Command to date should enable you to make either an affirmative or a negative determination to entitlement or at least enable you to conduct some type of meeting or negotiation to discuss the areas of differences specifically. You constantly refer to the broad term "cause and effect" and allege that we have failed to provide the requisite documentation to support this requirement. We do not agree with your contention. The data submitted to you clearly indicates the Government's failure to provide requisite contractually required data which caused an added contract scope and adversely effected and impacted the cost of contract performance.

Our position is that we responded to all questions posed by your letter of 16 December 1975. I guess you contend we didn't. When there is a difference of opinion between the Navy and our Company, generally a meeting has been convened to discuss such matters toward the goal of mutual understanding. We cannot respond to Paragraph three (3) of Reference (a) without specifics. We are at a loss to understand how negotiations can be conducted other than by utilizing experience and expertise. In many negotiations with the Navy over the years this is the way you have negotiated with us. The claim submission coupled with our subcontract negotiation memorandums attached thereto clearly show what you refer to as "rationale and methodology" for all cost proposals. The factual basis for the cost estimates are included in the claim data to our satisfaction. If they are not to your satisfaction be specific, ask us in detail and let's see if we can explain our claim to you.

Paragraph five (5) is vague as to what requirements you consider we have not met under your regulations and we are at a loss as how to respond. You advise broadly that we must demonstrate the necessity for a provisional pay-

ment under your regulations indicating corporate need. Where is the equity to a requirement by the Navy that compels a Contractor to finance the Navy's mistakes and inadequacies?

I suggest that a meeting, at the highest level, be convened to discuss your unilateral vague positions in an attempt to at least come to some meeting of the minds.

Very truly yours,

JOS. P. RUPPEL, *President.*

ENCLOSURE 5

MARCH 4, 1976.

NAVY SHIPBUILDING IN THE UNITED STATES

VIEWS OF GORDON W. RULE

Major premise

Where will the Navy find the shipbuilding capacity to produce our country's known requirements for ships?

Minor premise

If such capacity can be found, under what terms and conditions will it be available to the Navy?

MAJOR PREMISE

It seems reasonable to ask SECNAV and CNO who continue to say our Navy needs X number of new ships for the fleet by Y year, if they have a plan or blueprint of where they expect to get those X ships built.

I suggest two things greatly affect any answer to this major premise:

(i) We have no mobilization base in the United States for Navy shipbuilding.

(ii) The Navy plays games and places ships in predetermined yards under the guise of competition. (Examples are Trident submarines to EB and FFG's to Bath and Todd. Newport News is smart enough to know where Admiral Rickover wants the Tridents built and that they are only being asked to bid for window-dressing. Similarly, all signs clearly point to NAVSEA wanting both Todd yards building FFG's and again the rest of the industry are smart enough to know this.)

When I was in the Bureau of Ships—now NAVSEA—the Navy had a well recognized policy of keeping five building yards in business for Navy new construction work, Beth-Quincy, Electric Boat, New York Ship, Newport News and I forget the fifth yard.

The Maritime Commission had a comparable list of yards for their ships. We kept them in business by allocating ships to them.

When I returned to the Navy in 1963 in my present job, the then ASN (I&L) told me no such policy existed any longer and any yard could go out of existence. We are now paying the price for that shortsightedness. ASD (I&L) had a group working on mobilization planning and many times I asked our representative on that group why they wouldn't develop a mob plan for shipbuilding. A satisfactory answer was never forthcoming.

Were I Secretary of the Navy I would determine if any realistic plan was in existence for building the ships in the FYDP. If no such plan existed, and I mean good, sound long range planning, acceptable to the industry and understood by all, disciplinary action would surely be undertaken.

This apparent lack of planning was so obvious to me that I wrote a letter dated 8 March 1974 to the Chairman of the Senate Armed Services Committee, Senator Stennis, which letter stated in part:

"The foregoing is set out in order to better understand the situation facing the Navy—and a newly minted CNO. In capsule, the Navy is in an almost unbelievable situation. Unless a CNO is selected and confirmed by your Committee who fully understands the seriousness of this situation and has plans to cope with and remedy it in the very near future, the U.S. Navy will be in very deep trouble indeed.

"The serious situation I speak of is that the shipbuilding industry in the United States *does not want to build ships for the Navy.* That is not just my personal view, it is the attitude of shipbuilders in this country and Secretary Warner knows it. There is no evidence that the CNO understands this situation or has any plans for corrective action.

"It is very interesting for the present CNO to outline to your Committee the Navy's future ship requirements and how strong our Navy must be, *but he should be asked where these ships will be built, etc.* He should be questioned about the lack of competition and indeed no bids at all for specific ships presently required by the Navy and funded by the Congress.

"This is the situation facing the new SECNAV and CNO. Your Committee may wish to discuss with these new appointees their comprehension of this problem and what they intend to do about it."

ASN(I&L) Bowers stated in a recent meeting that he had been working with the Maritime Commission for a year looking toward a mutual agreeable mobilization plan for building ships. It's about time. Additionally, Admiral Kidd wanted to reopen Mare Island and Philadelphia Naval Shipyard well over two years ago in order to obtain additional needed capacity for new construction, but nothing happened.

MINOR PREMISE

If such capacity can be found, under what terms and conditions will it be available to the Navy?

Two things here are irrefutable. First, the Navy must get the required ships built without recourse to the Defense Production Act and second, the shipbuilding industry must be assured of fair contracts and treatment by the Navy, and a reasonable opportunity to earn a good profit for building the most complicated piece of hardware the Navy buys. The Navy should realize that one way or another, these shipyards will get paid what they are entitled to via changes, equitable adjustments under their contracts, claims or P.L. 85-804. There are enough good claims lawyers—many of whom worked for the Navy and know our weaknesses—to assure that.

Additionally, the following points must be considered in connection with this premise:

(i) The building of a Navy combatant ship always involves concurrent development and production. *There is no engineering development phase in shipbuilding* as there is in every other piece of hardware the Navy procures.

(ii) When the Navy is designing a ship and having it built concurrently, the result is massive changes—both authorized and constructive—requiring fair and prompt adjudication or they can develop into claims. It should be recognized that concurrency, rather than development, pilot production and then production will add at least twenty-five percent more to the cost of a procurement.

(iii) When the Navy utilizes the lead/follow yard method of ship procurement, claims and delays are inherent—they *always* have been.

(iv) Shipbuilding labor is 30-35% nonproductive or inefficient.

(v) The Navy makes unfair contracts for building the ships it requires and the industry knows and resents this. (Type of contract, delivery dates, pricing to meet an erroneous budget estimate, are prime examples of this.)

(vi) These unfair contracts have, of necessity, led to claims against the Navy, and although some of these claims are of dubious validity, those that are valid are not settled as promptly as they should be.

(vii) A review of shipbuilding claims—or requests for equitable adjustment—as they are sometimes termed for statistical purposes, will show that the Navy hasn't learned many lessons in recent years and that our track record of ship contracting has been disgraceful.

(viii) The Navy recently went to Court to sue our best surface ship builder, Newport News. When the Navy does this, and then is told by the Judge to negotiate your differences and report back to the Court—which is what the Navy should have been able to do without going to Court—it is obvious something is very wrong.

So much for the description of what this minor premise involves. Now, what needs to be done.

It is suggested that before the Navy can hope to have a successful shipbuilding program, there must be a reestablishment of mutual respect and trust with the shipbuilding industry in the United States. This can only be accomplished by deeds, not words. Instead of litigating and awarding claim inducing contracts providing fees for law firms, the following course of action is proposed:

(i) Recognize that our track record of ship procurement is very poor indeed and that at least 50% of the blame for that record is properly chargeable to the Navy. (The most important thing wrong with the Navy today—not the fleet but the producer side of the Navy—is that we will never admit we made a mistake.) Thus, it is essential that we recognize our deficiencies before we can hope to take corrective action.

(ii) The Navy today needs new faces to properly and intelligently provide the required climate for dealing with the shipbuilding industry and indeed for properly evaluating our own mistakes. Today people are polarized and captives of the ways and prejudices that have produced the conflicts, claims, etc. Someone must be found who will take hold of this problem and provide the new philosophy of complete fairness in all our dealings with the shipbuilding industry, both in the making and administration of our contracts. This result is achievable—by that right, tough-minded person or persons—without any loss of firmness and protection of the Government's best interests. What the goal here must be is simply fairness and respect for each other's position as distinguished from the current dug-in positions that produce adversary relationships without flexibility or reasonable fall back positions. That is what negotiation—to reach mutual agreement—is all about. It is fashionable for some persons in authority in the Navy to moan about how shipyards that formerly were privately owned and operated are now owned and operated by large conglomerates that are only interested in making a profit. This mentality probably still looks for a corner grocer instead of going to a chain store.

(iii) The most important short term objective must be the settlement of the Litton and Newport News problems. I submit the Litton yard is a national asset for future Navy new ship construction and we should recognize this as a fact. The Navy and DOD actively encouraged Litton to build this yard in Mississippi and the first Navy contract through that new yard—the LHA's—should have been a cost type contract, at least for the first ship. This Litton LHA matter should be settled under P. L. 85–804 as was Lockheed (C5A) and Grumman (F14) by reformation of the contract to cost type on the supportable theory of essentiality to the national defense. In my opinion, Litton is more deserving of 85–804 reformation treatment than Grumman ever was. Litton did not buy-in on the LHA contract and Grumman did. We need that modern yard for Navy work and we should be planning right now to put work in there. Newport News must be negotiated to settlement and I believe that can be accomplished if handled cooperatively by negotiation and not litigation. It is fully realized that any settlement over $25 million must be approved by the Congress. Thus, I would go to the Chairmen of the Armed Services and Appropriations Committees and fully apprise them of the planned settlement procedures and get their blessing in advance. I feel confident they would approve.

(iv) The most important short and long range objective must be the making of right type of ship construction contracts. A review of our track record in using firm fixed price contracts and later fixed price incentive contracts (incentive on cost only) for building Navy ships says loud and clear that it's about time we woke up to the fact that changes and improvements must be made. More specifically, it is recommended that the following suggestions be considered and if necessary, discussed with the shipbuilding industry via the Shipbuilders Council of America:

a. New construction Navy ships should be allocated to building yards under an approved shipbuilding mobilization plan. This would eliminate the specious competitive exercises we go through and would recognize the almost impossible task of competitively pricing the unknowns involved in the concurrency of development and construction of a ship or ships. The Navy allocates submarine overhauls by planning years ahead where each ship can be assigned. It is suggested that this same procedure would be prudent for the upcoming DE 1052 class overhauls rather than compete these overhauls.

b. With both the Seapower Subcommittee and the GAO taking positions against cost type contracts for shipbuilding, it appears the Navy will continue to utilize fixed price incentive contracts (cost only incentive) for Navy shipbuilding. This FPI type of contract can be made *a satisfactory contractual instrument.* It is not today because of the tortured manner in which we structure them. The basic test of a soundly structured FPI contract—and

indeed a CPIF contract—is the credibility of the target cost. The target cost should really be called "most probable cost" and should be that figure which the contractor has a 50/50 chance of overrunning or underrunning. This is fundamental in incentive contracting. It is this precise point—target cost—where the Navy starts the process of making unfair contracts. When the Navy negotiates a 95/5 share above target cost for the first 26 million of overrun of target, the target cost figure is patently phoney. Moreover, when the Navy negotiates a 95/5 share and then also a 152% ceiling, the target cost figure is patently ridiculous. First priority for the future must be the negotiation of more reasonable target costs for our FPI shipbuilding contracts and if the budget has to be changed, then change it.

c. When our ships are allocated rather than price competed, I would start the contractor to work by means of a cost-no-fee contract to be definitized to an FPI contract by an agreed upon date. The difference between a cost-no-fee interim contract and a letter contract is that the contractor will be paid 100% of his costs vice 80–85%, which is of great benefit from a cash flow point of view and also from an interest standpoint. The cost-no-fee interim contract would contain the unilateral definitization clause used in letter contracts and would provide that if it is not definitized by the agreed upon date the 100% of cost payments would revert to 80–85%. The reason for this is obvious.

d. The contractor would submit his proposal to definitize to an FPI contract and not competing for the contract price-wise, the likelihood is a more honest proposal. This will then be compared to our official Navy estimate for that particular building yard and a far more realistic target cost negotiated. At this point of definitization we would also have much more reliable subcontract costs available than trying to fully forward price. Consideration should also be given to a redetermination of price at say 60% completion as the Navy used to do.

e. With the negotiation of a realistic target cost, instead of dictated labor hours and costs—as we have done to meet a budget figure—the target profit, share and ceiling matrix would fall into place without having to be tortured to make up for an unrealistic target cost. With respect to profit, it is essential that a new and broadened philosophy be utilized, one which recognizes the shipbuilders' entitlement to a good/reasonable profit for building the most complicated hardware the Navy procures. If it should eventuate that a shipbuilder realized excessive profits then we should rely on the Renegotiation Board to take appropriate action.

I firmly believe this suggested outline would work, given the will to make it work on the part of the Navy and would provide the necessary inducement to industry to actively and willingly participate in our shipbuilding programs. Today, I believe these shipbuilders have reason to suspect that we are being unfair to them when we make our contracts. This feeling must be negated and I respectfully submit my approach would do it and would also comply with Secretary Clements' desires and objectives.

22 March 1976.

Navy Shipbuilding in the United States

Additional views of Gordon W. Rule

The views set out herein supplement those dated 4 March 1976, same subject. These supplemental views result from a review of the minutes of a 9 March 1976 meeting of private shipyard executive with Mr. Clements, Deputy Secretary of Defense.

What emerges from my review of these minutes is the substantive difference in the attitudes and complaints of the nuclear building yards—both surface and submarine—vs. the attitude and complaints of the non-nuclear building yards—both combatant and non-combatant. The basic difference is the difference between "cause for concern" and "cause for alarm".

Many of the industry complaints, some reiterative, are common to the non-nuclear and nuclear building yards, i.e., Quality Assurance, 7000.2 Requirements, CAS—Prime and Sub Level, WBS, Vendors' Costs, Pricing of Changes, Proposal Cost.

These complaints, while *cause for concern* to the Navy, are manageable in my opinion.

Contra, I believe that the following comments by the President of Newport News and the General Manager of Electric Boat Division, are *cause for alarm* by the Navy, DOD and the Congress:

Mr. Diesel, President of Newport News, stated that he believes the Navy's primary problem is whether there is going to be a private sector to do Navy shipbuilding.

Mr. Pierce, General Manager, Electric Boat, stated the company is not going to let the Navy run its business. He said "the Navy wants to run our business." He stated that nuclear submarines for the Navy are their only business. He said situation worse in last two years.

Because of the positions Newport News and Electric Boat occupy in building nuclear surface ships and submarines for the Navy, it is strongly urged that the proper officials take their comments seriously. There are those presently connected with Navy nuclear shipbuilding contractual matters who advise that these companies are bluffing in their stated warnings to the Navy concerning their part in future shipbuilding. Please do not succumb to that advice.

With the Congressional emphasis on nuclear combatant naval ships for the fleet of the future, I consider the Navy's number one priority to be the resolution of the causes of this situation and the reasons for the $1,097.2 billion in Requests for Equitable Adjustments (REA) for nuclear submarines and surface ships that have been submitted since 1 January 1975 and the millions more to come from these two nuclear building yards.

I have concluded from my review of the minutes of the 9 March 1976 meeting and the historical information available regarding claims that the Navy wants many things from the builders of our complicated combatant ships that we seem reluctant to pay for. Examples of these are set out above under industry complaints. This entire area goes to the climate that must be changed by deeds, not words.

In the 4 March 1976 paper I recommended:

(i) Allocation under an approved mobilization plan, not price competition for combatant warships.

(ii) Do not forward price but commence work under a cost-no-fee contract to be definitized to a fixed price incentive contract at some agreed upon future time. Under the cost-no-fee contract the contractor would bill for 100% of cost incurred.

More specifically, if this method of ship contracting were adopted the following problem areas would be accommodated, and properly so:

(i) The costs of preparing the proposal to definitize the cost-no-fee interim contract would be a reimbursed cost.

(ii) During the life of the interim cost-no-fee contract the shipbuilder could determine and negotiate the costs of compliance with 7000.2, CAS, Q. A. and the WBS and charge them to the contract.

(iii) There would be no interest costs during the interim cost-no-fee contract and more realistic progress payment provisions after definitization could negate interest as a problem.

(iv) The problem of vendors' certification of costs prior to issuance of a fully forward priced prime contract would be avoided by the definitization of the prime contract at a later date when vendors would be able to provide the required certificate.

If the Navy chooses to continue the practice of price competition for combatant ships, these areas could not be accommodated because of the impossibility to realistically foresee and price the unknowns of concurrent development and building of a combatant Navy ship.

Contra, if the Navy changes from price competition and full forward pricing of ships to allocation via a two-step contract procedure, I feel many of the problem areas of pricing would be moved "up front" and not left to later controversy, hard feelings and claims. I also feel strongly that the pricing of the shipbuilding contract will be far more realistic and credible.

Change orders and claims negotiations require attention. Both claims and changes settlements involve people and people are hard to come by these days, especially good people, and particularly in the SUPSHIP offices.

I am convinced, from experience and observations, that the Navy has allowed itself in recent years to be backed into a position whereby we have lost much of the required flexibility to exercise judgment and make more timely decisions in these two areas.

In 1969, I approved a claim settlement to Todd Shipbuilding Corporation for $96 million on DE 1062 Class ships. I had a legal memorandum of entitle-

ment, an audit report, a technical report and a good claims team recommendation. I exercised judgment and approved it.

That action worried some of our lawyers so much that they had the ground rules changed to require the lawyers to agree on the quantum of the settlement as well as legal entitlement. That move effectively restricted judgment by the contracting officer and greatly expanded the time required for settlement of claims. I certainly appreciate the role of the lawyers in claim matters, but I do feel we swing the pendulum to the extreme and that it should be swung back closer to center. I am not advocating getting the lawyers out of claims, I am advocating that they perform their proper function in the settlement of claims. Judgment and flexibility for the contracting officer must be restored if more prompt settlements are to eventuate. Today many young lawyers tend to fancy themselves as contracting officers when theirs should be an advisory function.

Changes should be fully priced at time of issuance or max priced to be definitized downward only at a later date. We keep saying this but not practicing it.

I have one overall suggestion to make with respect to the adjudication of changes and claims. This suggestion would probably require action by the Congress.

In preparation for the conclusion of World War II, the Congress enacted a very farsighted piece of legislation entitled the "Contract Settlement Act of 1944". The basic objective of this Act was to enable industry to make the transition from defense production back to peacetime production as expeditiously as possible. History of the time shows that it worked very well indeed in achieving its objectives.

One of the provisions of that Act was directed to the settlement of termination claims occasioned by the cessation of first, VE Day and subsequently VJ Day, when thousands of defense contracts were terminated overnight for the convenience of the Government. The Congress anticipated that the settlement of those termination claims would be difficult and time consuming to the possible detriment of the private contractors involved and the early restoration of the peacetime economy.

Section 106(f) of the Contract Settlement Act of 1944 (U.S.C.A. Title 41) provides as follows:

"(f) Each contracting agency shall allow and pay interest on the amount due and unpaid from time to time on any termination claim under a prime contract at the rate of 2½ per centum per annum for the period beginning thirty days after the date fixed for termination and ending with the date of final payment, except that (1) if the prime contractor unreasonably delays the settlement of his claim, interest shall not accrue for the period of such delay, etc. * * * In approving, ratifying, authorizing, or making termination settlements with subcontractors, each contracting agency shall allow interest on the termination claim of the subcontractor on the same basis and subject to the same conditions as are applicable to a prime contractor."

While this Congressional policy of paying interest on termination claims is not entirely analogous to claims and change orders under Navy shipbuilding contracts, I suggest it may be an appropriate method of encouraging settlements of those claims and changes that have exceeded a reasonable period of time. The possibility should be explored.

As stated at the outset, the contents of this paper supplement the 4 March 1976 views by me.

14 April 1976.

How Should the Navy Acquire Ships in the Future?

VIEWS OF GORDON W. RULE

The Navy today is in the position of enjoying a strong pro-Navy climate—both in the Congress and the Department of Defense—for an expanded program of new construction ships, mainly nuclear. Ironically, this strong pro-Navy shipbuilding climate comes at a time when the Navy's relations with the hard core private shipbuilding capability of the United States has deteriorated to such an extent that the Office of the Secretary of Defense has found it necessary to assume direction of the Navy's shipbuilding problems.

Add to this recognized unsatisfactory relationship the existence of over a billion dollars in unsettled claims/REA's—mostly nuclear—and the dimensions of the Navy's overall problem is clearly in focus.

Realizing that the existing unsatisfactory relations between the Navy and the private shipbuilders—particularly nuclear building yards—cannot be permitted to continue, a decision has been made in the Office of the Secretary of Defense to utilize the extralegal powers conferred by P. L. 85–805 in an attempt to reduce this backlog of claims/REA's. This decision is obviously constrained by (i) the extent such powers are deemed necessary and (ii) the extent reasonable agreements can be negotiated with the shipyards.

The ship construction capability for nuclear warships—submarine and surface—is concentrated in two building yards, Electric Boat and Newport News. These two yards presently have claims pending against the Navy in the approximate magnitude of one billion dollars and both of these yards are disenchanted with their contractual treatment by the Navy.

The existence of this situation is considered to be a serious threat to the national defense and therefore the decision to use P. L. 85–804, where necessary, is viewed as not only desirable but necessary.

Assuming that this claim situation can be settled amicably and to the satisfaction of the Congress, the Navy and the shipyards, the overall problem will be only partially resolved. In short, the Navy must recognize mistakes of the past which have led to the claims—both nuclear and non-nuclear—and take positive steps to preclude these mistakes in contracting for ships in the future.

I consider both Electric Boat and Newport News to be honorable shipbuilders and I suggest they are probably as concerned with the Navy's contracting practices in the future, as they are in their claims settlements of today.

To preclude another mountain of shipbuilding claims and to dispel the adversary relationship that exists today, the Navy must do two things which will be quite unpalatable, (i) admit the past mistakes in ship construction contracting and (ii) embrace entirely new concepts for future ship construction contracting. These two points encompass both nuclear and non-nuclear ship contracts.

It is my opinion that the unsatisfactory track record of Navy ship contracting can be traced to the use of one or more of the following causes:

(i) Price competition for warships.

(ii) Forward pricing of fixed price type contracts.

(iii) Use of unrealistic delivery dates.

(iv) Misjudging the economic impact of normal and abnormal inflation on our ship contracts.

(v) Wrong type of contract.

(vi) Unfair matrix in contracts, i.e., target cost, share, ceiling, etc.

(vii) Unfair or inappropriate escalation clauses.

(viii) Contracting to meet budget estimates.

(ix) Late GFE and GFI.

(x) Failure of Navy to properly recognize a nationwide shortage of shipbuilding labor force.

The negotiation of Navy shipbuilding contracts in the future must be bottomed on two elements absolutely essential to fair contracts, namely, good faith and a genuine desire by both parties to negotiate a mutually agreeable contract. In the future there can be no place for any individual connected with the making and administering of a ship contract who does not fully subscribe to these tenets—regardless of who or where that individual may be.

Future contracts for Navy new construction ships should be structured within the following cornerstones:

(i) Recognition of the fact that the building of a Naval warship always involves concurrent development and production, with all the unknowns inherent in such concurrency. The past practice of forward pricing fixed price type contracts to build ships requiring a building period of many years has been shown to be unrealistic, imprudent and claim producing. Reasonable risk assessments at the outset of such a contract I consider most impractical, if not impossible.

(ii) In the future, we should allocate combatant warships, auxiliaries and overhauls to building yards under an approved shipbuilding plan in this country. Price competition for warships has proven to be a failure. This would obviate the spending of large sums of money preparing so-called competitive price proposals.

(iii) The lead ship of a class should be built under a cost type contract.

(iv) The Navy should not contract for whole programs of ships but should build one or two before committing the program.

(v) When Navy ships are allocated to planned building yards, the work will be commenced by means of an interim cost type contract, preferably cost-no-fee. By an agreed upon date, the contractor will submit a proposal to build the ship or ships and for other than the lead ship, a definitive fixed price incentive type contract with provision for escalation, will be negotiated which will absorb the interim cost type contract. The cost of preparing the proposal will be paid by the Navy and because it will be a non-competitive proposal it will be more realistic. Moreover, by the time the interim cost type contract is definitized to a fixed price incentive contract, most or all subcontracts will be firmed.

(vi) If the budget estimate is insufficient to meet a realistic cost, then the Congress should be requested to provide additional funds at the outset, rather than the present practice of getting started with a known phoney cost figure and down the road acting surprised and blaming it on the shipbuilder.

(vii) The target cost of the fixed price incentive definitive contract must be a figure the contractor has a 50/50 chance of overrunning or underrunning. This is not the case today where the shipbuilders have no possibility of underrunning target cost.

(viii) During the lift of the interim cost type contract, the shipbuilder will determine and negotiate the costs of whatever the Navy wants, i.e., 7000.2 reporting, Cost Accounting Standards, Quality Assurance, Work Breakdown Structure, etc. and such costs will be included in the contract.

(ix) Do away with unilateral changes. Knock heads with the shipyard representatives and work nights, but come up with an agreed-on cost/delivery change before proceeding.

Despite the fact that Navy/nuclear shipbuilder relationships are now considered a serious threat to the national defense, I am not at all sanguine that any significant changes in our relations with the nuclear building yards will be forthcoming or that the necessary changes in our contracting practices with nuclear yards will be adopted.

Admiral Rickover is known for his outspoken criticism of corporate shipyard management and it is well recognized that he does attempt to usurp corporate management functions at these shipyards. His activities have reached the point where the two major nuclear yards have made it very clear indeed they no longer are going to tolerate his interference and dictatorial contracting attitude and philosophy. In my opinion, he knows this, hence his proposal to nationalize the private shipbuilding yards.

In addition to the above suggested changes in our ship contracting practices and procedures, I suggest that a very thorough study be made of the ship design capability of the Navy. This study should examine particularly the lead-follow yard concept of designing and building Navy ships. For example, Newport News designed the SSN 688 Class submarines under a design contract and are building the lead SSN 688 under another contract. Electric Boat is the only follow yard building SSN 688 Class ships other than Newport News. When Newport News delivers the drawings, plans, etc. to the Navy under their design contract, they become Government owned and then are Government furnished information (GFI) supplied by the Navy to Electric Boat and Newport News *and both yards* end up with large claims for late and defective plans (GFI) from the Navy. There must be a better way to design and build Navy ships.

Additional Navy Ships

(By Hon. Thomas N. Downing of Virginia)

IN THE HOUSE OF REPRESENTATIVES

THURSDAY, MARCH 18, 1976.

Mr. Downing of Virginia. Mr. Speaker, I have always been a fervent supporter of the military and I was delighted when the House Armed Services Committee recommended the authorization of additional Navy ships.

While I commend this action, I am distressed to learn the Navy does not have available funds to pay what they already owe to various shipyards

throughout the country. If this is true, it is an intolerable situation which must be quickly corrected.

There are other serious problems regarding the Navy's shipbuilding program which must also be resolved.

I include a letter addressed to me dated March 13, 1976, and signed by Mr. J. P. Diesel, president of Newport News Shipbuilding Co. in these present remarks. In his letter, Mr. Diesel states:

These issues threaten not only the future naval shipbuilding program but the one which is already underway.

He also says:

Time has run out.

I will also include a memorandum written by Mr. Gordon Rule, a senior Navy civilian for contract matters, along with my present remarks.

The Rule memorandum is an important document which must be read by those people in Government who are concerned about the future of the U.S. Navy. Action must be taken and it must be taken now.

The material follows:

MARCH 15, 1976.

Hon. THOMAS N. DOWNING,
Rayburn Building, Washington, D.C.

DEAR MR. DOWNING: The House Armed Services Committee recently recommended the authorization of additional Navy ships. However, you should be aware, as the Representative of the First District of Virginia, that it is a great frustration to Newport News Shipbuilding to find the Congress becoming aware of the need for future ships when the Navy has not yet come to grips with what they already owe to their shipbuilders.

I emphasize the question of the availability of funds and the question of the Navy's willingness or capability to promptly deal with the economic problems underlying its Naval shipbuilding program. These issues threaten not only the future Naval shipbuilding program but the one which is already under way. This situation is so severe that last summer we found it necessary to stop work on the DLGN41. We are now seriously considering similar action on the CVN70. We cannot see how it is reasonable or prudent to plow ahead with a project the size of the CVN70 in the present situation. Not only are the other Carriers not current in terms of pricing, but every other Naval shipbuilding program at Newport News is also seriously in arrears. Everyone knowledgeable appears to recognize this. I have received repeated assurances that the Navy recognizes that it does have significant financial obligations to us but nothing is done to resolve the underlying problems.

Recently the senior Navy civilian for contract matters, Mr. Gordon Rule, wrote a memorandum to the General Counsel of the Department of Defense, at that gentleman's request, to outline Mr. Rule's views of the problems with Navy shipbuilding. I have attached a copy. While I might not agree with the entirety of this memorandum, its thrust is correct and it describes fairly some causes of the Navy's problem with the shipbuilding industry. While this memorandum does not indicate Newport News' specific problem, I am sure you can appreciate them from our discussions.

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. For this reason, it is requested that the Rule memorandum be inserted in the Congressional Record. I, of course, will defer to you on how to do that. But we need this in the public domain, and we need it there quickly.

Sincerely,

J. P. DIESEL, *President.*

NAVY SHIPBUILDING IN THE UNITED STATES—VIEWS OF GORDON W. RULE

Major Premise: Where will the Navy find the shipbuilding capacity to produce our country's known requirements for ships?

Minor Premise: If such capacity can be found, under what terms and conditions will it be available to the Navy?

MAJOR PREMISE

It seems reasonable to ask SECNAV and CNO who continue to say our Navy needs X number of new ships for the fleet by Y year, if they have a plan or blueprint of where they expect to get those X ships built.

I suggest two things greatly effect any answer to this major premise:

(i) We have no mobilization base in the United States for Navy shipbuilding.

(ii) The Navy plays games and places ships in predetermined yards under the guise of competition. (Examples are Trident submarines to EB and FFG's to Bath and Todd. Newport News is smart enough to know where Admiral Rickover wants the Tridents built and that they are only being asked to bid for windowdressing. Similarly, all signs clearly point to NAVSEA wanting both Todd yards building FFG's and again the rest of the industry are smart enough to know this.)

When I was in the Bureau of Ships—now NAVSEA—the Navy had a well recognized policy of keeping five building yards in business for Navy new construction work, Beth-Quincy, Electric Boat, New York Ship, Newport News and I forget the fifth yard.

The Maritime Commission had a comparable list of yards for their ships. We kept them in business by allocating ships to them.

When I returned to the Navy in 1963 in my present job, the then ASN(I&L) told me no such policy existed any longer and any yard could go out of existence. We are now paying the price for that shortsightedness. ASD(I&L) had a group working on mobilization planning and many times I asked our representative on that group why they wouldn't develop a mob plan for shipbuilding. A satisfactory answer was never forthcoming.

Were I Secretary of the Navy I would determine if any realistic plan was in existence for building the ships in the FYDP. If no such plan existed, and I mean good, sound, long range planning, acceptable to the industry and understood by all, disciplinary action would surely be undertaken.

This apparent lack of planning was so obvious to me that I wrote a letter dated 8 March 1974 to the Chairman of the Senate Armed Services Committee, Senator Stennis, which letter stated in part:

"The foregoing is set out in order to better understand the situation facing the Navy—and a newly minted CNO. In capsule, the Navy is in an almost unbelievable situation. Unless a CNO is selected and confirmed by your Committee who fully understands the seriousness of this situation and has plans to cope with and remedy it in the very near future, the U.S. Navy will be in very deep trouble indeed.

"The serious situation I speak of is that the shipbuilding industry in the United States *does not want to build ships for the Navy.* That is not just my personal view, it is the attitude of shipbuilders in this country and Secretary Warner knows it. There is no evidence that the CNO understands this situation or has any plans for corrective action.

"It is very interesting for the present CNO to outline to your Committee the Navy's future ship requirements and how strong our Navy must be, *but he should be asked where these ships will be built, etc.* He should be questioned about the lack of competition and indeed no bids at all for specific ships presently required by the Navy and funded by the Congress.

"This is the situation facing the new SECNAV and CNO. Your Committee may wish to discuss with these new appointees their comprehension of this problem and what they intend to do about it."

ASN (I&L) Bowers stated in a recent meeting that he had been working with the Maritime Commission for a year looking toward a mutual agreeable mobilization plan for building ships. It's about time. Additionally, Admiral Kidd wanted to reopen Mare Island and Philadelphia Naval Shipyard well over two years ago in order to obtain additional needed capacity for new construction, but nothing happened.

MINOR PREMISE

If such capacity can be found, under what terms and conditions will it be available to the Navy?

Two things here are irrefutable. First, the Navy must get the required ships built without recourse to the Defense Production Act and second, the shipbuilding industry must be assured of fair contracts and treatment by the Navy, and a reasonable opportunity to earn a good profit for building the most complicated piece of hardware the Navy buys. The Navy should realize that one way or another, these shipyards will get paid what they are entitled to via changes, equitable adjustments under their contracts, claims or P.L.

85–804. There are enough good claims lawyers—many of whom worked for the Navy and know our weaknesses—to assure that.

Additionally, the following points must be considered in connection with this premise:

(i) The building of a Navy combatant ship always involves concurrent development and production. *There is no engineering development phase in shipbuilding* as there is in every other piece of hardware the Navy procures.

(ii) When the Navy is designing a ship and having it built concurrently, the result is massive changes—both authorized and constructive—requiring fair and prompt adjudication or they can develop into claims. It should be recognized that concurrency, rather than development, pilot production and then production will add at least twenty-five percent more to the cost of a procurement.

(iii) When the Navy utilizes the lead/follow yard method of ship procurement, claims and delays are inherent—they always have been.

(iv) Shipbuilding labor is 30–35% nonproductive or inefficient.

(v) The Navy makes unfair contracts for building the ships it requires and the industry knows and resents this. (Type of contract, delivery dates, pricing to meet an erroneous budget estimate, are prime examples of this.)

(vi) These unfair contracts have, of necessity, led to claims against the Navy, and although some of these claims are of dubious validity, those that are valid are not settled as promptly as they should be.

(vii) A review of shipbuilding claims—or requests for equitable adjustment as they are sometimes termed for statistical purposes, will show that the Navy hasn't learned many lessons in recent years and that our track record of ship contracting has been disgraceful.

(viii) The Navy recently went to Court with the best surface ship builder, Newport News. When the Navy does this and then is told by the Judge to negotiate your differences and report back to the Court—which is what the Navy should have been able to do without going to Court—it is obvious something is very wrong.

So much for the description of what this minor premise involves. Now, what needs to be done.

It is suggested that before the Navy can hope to have a successful shipbuilding program, there must be a reestablishment of mutual respect and trust with the shipbuilding industry in the United States. This can only be accomplished by deeds, not words. Instead of litigating and ??? claim inducing contracts providing fees for law firms, the following course of action is proposed:

(i) Recognize that our track record of ship procurement is very poor indeed and that at least 80% of the blame for that record is properly chargeable to the Navy. (The most important thing wrong with the Navy today—not the fleet but the producer side of the Navy—is that we will never admit we made a mistake.) Thus, it is essential that we recognize our deficiencies before we can hope to take corrective action.

(ii) The Navy today needs new faces to properly and intelligently provide the required climate for dealing with the shipbuilding industry and indeed for properly evaluating our own mistakes. Today people are polarized and captives of the ways and prejudices that have produced the conflicts, claims, etc. Someone must be found who will take hold of this problem and provide the new philosophy of complete fairness to all our dealings with the shipbuilding industry, both in the making and administration of our contracts. This result is achievable—by the right, tough-minded person or persons—without any loss of firmness and protection of the Government's best interests. What the goal here must be is simply fairness and respect for each other's position as distinguished from the current dug-in positions that produce adversary relationships without flexibility or reasonable fall back positions. That is what negotiation—to reach mutual agreement—is all about. It is fashionable for some persons in authority in the Navy to moan about how shipyards that formerly were privately owned and operated are now owned and operated by large conglomerates that are only interested in making a profit. This mentality probably still looks for a corner grocer instead of going to a chain store.

(iii) The most important short term objective must be the settlement of the Litton and Newport News problems. I submit the Litton yard is a national

asset for future Nevy new ship contruction and we should recognize this as a fact. The Navy and DOD actively encouraged Litton to build this yard in Mississippi and the first Navy contract through that new yard—the LHA's—should have been a cost type contract, at least for the first ship. This Litton LHA matter should be settled under P.L. 85–804 as was Lockheed (C5A) and Grumman (F14) by reformation of the contract to cost type on the supportable theory of essentiality to the national defense. In my opinion, Litton is more deserving of 85–804 reformation treatment than Grumman ever was. Litton did not buy-in on the LHA contract and Grumman did. We need that modern yard for Navy work and we should be planning right now to put work in there. Newport News must be negotiated to settlement and I believe that can be accomplished if handled cooperatively by negotiation and not litigation. It is fully realized that any settlement over $25 million must be approved by the Congress. Thus, I would go to the Chairman of the Armed Services and Appropriations Committees and fully apprise them of the planned settlement procedures and get their blessing in advance I feel confident they would approve.

(iv) The most important short and long range objective must be the making of right type of ship construction contracts. A review of our track record in using firm fixed price contracts and later fixed price incentive contracts (incentive on cost only) for building Navy ships says loud and clear that it's about time we woke up to the fact that changes and improvements must be made. More specifically it is recommended that the following suggestions be considered and if necessary, discussed with the shipbuilding industry via the Shipbuilders Council of America:

(a) New construction Navy ships should be allocated to building yards under an approved shipbuilding mobilization plan. This would eliminate the specious competitive exercise we go through and would recognize the almost impossible task of competitively pricing the unknowns involved in the concurrency of development and construction of a ship or ships. The Navy allocates submarine overhauls by planning years ahead where each ship be assigned. It is suggested that this same procedure would be prudent for the upcoming DE 1052 class overhauls rather than complete these overhauls.

(b) With both the Seapower Subcommittee and the GAO taking positions against cost type contracts for shipbuilding, it appears the Navy will continue to utilize fixed price incentive contracts (cost only incentive) for Navy shipbuilding. This FPI type of contract can be made a *satisfactory contractual instrument.* It is not today because of the tortured manner in which we structure them. The basic test of a soundly structural FPI contract—and indeed a CPIP contract—is the credibility of the target cost. The target cost should really be called "most probable cost" and should be that figure which the contractor has a 50/50 chance of overrunning or underrunning. This is fundamental in incentive contracting. It is this precise point—target cost—where the Navy starts the process of making unfair contracts. When the Navy negotiates a 95/5 share above target cost for the first 26 million of overrun of target, the target cost figure is patently phoney. Moreover, when the Navy negotiates a 95/5 share and then also a 152% ceiling, the target cost figure is patently ridiculous. First priority for the future must be the negotiation of more reasonable target costs for our FPI shipbuilding contracts and if the budget has to be changed, then change it.

(c) When our ships are allocated rather than price competed, I would start the contractor to work by means of a cost-no-fee contract to be definitized to an FPI contract by an agreed upon date. The difference between a cost-no-fee interim contract and a letter contract is that the contractor will be paid 100% of his costs vice 80–85%, which is of great benefit from a cash flow point of view and also from an interest standpoint. The cost-no-fee interim contract would contain the unilateral definitization clause used in letter contracts and would provide that if it is not definitized by the agreed upon date the 100% of cost payments would revert to 80–85%. The reason for this is obvious.

(d) The contractor would submit his proposal to definitize to an FPI contract and not competing for the contract price-wise, the likelihood is a more honest proposal. This will then be compared to our official Navy estimate for that particular building yard and a far more realistic target cost negotiated. At this point of definitization we would also have much more reliable

subcontract costs available than trying to fully forward price. Consideration should also be given to a redetermination of price at say 60% competition as the Navy used to do.

(e) With the negotiation of a realistic target cost, instead of dictated labor hours and costs—as we have done to meet a budget figure—the target profit, share and ceiling matrix would fall into place without having to be tortured to make up for an unrealistic target cost. With respect to profit, it is essential that a new and broadened philosophy be utilized, one which recognizes the shipbuilders' entitlement to a good/reasonable profit for building the most complicated hardware the Navy procures. If it should eventuate that a shipbuilder realized excessive profits then we should rely on the Renegotiation Board to take appropriate action.

I firmly believe this suggested outline would work, given the will to make it work on the part of the Navy and would provide the necessary inducement to industry to actively and willingly participate in our shipbuilding programs. Today, I believe these shipbuilders have reason to suspect that we are being unfair to them when we make our contracts. This feeling must be negated and I respectifully submit my approach would do it and would also comply with Secretary Clements' desires and objectives.

ITEM 26.—*Apr. 22, 1976—Memorandum from the Navy General Counsel to the Department of Defense General Counsel informing him that statements by Deputy Secretary of Defense Clements in support of the Public Law 85–804 effort could undermine the Government's position in the CGN 41 litigation and also undermine other Navy contracts.*

DEPARTMENT OF THE NAVY,
OFFICE OF THE GENERAL COUNSEL,
Washington, D.C., April 22, 1976.

From: General Counsel, Department of the Navy.
To: General Counsel, Department of Defense.
Subject: Pending Navy Litigation.

1. On April 19, 1976, members of my staff, together with attorneys from the Department of Justice, participated in a pre-trial conference in the United States District Court for the Eastern District on Virginia (Newport News Division) in the case of *U.S.* v. *Newport News Shipbuilding & Dry Dock Co., et al.* This case involves the validity of the option by which the Government contends that Newport News is obligated to construct and deliver the CGN–41. At the pre-trial conference a proposed litigation schedule was adopted looking toward argument of the Government's motion for a preliminary injunction on August 16, 1976, and for trial of the case itself commencing December 13, 1976. Although these dates appear to us to be extremely tight, we are preparing for trial on the basis that they will be met.

2. In the course of discussing the projected length of the trial, the Defendant's counsel (Martin Worthy, Esquire, of the Washington firm of Hamel, Park, McCabe and Saunders) indicated that the trial would last "at least several weeks." The Government responded that the presentation of its case would be considerably shorter. Mr. Worthy replied that he did not see the matter as that simple, citing the fact that the Deputy Secretary of Defense had made a formal finding that "these contracts were fundamentally unfair." A statement to this effect was in the Deputy Secretary of Defense letter to Senator Stennis of April 1976.

3. The allegation of "unfairness" is central to the Newport News defenses in this suit. Under the varying labels of commercial impracticability, unconscionability, mutual mistake, unilateral mistake, and other descriptions, Newport News has insisted that they are not obligated to construct and deliver the CGK–41 because such an obligation would entail ruinous and unforseen losses. The statements of the Deputy Secretary of Defense and the various documents in support of the proposed P.L. 85–804 relief to shipbuilders can thus be used by NNSDDC to buttress their defense to the Navy's action in the Federal Courts to enforce this contract. The statements, documents, and anticipated testimony in support of the 85–804 effort can also be expected to be used by the defendants in the event of a work stoppage by either

Litton, in the use of the DD–693 or LHR's, or Newport News in the case of the CVN–70. "The testimony" of the Deputy Secretary of Defense and others in support of the 85–804 effort thus have the potential for seriously undermining the Navy's position with respect to the duty of shipbuilders to perform under these contracts, whether or not the 85–804 effort is successful. The Department of Justice is not entirely informed on the dimensions of this problem, but they have already expressed their concern.

4. As you know, when we press our motions for Temporary Restraining Orders and Preliminary Injunctions, the Federal Courts sit in equity. It is axiomatic in this arena that the moving party have "clean hands." Thus, the Navy is in the awkward position of asking the Federal Court for an extraordinary order compelling these corporations to return to work under a contract that the Deputy Secretary of Defense has found to be unfair. In addition, at the time of trial on the merits of the option, Newport News' position re unconscionability will have been made for them by people within OSD and the Navy through letters and testimony to Congress. As a practical matter, it is difficult for us to refute Newport News' defense when the leaders of the Defense Department have publicly agreed with their position.

5. One has only to read the recent ASBCA opinion awarding Lockheed $62 million on the theory of estoppel because of pronouncements by the Deputy Secretary of Defense to realize the weight and authority given by the Courts to findings of that office. In my opinion, the situation at bar is very analogous.

6. At your convenience, I would very much appreciate discussing with you possible approaches to this problem.

E. GREY LEWIS,
General Counsel.

ITEM 27.—*Apr. 22, 1976—Memorandum from Admiral H. G. Rickover to Chief of Naval Material forwarding a copy of Admiral Rickover's notes for discussion on shipbuilding claims with the Assistant Secretary of Defense that day.*

DEPARTMENT OF THE NAVY,
NAVAL SEA SYSTEMS COMMAND,
Washington, D.C., April 2, 1976.

MEMORANDUM FOR THE CHIEF OF NAVAL MATERIAL

Subject: Shipbuilding claims.
Enclosure: (1) Notes for discussion with the Honorable Frank A. Shrontz, Assistant Secretary of Defense (I&L).

1. This morning I met with the Assistant Secretary of Defense (Installations and Logistics) at his request to discuss the subject of shipbuilding claims. He was accompanied by the Honorable Richard A. Wiley, Department of Defense General Counsel.

2. Enclosed is a copy of the memorandum I gave to them.

H. G. RICKOVER.

Enclosure.

NOTES FOR DISCUSSION WITH THE HONORABLE FRANK A. SHRONTZ, ASSISTANT SECRETARY OF DEFENSE (I&L)

Subject: Shipbuilding Claims.
References: (a) NAVSEA ltr to Mr. N. W. Freeman, Tenneco, Inc., of 6 August 1975; (b) Memo for Asst SECNAV (I&L) dated 24 March 1976; (c) Notes for discussion with Secretary Clements of 7 April 1976.

1. There are currently no outstanding claims against the Navy from Electric Boat Division of General Dynamics. The recent EBDiv claim against the contract for the first flight of follow SSN 688 Class submarines was handled by the Naval Sea Systems Command within the claims handling procedures presently in effect in the Navy. The President of the Electric Boat Division certified the claim in accordance with the requirements of Naval Procurement Directives as being current, accurate, and complete. In the claim release, EBDiv agreed to use their best efforts to submit by 1 December 1976 any remaining claims they may have on the first flight and on the second flight of the SSN 688 Class for events occurring up to 1 November 1976. They agreed

that such claims would be certified and would show the cause and effect relationship for which they consider the Government to be responsible under the contracts. Based on this settlement and claims release, and the history of experience in dealing with General Dynamics, there is good reason to believe that the Navy, if allowed to, could work out with EBDiv a reasonable settlement within the terms of the contracts using the Navy's normal claims processing procedures.

2. The major claim currently before the Navy from Ingalls Shipbuilding Division of Litton concerns the LHA's and, therefore, does not involve nuclear ships. The Litton claims concerning nuclear ships have already been reviewed by the Armed Services Board of Contract Appeals and are also under investigation by the Justice Department for possible fraud. The latter matter is currently being investigated before a grand jury in Alexandria, Virginia.

3. The largest unresolved issue concerning shipbuilding claims is how to handle the current Newport News Shipbuilding and Dry Dock Company of Tenneco, Inc. claims. These amount to a requested increase in contract ceiling prices on six contracts which total $894M. If the requested increase of $894M in ceiling prices were granted, Newport News would ultimately receive actual payments of about $443M, if the final costs of the ships are the same as the latest Newport News cost estimates submitted to the Navy. On the other hand, if the $894M increase in ceiling prices were approved, and the final costs of the ships as delivered turned out to be higher than the current Newport News estimates, then in accordance with the cost sharing provisions of the contracts Newport News would receive even more than the $443M. This increase in payments would occur whether or not the increased runout costs were caused by contractor responsible matters, such as slowing down remaining Navy work in order to enable Newport News to meet fixed price commitments on commercial work. If the Newport News claims against the Navy were paid as submitted, Newport News would receive all of their costs for the work they have done and are doing on construction of Navy ships, whether or not these costs were the responsibility of the Government, and would also receive a substantial profit on each contract.

4. There is no question that Newport News in submitting their claims has included in each one some items and some amounts for which the Navy owes them money. For many of these items, the Navy has tried for months, and in some cases years, to get Newport News to submit specific proposals identifying the cost that the Government owes them on the items, so that each could be negotiated on its merits. However, Newport News has reserved these items to include in their omnibus claims so as to ensure that they include at least some items for which there can be no question as to some entitlement.

5. The Navy, of course, must pay Newport News the amounts to which they are entitled by their contracts. The best and quickest way to do this would be for Newport News to submit claims that are factual and correctly relate Government responsible actions to the amount of money the Government owes them. If Newport News would do this, then their claims could be processed fairly and quickly.

6. However, Newport News has chosen to submit voluminous claims which do not relate Government cause to effect and which obfuscate the issues by alleging all sorts of Government actions as being responsible for increased costs, such as Norfolk Naval Shipyard's hiring practices. Newport News refuses to certify their claims as being current, complete, and accurate, and generally claims that the Navy is responsible, and owes them for everything that has happened at Newport News plus a substantial profit. References (a) and (b) discuss this matter in more detail. The result is that the Government is now faced with the basic question of whether the Navy should take responsibility for financial problems at Newport News regardless of the company's responsibility and performance under its Navy shipbuilding contracts.

7. The matter has now, as you are aware, been taken out of the Navy's hands; the Department of Defense has publicly stated that the Navy has handled shipbuilding contracts in an unsatisfactory manner, and that the present contract provisions are inequitable and have resulted in injustices and unfair consequences. In fact, in a pre-trial court hearing this week concerning the dispute over the validity of the option for the CGN 41, Newport News lawyers cited Department of Defense statements that the Navy's con-

tracts are unfair in support of their contention that the CGN 41 option is invalid.

8. When the Department of Defense proceeds with its presentation to the Congress of the need for reforming present shipbuilding contracts under Public Law 85–804, witnesses will, of course, have to substantiate the basis on which the Government finds the present contracts to be invalid. To the extent the Department of Defense succeeds in establishing these points, it could undermine the Navy's position in upholding the validity of the CGN 41 contract option or any other Government contract.

9. Also, there are indications that other contractors are watching this matter with great interest. For example, Curtis Wright Corporation which had withdrawn its request for relief under Public Law 85–804 for nuclear component contracts has now informed their prime contractor, the General Electric Company, that they are reevaluating their position in view of the more liberal approach announced by the Department of Defense concerning the use of Public Law 85–804.

10. Since the use of Public Law 85–804 in the case of Newport News has been initiated by the *Government* and not the *contractor*, and is apparently to be applied in order to ensure that the contractor receives profits on present fixed price incentive fee contracts, it is obvious that the entire defense industry will desire to evaluate the impact of the precedents set in light of their own situations. As a minimum, these actions can be expected to encourage defense contractors to handle their contractual dealings at the OSD level rather than at the Navy Systems Command level.

11. As I stated in reference (c), I believe that the contemplated, one-time granting of extra-contractual relief will not eliminate the basic problem. In fact, it may encourage contractors to believe that the Navy will henceforth be instructed to ensure their future profitability regardless of their contract performance. The impact of the use of Public Law 85–804 in this case could be profound on *all* existing and future Defense contracts.

H. G. RICKOVER.

ITEM 28.—*Apr. 24, 1976—Office of Navy General Counsel memorandum to Navy General Counsel Lewis commenting on a DOD Counsel opinion that Navy shipbuilding contracts might be reformed without resorting to Public Law 85–804. The Navy, legal memorandum found no legal basis to support that opinion*

DEPARTMENT OF THE NAVY,
OFFICE OF THE GENERAL COUNSEL,
Washington, D.C., April 24, 1976.

MEMORANDUM FOR MR. LEWIS

Subject: Adequacy of Consideration in Government Contracts.

The proposition has been advanced in connection with Mr. Clements' shipbuilding claims resolution project that, among other things, the contracts be amended to incorporate the "new" NAVSEA escalation clause in exchange for the contractors' release of all delay and disruption claims. On April 22 ASD (I&L) reported to the working group that DOD Counsel had advanced this proposition, which relies upon "commercial law" principles of contract consideration, as one which would avoid the need for resort to P.L. 85–804. We were given to understand that the plan was warmly endorsed by DEPSECDEF and the Executive Committee, and we were instructed to prepare for its presentation to the Senate Armed Services Committee in the hearings on April 29.

The delay and disruption claims involved have been asserted with a total face value on the order of $1 billion. The majority of them, however, have only recently been received and are in very early stages of analysis. The Navy thus has very little knowledge as to their potential merit or the value their release represents to the Government. The incorporation of the "new" escalation clause, on the other hand, is calculable, and would subject the Government to an increased potential obligation of several hundred million dollars.

While there should be no dispute among lawyers that the waiver of an unliquidated claim can constitute legal consideration for amending a contract,

the application of that principle to transactions in which the Government is a party poses special problems. As the U.S. District Court stated in *United States v. American Sales Corp.*, 27 F.2d 389 (S.D. Tex. 1928):

* * * it must be constantly borne in mind, in considering the rights of the United States growing out of the acts of its officers, that the United States never acts directly, but always through agents, and that the effect of the acts of these agents must be determined by the power granted to them. In short, the obligation of the United States on contracts entered into, not by Congress, but by agents empowered by Congress, must always be examined in the light, not of what the principals acting together may do, but of what an agent so authorized may commit his principal to.

Without belaboring the chain of delegated authority by which he acts, the power to obligate the Government under the shipbuilding contracts here in question resides in one or more Navy Contracting Officers. That authority is governed in many important respects by the Armed Services Procurement Act (10 U.S.C. 2301 et. seq.). It is limited by 31 U.S.C. 200, which states:

"No amount shall be recorded as an obligation of the United States unless it is supported by documentary evidence of—(1) a binding agreement in writing between the parties thereto, including Government agencies, in a manner and form and for a purpose authorized by law * * *."

And it is restricted by 10 U.S.C. 2202, which provides: "Notwithstanding any other provision of law, an officer or agency of the Department of Defense may obligate funds for procuring, producing, warehousing, or distributing supplies, or for related functions of supply management, only under regulations prescribed by the Secretary of Defense."

The ASPR represents SECDEF's implementation of the latter statute, and imposes the following general limitations upon actions of a Contracting Officer:

3-801.1 It is the policy of the Department of Defense to procure supplies and services from responsible sources at fair and reasonable prices calculated to result in the lowest ultimate overall cost to the Government. Good pricing depends primarily upon the exercise of sound judgment by all personnel concerned with the procurement.

3-801.2(a) Contracting officers * * * are the exclusive agents of their respective Departments to enter into and administer contracts on behalf of the Government in accordance with ASPR and Departmental procedures.

3-801.2(b) * * * determination of the suitability of the contract price to the Government always remains the responsibility of the contracting officer * * *

3-801.2(d) * * * The contracting officer is responsible for the exercise of the requisite judgments and is solely responsible for the final pricing decision * * *

3-807.2(a) Some form of price or cost analysis is required in connection with every negotiated procurement action. The method and degree of analysis, however, is dependent on the facts surrounding the particular procurement and pricing action. Cost analysis shall be performed in accordance with (c) below when cost or pricing data is required to be submitted under the conditions described in 3-807.3 * * *

3-807.2(c) [Cost analysis] includes the appropriate verification of cost data, the evaluation of specific elements of costs . . . and the projection of these data to determine the effect on prices of such factors as:

(4) Forecasting future trends in costs from historical cost experience is of primary importance, but care must be taken to assure that the effect of past inefficient or uneconomical practices are not projected into the future.

3-807.3(a) The contracting officer shall require the contractor to submit . . . cost or pricing data * * * and to certify * * * that, to the best of his knowledge and belief, the cost of pricing data he submitted was accurate, complete, and current prior to: (ii) the pricing of any modification to any formally advertised or negotiated contract * * * expected to exceed $100,000.

3-807.7 A certificate of Current Cost or Pricing Data shall not be considered a substitute for examination and analysis of the contractor's proposal. Contracting officers shall not rely on profit limiting statutes as remedies for ineffective pricing.

3-807.8 Each contract shall be priced separately and independently, and no consideration shall be given to losses or profits realized or anticipated in the performance of other contracts.

ASPM No. 1 ("Contract Pricing") The objective of the procurement process is to acquire necessary supplies and services of the desired quality, in a timely manner, and at fair and reasonable prices * * *

The contracting officer is responsible for the pricing arrangement * * * no matter how much help he gets in carrying the load, he is ultimately the one answerable for the quality of the pricing arrangement.

The obligations imposed upon the Contracting Officer by the regulations cited above are reinforced by decisions of the Comptroller General which require the Contracting Officer to determine that the Governmnt is receiving a "compensating benefit" or "adequate consideration" whenever he seeks to modify a Government contract in favor of another party, or to surrender or waive a vested contract right. In 15 Comp. Gen. 25 (1935), the Comptroller General announced as a general rule that "a contract may not be modified prejudicially to the interest of the United States without adequate consideration therefor." In developing this rule, the Comptroller General relied on the rule concerning the limited authority of agents of the United States. *United States v. American Sales Corp., supra.* He also relied on *Pacific Hardware & Steel Co. v. U.S.*, 49 Ct. Cl. 327; 335 (1914) ("It is unquestionably true that an official of the Government is not authorized to give away or remit a claim due the Government. This rule is grounded in a sound public policy and is not to be weakened.") and on *Bausch & Lomb Co. v. U.S.*, 78 Ct. Cl. 584, 607 (1934) ("Agents and officers of the Government have no authority to give away the money or property of the United States, either directly or under the guise of a contract that obligates the Government to pay a claim not otherwise enforcible against it."). In 15 Comp. Gen. 25 (1935), the agency proposed as consideration for increased compensation that the contractor give up his right to a bonus which he had not yet earned and which he might never earn. The Comptroller General concluded that "surrender of such an expectancy" either was not consideration or, if it was consideration, it was insufficient consideration for the proposed modification.

In 18 Comp. Gen. 114 (1935), the Contracting Officer and the contractor had concluded a negotiated price reduction for nonconforming goods, but the Comptroller General ruled that the Government agent's action "may not be accepted as binding on the Government" because the price reduction was not as great as the difference in the market price of the goods required and the goods delivered. See also 19 Comp. Gen. 48 (1939); 19 *Id.* 903 (1939); 22 *Id.* 260 (1942); 22 *Id.* 367 (1942); In 35 Comp. Gen. 56 (1955), the agency wanted to lower fees under foreign investment guaranty contracts so as to bring the rates into line with new rates in an amendment to the enabling statute enacted after the contracts were executed. Mindful of the rule requiring adequate consideration, the agency cited various benefits that they considered constituted adequate consideration: (1) simplification of administration of the program; (2) prospective investors would be encouraged to make investments; (3) cancellation of existing contracts would be discouraged. The Comptroller General rejected the agency's argument, stating that the cited benefits appeared "to be rather intangible and speculative and insufficient to justify a reduction in the rates." See also 40 Comp. Gen. 309 (1960); 40 *Id.* 584 (1961).

In 41 Comp. Gen. 169 (1961), the rule was slightly rephrased to say that a "compensating benefit" was required in order to waive a contractual right. In that case, after considering at length the legal merits of potential claims against the United States, the Comptroller General concluded that waiver of all claims against the United States was a "compensating benefit" for an extension of the payment schedule under the contract. In 41 Comp. Gen. 730, 736 (1962), the Comptroller set forth his standard of review of the issue of adequacy of consideration: Determination of the adequacy of consideration is "in the sound discretion of the contracting officer, and his action in such circumstances will not ordinarily be questioned by our Office unless clearly arbitrary or unreasonable." See also Unpublished Decisions B–157241, August 27, 1965; B–158739, April 18, 1966.

In 47 Comp. Gen. 170 (1967), the rule was again reworded: An agent of the Government is "without authority to waive vested rights without a corresponding consideration flowing to the Government for the waiver." In this case, several instances of waiver of Government rights were considered. In one of these, the Contracting Officer had increased the number of items to be

delivered under the contract. Apparently the additional item of equipment was worth only a fraction of what he agreed to pay for it.

Although the commercial law rule on adequacy of consideration was cited (i.e., that an extravagant promise for an inadequate consideration will be held to constitute legally sufficient consideration), I believe this must be regarded as an aberration. Rather, the Comptroller General's refusal to void this agreement to pay more for a piece of equipment that it was worth should be viewed as an application of the standard cited above, i.e., that the Comptroller General will not question the Contracting Officer's determination unless it is clearly arbitrary or unreasonable. It should also be noted that in all the cases which follow 47 Comp. Gen. 170, the commercial law principle of the sufficiency of consideration is not referred to again. Careful analysis reveals that the commercial law principle and the Comptroller General's rule are actually distinct and unrelated principles; it was simply fortuitous that the Comptroller General used the term "adequate consideration". That the Commercial law principle of sufficient consideration is not involved can be seen in the number of different phrases that the Comptroller General uses: "valuable consideration", "corresponding consideration", and especially "compensating benefit". Also, it should be apparent that the purposes behind the two principles are quite unrelated: in commercial law the principle of the sufficiency of consideration is used to determine when the parties are bound by their agreement; the Comptroller General's rule is based on the public policy that the Government's agents are without authority to give away the money, property or vested rights of the Government (in the absence of specific statutory authorization).

Another explanation for this aberration can be found in a statement of the rule in 40 Comp. Gen. 684 (1961): "[W]ithout a compensating benefit to the United States, agents and officers of the United States have no authority to dispose of the money or property of the United States, to modify existing contracts, or to surrender or waive contract rights that have vested in the Government." The emphasis on existing or vested rights should be noted. In 47 Comp. Gen. 170 we have what amounts to new procurement, a new contract. The statement of the rule quoted above is representative of all such statements in that it seems to be limited specifically to existing or vested rights and may reflect a reluctance on the part of the Comptroller General to get into the pricing of new procurement actions that would not exist in the case of existing or vested rights. This conclusion is borne out by the efforts made in B–184827, December 9, 1975 (75–2 CPD 381), to show that a new contract was really a modification of an existing contract. We might conclude from 47 Comp. Gen. 170, that the Comptroller General would not declare new procurement actions to be void unless there was a failure of consideration under commercial law principles.

One further point about 47 Comp. Gen. 170 should be noted. There another attempted waiver of the Government's rights (waiver of its vested right to liquidated damages) was voided by the Comptroller General even though it had been consummated for the reason that there was found to be no "compensating benefit". See also Unpublished Decisions B–174058, October 18, 1972; B–182406, June 3, 1975, 75–1 CPD 336.

The most recent application of the Comptroller General's rule can be found in unpublished decision B–184827 of December 9, 1975 (75–2 CPD 381). In that case the Contracting Officer attempted to enter into a new contract for the same steel pipe the contractor was required to deliver under an existing requirements contract. The new contract was at a higher price and the Comptroller General concluded that the new contract was really nothing more than a modification of the existing contract. Relying on the rule requiring adequate consideration, the Comptroller General held that the "contracting officer was without authority to release this contractual right without corresponding consideration passing to the Government. Therefore, the conclusion is reached that contract —5206 is void."

"The restriction against giving away the rights of the Government without corresponding consideration is intended to prevent improvidence in the procurement of goods and services. Such a limitation must be administered as to fairly and reasonably accomplish its important purpose. Such an extremely valuable safeguard to the public treasury should be enforced so as to uphold the policy behind the restriction."

To summarize, I believe we may conclude that the Contracting Officer must always exercise his discretion in a fair and reasonable manner in determining whether the Government is receiving a compensating benefit or corresponding consideration before he agrees to waive a vested right of the Government. If his determination can be shown to be "clearly arbitrary or unreasonable", the contract modification will be void.

Thus I believe it is beside the point to debate at length the issue of whether execution of the proposed plan would contain sufficient legal consideration to create an obligation enforceable against the Government. As the foregoing decisions indicate, the General Accounting Office, operating under a completely different principle, will declare void any contract modification waiving vested contractual rights of the Government in exchange for something which is clearly not corresponding consideration. It is the latter point that is at issue here—whether a Navy Contracting Officer, acting in accordance with the limitations imposed upon his authority by the ASPR, and mindful of the fact that he has no authority to give away the Government's rights without a compensating benefit, can find that the proposed exchange of escalation clauses less advantageous to the Government for the release of unevaluated claims represents a good deal for the United States. Legal advice that the proposed action would successfully bind the Government to pay several hundred million dollars only adds weight to his burden; it does not eliminate it.

ITEM 29.—*Apr. 28, 1976—Admiral Rickover Memorandum for the Chief of Naval Material commenting on Gordon Rule statements and memos dated March 4, 1976, March 18, 1976, and March 29, 1976 regarding shipbuilding claims, and related matters*

DEPARTMENT OF THE NAVY,
NAVAL SEA SYSTEMS COMMAND,
Washington, D.C., April 28, 1976.

MEMORANDUM FOR THE CHIEF OF NAVAL MATERIAL

Subject: Shipbuilding claims.

References: (a) Navy shipbuilding in the United States; views of Gordon W. Rule, dtd 4 March 1976; reprinted in Congressional Record of 18 March 1976. (b) Navy shipbuilding in the United States; additional views of Gordon W. Rule, dtd 22 March 1976. (c) Gordon W. Rule memo dtd 29 March 1976 to Chief of Naval Material, subj: "The Use of P.L. 85-804 to Remedy the Situation Existing in Three Shipyards in the United States, Which Adversely Affects the Defense of the United States—thoughts concerning". (d) My memorandum for ASN (I&L) dtd 24 March 1976, subj: Relations with Newport News Shipbuilding and Dry Dock Co. (e) My memorandum for DEPSECDEF dtd 7 Apr 1976, subj: Shipbuilding claims. (f) My memorandum for ASD(I&L) dtd 22 Apr 1976; subj: Shipbuilding claims. (g) My letter to Mr. N. W. Freeman, Chairman of the Board, Tenneco, Inc., dtd 6 August 1975.

1. In references (a), (b), and (c), Mr. Gordon Rule, Director, Procurement Control and Clearance Division, Naval Material Command, has set forth his views concerning Navy shipbuilding in the United States; the shipbuilding claims backlog; the causes of the backlog; and how the claims should be resolved. Mr. Rule attributes most of the current shipbuilding procurement problems to "unfair" Navy shipbuilding contracts which he contends are of the wrong type and which contain delivery dates and target costs that are unrealistic. Mr. Rule's proposed long-range solution to these problems is to eliminate the use of competition in awarding shipbuilding contracts and place these contracts with shipbuilders on a cost-plus basis, definitizing them only as the ships are well into the construction process. References (a), (b), and (c) have been widely circulated to key officials in the Defense Department. The purpose of this memorandum is to point out areas of disagreement between Mr. Rule's contentions and my own views regarding the shipbuilding claims problem.

2. Mr. Rule's memoranda fail to mention the many items of shipbuilder responsibility that have greatly contributed to cost increases; such as, in-

creased overhead, reduced productivity, inadequate manpower, construction errors requiring rework, etc. In the case of Newport News I have cited many such items in references (d) and (g).

3. In regard to Mr. Rule's allegations that the Navy shipbuilding contracts are unfair, it should be recognized that shipbuilders have traditionally enjoyed more favorable contract terms than other defense contractors engaged in fixed price work. Escalation provisions in shipbuilding contracts are more liberal than those employed in other defense contracts. Progress payment provisions in shipbuilding contracts also are more liberal than those employed in other fixed priced defense contracts. Moreover, the Navy assumes financial responsibility for many of the high risk aspects of ship construction by providing Government-furnished design and components.

4. Type of contract, delivery dates, target costs, share-line provisions, ceiling prices, and other terms and conditions of shipbuilding contracts are, in all cases, mutually agreed to at time of contract award. Contrary to Mr. Rule's statements neither I nor anyone on my staff has attempted to or is able to dictate labor hours or other contract terms to shipbuilders. Mr. Rule should know this since he reviewed each of the contracts before it was placed. In fact he is the only procurement official I know of still in a position of authority who was involved in all of the contracts currently being discussed. For example, in the case of the NIMITZ/EISENHOWER contract which accounts for one-fourth of the total Newport News claims, Mr. Rule personally attended many of the negotiating sessions as well as reviewed and approved the final contract.

5. Mr. Rule cites unfair or wrong escalation provisions as a possible basis for providing shipbuilders extra-contractual relief. There has been misunderstanding and unwarranted criticism of the so-called old escalation provisions used in shipbuilding contracts. Shipbuilders receive escalation protection through several means. Under the escalation clause, they receive escalation payments based on changes in the Bureau of Labor Statistics shipbuilding industry indices. In addition, they often include contingencies in their bids when they anticipate that the impact of inflation will be greater than the amounts that will be paid under the escalation clause. Also, the price of contract changes for extra work or Government-responsible delay include separate contingencies for escalation. To the extent shipbuilders actually incur more escalation than that covered by the escalation clause or included as a contingency in the contract price, they can recover most of the excess under cost sharing provisions up to the ceiling price of the contract, even if the excess is not due to Government-responsible causes.

6. Under Navy shipbuilding contracts shipbuilders agreed to accept the risk for cost increases beyond ceiling price, including the effects of inflation, unless under the terms of their contracts the responsibility rested with the Government. Thus, shipbuilders were well protected, even through the period of double digit inflation as long as they performed within the contract delivery date and ceiling price. In my view such an arrangement is both fair and equitable. The fact that the Navy subsequently adopted even more liberal escalation provisions in new contracts is primarily due to the shipbuilders superior bargaining position, not to basic inequity in the old escalation clause.

7. Mr. Rule states that although some of the current shipbuilding claims are of dubious value, those that are valid are not settled as promptly as they should be. But the evaluation and settlement of large, multi-million dollar shipbuilding claims is a difficult, time-consuming process, even when they are accurate and complete. More often, however, shipbuilding claims are inflated, and these claims tend to be far more difficult and time-consuming to evaluate, since the Government is forced to investigate every allegation whether founded or unfounded. Moreover, when a shipbuilder elects to prosecute his claim based upon how much money he needs to make his corporate profit or cash flow objectives, rather than what the Government legally owes, negotiations are arduous, time-consuming, and generally unsuccessful.

8. To discourage inflated claims and help speed claims processing, Navy Procurement Directives require that contractors certify at time of claim submission, that their claims are current, complete, and accurate. To date, Newport News has refused to provide the required affidavits. This further delays claim processing.

9. Although Newport News complains about slow handling of shipbuilding claims by the Navy, the company has submitted the bulk of its claims only within the past year. In fact, $665 million of the $894 million backlog of New-

port News claims were received since the first of this year. Despite Navy efforts to negotiate and settle promptly the price of contract changes, and items of alleged Government responsibility at the time the event occurs, the company has refused to do so, electing instead to save these items for use in developing subsequent, omnibus claims such as those recently submitted. Thus, delay in evaluating and settling claims often stems from a shipbuilder's decision to save up individual items for a large, "get-well" claim; the exaggerated nature of the claim; the company's refusal to certify its claim; and its unwillingness to prosecute claims based on their legal merit. The only way to settle such claims promptly is to pay the contractor whatever he wants, regardless of legal entitlement.

10. Mr. Rule points out that there are two sides to every question and that the causes of shipbuilding claims cannot be all the fault of the shipbuilder. To my knowledge, no one in the Navy has suggested that shipbuilding claims are completely without merit. However, from what I have seen, the Navy has been willing to pay what it legally owes. The recent $97 million claim settlement with Electric Boat is a good example. The contractor submitted a claim, and certified that it was current, complete, and accurate. The Navy reviewed the claim and settled it for the amount the Navy determined it legally owed. In claim settlements to date, the Navy seems to have been fair in acknowledging its responsibility.

11. Mr. Rule states that the shipyards involved in the proposed P.L. 85–804 action must realize they have an obligation to cooperate and not expect to obtain benefits beyond what is reasonably determined to be Navy responsibility. However, to determine what the Navy legally owes requires a thorough legal and technical review of the claims. Such a review has not yet been performed. Without such a review by competent legal and technical personnel, neither Mr. Rule nor anyone else can determine how much of what the shipbuilders request is beyond Navy responsibility.

12. Mr. Rule has recommended that in the future the Navy allocate its ship construction contracts to shipyards in accordance with a pre-determined mobilization plan rather than attempt to obtain price competition for combatant warships. He proposes that the Navy then authorize starting ship construction under a cost-no-fee contract to be definitized into a fixed price incentive contract later in the construction period. Mr. Rule's proposed arrangement would eliminate any pressure of price competition in cases where more than one yard can build a ship. Moreover, by routinely authorizing construction before pricing the contract, the Navy would be deliberately placing itself in a poor negotiating position. Since the amount of profit would presumably be based on the cost, the profit incentive to reduce costs through improved efficiency and productivity would be greatly reduced.

13. Reference (d) presented a summary of my views on the Newport News situation. I made recommendations based on the assumption that the Navy would insist on enforcing its contract terms. In references (e) and (f), I pointed out that the one-time granting of extra-contractual relief is only a temporary remedy; that some shipbuilders upon whom we depend apparently will honor contracts only to the extent they are satisfied with the financial outcome; and that granting P.L. 85–804 relief would create many problems. I recommended that if such a shipbuilder is to be excused from his contracts and given financial relief, the Navy should acquire title to the shipyard as a condition of a P.L. 85–804 settlement, and operate it under cost-plus contract with private industry as a Government-owned, Contractor-operated facility. In that way, the shipbuilder would get his guaranteed profit; the Navy would be assured of adequate shipbuilding facilities, regardless of market demands for commercial ships; and perhaps both contractor and Government personnel could then concentrate their efforts on the difficult task of building ships. The Energy Research and Development Administration and its predecessor, the Atomic Energy Commission, have operated their laboratories and facilities in this manner for 30 years. In this regard, it should be borne in mind that the Government already owns a large amount of the facilities defense contractors operate in manufacturing defense equipment. With Government ownership of the facilities, the operating contractor would still be responsible for efficient performance of the work, but would no longer be in a position to divert the facilities to other work. Further, if the Government were not satisfied with the performance of the operating contractor, the Government could replace the contractor.

14. In summary, Mr. Rule urges excusing shipbuilders from their contract obligations on the basis that alleged poor Navy procurement practices or unfair Navy contracts led to the current claims problem. This ignores the problem that some shipbuilders have been unwilling to settle claims on the basis of legal entitlement. To the extent that those contractors who refuse to honor their contracts are rewarded by extra-contractual payments, other defense conractors maybe encouraged to seek similar relief. Instead of resolving the claims problem, extra-contractual payments could result in an increase in claims throughout the defense industry and development of an attitude among defense procurement personnel that they are to pay whatever contractors request.

15. I would appreciate it if you would distribute this memorandum to those officials who were provided official or unofficial copies of references (a), (b), and (c) so that in their deliberations they can consider the information contained herein.

H. G. RICKOVER.

ITEM 30.—*Apr. 29, 1976—Deputy Secretary of Defense Clements statement before the Senate Admed Services Committee regarding Public Law 85–804 proposal*

I. INTRODUCTION

Mr. Chairman, members of the Armed Services Committee, 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 appearance before your Committee 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, Mr. Chairman, this program has not lacked over-sight, review, studies in detail by the Congress, the G.A.O., 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. The Joint Economic Committee conducted extensive hearings on "The Acquisition of Weapons Systems" in the period 1969–73. The Navy's shipbuilding program is thoroughly covered in that 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 several of 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.

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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.

* * * * * * *

6. There have been long delays in the settlement of shipbuilders' claims. In part, delays have been due to 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.

* * * * * * *

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 late 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 Sea Power 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 1969–1 April 1976.

Category B—Request for Equitable Adjustments 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 was settled for $631 million (or 47.9%). About 77% of the settlements were for conventional ships, i.e. aircraft carriers, Destroyers, Destroyer Escorts, Amphibious ships, Fleet tenders, and Fleet auxiliaries. The remainder were for nuclear ships, mainly submarines.

In Category "B" (outstanding REA's or Claims) there are 8 REA's in hand for a total of $1,402 million. In addition, there are anticipated REA's for more than $300 million expected to be filed before the end of 1976. About two-thirds of these claims are 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 only two shipbuilders' appeals for relief have been decided. The Lockheed Shipbuilding Company claim for $62 million settlement has been upheld by the Board. The claimed amount of $24 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 docketted by the Board 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 ongoing 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 discussed.

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

Mr. Chairman, in my letter to you earlier this month (2 April), I said that I had informed the Secretary of the Navy and the Chief of Naval Operations of my determination to take remedial action under P.L. 85–804 because of the threat to our national defense which the unsatisfactory business relations between the Navy and the shipbuilders has brought about. I would like now to briefly comment on several specific situations which in the aggregate have hardened my resolve to seek and direct early remedial action.

The Newport News Shipbuilding and Dry Dock Co. Situation

In July 1975 in a prepared statement to a DoD review group, Mr. John Diesel, President of Newport News, said:

"What you see here is a scenario for another shipbuilder to say 'enough' of Navy business, and probably one that Bethlehem Steel and New York Shipbuilding faced prior to going out of Navy shipbuilding. This would add Newport News to the list of five shipyards no longer in the Naval nuclear ship construction programs, leaving only one active."

The statement went on to say that Newport News would have been bankrupt and "without a prayer for obtaining private capital," had not Tenneco financed the losses, the working capital and the capital improvements requirements. The present profitability and future potential in commercial sales was cited as the rationale for Tenneco's support of the shipyard. The statement concluded, with respect to Newport News' financial situation, as follows:

"Summarizing the historical reference for Newport News, the past five years have been bad for the shipyard with its 1969 equity base seriously eroded because of the negative returns on naval shipbuilding. They will be nothing compared to the next five years if the Navy does not provide a sufficient profit base to justify continuing Naval shipbuilding by Newport News."

Examples of the hardening attitude of the management at Newport News have been:

(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 DLGN-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 DLGN-41 project on an interim twelve-month

modus operandi basis wherein Newport News is reimbursed its cost plus a fee while the parties try to negotiate their differences. It is my understanding that up to the present very little real progress has been made towards a mutual agreement regarding the DLGN-41 contract.

(c) The strong reluctance of Newport News last year to bid on the Navy's FY 1975 SSN (688 class)) follow-on production R.F.P. 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.

The Electric Boat Situation

The E. B. Division of General Dynamics Corp. has currently in hand contracts for 18 SSN-688 class submarines and 4 Trident submarines. Three additional Trident submarines are programmed to be awarded in FYs 78 and 79. Recently a settlement of $97 million on a claim for $232 million was made by the Navy on the first production flight of 7 SSN 688 boats. As part of this settlement, E. B. was requested to submit by December 1976 the balance of their claim against this contract and any claim against the 2nd production flight of SSN 688's. A multi-million dollar claim is 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 5 LHA's and 30 DD963 class destroyers. Deliveries on both of 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 my understanding that Litton faces up to a $300-350 million loss in the LHA contract and a minimum profit in the DD963 contract—although there are some who do not see any profit accruing 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 F. F. G. program, I was very concerned at the lack of response by the industry to Navy's R. F. P. 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 2 contractors responded—BIW and Todd. On inquiry, I learned that Avondale's top management was vehemently opposed to certain Navy policies and practices used in naval ship procurements and, perhaps more importantly, Avondale was psychologically upset 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. 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 FY 72 and 73 submarine tender (AS) RFP 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.

IV. PRESENT STATUS OF THE NAVY'S SHIPBUILDING PRODUCTION BASE—AN ASSESSMENT

In 1960, 14 private shipyards were engaged in the construction of 83 major combatant, amphibious warfare, and large auxiliary naval vessels. Also, naval vessels were being built in five naval shipyards. Fifteen years later, in 1975, over 90% of the Navy's shipbuilding program (62 of 66 ships) was concentrated in three yards (Newport News, E. B., and Litton) and no new construction ship project has been assigned to a naval shipyard since 1967. This situation resulted because the Navy had consciously made a policy decision in the late sixties to concentrate their work in a few large yards on the basis that mobilization planning and policies to insure the availability of a broad shipbuilding base to support the Navy in emergencies, was no longer necessary or economically affordable. I believe this was a mistaken policy—then, and certainly today it is.

Mr. Chairman, following the Seapower Subcommittee hearings in 1974, I formed in concert with the Secretary of Commerce, a joint DoD/Department of Commerce Informal Planning Group to implement some of the planning recommendations concerning a re-assessment of the mobilization requirements of the U.S. for shipbuilding, overhaul, repair and conversion of Naval and commercial ships, and the readiness of the U.S. shipbuilding industry to support these requirements. In addition, the DoD and Commerce/MARAD joined with the Office of Management and Budget (OMB) in 1975 in a study to develop five year projections of subsidized, private unsubsidized, and Navy ship construction in U.S. shipyards, to identify potentially conflicting demands for resources among the programs, to recommend possible solutions to identified problems, and to assess predictive techniques. The resource availability analysis was to encompass shipbuilding, shipway space, critical ship components plus steel, and skilled manpower.

The OMB/DoD/Commerce study is classified but I can state its scope and conclusions as follows:

SCOPE

Shipbuilding Programs—Two projected programs were analyzed. In the first, or base-case program, the Navy ship list is similar to that now included in the DoD Five Year Defense Plan (FYDP), and the MARAD list reflects annual construction differential subsidy (CDS) funding at a rate of $250 million, which is the currently approved rate. The second program, designated high-level, includes Navy ships needed for a buildup to a 600-ship force, and the CDS projection is based on an annual CDS funding level of $300 million. A third program, designated low-level, was developed but it was not subjected to analysis. It encompassed a Navy program smaller than the FYDP program and a MARAD projection keyed to yearly CDS appropriations of $200 million.

CONCLUSIONS

1. Base-Case and High-Level Programs:

There is sufficient shipyard capacity and materials are potentially available to meet construction requirements.

There is a requirement to improve and expand shipyard labor training programs.

Shipyards will continue to experience high labor turnover, particularly in the mid-Atlantic and Gulf Coast regions, but, shipyard labor problems anticipated under the base-case and high-level programs will not be as difficult in general during the period 1975–1980 as problems encountered by the industry in 1973 and 1974.

The availability of trained and trainable workers will present a significantly greater problem at Newport News than in the balance of the industry.

While it cannot be predicted with high confidence that there will be no slippage of ship delivery schedules, there is no available evidence that slippage will necessarily occur.

Commitment by shipbuilders of yard capacity needed to do Navy or CDS program shipbuilding work as opposed to other ship or non-ship work, such as drilling rig construction, should be reassessed on a continuing basis.

There is need for greater pre-award assurance that contract work can be accomplished, particuraly in yards with known problems.

SOME GENERAL PRINCIPLES

Mr. Chairman, in my statement thus far one might conclude that I have reached a harsh judgment of the Navy's management of its shipbuilding program over the past ten years. Such a conclusion is incorrect and simplistic. Most of what I have outlined thus far has been previously well reported here in Congress, publicly by the industry, or in the press. I have reiterated it in order to set the stage for a mutual appreciation by your committee and we in DoD of the overall size of the problem, the many facets involved, and the grave impact it has on our national defense.

The Navy Department leadership—Secretaries Warner and Middendorf; the CNO's, Admiral Zumwalt and Admiral Holloway; the Chiefs of Naval Material, Admiral Kidd and Admiral Michaelis; all of these responsible officials have worked earnestly and with dedication to bring about an amelioration of the manifold problems alluded to and to address in an equitable and legal manner the many complaints, claims, and controversies that the shipbuilders have lodged with the Navy. Unfortunately, for a variety of reasons largely identified with the unusual economic conditions of the past five years and rigid nature of the contracts signed in the period 1968–1973, their efforts have not been successful.

And I must admit, also, that I have been reluctant to form my present judgment that it is essential that the Secretary of Defense invoke P.L. 85–804 to deal with this threat to our national defense.

In October 1974, I tabled with the Seapower Subcommittee of the HASC a set of general principles which I believe respond to most of the problems of the past 10 to 15 years in the Navy's shipbuilding program. In view of the foregoing I would like to restate these at this time.

General Principles

U.S. Seapower is a vital part of our national security. It is made up of the Navy, the Marine Corps, and the Merchant Marine. It is essential that the Secretary of Defense and the Secretary of Commerce maintain a close and continuing liaison to insure the complementary nature of plans and policies which guide the maintenance and development of these elements.

The Private U.S. Shipbuilding industry and the Naval shipyards are both vitally essential to our National security. The government has been and will continue to be a principal customer of the industry. It is incumbent upon the DoD and the Department of Commerce (MARAD) to deal in a fair and equitable manner with the members of the industry and to foster a cooperative mutual professional association in support of our nation's seapower.

Naval construction shall be conducted in private shipyards to the maximum extent consistent with the mobilization requirement for maintenance of Naval shipyards and the capability of private yards to perform in a timely manner. Some new construction should be assigned to the Naval shipyards on a continuing basis.[1]

The "lead ship-follow ships" technique should be employed. Unless military exigencies require otherwise, the first ship of a class should be substantially completed before the construction of other ships of the same class is begun so that the class design is finalized and construction problems resolved before subsequent ships are partially completed. Every effort shall be made to insure that contract designs and specifications are complete and adequate prior to award of contract in order to minimize change orders.

Ship construction contracts should be of a type appropriate to the level of risk involved in their performance: generally, cost type for lead ships and fixed price incentive type for follow ships. These contracts, especially the fixed price incentive type, should include escalation provisions which protect contractors against abnormal inflationary cost growth while maintaining dis-

[1] On 21 April 1976, by memo to the Secretary of the Navy, the DepSecDef directed the Navy to submit a plan for the allocation of auxiliary type ship(s) of FY 77 program to naval shipyard(s).

cipline against real cost growth; they should provide for an adequate profit commensurate with the risk, investment and performance to yield a fair rate of return to the contractors and to maintain a viable shipbuilding industry.

Oversight of government contractors, including requirements for cost reporting, financial audits, management reviews, and on-site inspections, shall be the minimum consistent with the Defense Department's obligation to the American public to safeguard its tax dollars. Surveillance for its own sake will not be tolerated.

Ship acquisition program managers shall be given the necessary authority and responsibility to manage ships acquisitions effectively and efficiently. The program manager should be the man in charge of all aspects of an acquisition program and should not be restricted by overlapping layers of authority. The on-site government representative (Supervisor of Shipbuilding) should be the direct representative of the program manager.

The Defense Department should insure that contract disputes are settled or decided as speedily and inexpensively as possible consistent with equity and due process. The methods and procedures currently used by the Armed Services Board of Contract Appeals (ASBCA) should be examined to determine their effectiveness in accomplishing this goal. In addition, the Secretary of Defense and the Secretaries of the Military Services should examine other alternatives for the expeditious and inexpensive resolution of contract disputes.

To improve and stabilize our ship acquisition planning program the DoD should request multi-year authorization of the Naval Shipbuilding Program from the Congress. With such planning, the Navy, together with MARAD, should inform the shipbuilding industry of their multi-year forecasts so that industry can plan its facilities and manpower projections in a more orderly fashion.

The United States must adequately fund the Navy shipbuilding program that is deemed required to meet the demands of national security. With the U.S. Navy currently at its lowest level in number of ships since before World War II, it is essential that new ship programs go forward. Problems in acquisition management and unprecedented and unanticipated inflation have created a current situation where the Navy has on hand considerably less funds than are required to complete ships in FY 75 and prior year programs. The Defense Department, working with the Congress, must develop a straightforward solution to this serious problem.

VI. CURRENT PLAN AND ACTIVITY TO EXERCISE AUTHORITY OF PUBLIC LAW 85–804

Mr. Chairman, as I informed you in my letter of 2 April, I appointed on 30 March 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 P.L. 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).
Admiral F. H. Michaelis, Chief of Naval Material.
VAdmiral R. C. Gooding, USN, Commander, Naval Sea Systems Command.

This Committee has been very active since 30 March 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 engaging in dialog with the three major contractors (Newport News, Electric Boat and Litton). Supporting the Committee is a working group chaired by RAdmiral L.E. Hopkins, 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 1968–73 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 provisions of these contracts.

It appears now that it will require at least another 30 to 45 days for the Committee to accomplish its detailed study and negotiation with the shipbuilders, and formulate their firm recommendations. Shortly after this I should be able to make the formal P.L. 85–804 determination necessary to implement the appropriate contractual actions. On this basis I would hope to have taken such action on or about 15 June.

Mr. Chairman, I am mindful of the legal requirement to inform the Committees of Armed Services of the Senate and the House of Representatives in writing of P.L. 85–804 proposals to obligate the United States in any amount in excess of $25,000,000; and of the requirement for a period of 60 days of continuous session of Congress to expire following the date on which such notice was transmitted to such committees and neither House of Congress has adopted within such 60 day period a resolution disapproving such obligation. I expect to formally advise both committees of my proposed action in the next few days.

At this time I can only advise you tentatively concerning the funding that will be required to support this proposed action. The President's 1977 budget request of $1.6 billion for full funding of FY 75 and prior year programs included $1,090 million for escalation and $320 million for claims. Of this amount only $320 million will be available for solution of the shipbuilding problems we are discussing today. It is our current best estimate that this amount will not be adequate; however, we are not yet prepared to provide a more definitive estimate because discussions with the shipbuilders must develop further.

In this regard, we are concerned about the actions of the House to abandon the full funding concept which we strongly support. The House action would be detrimental to our shipbuilding problems. In any event, I would expect to advise you in more detail and with more certainty in the near future.

VII. ESCALATION FORMS—THE OLD AND THE NEW

In applying the extraordinary broad authority of P.L. 85–804 I am mindful of the statement in the report of the Committee on Judiciary which accompanied the bil lauthorizing the making, amendment, and modification of contracts to facilitate the national defense, which became P.L. 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 present judgment that the largest part of the inequities which we recognize in on-going contracts signed in the period 1968–1973, can be overcome by a reformation of the provision for escalation. In doing this, the government would be applying to these older contracts a current and more adequate escalation provision being written into new shipbuilding contracts.

Let me contrast the old escalation forms and the new types.

The Old Type—(The 1962 Standard Escalation Clause).

The traditional contractural provisions for escalation for shipbuilding contracts were designed to sustain for the contractor the same incentives he would have under a firm fixed-price contract without escalation. Escalation or economic fluctuation is measured by a single labor index and a single material index. The labor index is computed and published by BLS based upon direct labor data input from approximately 17 different ship-builders spread around the entire nation. The material index is a weighted composite from the BLS publication "Wholesale Prices and Wholesale Price Indices." The weighting is as follows: 45% Iron & Steel; 40% General Purpose Mach. & Equip.; and 15% Elec. Mach. & Equip.

The bases for escalation payment are set forth in the contract schedule in a predetermined and fixed way. The mix of labor and material and the expenditure profile is determined prior to contract award and remains fixed throughout the entire contract period, except in the event of partial termination. Therefore, the only unknown relevant to the amount of escalation payments to be made is the movement of the relevant index.

To assure that the intent of the parties at the outset is not disrupted during the life of the contract, changes are priced as though there was no provision for escalation in the contract, except, that in the event of a cost decrease change, consideration is given to the amount of escalation which might be paid on those decreased costs as a result of the change.

Provisions are made in the contract to assure that there is a control on the combination of escalation payments and progress payments to be made

to avoid excessive payments—payments are generally limited to 105% of cost incurred, greater progress notwithstanding.

The clause does not cover any extension in performance beyond the original contract delivery date; and further, it does not cover work added by contract modification. Such price adjustments are made on the same basis as if the contract did not provide for escalation. In other words, labor and material adjustments will be priced on the basis of current estimates of the work covered by the modification involved. This procedure loses utility with unpredictable and high inflation rates and is further impacted by the long periods of time that must be anticipated in multi-ship contracts.

When the realities of a shipbuilding program are considered, the potential inequities of the clause become obvious. The clause can operate unfairly with respect to contractors in that:

(1) it exposes the contractor to the risk of inflation whenever performance is extended;

(2) changed work is excluded from coverage under the clause thereby forcing the contractor and the government to try to predict the effects of future inflation when pricing the changes;

(3) the consequential effect of the inflationary period of the early '70s which the contractors could not have been exepected to predict and for which the present contracts offer no relief is the extended delivery periods for ship board equipment and materials. To the extent that these extended deliveries caused prices to be higher and to be paid in a later period and to the extent they caused ship construction to fall in a later time frame neither the escalation clause nor the original incentive pricing arrangement adequately protected the contractor.

To summarize, the "traditional" clause affords an adequate vehicle to compensate a contractor for changes in the cost of labor and material in an environment where either performance proceeds relatively in accordance with the original expectations of the parties at the time they entered into the contract, or where the parties are able to agree promptly on the responsibility for variations from the scheduled performance; or where the level of the applicable BLS Index is relatively constant or changes at a rate predictable at the time the contract was executed.

During the Korean War period there was a steady percentage increase in the Material and Labor Index values of approximately 5%–6%. For the next ten years the percentage increase in the Material Index was a very low 0.4% and while the Labor Index increased at a slightly greater rate the trend was a steady increase over a period of approximately 5 to 6 years. Starting in 1966 there was an increase in both Indices to approximately 5% to 6% but in line with a trend that the contractors had previously experienced and therefore would apparently have developed some degree of confidence in the predictability of the trend. This period lasted for approximately six years.

Unfortunately, during the period 1973–75 none of these stable conditions have proved to be the case in Navy shipbuilding contracts. Performance of contracts was delayed for a variety of reasons but also for such uncontrollable events as the oil embargo, international economic dislocation following in the embargo, and raw material shortages. Simultaneously, and for many of the same reasons, the rate of increase in the BLS indices accelerated. The effect of these two factors on contractors was both to increase the likelihood of late performance as well as the contractual penalty it enacted in the form of increased costs of work in a later period which was uncompensated by escalation.

In mid-1972 an inflationary trend began that certainly was not predicted and for which there was no recent experience. During the fiscal years of 1974 and 1975 the Labor Index increased 8.8% and 12.6% while the Material Index increased 22.7% and 15.1%. The impact of these unpredictable changes in past trends had a significant impact on work performed in a time frame after the original contract delivery date for which the contractor could not be compensated by the escalation provisions of the contract. The forward pricing of work added by change orders could not be accomplished because of the lack of confidence in predicted labor and material prices.

In the past, although contractors had performed work after contract delivery dates, there was not a significant financial problem as long as there was only moderate predictable inflation. The "traditional" or formula method of paying escalation provided cash flow to the contractor in some

cases prior to the purchase of material. This positive cash flow and the positive aspects considering the time values of money ameliorated the economic and financial disadvantage of performing after expiration of contract escalation coverage. However, when the runaway inflation of 1973 and 1974 occurred, the contractors quickly found that the cash flow advantages of the old escalation clause was quickly and completely overshadowed by the inflation rates experienced in the BLS indices.

The New Standard Escalation Clause

In response to the inequities in the traditional clause, and experience in negotiating new shipbuilding contracts, the Navy has developed in 1975 a new escalation clause for use in new contracts. This clause has the following general characteristics:

(a) Escalation is paid on the basis of actual expenditure phasing, as incurred, rather than on the basis of a pre-established and fixed phasing.

(b) Escalation is paid on the basis of allowable costs incurred not to exceed ceiling price rather than on the fixed basis of initial target cost.

(c) Escalation coverage does not cease on a date related to contract delivery date but continues to actual delivery date.

(d) For periods beyond the contract delivery date, escalation is paid on the basis of the BLS index for the contract delivery date or the then current index value, whichever is less.

The approach in this clause has many advantages:

(a) It represents an equitable sharing of contract risk, consistent with the sharing inherent in an FPI contract.

(b) It reduces the need for contingency pricing which is consistent with the central purpose of basic DoD escalation policy.

(c) It supplements the delivery incentive provided through contract delivery provisions and basic contract incentive pricing through the "index ceiling" at contract delivery date.

(d) It more accurately reflects cost growth due to economic factors as opposed to lack of production efficiencies, etc.

(e) It limits the maximum amount of escalation to that based on costs not to exceed ceiling price.

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 1980s and beyond. I am satisfied that a major portion of the Navy shipbuilding 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 certain of their terms have proven to be unworkable. Economic events of recent years have far overtaken the pricing structures incorporated in these long-term contracts, and while new contracts will better protect the shipbuilders against such unanticipated business fluctuations, many years of performance still remain under these existing agreements. The litigious atmosphere and mutual distrust spawned by this situation has diverted the efforts of all parties from their primary job of constructing new naval vessels and seriously threatens the success of further shipbuilding construction programs being planned.

VIII. PLANNED STEPS TO IMPROVE NAVY SHIPBUILDING CONTRACTING AND CONTRACT ADMINISTRATION PROCEDURES

While I believe forthright action utilizing the broad authority of PL 85-804 is the most effective immediate and essential step towards resolving the current serious problems typified by the many claims and unsatisfactory business relations that exist between the Navy and the shipbuilders, I also believe that we—both the Navy and the shipbuilders—need to reform and improve our business and interpersonal relations and procedures if we are to make positive steps forward in the future and avoid the mistakes and sins of the past.

Senior Navy and OSD personnel have developed a plan in this regard that can be discussed in three parts: (1) Improving flexibility in contracting;

(2) Strengthening personnel staffing in project and procurement offices; (3) Refinement and acceleration of Navy contract administration.

Improving Flexibility in Contracting

The plans for improving flexibility in contracting have, for the most part, been drawn from contracting practices which have been tried and proven successful, or from practices which have been generated to cope with inflation, shortages and other similar problems frequently confronting the Navy and its contractors under long term shipbuilding contracts.

The idea of greater flexibility in contracting rests upon the premise that risk sharing must at all times be fair. This means that in times of economic uncertainty such flexibility must afford protection for both contracting parties, that is, neither devastating losses on the one hand for the contractors, nor prices on the other hand that are unreasonable for the Government to pay.

Based on this approach, the following contracting policies and procedures will be more widely employed in the negotiation of prices, contract terms, and conditions at the time of award of new shipbuilding contracts.

(a) *Economic Adjustment (Escalation) Clauses.*—The new escalation clause described above, or similar type clauses, affords the contractor substantial protection for material and labor escalation over the performance period of the contract.

(b) *Use of Cost-Type Contracts for Lead Ships.*—In some cases, it will be desirable to contract for the lead ship of a class under a cost-type contract, in recognition of the very high risk associated with such contracts.

(c) *Increased Ceiling Protection in Incentive Contracts Appropriate for Series Production.*—It is a well-known fact that there are very substantial technical, engineering and production risks in producing today's complex combatant ships. The employment of higher ceilings, that is, higher target to ceiling spreads in incentive contracts, is therefore a means of recognizing these risks without shifting 100% of such risks to the Government. In other words, the contractor must continue to perform to a price even though that price expressed as a ceiling may be somewhat higher than was the practice in the 1960s during which the shipbuilding claims arose.

(d) *Latent/Patent Defects Policy Covering Government-Furnished Data.*—This policy, which had been recently employed on an experimental or optional basis in Navy contracts, will be applied generally to all new contracts. The policy provides that a patient defect, that is, a defect which is discovered by the contractor in the bid or quotation turn-around period, will be corrected by the contractor and will be paid for in the negotiated price of the contract at time of award. A latent defect which would not be discovered until later during the performance period would be covered by a clause in the contract requiring the Navy to pay for the correction of the latent defect when it is discovered. The new policy supersedes a former policy of using disclaimer clauses which put the risk of such defects upon the contractor.

(e) *Use of Fall-Back Options—Late or Defective Government-Furnished Property.*—This approach entails the idea of planning ahead of time for a fall-back option to another proven item of equipment should the preferred item of Government-furnished property prove to be defective, or so late as to have a devastating effect upon the overall shipbuilding program.

(f) *More Realistic Delivery Schedules.*—In certain former cases, delivery schedules were either optimistic or were not attainable due to delays in the planning and award process or for other reasons. Because of the close tie-in between the delivery time frame and the adequacy of the pricing and economic adjustment or escalation clause terms of shipbuilding contracts it is imperative that realistic delivery schedules be adopted and that the contract pricing and escalation protection be premised upon such schedules.

(g) *Increased Delivery Time Interval Between Lead and Follow Ships.*—By increasing the delivery time interval between lead and follow ships, a more orderly transmission and communication interval will be provided for covering lead ship plans and all related interfaces and communications.

(h) *Design Review by Follow Yards.*—In some cases it will be desirable and necessary to provide for design review by the follow yard, or by a potential follow yard under a separate design review contract. The result of this step is a verification of design feasibility and an excellent communication vehicle for early training, learning, and other related advance preparation where the design review yard in turn becomes the follow yard producer.

In summary, Mr. Chairman, the above items are descriptive of some of the more important procurement policy and procedure changes aimed at introducing greater flexibility and a more balanced risk-sharing into the Navy's future shipbuilding contracts. I am convinced that changes in this direction are essential to the timely achievement of the Navy's true shipbuilding needs as authorized by the Congress, and also essential to maintaining a viable shipbuilding industry in this country.

I think that the Navy has the procurement authority under present laws and Department of Defense regulations to undertake most if not all of these new or revised procurement policies and practices. To the extent that there are any implementing actions which may be required by the Department of Defense, I will initiate such actions promptly.

Strengthening Personnel Staffing in Project and Procurement Offices:

I am convinced that certain actions are necessary to strengthen personnel staffing at the senior level in the Navy's project and procurement offices. I am speaking both of military and civilian senior positions which are now unfilled because of previously directed reductions in military and civilian staffings and of some critical new positions which must be created to strengthen the Navy's project management, shipyard management, contracting officer, and negotiating capabilities.

While reductions in all of the Department of Defense components have been necessary, it is apparent that a thorough assessment of senior military and civilian capability must be made. This assessment must assure that each project and procurement office assigned to or covering a critical Navy program is adequately and properly staffed with senior personnel.

To carry this out I have been assured by the Navy that such an assessment will be made and that actions to carry out necessary replacements or new assignments will be promptly accomplished. To the extent that any implementing actions are required by the Department of Defense to bring about this strengthening of senior military and civilian personnel staffing, I will initiate the necessary steps.

Refinement and Acceleration of Navy Contract Administration Changes:

We are cognizant of several causes of claims which the General Accounting Office recently cited in its 1974 Report on Shipbuilding Claims:

- Inadequate or defective specifications
- Defective and late GFI and GFM
- Unanticipated increases in quality assurance requirements
- Failure to identify early potential claim problems

We know that defective or inadequate specifications are major contributing factors to claims. I am directing the Navy to review actions taken to date to ameliorate this problem. I am asking for a detailed review of all past and pending claims; a clear identification of the reasons behind the specification defects and inadequacies that have occurred; an articulation of the lessons learned from these experiences; and a teaching of these lessons learned to the people who have a need to know, i.e., the Navy technical specification interns. I consider this an important item and will follow-up on its implementation.

We are going to plan ahead more effectively to reduce the impact of late and defective GFM that may occur. This is sometimes a significant element in shipbuilding claims because of the complex sequential nature of shipbuilding which requires the availability of suitable equipment for timely installation.

By careful planning, we can avoid ordering systems which are beyond the state of the art, or where not avoidable, provide for alternative or fallback options in the event that the GFM is late or defective. To minimize the employment of such options, I am recommending a comprehensive review of the Navy's reporting system.

I want to minimize excessive Navy inspection. More specifically, contractors complain about how inspectors insist that contract work be performed in a certain way, or that additional work be performed. contrary to the contractor's protests. We certainly want a product that fully complies with the terms of the contract, but we don't want to see the unnecessary creation of constructive change orders under the guise of quality assurance. I will recommend that training programs be implemented providing guidance to Navy

inspectors on the handling of situations involving contractor protesting the directions of Navy inspectors. Moreover, I will ask that quality assurance procedures be clearly defined with a view towards minimizing disputes involving the inspection system.

Finally, I believe there is more that we can do to identify potential claims-related trouble early enough in the contract performance to facilitate its resolution. The Navy is already contractually obligating the contractor to notify the Navy when it feels an event has occurred giving rise to increased Navy-responsible costs. In this regard, the notification which must occur within a specified number of days permits early forward pricing and adjustment of this claim. I am requesting the Navy to refine this surveillance effort by establishing daily inspection teams to record and photograph claims-related events and to participate in timely and equitable adjudication of potential claims.

Suggestions for Industry

Mr. Chairman, as I have mentioned before, some might construe my remarks as being largely critical of the Navy. Such a conclusion is only half true, for I firmly believe that the industry also has contributed in a large measure to the present crisis. With this in mind, I would urge the following actions for the shipbuilders towards improving relations with the Navy and bringing about significant efficiencies in our naval ship acquisition program.

(a) In a cooperative effort with the government seek to establish in a business-like manner, greater visibility between costs and work performed.

(b) Accept the fact that as one party to a contract, private shipbuilders share the responsibility for the excessively adversarial relationship that has existed. In the past ten or more years, many mistakes have been made on both sides of the table. In the public interest, industry and the government should strive to avoid such mistakes in the future.

(c) Prior to entering into a Navy shipbuilding contract, the shipbuilder should carefully review in detail the proposed contract delivery schedules and independently assess the realism of the schedule against his own capacity (i.e., facilities and manpower), the state of his order book, and the projected availability of government furnished information and material. Shipbuilders should not contract to do work to a schedule that is impractical if not impossible.

(d) Of equal importance, shipbuilders should carefulyl examine the adequacy and completeness of the contract plans and specifications. They should raise questions and insist on amplification of the government's procurement proposals, where necessary, to enable the contractor to make a realistic bid as to price and time.

(e) Recognize that when a deliberate "buy-in" with an unrealistic bid is made, any attempt to "get well" via the "change-order" or claims route will be noted by the government and firm action taken to prevent unwarranted price adjustments.

(f) As an industry, work to improve the overall attractiveness of shipbuilding employment, and in concert with the government, increase the formal training programs (e.g., apprentice schools) offered nationwide so that prospects for available work force increases may be realized.

(g) Increase overall labor productivity. Display of multi-year building programs and encouragement of reasonable profits for capable firms should enable the shipbuilding community to increase overall productivity and reduce the extreme labor intensiveness of naval shipbuilding in the United States. Increasing labor productivity would decrease shipbuilding cost susceptibility to wage rate inflation and would be beneficial for all parties.

IX. CONCLUSION

Mr. Chairman, I believe I have covered the background, the current status, and our present and future plans to resolve the numerous difficulties that beset the Navy's shipbuilding program. May I summarize briefly reasons why we in DoD must take the actions I have discussed in this statement and why I earnestly solicit the strong support of the committee to perimt us to go forward.

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.

The Navy is currently providing broad, equitable economic coverages in its new major shipbuilding contracts. By recognizing the principle that equity will be served by backfitting this superior coverage to all on-going major shipbuilding contracts, the government is effectively discharging its responsibilities in the partnership with the shipbuilding industry.

Sgnificant economic advantage will accrue to the Navy. Much manpower and other resources can be more productively used in acquiring new ships that are currently involved in the complex and time consuming claims processing procedures. Key Navy people, such as the ship acquisition program managers, the supervisors of shipbuilding, the functional and technical support personnel will more readily be able to get in harness with the shipbuilders in achieveing the common goal of efficiently rebuilding the Navy.

The current large backlog of shipbuilding claims should be resolved or cancelled.

Future shipbuilding claims on these contracts will be minimized. Basic features of new escalation coverage provide strong deterrent to claims in the future.

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, JANUARY 1, 1969-APRIL 1, 1976

	Number of claims	Claimed amount	Settlement amount	Settlement as percentage of claim	Types of vessels
General Dynamics:					
Electric Boat Div	8	$294,600	$122,600	41.6	SSN, SSBN.
Quincy Div	8	216,755	[1] 90,124	41.6	AE, AS, ROR, LSD.
Total	16	511,355	212,724	41.6	
Litton Systems (Ingalls)	3	34,119	19,922	58.4	SSN, AE, LPH.
Newport News S&DD Co	10	145,562	78,220	53.7	CVA, SSBN, SSN, LCC, LKA.
Alabama DD&SB Co	1	14,219	4,977	35.0	ASR.
Avondale Shipyards	2	169,144	80,000	47.3	DE.
Bethlehem Steel	2	52,173	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 & SB	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 non-nuclear		74.3	77.1		
Total		100.0	100.0		

[1] Includes $-0—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 P—REQUESTS FOR EQUITABLE ADJUSTMENT PENDING AS OF APRIL 1, 1976

	Amount of claim	Percent
Pending as of April 1, 1976, Boland Marine DLG–10 [1]	$3,297,314	
Litton Systems (Ingalls) LHA	504,847,301	
Newport News SB & DD 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	508,144,605	36.2
Nuclear	894,305,520	63.8
Total	1,402,450,125	100.0

[1] Conversion and Modernization Contract.

Notes.—Anticipated to be received in CY 1976: General Dynamics Corp. (Elec. Boat Div.) $300 million; National Steel and Shipbuilding Company $20.0 million.

STATISTICAL SUMMARY: NAVY SHIPBUILDING PROGRAM; CATEGORY C—ASBCA DECISIONS; JANUARY 1, 1969–APRIL 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, 1975 reaffirmed Oct. 24, 1975.	170,192,538	[2] $61,612,158
Total		[3] 193,608,784	[3] 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] 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.
[3] 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]	31,156
LHA ($505 million) [2]	
Total	138,977
Merrit-Chapman & Scott (formerly New York Shipbuilding)	6,844
Todd Shipbuilding Co.: Agor	2,965
Grand total	148,786

[1] ASBCA decision of Apr. 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.

ITEM 31.—*Apr. 30, 1976—Deputy Secretary Clements letter to Senator Proxmire forwarding a copy of Mr. Clements' April 29, 1976 statement to the Senate Armed Services Committee (for enclosure see item 15)*

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C., April 30, 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: This is a follow-up note to my letter to you of April 22nd. As you know, I appeared before the Senate Armed Services Committee yesterday, 29 April, to testify in matters concerning the Navy's shipbuilding program and the action I propose to take by utilizing the authority of P.L. 85–804 to remedy the serious and critical problems in that program which threaten the national defense. Although you may already have seen my statement to the Senate Armed Services Committee, I take this opportunity to forward two copies to you because I think it is appropriate back-up material and very germane to the hearings which you plan to conduct commencing on 12 May.

In addition, I am also enclosing a copy of a special study entitled "Report to the Deputy Secretary of Defense, A Survey of the Navy Shipbuilding Claims Problems, July 1974."[1] In September, 1974, I furnished copies of this study to the chairmen of our principal oversight committees in the Senate and the House. I believe you will find the study quite comprehensive and still very much in date.

Again, Mr. Chairman, I would like to express my strong desire to have an opportunity to meet with you informally prior to the hearing on 12 May—either in your office or, if convenient to you, I would be pleased to have you join me for lunch here in the Pentagon.

Sincerely,

BILL CLEMENTS.

ITEM 32.—*Apr. 30, 1976—Deputy Secretary of Defense letter to Congressman Price, Chairman of the House Armed Services Committee providing official notice required by Public Law 85–804 prior to taking action under Public Law 85–804 in excess of $25 million. The letter states that although negotiations with the shipbuilders involved have not been completed it is reasonably certain that the additional cost to the Government will be between $500 and $700 million*

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C.

Hon. MELVIN PRICE,
Chairman, Committee on Armed Services,
U.S. House of Representatives,
Washington, D.C.

DEAR MR. CHAIRMAN: From 1969, the Navy shipbuilding program has had numerous problems with the shipbuilders growing out of contractual disputes concerning many technical and procedural matters, but largely focused on the assessment of responsibility for delay and disruption. As of 1 April 1976, the total of these disputes amounts to $3,189 million. As of that date, $1,317 million of these claims have been settled for $631 million, and there are pending claims in the amount of $1,872 million in negotiation or litigation.

These disputes have created prolonged litigious confrontations between the Navy and the shipbuilders which has brought about actual and threatened stop work actions by the shipbuilders on important major Naval combatant ship construction projects. It is my judgment, after considerable study and inquiry over the past three years, that there is implicit in many of the disputes significant mutual damage. Transcending the specific of the many claims against the government is the inequity which the unanticipated inflation of the early 70's wrought upon the shipbuilders who entered into very large fixed price type contracts for ship construction work extending over periods of 4 to 10 years or more. This double digit inflation was not predicted by either party to these contracts.

[1] Enclosure may be found in DoD files.

It is not the policy of the Government to relieve contractors from the burdens of unprofitable contracts fairly entered into; however, neither is it in the Government's interest to enforce contracts of such importance to the national defense when certain of their terms have proved to be the source of critical problems which threaten the national defense. Economic events of recent years have far overtaken the pricing structure incorporated in many of these long term contracts especially when performance was delayed beyond contract delivery dates. And while the new contracts which have been made with the shipbuilders since 1974 will better protect the shipbuilders against such unanticipated business fluctuations, many years of performance still remain under the older contracts initiated in the period 1968–1973. These older contracts, 11 in number, provide for the construction of 70 major naval vessels (including aircraft carriers, missile cruisers, destroyers, amphibious assault ships, attack submarines, many of which are nuclear powered,) which have and will join the operating fleets in the 1974–1981 period. The older contracts involved are identified in the attachment.

Mr. Chairman, in many discussions over the past year with the Secretary of the Navy and other senior Navy officials, we have sought to find ways and means to bring about a more expeditious, legal, and equitable settlement of these many outstanding claims. The Navy has devoted significant manpower, both in-house and by contract, to speed up the analysis of the shipbuilders' claims. Additionally, much consideration has been given to examining the practicability of modifying these older contracts on a quid pro quo basis with the shipbuilders without resorting to P.L. 85–804. Reluctantly, I am now convinced that neither of these alternatives will yield an adequate remedy in reasonable time or eliminate the acrimonious and adversarial environment that now marks the Navy-shipbuilders business relations.

In view of the foregoing, and as required by P.L. 85–804, as amended by P.L. 93–155 (1973), which requires that 60 days of continuous session of Congress expire prior to my taking action under the law absent a congressional resolution disapproving the obligation of funds in excess of $25 million, I am formally notifying you, as of this date, of my intent to use the authority of P.L. 85–804. In so doing I intend to bring about early remedial actions (including such interim contract financing as may be necessary) concerning the contract disputes between the Navy and the shipbuilders which I find now to constitute a major threat to the national defense.

Although the exact terms of the plan under P.L. 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 FY 1977 budget request for Shipbuilding and Conversion, Navy includes $1,623 million for Cost growth and Escalation. The P.L. 85–804 plan as outlined above can not 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 P.L. 85–804 become more firm.

Sincerely,

W. P. CLEMENTS, Jr.

Enclosure.

Shipbuilding Contracts Proposed for Modification Under P.L. 85–804

Contractor:	
Electric Boat Division	N00024–71–C–0268
General Dynamics Corp	N00024–74–C–0206
Ingalls Shipbuilding Division	N00024–69–C–0283
Litton Systems, Inc	N00024–70–C–0275
Newport News Shipbuilding & Dry Dock Co. (Tenneco Corp.)	N00024–67–C–0325
	N00024–68–C–0355
	N00024–69–C–0307
	N00024–70–C–0252
	N00024–70–C–0269
	N00024–71–C–0270
National Steel & Shipbuilding Co	N00024–73–C–0227

ITEM 33.—*May 3, 1976—Letter from Congressman Les Aspin to Admiral Rickover requesting his views on the advisability of invoking Public Law 85–804 to settle Navy shipbuilding claims*

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D.C., May 3, 1976.

Adm. H. G. RICKOVER,
Nuclear Power Director, Naval Sea Systems Command, Department of the Navy, Washington, D.C.

DEAR ADMIRAL RICKOVER: On April 30th, 1976, the Deputy Secretary of Defense William P. Clements, Jr., formally notified Congress of his intention to invoke the provisions of Public Law 85–804 on eleven Navy shipbuilding contracts, including two contracts for the construction of SSN–688 nuclear-powered submarines at the Electric Boat division of General Dynamics Corporation, and six contracts involving the construction of nuclear-powered cruisers and aircraft carriers at Newport News Shipbuilding and Drydock Company, a subsidiary of Tenneco Corporation.

In testimony on Thursday, April 29th, before the Senate Armed Services Committee, Deputy Secretary Clements outlined his plans for the use of Public Law 85–804. Essentially, Mr. Clements proposes to rewrite existing contracts, principally altering the escalation clause, in exchange for an agreement by the shipbuilders to drop all current and future claims.

I have had an opportunity to review your testimony of September 23rd, 1974, before the Sea Power Subcommittee of the House Armed Services Committee. In your testimony (Page 1267), you state that "I know of no other segment of the defense industry where contractors receive such favorable escalation and progress payment provisions from their contractors." You added that "some shipbuilders, however, are asking to be treated as a special part of the American economy—a part that should suffer no losses no matter what mistakes they make and be assured of netting the full profit they expected at the outset."

As you know, under Public Law 93–155, which amended Public Law 85–804, Congress has sixty days in which either house may disapprove the use of Public Law 85–804. Since the principal purpose of the use of Public Law 85–804 is to improve the generosity of the escalation clause, and in view of your earlier statement before the Sea Power Subcommittee that no other segment of the defense industry receives more favorable clauses, I hope that you could comment on the legality, propriety, wisdom, and long-term impact of this proposal.

Later in your testimony (Page 1295), you indicated that some people were advocating the settling of claims as a management decision, not as a legal decision. Later (Page 1329), you expressed your opposition to this viewpoint. You stated, "I strongly disagree with such a course of action. As I have already said, claims should be settled strictly on their legal merits. The taxpayer is entitled to this. While the kinds of settlements recommended by the Department of Defense report may be expedient, they undermine the integrity of government contracts. Why should the Navy waste time negotiating fixed price contracts if it ultimately intends to bailout any losses afterwards, as if the contract were cost type?" You added that "the pressure shipbuilders are putting on the Defense Department directly to settle the claims quickly and the danger that such pressure would lead to improper settlements" must not be overlooked. "As I see it, claims by shipbuilders have become a method of converting fixed price contracts into cost-plus contracts," you said.

It is clear to me that the action proposed by the Department of Defense for the use of Public Law 85–804 goes well beyond a management decision to accept claims to which the contractor is not legally entitled. Since you have been deeply involved in the management of a number of these programs, I hope that you could provide me with your comments on the wisdom of the proposal to abolish the claims settlement process and replace it with a generous and liberal rewriting of contracts. Does it appear to you that this process will convert the contract into defacto if not dejure cost-plus contracts?

As a member of the House Armed Services Committee, I believe that it is very important that our committee and the Sea Power Subcommittee make an informed judgment on the proposal. The potential liability to the govern-

ment is so high that the impact of the use of Public Law 85–804 on our ability to produce needed ships at the lowest possible cost to the taxpayer may be endangered.

In your initial discussion with a member of my staff, you suggested a review of your testimony before the Sea Power Subcommittee to ascertain your views on claims. As I indicated earlier, such a review has been made. Unfortunately, since the use of Public Law 85–804 was not an issue at the time, you had not commented before my committee on its potential use. I look forward to receiving your comments.

Thank you very much for your cooperation in this matter.

Sincerely,

LES ASPIN, *Member of Congress.*

ITEM 34.—*May 4, 1976—Letter from Assistant Secretary of Defense Frank A. Shrontz to Senator Proxmire forwarding detailed information on pending Navy shipbuilding claims*

ASSISTANT SECRETARY OF DEFENSE,
Washington, D.C., May 4, 1976.

Hon. WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government, Congress of the United States, Joint Economic Committee, Washington, D.C.

DEAR MR. CHAIRMAN: This is in furtherance of Deputy Secretary of Defense Clements' letter of April 22, 1976 and provides the data on the shipbuilding claims which you requested in your letter of April 9, 1976.

Sincerely,

FRANK A. SHRONTZ,
Assistant Secretary of Defense
(Installations and Logistics).

Enclosures.

PENDING SHIPBUILDING CLAIMS

Shipbuilder	Number	Type	Contract description: Ship type: Description	Hull	Contract price: Original	Contract price: Current	Status: Number completed	Status: Number in construction	Status: Percent of completion	Claim amount: Original	Claim amount: Current
Ingalls Shipbuilding Div	N00024-69-C-0283	FPIS	Amphibious Assault ship.	LHA	$1,012,500,000	807,600,000	0	5	82.7	$270,000,000	$504,847,300
				1	(1)				98.0		
				2					89.7		
				3					82.2		
				4					71.9		
				5					71.0		
Newport News Shipbuilding	N00024-68-C-0355	FPIE	Guided Missile Cruiser (Nuclear)	CGN	175,000,000	179,971,886	2	0	100.0	35,036,981	151,040,521
				36					100.0		
				37					100.0		
Newport News Shipbuilding	N00024-70-C-0252	FPIE	Guided Missile Cruiser (Nuclear)	CGN	300,000,000	303,082,196	0	4	55.6	159,774,936	(2)
				38					93.1		
				39					67.1		
				40					48.0		
				41	86,400,000	100,900,000			14.3	(3)	
Newport News Shipbuilding	N00024-70-C-0269	FPIE	Attack submarine (Nuclear).	SSN 688	83,300,000	86,900,000	0	1	96.6	46,203,379	78,543,149
Newport News Shipbuilding	N00024-71-C-0270	FPIE	Attack submarine (Nuclear).	SSN	249,500,000	253,400,000	0	4	63.2		
				689					81.0	96,277,734	191,567,199
				691					70.0		
				693					55.4		
				695					46.2		
Newport News Shipbuilding	N00014-67-C-0325	FPIE	Aircraft carrier (Nuclear).	CVN	760,000,000	791,300,000	1	2	90.5	221,280,223	(2)
				68					100.0		
				69					80.0		
				70	(4)				7.0	(3)	
Newport News Shipbuilding	N00024-69-C-0307	FPIE	Attack submarine (Nuclear).	SSN	96,800,000	98,350,000	2	0	100.0	92,099,492	(2)
				686							
				687							
Boland Marine [5]	N00024-74-C-0241	FPI	Guided missile Frigate.	DLG-10	22,365,000	26,723,099	0	1	78.0	3,297,114	3,297,114

[1] Based on 9 ships.
[2] No change.
[3] Not included in claim.
[4] Not definitized.
[5] Modern and conversion.

Notes:
FPI=Fixed Price Incentive.
FPIE=Fixed Price Incentive with Escalation.
FPIS=Fixed Price Incentive Successive Target.

Shipbuilder	Number	Type	Contract description				Status				
			Ship type		Contract price						
			Description	Hull	Original	Current	Number completed	Number in construction	Percent of completion	Original claim amount	Current appeal amount
Ingalls Shipbuilding Division..	N0bs-4374	FFPE	Submarine, nuclear..	SSN-621	$23, 405, 750	$54, 125, 125	1	0	100	$94, 536, 717	$107, 820, 866
	N0bs-4510	FFPE	Submarine, nuclear..	SSN-639	29, 500, 000	56, 638, 908	1	0	100		
	N0bs-4582	FFPE	Submarine, nuclear..	SSN-648, 662	59, 971, 870	98, 898, 751	2	0	100		
	N0bs-4625	FFPE	Amphibious transportation dock.	LPD-7, 8	51, 458, 000	61, 707, 757	2	0	100		
	N0bs-4616	FFPE	Amphibious assualt ship.	LPH-10	31, 972, 000	34, 841, 166	1	0	100		
	N0bs-21(A)	FFPE	Amphibious assualt ship.	LPH-12	37, 874, 000	43, 782, 697	1	0	100		
	N0bs-4924	FFPE	Dock landing ship...	LSD-36	24, 374, 150	26, 115, 676	1	0	100		
Ingalls Shipbuilding Division..	N00024-68-C-0342	FPIE	Submarine, nuclear..	SSN-680, 2, 3	107, 416, 500	140, 998, 934	3	0	100		
Ingalls Shipbuilding Division..	N00024-69-C-0283	----------	----------	(2)	----------	----------	----------	----------	----------	----------	(1)
Lockheed Shipbuilding Construction Co.	N0bs-4660	----------	----------	(4)	----------	----------	----------	----------	----------	(3)	(2) (4)
	N0bs-4765	----------	----------	----------	----------	----------	----------	----------	----------	----------	----------
	N0bs-4795	----------	----------	----------	----------	----------	----------	----------	----------	----------	----------
	N0bs-4902	----------	----------	----------	----------	----------	----------	----------	----------	----------	----------
Merrit-Chapman & Scott (formerly New York shipbuilding.)	N0bs-3920	FPE	Guided missile destroyer.	DDG-4, 5, 6	49, 123, 500	(5)	3	0	100	3, 761, 696	6, 844, 000
	N0bs-4247	FPE	Guided missile frigate.	DLG-19, 20	49, 886, 594	(5)	2	0	100		
	N0bs-4268	FPER	Submarine, nuclear..	SSN-603, 4	45, 389, 098	(5)	2	0	100		
	N0bs-4294	FPE	Guided missile Destroyer.	DDG-15, 16, 17.	47, 313, 996	(5)	3	0	100		
	N0bs-4356	FPE	Submarine, nuclear..	SSN-612	26, 133, 753	(5)	1	0	100		
	N0bs-4569	FPE	Guided missile frigate nuclear.	DLGN-35	53, 987, 001	(5)	1	0	100		
	N0bs-4655	FPE	Fast combat support.	AOE-2	48, 484, 000	(5)	1	0	100		
Todd Shipbuilding, Seattle....	N00024-69-C-0256	FFP	Oceanographic research.	AGOR-16	13, 950, 000	(5)	1	0	100	2, 888, 342	2, 965, 000

[1] ASBCA decision of Apr. 16, 1976, determined the adjusted claim to be $30,335,136 and further determined $17,175,764 to be due contractor.
[2] Withdrawn from docket to permit further negotiations. Included in "Pending Shipbuilding Claims."
[3] Suspended from docket.
[4] Award by ASBCA to contractor but not yet paid due to allegation of possible fraud.
[5] Unable to obtain final contract price. Information is not readily available.

Note.—FPIE=Fixed Price Incentive with Escalation.
FPE=Fixed Price, Escalation.
FPER=Fixed Price Escalation, Redeterminable.
FFPE=Firm Fixed Price with Escalation.

SHIPBUILDING CLAIMS—ASBCA DECISIONS

Shipbuilder	Number	Type	Contract description: Ship type: Description	Contract description: Ship type: Hull	Contract price: Original	Contract price: Current	Status: Number of companies	Status: Number in construction	Status: Percent of companies	Original claim amount	Current appeal amount
General Dynamics (Quincy)	NObs-4509	FPE	Submarine, nuclear	SSN-638	$28,456,000	(1)	1	0	100	$10,300,000	$23,416,246
	NObs-4583	FPE	Submarine, nuclear	SSN-649	33,500,000	(1)	1	0	100	9,500,000	(2)
Lockheed Shpbldg. & Construction Co.	NObs-4660	FFP	Amphibious Transport Dock.	LPD-9,10	50,445,000	$68,004,933	2	0	100	24,151,451	[3] 38,211,262
	NObs-4765	FFP	Amphibious Transport Dock.	LPD-11,12,13.	69,774,000	86,017,218	3	0	100	24,991,341	39,777,809
	NObs-4785	FFP	Escort Ship	DE-1057,63,65,69,73.	60,285,000	68,877,000	5	0	100	30,783,460	59,253,650
	NObs-4902	FFP	Amphibious Transport Dock.	LPD-14,15	48,395,000	63,201,935	2	0	100	20,198,260	32,949,817

[1] Unable to obtain final contract price. Information is not readily available.
[2] ASBCA denied contractor's claim. Suit has been filed with the U.S. Court of Claims.
[3] Award made by ASBCA to contractor. Not yet paid due to allegation of possible fraud.
Note.—FFP=Firm Fixed Price

ITEM 35.—*May 4, 1976—Memorandum from the Assistant General Counsel of the Department of Defense to the General Counsel concerning the power of the Deputy Secretary of Defense to exercise the authority of Public Law 85–804*

DEPARTMENT OF DEFENSE,
OFFICE OF THE GENERAL COUNSEL,
Washington, D.C., May 4, 1976.

MEMORANDUM FOR THE GENERAL COUNSEL

Subject: Public Law 85–804; Exercise Thereof by Deputy Secretary of Defense Clements.

The question has been raised as to the authority of Deputy Secretary of Defense Clements to exercise the statutory authority provided by Public Law 85–804, 50 U.S.C. 1431–1435.

The authority provided by this statute is by the terms of the statute itself vested in the President. The President, in turn, has delegated it to the heads of various departments and agencies by Executive Order 10789 of November 14, 1958, as amended. With respect to the Department of Defense, the above Executive Order authorized its exercise within this Department "whenever, in the judgment of the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, or the Secretary of the Air Force, or the duly authorized representative of any such Secretary, the national defense will be facilitated thereby."

Section 134(b) of title 10, United States Code, provides that the Deputy Secretaries of Defense shall perform such duties and exercise such powers as the Secretary of Defense may prescribe. By DoD Directive 5105.2, dated January 27, 1976, the Secretary of Defense (with certain exceptions not pertinent here) delegated to Deputy Secretary of Defense Clements "full power of authority to act for the Secretary of Defense upon any and all matters concerning which the Secretary of Defense is authorized to act pursuant to law."

From the above, it seems quite clear that the Deputy Secretary of Defense Clements has power to exercise the authority of Public Law 85–804.

Executive Order 10789 also provided that with respect to the Department of Defense the exercise of the authority of Public Law 85–804 was subject to such regulations as may be prescribed or approved by the Secretary of Defense. Current regulations, approved by the Secretary of Defense, exist in Section XVII, of the Armed Services Procurement Regulation. Part 2 of Section XVII, among other things not pertinent here, addresses itself to "amendments without consideration". Part 3 of Section XVII constitutes all the powers under the law not covered by Part 2. The proposed actions with respect to the ship building contracts (i.e., primarily to amend the contracts to provide a broader form escalation clause but also with the intent to obtain consideration from the contractors in terms of the waiver of certain claims) is not a type of action within the contemplation of Part 2 but rather is an action which more properly falls within the coverage of Part 3, the so-called residual powers. The findings and procedures required by Part 3 will be applied.

JAMES P. NASH,
Assistant General Counsel
(Logistics).

ITEM 36.—*May 7, 1976—Letter from Deputy Commander for Contracts, Naval Sea Systems Command to Mr. Richard Kaufman, General Counsel, Joint Economic Committee, forwarding information regarding revisions of Navy shipbuilding claims*

DEPARTMENT OF THE NAVY,
NAVAL SEA SYSTEMS COMMAND,
Washington, D.C., May 7, 1976.

MEMORANDUM FOR MR. RICHARD KAUFMAN, GENERAL COUNSEL, JOINT ECONOMIC COMMITTEE

Subject: Data Regarding Current Shipbuilding Claims.

1. Attached is the information that you requested regarding revisions of Navy claims.

L. E. HOPKINS,
Deputy Commander for Contracts.

Enclosures.

DATA REGARDING CURRENT SHIPBUILDING CLAIMS

Company	Hull number	Claim sub. date	Original claim sub.	Amount of revenue	Date of revenue	Current claim amount
Newport News	CGN 36, 37	June 11, 1973	$35, 036, 981	$3, 670, 662	Sept. 13, 1973	
				3, 664, 600	Nov. 12, 1973	
				848, 603	Jan. 1, 1974	
				6, 088, 316	June 3; 1974	
				19, 456, 498	Oct. 31, 1974	
				82, 274, 861	Feb. 13, 1976	$151, 040, 521
Do	CGN 38–40	June 8, 1975	159, 774, 936	(1)	(1)	159, 774, 936
Do	SSN 688	July 2, 1975	46, 203, 379	32, 339, 770	Mar. 8, 1976	78, 543, 149
Do	SSN 689,691, 693, 695	July 2, 1975	96, 277, 734	95, 289, 456	do	191, 567, 199
Do	SSN 686,687	Mar. 8, 1976	92, 099, 492	(1)	(1)	92, 099, 492
Do	CVN 68 and 69	Feb. 19, 1976	221, 280, 223	(1)	(1)	221, 280, 223
Ingalls Shipbuilding	LHA 1–5	March 3, 1972	270, 700, 000	105, 300, 000	March 3, 1973[2]	
				24, 000, 000	July 7, 1974	
				104, 847, 301	April 4, 1975	504, 847, 301

[1] No change.
[2] LHA claim never fully documented by Ingalls. Now in process of full documentation in accordance with agreed plan of action January 1976.

ITEM 37.—*May 10, 1976—Listing of pending claims by shipbuilders against the Navy as of April 1, 1976*

CLAIMS BY SHIPBUILDERS AGAINST THE NAVY

[Pending as of April 1, 1976]

Shipbuilder	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 68–68	Feburary 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	104,847,301
	Agreement to renegotiate January 1976	
Subtotal		504,847,301
Boland Marine: DLG–10	Aug. 13, 1975	3,297,314
Total		1,402,450,135

ITEM 38.—*May 17, 1976—Admiral Rickover letter to Congressman Les Aspin in response to his request for comments on the proposal to use Public Law 85–804 to resolve Navy shipbuilding claims. Admiral Rickover comments, "Why bother negotiating and signing contracts if they are not going to be enforced?"*

DEPARTMENT OF THE NAVY,
NAVAL SEA SYSTEMS COMMAND,
Washington, D.C., May 17, 1976.

HON. LES ASPIN,
Cannon House Office Building,
U.S. House of Representatives,
Washington, D.C.

DEAR MR. ASPIN: This is in reply to your letter of May 3, 1976. In this letter you stated that you had reviewed my testimony of September 24, 1974 before the Sea Power Subcommittee of the House Armed Services Committee concerning contracts and claims. You requested my comments on the "legality, propriety, wisdom and long-term impact" of the current Defense Department proposal to use Public Law 85–804 to modify certain shipbuilding contracts.

As my testimony shows, I have long advocated enforcement of defense contracts and settlement of claims on their legal merits. I view the issue this way: Why bother negotiating and signing contracts if they are not going to be enforced?

My testimony also shows that if defense officials consider the Navy should settle claims for more than contractors are legally owed, or on any basis which bypasses orderly procedures for settlement of claims, they can exercise their authority to provide extra-contractual relief under the provisions of Public Law 85–804. I have made it clear I fully understand that any settlement made under P.L. 85–804 is a matter within the purview of defense officials and the Congress.

Defense officials have notified Congress of their intention to provide P.L. 85–804 relief to Newport News Shipbuilding and Dry Dock Company, a divi-

sion of Tenneco; to Electric Boat Division of General Dynamics; to Ingalls Shipbuilding Division of Litton Industries; and to National Steel and Shipbuilding Company. They are doing this to resolve the backlog of shipbuilding claims quickly.

The terms of the P.L. 85–804 settlements with these shipbuilders have not yet been negotiated. Some of the claims have not yet been submitted. The claims in hand have not been reviewed to determine Government responsibility for the amounts claimed. For these reasons, I am in no position to give an opinion on whether the final settlements will satisfactorily resolve the shipbuilding claims problem. I have pointed out to my superiors that the extent to which the proposed settlements result in the Government paying for items for which contractors are liable may set precedents which could undermine the integrity of Government contracts—not only those in shipbuilding but throughout the defense industry, and possibly other segments of industry as well.

During the past ten years, it has become increasingly common for some shipbuilders who overrun their contracts to submit large, after-the-fact claims in an effort to get the Government to pay for the overrun plus a desired profit. Frequently these claims are exaggerated. Some shipbuilders from the outset of a contract collect a record of every item for which they can find any basis to allege Government responsibility. Years later, when the shipbuilder knows what his final costs will be, these items are consolidated into a general allegation of Government responsibility for all delays and costs experienced, without relating the individual causes to specific effects. The amount claimed is often inflated sufficiently to produce the profit desired by the shipbuilder, even if the claim is settled for only a fraction of the claimed amount.

When such claims are submitted the Navy must 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, 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 obviously time consuming. Sometimes it appears that a shipbuilder saves up these claims to submit to the Navy over a short period, thus creating a large claims backlog. It is not then uncommon for some shipbuilders to pressure defense officials to settle the claims quickly.

Under the terms of Navy shipbuilding contracts, shipbuilders are compensated for changes, disruption, delays and other cost increases, which arise from causes which are the Government responsibility. The Navy policy is to resolve each item with the shipbuilder as soon as the cause is identified. However, when it becomes evident that the costs attributable to Government-responsible causes are not enough to yield their desired profit, they hold out for higher amounts. They save up items over a period of years which are then submitted as an omnibus claim. They exaggerate the effects of Government actions. They refuse to support the elements with cause and effect analysis. They revise claims repeatedly. They threaten to stop work if the claims are not paid quickly. They complain publicly and to defense officials about unfair treatment. By these means some shipbuilders believe they will be paid more than if their claims were settled on legal merits.

Some shipbuilders allege in claims that all delays and cost increases are the Government's fault, even when they know that much of the delay and increased cost were caused by factors within the shipbuilder's contractual responsibility. The Navy's normal claims evaluation procedure is to determine and pay only for items of Government responsibility. When agreement cannot be reached the contract calls for referral to the Armed Services Board of Contract Appeals.

The proposed P.L. 85–804 approach would by-pass this process. The decision to apply P.L. 85–804 to shipbuilding claims introduces questions which must be considered by those responsible for implementing this decision. For example:

a. How can the Government determine a fair and equitable settlement 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 P.L. 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 P.L. 85–804 relief be applied without undermining the requirement contained in the Armed Services Procurement Regulations that all other legal or administrative remedies must first be exhausted?

f. How can settlements be reached that do not leave currently pending claims outstanding?

g. How can settlements be reached that do not encourage future claims?

h. 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 the practice of trying to improve their financial position by submitting massive claims?

i. How can the Government have effective business relationships if contractors can conclude the Government will not enforce its contracts?

Statements have been made to the effect that P.L. 85–804 relief is needed because Navy shipbuilding contracts awarded during the late 1960's and early 1970's were inequitable, unfair, or unworkable. The principal reason given is that they allegedly did not protect the contractor adequately against the effects of inflation. The "inequity" stems from the fact that shipbuilding contracts do not protect shipbuilders against the effects of inflation when ships are delivered late or at higher cost for reasons that, under the terms of the contract, are the shipbuilder's responsibility.

When the contracts were negotiated, both the Navy and the shipbuilders were well aware that the contracts did not provide such protection. Moreover, I am aware of no shipbuilder claim which asserts that the escalation clause is inequitable or that the Government is responsible to provide escalation protection for contractor-responsible delays.

The escalation provisions of shipbuilding contracts provide for payments to shipbuilders based on changes in economic indices prepared specifically for the shipbuilding industry by the Department of Labor. Such protection against unanticipated inflation is rarely found in defense contracts outside the shipbuilding industry. Therefore, shipbuilders are better protected from the effects of unanticipated inflation than any other segment of the defense industry. Contractors other than shipbuilders accept the risk of unanticipated inflation on contracts which require many years to complete. In shipbuilding contracts, on the contrary, that risk is taken by the Government to the extent the shipbuilder performs within the negotiated target amounts of the contract.

Shipbuilders suffer from inflation only to the extent their delays or cost overruns are not caused by actions which are the Navy's responsibility under the contract. When the Government is responsible for cost increases beyond the original contract amounts, the contracts provide for reimbursement, including escalation. When the contractor is responsible, the extra costs are his to absorb. That is the identical method used to pay for changes on all other defense contracts.

If the Navy's shipbuilding contracts are determined to be inequitable because they do not protect the shipbuilders from the effects of inflation on contractor-responsible costs, it could then be argued that all long term Government contracts and subcontracts which do not provide such protection are also inequitable.

Apart from whether Congress accepts the characterization of Navy shipbuilding contracts as unfair, inequitable, or unworkable, some shipbuilders may now argue in courts of law that Navy shipbuilding contracts have been impeached by such statements of defense officials before the Congress and are therefore unenforceable. The Navy is already experiencing problems in this regard. Last month in a court pre-trial hearing, Newport News lawyers cited Defense Department statements that Navy contracts are unfair, in support of their contention that the option for the nuclear cruiser CGN–41 is invalid. Thus, should the Defense Department be unable to negotiate a P.L. 85–804 settlement with the shipbuilders, statements made by officials in support of the P.L. 85–804 action might render the contracts unenforceable.

Consequently, if the requested use of P.L. 85–804 is not approved, I believe Congress would be well-advised to establish a formal record as to whether the Navy shipbuilding contracts are, in fact, unfair, inequitable, or unworkable. In this way the statements of defense officials in support of the P.L. 85–804 action will not, of themselves, be sufficient to render Navy shipbuilding and other Government contracts legally unenforceable.

Complaints have been made that the Navy is handling its claims slowly. The impression is left that these delays are causing financial hardship to shipbuilders. In this regard the following status of claims at the four shipyards included in the proposed P.L. 85–804 settlement should be considered:

a. National Steel and Shipbuilding Company. I understand that this company has announced its intention to submit a claim, but to date it has not done so.

b. Electric Boat Division of General Dynamics. One large claim was recently settled for $97 million following normal Navy procedures. Electric Boat currently has no other outstanding shipbuilding claims against the Navy. The company has notified the Navy that a claim on the SSN Class ships will be submitted later this year. They have agreed that this claim will be certified as current, accurate, and complete as of 1 November 1976; also the claim will document cause and effect of all Government-responsible items.

c. Ingalls Shipbuilding Division of Litton Industries. The $504.8 million LHA claim is the only Litton claim currently outstanding in the Navy. Although this claim was first asserted in general terms some four years ago, the company did not agree until January, 1976 to submit a documented claim. The Navy is now receiving portions of the claim for evaluation. One $107.8 million shipyard-wide "ripple" claim has been heard by the Armed Services Board of Contract Appeals; the final Board decision is pending. The Board recently issued its decision in the case of a $31.2 million Litton submarine claim, awarding the company $16.5 million. This is the claim before a Federal Grand Jury for investigation of possible fraud.

d. Newport News Shipbuilding and Dry Dock Company, Inc. Of the $894 million increase in ceiling prices requested in the claims submitted, all but $69 million was submitted within the last ten months; $665 million was submitted in the past four months. To date, although so requested by the Navy, company officials have refused to certify these claims as being current, complete, and accurate. Navy Procurement Directives require such certification prior to commencing evaluation.

These claims are voluminous. A cursory review indicates that in many cases these claims do not relate specific causes to specific effects. Extensive Navy effort will be required to determine the amount the Navy actually owes Newport News.

In this regard, if the Navy were to adjust contract ceiling prices by the full $894 million requested, the actual additional Navy cash payments to the company would be about $450 million. This figure is based on the assumption that Newport News will complete the ships within the estimates contained in their latest cost reports. Such a settlement would result in Newport News recovering all their costs plus about twice the aggregate target profits specified in the original contracts. Even if the claims were settled for but 40 percent of the $894 million claimed, Newport News would recover all their costs plus roughly the same aggregate target profit specified in the original contracts.

As discussed below, much of the financial problem on Newport News-Navy shipbuilding contracts is the outgrowth of company actions taken several years ago. Thus, it is apparent that the Newport News claims are highly inflated.

The above status summary shows that, while it does take considerable time to evaluate complex, multi-million dollar claims particularly when they are inflated and do not reasonably relate cause and effect—the allegation that the Navy has been slow in processing the current claims backlog is misleading.

The basic question in the Newport News situation is whether the Navy will take responsibility for financial problems at Newport News regardless of the company's responsibility and performance under its Navy shipbuilding contracts. In my opinion most of the financial problem on Newport News-Navy shipbuilding contracts is the outgrowth of company actions.

In 1971, Newport News projected a need to build up manpower from 18,200 early in 1971 to over 30,000 employees in 1973 to meet its commitments on

existing Navy contracts. In the fall of 1972, Newport News signed a contract for three Liquified Natural Gas Carriers (LNG's) and announced plans to build a new yard for construction of these and other merchant ships. The decision to take these actions was made by Tenneco without any prior consultation or agreement by the Navy—as it was then Newport News' right to do.

At that time, Newport News had an employment level of about 27,000 people and was still building up its manpower. Newport News and Tenneco officials stated at the time that they expected to make manpower for the commercial work available within their expected 30,000 employment level due to a projected decline in Navy work starting in mid-1974.

In early 1973, shipyard productivity decreased and there was a large increase in fabrication errors—apparently caused by the lower skill level of the new hires. In 1973, Newport News announced that it had abandoned its plans to build up to the 30,000 employees which it had projected were necessary to meet commitments on Navy contracts. Since that time the employment level has decreased to the present level of about 22,000.

The decline in productivity and increase in rework during the work force expansion caused an increase in the number of manhours required to complete present Navy contracts. To accommodate this increase in manhours and the shortfall in manning, Newport News stretched out Navy ship construction schedules. Under the contract terms these manpower problems and the costs of escalation on the deferred work are the responsibility of the shipyard.

The shipyard still does not have sufficient trained manpower to meet existing commitments on Navy contracts. As a result, the company is currently faced with: (1) building up the manpower assigned to commercial contracts, (2) delaying the commercial ships, or (3) delaying the Navy ships further. Newport News in its claims states that the Navy is responsible for all the delays and higher costs which accrue on Navy work.

While Newport News is owed some money on its claims, the company, by the nature of its claims submissions, has made it very difficult and time consuming to sort out the items for which legal entitlement does exist. It is reasonable to conclude from the manner in which the claims have been presented that the company believes actual entitlement under these claims to be considerably less than the amount being sought.

Statements have been made to the effect that the shipbuilding claims problem stems principally from the fact that many of these ships are nuclear powered. The type of power plant used in a ship has nothing to do with the issue of whether or not there will be claims. In the early 1970's the large shipbuilding claims involved primarily non-nuclear ships and non-nuclear shipyards, such as Avondale, Todd, and Lockheed; Newport News submitted several claims on non-nuclear ships.

The recent claims by Newport News and Electric Boat involve nuclear ships, since those yards currently build only nuclear ships for the Navy. The Litton claims are only to a smaller extent involved with nuclear ships.

Even in the case of nuclear ships, except for the nuclear propulsion plant—for which I am responsible—the ships are built to the same standards and with the same methods employed on non-nuclear ships. Thus, it is not correct to characterize the shipbuilding claims problem as one predominantly associated with nuclear power.

A specific example may help illustrate what the Navy is up against. Much of the impetus for the decision to settle shipbuilding claims under P.L. 85–804, in my view, stems from the efforts of Newport News officials and their superiors in Tenneco. About two years ago they began airing complaints about the Navy before Congress and in the press. Company officials took the position that on all Navy shipbuilding contracts they should be guaranteed a 7 percent profit after paying interest and other unallowable costs. To the extent they realize less, they recommended that the Navy adjust its contracts to yield the desired results and modify Navy procurement policies to ensure profitability in future contracts.

Despite Newport News' notification as early as October, 1974 of its intention to submit claims, the company did not submit these until recently—$825 million of the $894 million total in the last ten months, $665 million in the last four months. But the pressure has been intense to settle these claims immediately. On February 19, 1976, Newport News submitted its largest claim on a single contract; a $221 million, sixteen volume claim against the car-

riers CVN 68 and CVN 69. (Newport News cost reports submitted to the Navy indicate that they have recovered all costs to date on this contract and that, without the claim, Newport News estimates they will make a profit of about $30 million on the CVN 68 and CVN 69.) The following day the President of Newport News sent a letter to the Chief of Naval Operations intimating that Newport News was considering stopping work on the CVN 70 and not entering into new Navy shipbuilding contracts until its claims were resolved.

Six months earlier, Newport News actually stopped work on 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 CGN 41 option because they want a higher price. Although the 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. In this regard, it is worth noting that the Navy is at a disadvantage in the litigation due to the imbalance in legal resources being applied on this case. The brunt of the Navy's legal work on this case is currently being handled by one lawyer, two years out of law school, who is handling this case as one of several assignments. Newport News, on the other hand, has thus far charged to the Navy contract over $155 thousand of outside counsel fees on the CGN 41 option dispute plus a seven percent profit to Newport News. It is interesting to me that I have been unable to get the Navy to hire outside counsel to help the Navy prepare its case, but the Navy is paying Newport News for its outside counsel.

Newport News officials have made their intentions clear. On March 15, 1976, the President, Newport News sent a letter to Congressman Downing (reprinted in the March 18 Congressional Record) 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 their public statements; by complaints to defense officials and Members of Congress; by threats of taking no future Navy business; and in the case of CGN 41, by challenging the validity of the CGN 41 option and actually stopping work. In my own case, a well-known Washington attorney under retainer to Tenneco, last year lobbied extensively in Congress and in the Executive Branch in an effort to dissuade the Secretary of the Navy from extending me on active duty when my reappointment came up for renewal last January.

There seems to be a tendency by some defense officials to view the shipbuilding claims problem as simply a problem in human relations. In actuality it is strictly one of money. If a shipbuilder is going 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 be paid only what he is legally owed, regardless of pressures the company may bring to bear.

I believe the Navy would be better off if it would insist on compliance with its contracts—in federal court if necessary—to maintain a sound basis for conducting future business. If contractors believe they will be excused from their contract obligations by submitting inflated claims, refusing to honor contracts, complaining to higher authority, and the like, they and others will be encouraged to follow this approach in the future.

I recognize that senior defense officials have responsibilities far broader than my own and as a result may have to view problems differently than I do. Perhaps, because of our dependence on particular private shipbuilders they may be able to refuse to honor contracts. If this is the case, and the Navy is going to have to guarantee profit on shipbuilding contracts under threat of not being able to get Navy ships, I would favor the Government acquiring title to such shipyards. They could then be operated by private industry under long-term contracts that would guarantee the operating contractor a profit. In that way the Navy would have an assured source of supply; shipbuilding would be financially attractive to contractors (no investment together with a guaranteed profit); and perhaps both the Navy and its shipbuilders could concentrate on ship construction rather than contract disputes. If the contractor did not perform satisfactorily the Navy could seek a different contractor to operate the facility. This approach would prevent the shipbuilder from again forcing reformation of his contracts by threats of diverting his manpower and facilities to other work.

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. Actually, the procurement of military hardware from Government-owned, contractor-operated facilities is not a novel method in defense procurement. In fact, it appears that Navy ships are among the few major weapon systems not presently being procured from contractors who use large amounts of Government-owned facilities. Specifically:

a. As of 1975, Department of Defense investment in terms of acquisition cost, in its 88 Government-owned, contractor-operated facilities totaled almost $4 billion. Since most of these plants were built during World War II or the 1950's, the current value of these facilities is undoubtedly significantly greater than the original acquisition costs.

b. The Air Force has 32 major plants which produce and assemble airframes, engines, guided missiles, and electronics for both defense and for commercial customers. The contractors operating these plants rely extensively on Government-owned facilities to perform their contracts. Examples of aircraft weapon systems produced in whole or part at Air Force plants are the B–1 bomber; the F–4, F–15, and F–16 fighters; the F–111 fighter bomber; and the C–5A, C–130, C–140, C–141 cargo planes. Missile systems produced in Air Force plants include the Titan III, Minuteman II and III, SRAM, Genie, TOW, Phoenix, Maverick, and Harpoon.

c. The Navy has 23 active plants dependent on Government-owned facilities to produce and assemble airframes, rocket engines, guided missiles, gun mounts, and electronics. Aircraft weapon systems produced at Navy Government-owned, contractor-operated plants include the F–14 fighter, the A–6E bomber, the EA–6B electronic warfare plane, the E–2C early warning aircraft, the A–7 Corsair II bomber, and the T–2 trainer. Missile systems produced in Navy-owned plants include the Standard and Redeye missile systems, the Condor and Sparrow III missiles, and the Polaris, Poseidon, and Trident I missiles.

d. The Army has 24 ammunition plants which are entirely owned by the Government and operated by contractors. The acquisition value of these ammunition plants exceeds $2 billion. In addition, the Army has 9 other industrial facilities with a total acquisition value greater than $200 million. The Army's M60A1 tanks are built in a Government-owned, contractor-operated facility. Dragon missiles and UH–1 "Huey" helicopters are assembled in Government-owned, contractor-operated facilities.

Except for the Army ammunition plants, most of these facilities are provided under facilities contracts in which the contractor gets rent-free use of the facility for Government work. Many of these plants have Government- and contractor-owned assets intermingled such that the plant cannot be operated properly without the consent and participation of both the Government and the contractor. This co-mingling of assets prevents the Government from changing plant contractors in the event of unsatisfactory management, even if the Government has paid for nearly the whole plant.

Large amounts of the Defense Department's procurement budget are spent on weapons systems produced primarily in Government-owned, contractor-operated facilities. In FY 1976 alone, Congress appropriated:

$1,036,100,000 for the F–14A fighter, A–6E bomber, EA–6B electronic warfare plane, and the E–2C early warning aircraft—all to be assembled by a contractor at the Navy's plants at Bethpage and Calverton, New York.

$1,415,500,000 for the F–15 fighter to be produced by a contractor at the Air Force's facility in St. Louis, Missouri.

$451,100,000 for M60A1 tanks to be built by a contractor in the Army's tank plant in Detroit, Michigan.

$265,800,000 for Minuteman III missiles which will be built in Air Force facilities and $199,900,000 for the Trident missile which is being developed and is to be produced in a Navy-owned facility.

Thus, if building ships in Government-owned, contractor-operated shipyards is labelled nationalization of an industry and abandonment of the free-enterprise system, then shipbuilding would be one of the last segments of defense industry to be so nationalized. The major difference under the concept I would propose and past Defense Department practice, however, would be that

the Government would own the entire shipyard so that the operating contractor could not render the shipyard useless simply by denying use of essential, contractor-owned facilities. The Navy should also retain the right to change operating contractors if they did not perform satisfactorily. This difference would be a major improvement over the manner in which many of our defense procurement dollars are presently spent.

I trust this letter is responsive to your request. In view of the fact that the general problem of Navy shipbuilding claims is presently the subject of public hearings by the House Armed Services Committee, I have taken the liberty of providing a copy of my response to the Chairman of that Committee.

Respectfully,

H. G. RICKOVER.

ITEM 39.—*May 18, 1976—Senator Proxmire speech to the Senate, "Shipbuilding Claims Against the Navy: A Manufactured Crisis"*

Mr. PROXMIRE. Mr. President, William P. Clements, Deputy Secretary of Defense, has formally notified Congress that the Pentagon is invoking its national emergency powers under Public Law 85–804 to pay over half a billion dollars to two Navy contractors. The two contractors, Newport News Shipbuilding & Drydock Co. and the Ingalls Shipbuilding Division of Litton, have filed $1.4 billion worth of shipbuilding claims against the Navy.

In addition, Mr. Clements says that about $300 million in claims is about to be filed by the Electric Boat Division of General Dynamics. These claims have not yet been received by the Navy.

THE CLAIMS HAVE NOT BEEN FULLY AUDITED

Part of Mr. Clements' argument in support of emergency treatment of the claims, rather than the normal settlement procedures followed by the Navy, is that the claims represent long-standing disputes and therefore must be quickly resolved. The impression has been created that the claims are old and that they have been unresolved for a long period of time.

The facts are that most of Newport News' claims were either filed for the first time or revised this year, and that the backup documentation for Litton's claims has still not been submitted to the Navy.

What this means is that the Navy has still not had a chance to fully audit or analyze the claims. For the Government to pay the claims wholly or in part without a full audit and analysis would be like buying a pig in a poke.

Such an action is objectionable as a matter of principle. The taxpayer should not have to pay for unaudited, unanalyzed claims.

Paying these particular claims before they are fully audited is especially objectionable.

A MANUFACTURED CRISIS

After reviewing the facts and the sequence of events in this matter, I am forced to conclude that the Pentagon is conspiring with the shipbuilders to manufacture a crisis designed to cover up cost overruns and possible false claims that could cost the taxpayer hundreds of millions of dollars.

The facts surrounding the $1.4 million in claims filed by Newport News and Litton against the Navy show that they are based at least in part on vague estimates, phony assertions and inflated figures.

The facts also show that the timing of many of the claims coincide with pressures applied to get them quickly settled and that the Pentagon is now trying to exempt the contractors from audits of their claims and pay them under a national emergency law.

CLEMENTS PROPOSAL IS FOR A BAILOUT

The Pentagon's purpose seems to be to bail out two defense contractors who have incurred huge cost overruns because of their own inefficiency and failures to deliver on time

I am confident that if the claims were thoroughly audited, they would be revealed as largely a mixture of hocum and hot air.

The squeeze play engineered by Clements and the shipbuilders has already resulted in recent provisional payments of nearly $20 million to Litton based on an incomplete analysis of partial information.

Litton asserts that the Navy agreed in a March 1976 meeting to pay the company $50 million in provisional payments. I am informed that Navy officials deny making any such agreements.

SHIPBUILDERS HAVE WITHHELD DOCUMENTATION

Part of Litton's and Newport News' strategy has been to withhold supplying the Navy with the documentation of their claims in order to delay or prevent Government auditors from examining them. Three-fourths of Newport News' $894 million in claims were either filed for the first time or substantially revised this year. Newport News began preparing its claims years ago, sat on them for months after the paperwork was completed, and then dumped most of them in the Navy's lap last February and March.

In January, Clement met personally with J. P. Diesel, president of Newport News, to discuss the claims before most of them had even been filed. Early in February Clements ordered Adm. James L. Holloway, Chief of Naval Operations, to come up with the plan to resolve the claims dispute with Newport News in 30 days. Some of the largest claims had still not been filed.

NUCLEAR CARRIER CLAIM FILED FEBRUARY 1976

Newport News' largest single claim—$221 million for the aircraft carriers *Nimitz* and *Eisenhower*—was filed on February 19, 1976, together with 16 thick volumes of documentation. On February 20, Diesel wrote to the Navy threatening to stop work on other Navy ships unless there was progress toward settlement of its claims.

NUCLEAR SUBMARINE CLAIMS FILED MARCH 1976

Newport News' $92 million claim for the nuclear submarines SSN 686 and SSN 687 was not filed until March 1976. I am informed that Newport News completed its price estimates for this claim in May 1975.

Another curious fact about the SSN 687 and SSN 687 claims is that General Dynamics built four submarines of the same class, in the same time period, in accordance with the same designs. Yet General Dynamics has no significant claims against the Navy for its submarines.

NEWPORT NEWS CLAIMS FILLED WITH DISCLAIMERS

Other disturbing facts about the Newport News claims are:

First, the statements accompanying the claims are filled with disclaimers indicating the company would not be able to prove the Navy owes the amounts alleged.

Second, with regard to its $160 million claim on the cruisers CGN 38, 39, and 40, documentation "includes the team's analysis of contemporary documents and working files which might be lost when the project goes into final completion stages." The contractor also admits "some errors may have been made" in its estimates, and that the specific impact of what the Navy is alleged to have done "is difficult to identify."

Third, Newport News also admits "some errors may have been made" in its nuclear submarine claim, that its conclusions cannot be proven with certainty, and that it may be evaluated differently by the Government.

Fourth, Newport News refuses to certify its claims although Navy regulations require that contractors certify that their claims are "current, complete and accurate" in a sworn affidavit.

LITTON LHA CLAIM STILL NOT FULLY DOCUMENTED

Litton's claim on the helicopter carrier program—LHA—was originally $270 million in 1972 and was revised upwards three times until it reached the total of $505 million in April 1975.

The Navy rejected Litton's original claim in 1973 on the grounds that it had failed to substantiate its allegations with facts. The Navy did agree to pay Litton $169.7 million for cancellation costs when the LHA program was cut back from nine ships to five ships. Litton appealed the decision to the Armed Services Board of Contract Appeals instead of providing the Navy with supporting facts.

In January 1976, the Navy and Litton agreed that the contractor would withdraw its appeal, begin documenting the LHA claim, and resume nego-

tiations after the Navy examined the backup data. Litton's documentation began arriving in March, enabling the Navy for the first time to begin analyzing the facts behind the claim. In the latter part of March, Secretary Clements pulled the rug out from beneath the Navy by deciding the Government should provide financial relief to Newport News and Litton through its national emergency powers.

EARLIER LITTON CLAIM UNDER INVESTIGATION BY JUSTICE DEPT.

Among the disturbing facts about Litton are the following:

First, an earlier Litton claim on a submarine contract was referred by the Navy to the Justice Department for investigation of possible fraud. That investigation is now taking place.

Second, in 1972 Roy Ash, president of Litton, urged the Navy to ask Congress for $1 billion to $2 billion to solve LHA and other shipbuilding problems. Ash said he discussed such a program with a Mr. Connally, who was quoted as saying that it should be positively presented, "on a grand scale—make it bigger than the Congress."

Third, only a fraction of the supporting data to the LHA claim has been submitted to the Navy.

Fourth, Litton's shipyard facility has been proven to be inefficient and poorly managed by a number of Government investigations. This is the same company that ordered a ship cut in half so that when welded back together Litton could claim that it had been built according to modern, modular construction techniques.

THE REAL ISSUE—WHO IS TO BLAME FOR DELAYS AND COST OVERRUNS?

I believe Secretary Clements is a man of high integrity and that he is dedicated to the public interest. I also feel certain that the Navy must share some of the responsibility for the problems in the shipbuilding program. The real issue is, who is to blame for the schedule delays and the cost overruns?

THE CLAIMS MUST BE FULLY AUDITED AND ANALYZED

There is no way to decide this issue until the claims are thoroughly audited and analyzed.

The contractors should have nothing to fear from a Navy audit if the claims are legitimate.

The taxpayer should not have to pay anything for unaudited, unanalyzed and unsubstantiated claims.

Under the law the Senate and the House each have 60 days of continuous session to adopt a resolution disapproving the Pentagon's proposal. Clearly, there is no national emergency justifying the wholesale bailout of the shipbuilding industry proposed by Mr. Clements. It is also of interest that the shipbuilders themselves have not asked for the kind of relief contemplated by the law that is being invoked.

The Senate should reject the Clements proposal.

ITEM 40.—*May 19, 1976—Senator Proxmire letter to Senator Stennis requesting that the Defense Department withdraw the Public Law 85-804 notification until all pertinent facts and information the Congress needs are available*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., May 19, 1976.

Hon. JOHN C. STENNIS,
U.S. Senate,
Washington, D.C.

DEAR JOHN: I thought it might be useful if I explained my position on Secretary Clements' proposal with regard to shipbuilding claims, in view of our recent conversation.

Let me say at the outset that I do not question anyone's motives on this matter. The problem is a complex one and there is room for differences of opinion on many of the questions involved. In addition, serious consideration

must be given to the requirements of national defense and the needs of the Navy for ships.

On the other hand, there are fundamental principles at issue with regard to the responsibility of Congress for public funds. I am sure you will agree that certain prerequisites should be met before any taxpayer's money is used to reimburse a contractor for a claim against the government. The first prerequisite is that government should be certain that the claim is accurate and that there is government liability.

The fact is that the government has not conducted a full audit and a comprehensive analysis of either the Newport News claims, which total $894.3 million, or the Litton claim, which totals $504.8 million. The reason the government has not yet done its audit is that in the Newport News case three-fourths of its claims have been filed only this year or have been revised this year. As you know, it takes many months and sometimes years for a company to prepare a major claim. It has simply not been possible for the Navy to complete an audit of the claims that have been so recently filed.

In Litton's case, although the claim was originally filed in 1972, it has been revised substantially on three different occasions and, in addition, the complete documentation of the claim has still not been supplied to the Navy.

I find it very hard to justify any proposal that would pay out large sums of money to government contractors for unaudited claims.

Another disturbing aspect of this matter is the fact that statements have been made suggesting the shipbuilders might be forced to stop work on Navy ships because of their losses on ship contracts and their overall negative cash flow situation. This seems to be the basis for invoking PL 85–804 which provides extraordinary relief for government contractors.

Here too, there has been little, if any, substantiation of the assertions that have been made.

Finally, I am deeply concerned over the way PL 85–804 has been invoked by Secretary Clements in light of the 1973 amendment to PL 93–155. You will recall that the 1973 amendment was adopted to give Congress 60 days of continuous session to decide whether to adopt a resolution disapproving proposals such as the present one.

As one of the authors of that amendment, I can say that it was clearly intended for Congress to have all the information, including the full facts and details of any such proposal, before it during the 60 days. In this case, however, we still do not have the full facts and details of the proposal. Secretary Clements has said he would provide more information in June.

I find this procedure highly irregular and in violation of the intent of the law. It is simply not possible for Congress to consider whether to approve a proposal during a 60 day period if the full facts of the proposal are not available during the same 60 day period.

I would suggest that, at the very least, the proposal be withdrawn and resubmitted when the Defense Department has all the pertinent facts and information that Congress needs in order to consider it.

I also feel very strongly, as I am sure you do, that major claims against the government should not be paid unless the claims have been fully documented and audited, and there has been a determination of legal liability. Moreover, in order to invoke PL 85–804, which provides for extraordinary relief to government contractors experiencing financial difficulties, the fact that the contactors are having financial difficulties entitling them to this extraordinary relief should be fully established.

I would like to work with you further in a constructive way to help resolve these problems.

Sincerely,

WILLIAM PROXMIRE, *U.S. Senate.*

ITEM 41.—*May 19, 1976—New York Times article entitled, "U.S. Deal Could Change Losses to Profits for Three Shipbuilders"*

(By John W. Finney)

WASHINGTON.—Three of the Navy's principal shipbuilders could turn an anticipated loss of $467 million into at least a $74 million profit with the contractual relief being offered them by the Defense Department.

Under the proposed revision of the shipbuilding contracts with the Navy, the profit could be as much as $300 million. However, Defense Department officials do not expect to settle at the higher level in the current negotiations with the shipbuilders.

Deputy Defense Secretary William P. Clements confirmed the projected profit figures to reporters as he appeared today before the House Armed Services Committee to defend a proposed arrangement. Under the plan, the Navy would settle some $1.8 billion in claims by the three companies by reopening their contracts and giving them additional money.

The basic change would be to allow the shipbuilders cost escalation on ships they have failed to deliver to the Navy on schedule.

The three companies involved are the Ingalls Shipyard division of Litton Industries, the Newport News Shipbuilding and Drydock division of Tenneco Inc., and the Electric Boat division of the Dynamics Corporation. Among them, they expect a $467 million loss on 11 contracts they hold with the Navy to build 70 ships and submarines.

Under critical questions by committee members, Mr. Clements repeatedly insisted that the proposed revision of the contracts would not amount to a bailout of the companies.

Rather, he said, the proposed arrangement was designed to achieve an "early and equitable resolution" of a problem that he said was reaching "crisis proportions," with the shipbuilders reluctant to take on new Navy work unless their past claims were settled.

Figures supplied by Pentagon officials to Representative Les Aspin, Democrat of Wisconsin and a member of the committee, showed that under the new cost-escalation clause, Litton which faces a loss of $207 million on two contracts to build 35 ships, would be given an additional $239 million and make a profit ranging from $32 million to $47 million. The range in the profits depends on what new delivery dates and terms are set in the revised contracts.

PROFIT NOW EXPECTED

Newport News Shipbuilding and Drydock, which faces an estimated loss of $127 million on six contracts for 16 nuclear powered ships and submarines, would be given an escalation payment of from $145 million to $210 million and make an estimated profit ranging from $30 million to $101 million.

In addition, it would be given an additional $75 million for construction of the nuclear powered carrier Vinson, which it has threatened to stop building unless its claims on past contracts are settled.

The Electric Boat division of General Dynamics, which faces an anticipated loss of $135 million on two contracts to build 18 nuclear powered submarines, would be given escalation payments ranging from $178 million to $288 million and make a profit ranging from $18.4 million to $153.3 million.

In confirming the basic accuracy of the figures supplied to reporters by an Aspin Aide, Mr. Clements placed the minimum anticipated profits for Litton at about $22 million, for Newport News Shipbuilding and Drydock at $32 million and for Electric Boat at $20 million.

Mr. Clements pointed out to reporters that the total of $74 million in profits would be on contracts totaling $8 billion and taking up to eight years to complete.

He also told reporters "that Litton, which he noted has unconditionally guaranteed" the contracts of its Ingalls Shipbuilding division, had a "serious" cash-flow problem, growing in large measure out of its work for the Navy.

Even with the contractual relief, he noted, Litton faces a $130 million loss on its contract to build five helicopter carriers for the Navy.

"If that's a bailout, I don't understand what a bailout is," he observed at one point to the committee.

DESTROYER PROFIT EXPECTED

The loss on the helicopter carriers would be offset by a $112 million profit the company expects to make in building 30 destroyers as well as the new cost-escalation payments.

According to Defense Department officials, Litton has complained that the additional payments would not be sufficient to solve its cash-flow problems.

Mr. Clements disclosed that the Defense Department was discussing other contractual relief for the company, such as amending clauses dealing with warranties on the ships and penalties on late deliveries.

The opposition to the proposed arrangement seemed to be abating within the committee, which was initially critical of the emergency plan for bypassing the Navy's normal procedures for settling claims by shipbuilders.

The committee majority seemed prepared to go along with the basic Clements argument that the emergency action was necessary to remove "the acrimonious atmosphere" between the Navy and the shipbuilders and to get built the ships needed by the Navy.

In a speech on the Senate floor, Senator William Proxmire, Democrat of Wisconsin accused Mr. Clements and the shipbuilders of engineering a "squeeze play" to "bail out defense contractors who have incurred huge cost overruns because of their own inefficiency and failure to deliver on time."

ITEM 42.—*May 20, 1976—New York Times article entitled "Rickover Wants Shipyards to Comply With Contracts"*

(By John W. Finney)

WASHINGTON.—Adm. Hyman G. Rickover advocated today that shipyards be forced to comply with their contracts with the Navy rather than being given a settlement on what he described as their "inflated" claims against the Government.

The admiral publicly entered the debate in a 13-page letter to Representative Les Aspin, Democrat of Wisconsin, a member of the House Armed Services Committee.

As he has done privately with senior members of the committee, Admiral Rickover openly opposed a proposal worked out by Deputy Defense Secretary William P. Clements, Jr. to settle some $1.8 billion in claims by rewriting the contracts to give three shipyards additional money on ships they have failed to deliver to the Navy on schedule.

Without settlement of the claims, the three shipyards—the Ingalls Shipbuilding division of Litton Systems Inc., the Newport News Shipbuilding and Drydock Company, a subsidiary of the Tenneco Corporation and the Electric Boat division of the General Dynamics Corporation—face an estimated loss of $467 million on contracts to build 70 ships and submarines for the Navy Under the Clements proposal to reopen the contracts, they would make a profit of at least $74 million.

Rather than reopen the contracts, Admiral Rickover advocated that the claims be settled "on their legal merits" through the established claims settlement procedures of the Navy. "Why bother negotiating and signing contracts if they are not going to be enforced?" he asked.

Throughout the letter ran a charge by the admiral, who has long been at odds with the shipyards, that the claims were exaggerated and were largely to cover cost increases for which the shipyards, not the Navy, were responsible. About two-thirds of the claims are on nuclear-powered ships and submarines, whose construction falls under the supervision of Admiral Rickover.

"During the past 10 years, it has become increasingly common for some shipbuilders who overrun their contracts to submit large after-the-fact claims in an effort to get the Government to pay for the overrun plus a desired profit," he said. "Frequently these claims are exaggerated."

The shipyards, he said, "exaggerate the effects of Government actions. They refuse to support the elements with cause and effect analysis. They revise claims repeatedly. They threaten to stop work if the claims are not paid quickly. They complain publicly and to defense officials about unfair treatment.

"By these means, some shipbuilders believe they will be paid more than if their claims were settled on legal merits," said.

As an example of the "pressure" that he said the shipbuilders sought to apply to the Pentagon, Admiral Rickover said that " a well know Washington lawyer under retainer to Tenneco last year lobbied extensively in Congress and in the executive branch in an effort to dissuade the Secretary of the Navy from extending me on active duty when my reappointment came up for renewal last January."

Thomas G. Corcoran, a prominent lawyer-lobbyist who for more than a decade has represented Tenneco, said in an interview that he had been ap-

proached by Navy officials about "how could they get Rickover out of the hair of the shipbuilders" and he had replied: "why don't you make him Commandant of the Naval Academy?"

Mr. Corcoran, whose Washington connections go back to New Deal days, insisted that he had not lobbied in Congress against another two-year tour of active duty for the 76-year-old admiral, who, he said, "regards me as a personal enemy because I have been standing in the way of his effort to nationalize the shipyards."

Mr. Corcoran was notably present at a hearing yesterday of the House Armed Services Committee, shaking the hands of Navy admirals who were publicly supporting the Clements plan.

Within some Congressional circles, the Clements proposal is viewed as an attempt by the Defense Department and the shipbuilders to cut down the independent, demanding authority that Admiral Rickover has exercised over the shipbuilders. If so, it could present a personal test of political power, since Admiral Rickover has considerable influence among senior members of the House Armed Services Committee.

Admiral Rickover suggested that "if the Navy is going to have to guarantee profit on shipbuilding contracts under threat of not being able to get Navy ships," then the Federal Government should acquire title to the shipyards and have them operated by private industry under long-term contracts.

ITEM 43.—*May 27, 1976—Senator Proxmire letter to Secretary of the Navy Middendorf requesting information about a news report that Thomas G. Corcoran, a prominent lawyer/lobbyist for Tenneco, had been approached by Navy officials about "how could they get Rickover out of the hair of the shipbuilders"*

HON. J. WILLIAM MIDDENDORF II,
Secretary of the Navy,
Washington, D.C.

DEAR MR. SECRETARY: The May 19, 1976 issue of the *New York Times* contains an article entitled "Rickover Wants Shipyards to Comply With Contracts." The article quoted from a letter Admiral Rickover sent to a Member of Congress on the Defense Department's decision to pay shipbuilding claims by use of Public Law 85–804 instead of using the normal claims settlement procedures.

Admiral Rickover is quoted as saying, "A well-known Washington lawyer under retainer to Tenneco last year lobbied extensively in Congress and in the the executive branch in an effort to dissuade the Secretary of the Navy from extending me on active duty when my reappointment came up for renewal last January." The article continued:

"Thomas G. Corcoran, a prominent lawyer-lobbyist who for more than a decade has represented Tenneco, said in an interview that he had been approached by Navy officials about 'how could they get Rickover out of the hair of the shipbuilders and he had replied: 'Why don't you make him Commandant of the Naval Academy?'

"Mr. Corcoran, whose Washington connections go back to New Deal days, insisted that he had not lobbied in Congress against another two-year tour of active duty for the 76 year old admiral, who he said 'regards me as a personal enemy because I have been standing in the way of his effort to nationalize the shipyards.'"

I have had a long standing concern about undue influence on the defense establishment exercised by some large defense contractors. The current Defense Department proposal to try to pay claims under Public Law 85–804 apparently grows out of such pressure by Navy shipbuilders.

In this regard I would like answers to the following questions:

1. Did you or anyone else in the Navy or Defense Department every contract Mr. Corcoran to ask his advice on how you could get Admiral Rickover "out of the hair of the shipbuilders?" If so, why was he thus approached? Who in the Navy or Defense Department approached him? When? What specific questions was he asked? What advice did he render? What action did the Navy or DOD take as a result?

2. Did Mr. Corcoran or other representatives or officials of Newport News or Tenneco express their views on the advisability of giving Admiral Rickover a different assignment to you or any other Navy or Defense Department

officials? If so, which Navy or Defense officials were contacted and when? What specific company officials or representatives were involved? What was their advice? Were there any company actions suggested, such as a refusal to do Navy work or take additional Navy business, if Admiral Rickover were reappointed.

3. Have you or other Navy or Defense Department officials had any discussions with Mr. Corcoran or any other lobbyist, representative or official of or Tenneco about the difficulties Newport News is experiencing with its Navy shipbuilding contracts? If so, please state the date and location of such discussions and briefly describe them.

I would appreciate your prompt response to the above questions.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 44.—*June 2, 1976—Newport News Daily Press article entitled "Settlement of Ship Claims Could Exceed Estimates"*

WASHINGTON (AP).—Officials of Congress' General Accounting Office testified Tuesday the cost of settling $1.7 billion in shipbuilding claims could far exceed the $747 million the Navy estimates.

Deputy Comptroller Gen. Robert F. Keller told the House Armed Services Committee that aside from the $747 million there is no assurance the four major shipbuilders involved will drop all the $1.7 billion in claims.

Under questioning from Ships Subcommittee Chairman Charles Bennett, D-Fla., Keller refused to rule out even the possibility that the settlement could wind up costing more than the $1.7 billion in claims.

While testifying he had no reason to believe that would happen, Keller told Bennett: "It is an unlimited possibility."

Keller and aides testified at hearings on proposals to veto action by Deputy Secretary of Defense William P. Clements to quickly settle the $1.7 billion in claims with a one-time emergency arrangement.

The arrangement basically would be to change cost escalation clauses in the shipbuilders' present contracts so that they would be paid their actual costs, even for delivering ships late, instead of the contracts' estimated costs.

Keller said the GAO estimates the settlement would turn $463 million in losses the shipbuilders now face on the contracts into $103 million in profits.

The shipbuilders involved are General Dynamics' Electric Boat Division, Litton's Ingalls Shipbuilding Division, the Newport News Shipbuilding and Dry Dock Co. and National Steel and Shipbuilding Co.

Newport News Shipbuilding and Dry Dock Co. had no comment.

Clements testified last month the emergency settlement is needed because the shipbuilders are threatning to stop building ships for the Navy because of inability to make profits on the work.

The GAO's Keller said there is no way to know if that would happen.

But he said the GAO is not convinced on the basis of its investigation so far that the shipbuilders could not complete the 70 ships in the 11 disputed contracts without the emergency action.

Keller disclosed that the Navy estimates the contract revision would cost up to $747 million and could go higher if inflation goes higher than the Navy expects.

Beyond that, Keller said, there is no way to know until the Navy completes negotiations with the shipbuilders how much of the $1.7 billion in claims they will drop in return for the contract revision.

Clements has promised to give Congress those figures by June 10, about 20 days before its 60 day period for vetoing the action runs out July 1.

But Rep. Samuel S. Stratton, D-N.Y., said Congress should simply veto the present action for lack of information and let a new 60 day period start when Clements comes with hard figures on what the settlement will cost.

Stratton also asked Keller if Clements had not violated the spirit of the congressional veto provision of his emergency action by not giving Congress full figures at the start.

"That certainly is the way I would come out of it," Keller replied.

ITEM 45.—*June 2, 1976—Gordon W. Rule speech before the Shipbuilders Council of America entitled "Relations Between the Navy and the Shipbuilding Industry of the United States"*

RELATIONS BETWEEN THE NAVY AND THE SHIPBUILDING INDUSTRY OF THE UNITED STATES

Good afternoon, ladies and gentlemen.

The very kind invitation to speak here today stated that this luncheon reception was "honoring" me.

This sort of terminology causes me considerable heartburn. It is somewhat analogous to Senator Proxmire inviting me to testify and addressing me as "Dear Gordon" and signing it "Bill." I have asked him not to do that because some of my well-wishers seize upon that as evidence of a cozy relationship with the senator.

Now you shipbuilders are "honoring" me. These same well-wishers are already making noises because of some recent writings of mine. I told them Captain Wells said that all "honoring" means is that I should feel honored to have been invited to speak and get a free lunch and I left it at that. Suffice to say, I am honored to speak here today.

In my present job in the Navy I don't get to meet many of the present generation of shipbuilders. I get exposed indirectly from time to time to some of your problems but unfortunately I am removed from an action role in trying to help solve those problems at the operating level in the Navy—which is where they should be solved or prevented.

PAST RELATIONS

I do however have a feeling of nostalgia for the shipbuilding industry. When on active duty in the Navy some years ago, I was head of the Contracts Division in the then Bureau of Ships. Well do I recall doing business with John Newell of Bath, William Francis Gibbs of Gibbs and Cox, Tom Bossert of New York Ship, Bill Blewitt of Newport News, Ray Ferris of Bethlehem, Quincy, and last but by no means least, Munro Lanier of Ingalls. Is it any wonder that I feel nostalgic today? I remember those men with great respect and affection. They were tough minded but they were fair and intellectually honest men and it was a pleasure doing business with them. Our relations were excellent and if they were here today, I know they would confirm that statement.

With those recollections of past relations with the private shipbuilders of our country, I feel compelled to give you my personal views concerning present day relations between the Navy and the shipbuilding industry.

TODAY'S RELATIONS

Today the Navy has the complete antithesis of those fine relationships I knew. Today we have the Office of the Secretary of Defense characterizing the relationship as:

(I) "The litigious atmosphere and mutual distrust"

(II) "Acrimonious and adversarial business relations"

(III) "The Secretary of Defense and I believe this situation constitutes a serious problem for our national defense"

(IV) "Secretary Rumsfeld and I share the concerns 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".

Let me make very clear that when I refer to the Navy, I am talking only about the producer side of the Navy—not the user side, which is the fleet.

I see the producer side of the Navy in the deepest trouble in our history. When the shipbuilders of this country—more specifically the nuclear shipbuilders—are at battle stations in opposition to unfair contractual practices, dictatorial philosophies and treatment, lack of mutual respect, and clear indications that they do not want to do business with the Navy under present conditions, it is about time we in the Navy recognized the fates of life and did something about them.

DECISION BY OFFICE OF THE SECRETARY OF DEFENSE

The Office of the Secretary of Defense, in an effort to bring about a restoration of proper business relations between the Navy and the shipbuilders, decided upon a specific course of action, as a necessary first step. This course of action—the use of P.L. 85–804—may or may not prove successful, but it was and is their considered judgment to proceed in that manner "to surmount what constitutes a serious threat to our national defense". One would suppose that the Navy would fully support their decision.

I support that decision. When this shipbuilding situation is determined by Secretary Rumsfeld and Deputy Secretary Clements to be *a serious threat to the national defense,* I fall in line. I may have some doubts of the mechanics of implementation, but none about the decision itself. As a member of the Navy Contract Adjustment Board for over twelve years, I am familiar with P.L. 85–804, and the residual powers of that law.

Some members of the Congress have raised questions about this course of action and their right, and indeed their duty, to do so is fully recognized. Because of the national defense aspects of this intolerable Navy/shipbuilder relationship, the Congress must be fully apprised of any proposed Executive Department action in order that they may disapprove that proposed action and substitute their own remedial alternatives.

REACTION WITHIN NAVY

I have talked and written a great deal about the lack of discipline on the producer side of the Navy. There is real discipline on the user side of the Navy—the fleet. Navy Regs. provide clear discipline for the fleet but procurement of ships cannot be conducted under Navy Regs.

But here on the producer side of the Navy, when the Secretary of Defense and his Deputy make a policy decision to take a certain course of action in a situation found by them to "constitute a serious threat to our national defense" what happens? We see from within the Navy calculated and deliberate opposition to the decision to utilize P.L. 85–804. Similarly, we see a continued advocacy for the government taking over private shipyards, despite the emphatic rejection of that proposal by the Secretary of Defense.

It is not often that the taxpayers of this country are exposed to such a spectacle of waste and lack of discipline. Here in Washington today we have a group of government employees—including Assistant Secretaries of Defense and Navy and four-star Admirals—working night and day and weekends in a sincere effort to carry out policy decisions of the Secretary of Defense and his Deputy. In this same city of Washington today we have a second group of high priced government employees whose loyalties are obviously not to the Secretary of Defense, working night and day to torpedo the carrying out of their decisions. What this second group is doing at the taxpayers expense is reprehensible, in my opinion.

RESPONSIBILITY FOR DEFIANT OPPOSITION

Up to this point, I have described the situation facing the Navy and the Department of Defense today. What I now have to say about the basic responsibility for that situation gives me no pleasure, but it must be said. I fully realize that what I say will be termed emotional, intemperate, extreme, etc. It is not meant to be but that is the risk one takes at a time like this.

The existing adversary relationship between the Navy and the shipbuilders of this country requires surgery, not treatment, and that is precisely what I propose.

We could discuss ad-absurdum the various charges and countercharges that have been made as the root causes for today's unsat shipbuilder relationship. As usual, some of these charges are real, some are retaliatory, some are specious, etc. Suffice to say, claims are not the cause of this unsat relationship, they are the result of a much more basic cause.

From where I sit in the Navy, it is my considered opinion that there is one man basically responsible for (I) openly defying the Office of the Secretary of Defense on the decision to utilize P.L. 85–804 to surmount a serious threat to the national defense, (II) continuing to urge takeover by the government of the private shipbuilding facilities of these United States, knowing that the Secretary of Defense has said negative to that proposal, (III) the past and

continued harrassment of private nuclear shipyard management and (IV) the dictatorial contracting practices that have resulted in shipbuilder claims.

That man is Admiral Hyman G. Rickover.

It must be realized that Admiral Rickover has been carrying on undeclared war with the rest of the Navy and our nuclear shipbuilding contractors for many years. He and his office are primarily responsible for the breakdown in normal business relations with the nuclear shipbuilders. He has declared open war on our only nuclear surface shipbuilder and his irrational stream of correspondence indicates clearly that the Navy's relations with that shipbuilder are not just impaired, he has destroyed them.

I suggest that Admiral Rickover wants the Navy's relations with this shipbuilder so completely destroyed that he can find an excuse to continue his retaliatory advocacy of government takeover.

Moreover, I suggest this man is on a deliberate course of action to prevent the amicable settlement of any claim from this shipbuilder and he will resort to the Department of Justice, the ASBCA or the Courts to prevent such settlement.

Navy Secretaries and the CNO cannot be unaware of what this man is doing, but to date they have taken no positive action to prevent or restrain him. The recent comments by the CNO to the Congress concerning Admiral Rickover's interference with the Navy's ship requirements was a refreshing start in the right direction.

I have observed and dealt with Admiral Rickover's procurement practices for many years. I have listened to him testify before Congressional Committees, have read many letters and memoranda signed by him and have read volumes of his testimony given in Executive session. I have concluded that this man does not know the meaning of mutual agreement, mutual trust or mutual respect. His attitude and philosophy toward private industry and his methods of operation are arrogant, autocratic and totally foreign to our American concepts of simple decency and fairness.

The ultimate of this man's contempt for higher authority occurred just a few hours before Secretary Clements and his associates were to testify *under oath* before the House Armed Services Committee on 18 May 1976 to discuss the decision to utilize P.L. 85–804 as the first step to restoring normal relations with the shipbuilding industry. Admiral Rickover released to a member of that Committee a thirteen-page *unclassified* letter in opposition to what Secretary Clements was to explain to the Committee. He and his staff are the second group working here in Washington to torpedo the policy decision of the Secretary of Defense that I referred to earlier. I find his actions utterly contemptuous.

Ladies and gentlemen, how long should any military officer in the Department of Defense be permitted to openly defy the Secretary of Defense and his Deputy who have made decisions which they feel necessary to surmount a *serious threat to the national defense?*

REQUIRED ACTION

In my opinion, Admiral Rickover, *by his own actions*, has made his continued presence in the Navy incompatible with sound management and necessary military discipline. He has made himself a liability to the Navy and tragically has begun to destroy the very capability he helped to create. His patent contempt for, and treatment of, the private business sector in this country is unacceptable by any reasonable standard of conduct by a government employee—military or civilian.

Admiral Rickover has so arrogantly abused the power of the government that has been reposed in his high office that he has forfeited the right to hold that office. The ultimate in this man's stated philosophy is that the United States Navy can build the ships required for the fleet by court order if he cannot take over the private shipyards.

Discipline on the producer side of our great Navy and the future of our nuclear shipbuilding programs requires that Admiral Rickover be disciplined for contumacy and/or insubordination. The severity of the disciplinary action required should be bottomed on recommendations by the Inspector General of the Navy to the Chief of Naval Operations and the Secretary of the Navy, following a thorough investigation. At the very least, he should be relieved of any and all influence or control over the contractual and business relations with our country's nuclear shipbuilders.

CONCLUSION

In my considered opinion—and I have thought about this a great deal—there is no other way the Navy can meaningfully begin to restore proper relations with our nuclear shipbuilders than to take such disciplinary action. P.L. 85–804 relief alone will not rectify the unsatisfactory management of Navy shipbuilding that Secretary Stennis has mentioned and Secretary Rumsfeld and Deputy Secretary Clements acknowledge. The burden is on the Navy to move first because of the Government's obligation to assure fair treatment for its citizens and those with whom it does business. When this first step is taken, the rest will begin to fall in place.

The Navy is on the spot. If Admiral Rickover is permitted to continue his flagrant contempt for, and harrassment of, both the Navy and the shipbuilders of this country, then I say to you, "God help our Navy".

ITEM 46.—*June 2, 1976—Excerpts from the Congressional Record of a list of former statements by Gordon Rule on the subject of claim settlements before hearings of the Joint Economic Committee in the period of 1969 through 1972*

APPARENT CHANGE IN POSITION TAKEN BY MR. GORDON RULE

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from California (Mr. BOB WILSON) is recognized for 10 minutes.

Mr. BOB WILSON. Mr. Speaker, Mr. Gordon W. Rule, a procurement official in the Navy's Office of the Chief of Naval Material, gave a speech today before the Shipbuilder's Council of America in which he supported the decision by the Department of Defense to use the authority of Public Law 85–804, to reform shipbuilding contracts in order to resolve the Navy's shipbuilding claims problem. His speech was very interesting. In it he made a number of caustic comments which appear to be directly contrary to the positions he has advocated over the past several years.

Since many of my colleagues will doubtless read accounts of his speech in the press, I think it is important that all Members be aware of positions Mr. Rule has taken on these matters in the past, decisions which my staff have researched for me. I introduce in the RECORD at this point extracts from some previous statements Mr. Rule has made which are all in the public record, but which seems to indicate a change of position, or a convenient memory for the gentleman:

ON GORDON RULE'S PHILISOPHY OF CLAIMS SETTLEMENTS

* * * The philosophy seems to be growing, that put in a big claim, scrub this contract and find every detail that you can put a claim in for and you will get it settled for 30, 40, or 50 percent or whatever you put the claim in in for. That seems to be a spreading philosophy.

"I can assure you that it is a philosophy not shared by the Navy. We have a philosophy but it is not that one. Our philosophy is that when a shipbuilder or anyone else presents a claim to the Government the burden of proof is on them to prove every single dollar. We have to be fair and reasonable with them and pay them when they can establish reasonably that we, by our actions or inactions, have caused them to incur additional costs.

"But our philosophy is that the burden of proof is on them to prove that claim—and this is going to make it difficult because some of them, I don't think are going to be able to prove their claim, in which event we will make a contracting officer's determination and let them, if they wish, go to the Armed Services Board of Contract Appeals. If we are going to err it will be on the side of the Government and on the side of the taxpayer and we will not just pay these claims." (Joint Economic Committee, 1969, p. 155.)

ON INFLATED CLAIMS

"Mr. Staats testified yesterday that their records showed that the average of the claims that have been settled were settled at, I believe he said 37 percent of the amount claimed, and this ought to tell you something. This ought

to tell you that the claims were almost fraudulent in the first place. Even if they were settled at 37 percent, which seems to me a little high, but even if that is the right figure, to be able to knock off of a claim 63 percent—if we had that sort of over-statement in proposal for new procurement, if people were coming in on new contract proposals and giving us amounts of money that we would reduce that much, we would yell fraud, believe me.

"When we reduce a contractor's proposal by 10 or 15 percent, that is high. But when these people come in with these claims and we can settle them at 37 percent, you have to ask yourself where was the rest, and so far as I am concerned it is just padding and this is why I take a hard-nosed view of claims. Some people do not. This is why I have gotten the American Bar Association, the claims lawyers and everybody else, p.o.'ed at me, but I do not care.

"I know these things are not correct. I know that they are taking us to the cleaners. And this is why I agree with Admiral Rickover, the claims should not be a negotiation. These people file these big claims and the thing they want to do quickly is sit down and negotiate. I say that they ought not be negotiated. I agree with Admiral Rickover. We ought to look at them carefully, discuss them carefully with the claimant, go over and find the facts, discuss endlessly almost, to be fair, but then we ought to make up our minds what that claim is worth and say this is it. No negotiation." (Joint Economic Committee, 1972, p. 1461)

ON CONTRACTORS ABILITY TO FIND BASES FOR CLAIMS

"* * * Well, as Admiral Rickover has said—hope you don't mind me quoting him, since you quote him so much yourself, so I will follow in your footsteps—as Admiral Rickover has said, and quite properly. If somebody sets out to find something wrong in a Government drawing or a Government specification, with a view toward filing a claim, there just isn't a contract, I guess, that that couldn't take place in." (*Joint Economic Committee*, 1971, p. 1124)

BAIL OUTS

There are these companies that take the attitude, and thankfully most companies in industry, the defense industry, do not take this attitude, but there are some, and they are pretty obvious who they are, that take this attitude that it is a way of life. 'get the contract and Uncle Sugar somehow will bail us out.'" (*Joint Economic Committee*, 1972, p. 1921)

ON HOW SOME AMOUNTS ARE COMPUTED

"* * * The amount of the claim is exactly the difference between the face value of the contracts they bid on and got, and how much they lost on each one of the six, and how much it is going to cost to complete the other three. Just a nice round figure, it is exactly every dollar they have lost and that is the theory of their claim.

"I asked the man who gave me this information from the company if losing money on every contract they ever had with the Navy didn't tell him something. Didn't it perhaps tell him that they might be a little inefficient, or that maybe they shouldn't be in the shipbuilding business at all, and he said, 'Yes, it tells us that.' And I said 'Well, how do you reflect that sort of thing in the amount of this claim," and he said, 'Oh, that is for negotiatoin.'" (*Joint Economic Committee*, 1969, p. 155)

ON CONTRACTS CONTAINING THE SEEDS OF CLAIMS

"* * * I have learned what to look for and what not to look for to a much greater extent that I ever was capable of doing before and I want to state for the record with all the clarity and force at my command that I am not going to approve another contract. I don't care how big they are, I am not going to approve another one and I will take it all the way to the Secretary of the Navy, if I spot in there the seeds of a claim, and you can see these things." (*Joint Economic Committee*, 1969, p. 156)

(NOTE—As head of the Naval Material Command's Procurement control and Clearance Division, Mr. Rule reviewed and approved most of the contracts for which P.L. 85-804 relief is being requested.)

ON REFUSING TO OVER-PAY CLAIMS

"As I say, we will take care of these (claims) as expeditiously as we can, and certainly we won't pay out $1 more than can be shown to be merited." (*Joint Economic Committee*, 1969, p. 156)

ON RESTRUCTURING CONTRACTS

"I sat in a meeting with an admiral once who was just about to do that. He made a statement, the company had come in and was crying about losing money, and he said, 'I am going to reform the contract.'

"And I said in front of the whole group, 'Over my dead body, you will reform that contract * * *.

* * * * * * *

"* * * I would oppose restructuring any contract. Of course, there is such a thing now as being able to change a clause or change something for consideration, which I would have to see and judge whether it is adequate or not. You can do a lot of things if you have consideration. But to restructure something for no consideration, absolutely not." (*Joint Economic Committee*, 1971, pp. 1126–1127)

ON INVOLVEMENT OF SUPERIORS IN CLAIM NEGOTIATIONS

"* * * In my opinion, it has been wrong in the last year for the commander of the Naval Ship Systems Command to personally inject himself into and negotiate these settlements himself. I think he should stay out of them."

* * * * * * *

"But he wanted in the shipbuilding claims, the Commander felt that he wanted to get them settled speedily. So he charged ahead and made a couple of negotiated settlements. Now he is having a hard time justifying them. I think this is wrong." (*Joint Economic Committee*, 1971, p. 1117)

ROLE OF LAWYERS IN CLAIM SETTLEMENTS

"* * * When you talk about claims against the Navy and against the Government, the one person you ought to think of is the lawyer. It is a lawyer's role in these claims to make a determination of entitlement. And until or unless he does, nobody should come up with a figure for negotiation, and certainly no negotiation should take place * * *" (*Joint Economic Committee*, 1971, p. 1118)

ON CLAIM-FREE CLAUSES

"I would like to say that in the area of what we have done about trying to preclude claims—I would like to call your attention to the fact that in the nuclear area Admiral Rickover's group came up with what appears to be a good innovation, going to the point of late delivery of Government-furnished material, which is, as you know, always a big element in these claims. Admiral Rickover's people came up with what we call a claim-free clause. If the ship delivery date, for example, is December of this year, and there is doubt that nuclear components will get to the shipyard in time to meet that delivery date, we have asked contractors in the nuclear area to give us their estimate of a claim-free period, for example, 6 months or a year, if our Government-furnished material is late, how much it will cost us, and then they won't have a claim. It has been tried in two or three cases. It is a little too early to tell how it is going to work out. But it is a step in the right direction, and I think that Admiral Rickover's people are to be commended for coming up with this idea." (*Joint Economic Committee*, 1971, p. 1116)

ON NEGOTIATING SETTLEMENTS IN ADVANCE OF SUBSTANTIATION

"* * * There are two cases now where the negotiated agreement was made with the contractors, in December 1970, and one in January 1971. And those cases haven't come to us yet, because although they have been negotiated now comes the job of substantiating what they negotiated. And that is just exactly the wrong way to do it.

"You ought to have, as Admiral Rickover says, the legal entitlement clearly spelled out, the audit report clearly spelled out, and the technical report on

which to base the amount of the negotiated settlement. It has been done exactly as you say, the wrong way." (*Joint Economic Committee*, 1971, p. 1117)

ON THE RIGHT AND WRONG WAY TO SETTLE CLAIMS

"But I want to point out that we have not rushed claims through. This is for a lot of reasons. We are having a lot of problems with them. But I can assure you, and I can assure the GAO and Admiral Rickover and anybody else who is interested, that your fears are not well founded that we are not kicking these claims around or bargaining them or settling them on a percentage basis * * *.

"Now, I will admit to you that there are people in the Navy that are handling these claims that would settle them just about the way you fear they are being settled. But those people are not getting their way. They have tried it. But all of these claims over $5 million have to go through * * * this Special Claims Review Group. And they haven't gone through there, and they are not going to go through this group, until or unless, as you and Admiral Rickover and the GAO have said, every dollar is factually supportable and legal entitlement is found * * *." (*Joint Economic Committee*, 1971, pp. 1115–1116)

ON OUTSIDE PRESSURE FOR CLAIMS SETTLEMENT

"It is something that I personally feel strongly about because I have been working on these things for so many years. Normally, claims go through without this pressure. When anything happens outside that normal, you begin to wonder about the merits of the claim. It is just part of the business. Because a lot of people will substitute, or try to substitute pressure for merit." *Joint Economic Committee*, 1972, p. 1257)

ON PROPER OBJECTIVE OF CLAIMS

"The objective of a claim should be the identification and payment of those additional costs incurred, or to be incurred, by the contractor which are demonstrably caused by Government action or inaction." (*Joint Economic Committee*, 1972, pp. 1235–1236)

ITEM 47.—*June 3, 1976—Excerpts from The Congressional Record of a list of more statements by Gordon Rule on the subjects of claim settlements and defense contracting before hearings of the Joint Economic Committee in the period of 1969 through 1975*

SETTING THE RECORD STRAIGHT ON WHAT GORDON W. RULE STANDS FOR

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from California (Mr. BOB WILSON) is recognized for 5 minutes.

Mr. BOB WILSON. Mr. Speaker, with further regard to Mr. Gordon W. Rule's somewhat unruly conduct in a speech yesterday before the Shipbuilder's Council of America, I think it prudent to point out more of the contradictions in his past positions as compared with his recent statements, as I did yesterday. I believe Mr. Rule was doing nothing more than talking to his audience in order to gain favor with that audience and would like to set the record straight on just what it is that Mr. Rule stands for.

ON HOW TO HANDLE CLAIMS

"I have thought a lot about claims for various reasons and I do have some recommendations. Bear in mind that my philosophy on claims against the government, unilateral claims, submitted by—we are talking about shipbuilders now who come in years after—in some instances the ships have delivered—and say, you owe us $50 million, $100 million, I just want to say that I characterize that as an adversary proceeding. I don't think that is just another negotiation. I think that when a contractor comes in like that, unilaterally with five stacks of volumes prepared by so-called experts, I think that is an adversary procedure and I would treat it as such. And it is that feeling that makes me get to the point in my thinking where I say, these things should not be negotiated.

"You negotiate new procurement. You do this because, in every new procurement, when a contractor gives you his proposal, there is a big grey area of costs that he wants, and you only sort out those grey areas by sitting at the table and negotiating them and then you determine how much you should pay for what it is you want.

"But when a claimant comes in unilaterally for millions of dollars that we are now told are settled for an average of 37 percent of the claim, my philosophy is that the grey area then cannot be substantiated those grey areas should be left for a board or a court to decide.

"Now there are people who don't feel that way obviously. The lawyers are not very profiligation. Lawyers like to settle things. This is the only objection to—possible objection to Admiral Rickover's memorandum. I would be all in favor of turning them over to the lawyers if you had a hard-nosed staff of lawyers. If you had a bunch of panty-waists who wanted to settle everything and not go and slug it out at the ASBCA and do the hard work, I wouldn't be in favor of that.

"I would suggest that we get these claims, we scrub them, we sit down with the contractor and go over all the areas so that he cannot say we have been arbitrary or capricious. We would discuss every possible point in the claim with them and then make our judgment as to what the claim is worth and we have no negotiations. We tell the contractor, here is our evaluation. You can take this and settle right now. If you don't, we will make a CO decision, a contracting officer's decision right now for that amount and you can appeal.

"Now, that is—if I had carte blanche I think that is the way I would do it." (Joint Economic Committee, 1972, pp. 1486–1487)

ON NEGOTIATING CLAIMS

"Now, when a contractor comes in with a claim that he unilaterally has prepared * * * I ought to sit down with you and see if it has any merit, and I ought to talk to you and see what facts you have got to justify your claim. But rather than, after having gone through this fact finding exercise, rather than, then starting to negotiate with you I ought to tell you, 'OK, you have said I owe you a $100. Now, all the facts in this case tell me that I owe you $15.' and that right to the point. This is I might say, the philosophy that Admiral Rickover believes in, that is what he did in that submarine contract with Litton. He determined how much we owed them and he said, 'I will pay you that,' and no negotiation. That is the way I think claims should be handled." (Joint Economic Committee, 1973, p. 1914)

ON GRUMMAN AND BUY-INS

"Now, the question I have bee asked is. Well Grumman says they expected to make up the reduction (in their bid price) by future business. They expected to get the space shuttle program, they had no idea that inflation would creep or gallop as much as it has done" and I have been asked "Well, isn't there some merit to these contentions of Grumman? And my answer is, absolutely not. These are big boys. They are not kids, they know how to bid on contracts. I am afraid they had the philosophy, as so many other companies had, "Get the contract and then you will get bailed-out," and I just am not persuaded by the fact that they are so naive that they can now expect the Government to bail them out of this contract." (Joint Economic Committee, 1973, p. 1826)

ON PRIVATE ENTERPRISE AND BAIL-OUTS

"Now I want to make two, I want to put forward two thoughts on that. You may not remember, but Congress passed a law entitled Public Law 85–804, which provided a means for the Government, for want of a better term, bailing out or assisting defense contractors who get into trouble financially.

* * * * * * *

"Rather than permit the Government to continue to be soft on favorite contractors, I suggest we admit failure of our free enterprise system and proceed to nationalize or socialize certain industry segments. Certain contractors, in my opinion, are in effect asking for this. We ought to make up our mind, do we want free enterprise with its success and its failures, and

by 'failures' I mean bankruptcies. Do we want that kind of system or do we want something else.

"Do we want a special privileged group of defense contractors who by their size and/or influence can get bailed out, which is most unfair to the majority of contractors in this country. As I see it, we have already moved to a quasiwelfare industry, certainly without having guts enough to tell the taxpayer free enterprise is out, and socialism is in. And I think we ought to give consideration to taking that route with some of those contractors." (Joint Economic Committee, 1973. pp. 1921–1922)

ON PERFORMANCE OF SOME DEFENSE CONTRACTS

"Everything I am going to say today is based on one fundamental point that I have in mind, and that is that I do not like to see the Navy get pushed around. There are two ways that the Navy can get pushed around. One is at sea, if we are weak and the other is at home, by large defense contractors who rarely, if ever, give us what we pay them to give us; namely, quality, on-time delivery, and reasonable cost, and I do not want to be pushed around and I do not want to see the Navy get pushed around by those contractors, and I have a very strong feeling that they are doing that. So, everything I am saying this morning is geared to that basic promise.

"I would like to say a few words about the F–14, lot 5. I would like to very much congratulate Mr. Warner, Secretary of the Navy, and Admiral Kidd for the decision that they made about a week ago to exercise that option. We all know the result of their exercising that option: we know what Grumman has said, but I certainly congratulate those men for making that decision. It is a step in the right direction, and I hope they maintain that posture.

"I hope that other companies who, that I know personally, have been standing in line waiting to see what we do on lot 5. I hope that they get a little bit of a message from that, and I hope that that attitude prevails on down through the Litton's and everybody else who has a contract and in some way want it reformed or want to get out of it." (Joint Economic Committee, 1973, p. 1983)

ON ENFORCEMENT OF LOSS CONTRACTS

"I have long contended that Defense procurement would be sanitized by permitting Defense contractors to go into bankruptcy if they fail to meet their contractual commitments and obligations. The DOD would obtain our contracted for procurements if a company goes into bankruptcy and such action can result in needed management changes. We all know however, that the Lockheeds, Grummans, Northrops, et al., are sacred cows for the politicians and the Defense heirarchy with the result that corporate morality is all but forgotten.

"These corporations who do business with the DOD on their terms are not even subjected to enlightened trade association disciplines in their industry. Even voluntary codes of ethics and fair trade practices are either non-existent or non-enforced and collectively they laugh at efforts to require them to be truly accountable for their spending of the taxpayers defense dollars." (Remarks of Gordon W. Rule at the Navy Procurement Officers' Seminar, Washington, D.C., 30 October 1975)

ON ADMIRAL RICKOVER

"Three pleasant notes to include: * * *

* * * * * * *

"(3) Last, but by no means least, the retention on active duty of Admiral Rickover who, no matter what anyone thinks of him, knows exactly what he is doing and does it well." (Remarks of Gordon W. Rule at the Navy Procurement Officers' Seminar, Washington, D.C., 30 October 1975)

ON CONTRACTOR MORALITY

"I would like to ask you ladies and gentlemen at this point, if any of you believe that these Defense contractors who have admitted illegal campaign contributions in the United States and bribes, kickbacks, etc., abroad have a double standard and corporate morality which precludes them from improper

and/or illegal practices in this country when trying to obtain Defense contracts. In short, do you believe for one minute that they have one corporate policy within the United States and another that takes effect the minute they leave our shores? I don't believe it and neither do you. The Northrop story shows it isn't so." (Remarks of Gordon W. Rule at the Navy Procurement Officers' Seminar, Washington, D.C., 30 October 1975)

ON THE GENEROSITY OF SHIPBUILDING ESCALATION PAYMENTS

"Navy contracts today include labor and material escalation provisions, some of which even protect a contractor after his contract delivery dates, regardless of whose fault the late delivery may be. Additionally, defense contractors are asking—and getting—labor rate projections of up to 20% per year on the grounds that labor agreements are to be negotiated and coverage is therefore demanded in the contract for rate increases.

* * * * * * *

"It really doesn't take a great brain to realize that when the labor unions know the extent to which the Government has protected the contractors against wage increases, there really won't be much hard bargaining at the negotiating table on the part of the protected contractors." (Remarks of Gordon W. Rule at the Navy Procurement Officers' Seminar, Washington, D.C., 30 October 1975)

ON THE SUCCESS OF THE FREE ENTERPRISE SYSTEM

"Let me just say this, It is my considered opinion that our taxpayers defense contracts are being ripped off shamefully and until or unless this country reimposes wage and price controls—at least on the Defense contractor—we, as a country, will continue to head downhill to disaster or to another form of Government than that which exists today." (Remarks of Gordon W. Rule at the Navy Procurement Officers' Seminar, Washington, D.C., 30 October 1975)

ON THE LOCKHEED BAILOUT AND ITS PRECEDENT

"I think it is most unwise, I think from a procurement point of view it is most unwise. And I can tell you that there are other companies standing in line right now, and if we do this for Lockheed, we will have set a precedent that I don't think we will ever live down." (Joint Economic Committee, 1971, p. 1120)

ON GRUMMAN AND LOCKHEED

"Grumman obtained that contract in a competitive climate. And they are big boys and they knew what they were doing. And this is one of the areas that I think falls right in line back of Lockheed. If we start bailing Lockheed out, Grumman is going to be standing right in the wings, and I think it is time we held some of these people to some of these contracts. And if they lose money, it is just too bad." (Joint Economic Committee, 1971, p. 1127)

ON ENFORCING CONTRACTS

"* * * I testified against the Lockheed loan because I thought it was a dangerous precedent, but I would just like to quote to you as one suggestion what Mr. Packard said just a couple of weeks ago when he got the Forrestal Award. He said: 'What is the solution—after describing the game playing that goes on between industry and the services—'what is the solution? We are going to have to stop this problem of people playing games with each other, games that will destroy us if we do not bring them to a halt.' And here is the point I want to make,

"Let us take the case of the F–14. The only sensible course is to hold the contractor to his contract. And he never was more right in his life * * *." (Joint Economic Committee, 1972, p. 1462)

ON RESPONSIBILITY OF PARENT CORPORATION TO STAND BEHIND CONTRACTS IN HIS SHIPBUILDING DIVISION

"I would like to make one more point in answer to your question why I advised Admiral Kidd not to sign this provisional payment. Avondale is a

division of the Ogden Corp., a conglomerate with a lot of money. If they had simply said we are turning off the spigot, we are not going to finance Avondale any more. I think we should have gone after Ogden and made them put up the money rather than let them off the hook." (Joint Economic Committee, 1972, p. 1482)

ON SUBSTANTIATING CLAIMS

"* * * But those claims have not gone up to my group yet. And they won't get through unless they are 100 percent legally entitled and factually supportable." (Joint Economic Committee, 1971, p. 1116)

ON REFUSING TO OVER-PAY CLAIMS

"As I say, we will take care of these (claims) as expeditiously as we can, and certainly we won't pay out $1 more than can be shown to be merited." (Joint Economic Committee, 1969, p. 156)

ITEM 48.—*June 8, 1976—Letter from Navy General Counsel Lewis to Senator Proxmire taking exception to Admiral Rickover's testimony regarding the Navy's legal services*

DEPARTMENT OF THE NAVY,
OFFICE OF THE GENERAL COUNSEL,
Washington, D.C., June 8, 1976.

Hon. WILLIAM PROXMIRE,
U.S. Senate, Washington, D.C.

DEAR SENATOR PROXMIRE: During his June 7 testimony on shipbuilding claims before the Joint Economic Committee's Subcommittee on Priorities and Economy in Government, Admiral H. G. Rickover raised an issue that he has been pursuing for some time regarding the Navy's legal services. His opening remarks seem intended to convey the impression that the Navy Office of the General Counsel is vastly understaffed in the areas of claims and litigation, and during questioning he expressed his support for Section 703 of the House DoD Authorization Bill to enable the Navy to hire outside counsel.

This is a subject upon which I have taken strong exception to Admiral Rickover's views. I believe he has inaccurately portrayed the ability of this Office to carry out its duties, and that the remedial legislation he supports is unnecessary and would not be in the best interests of the Navy. I have recently set forth my own views in the attached letter to the Chief Counsel for the Senate Committee on Armed Services, and in view of the introduction of this subject into your Subcommittee's hearings I am taking the liberty of furnishing a copy of that letter for your information.

Sincerely,

E. GREY LEWIS,
General Counsel.

ITEM 49.—*June 8, 1976—Letter from Deputy Secretary of Defense Clements to Speaker of the House withdrawing prior notification of intent to use Public Law 85-804 to resolve Navy shipbuilding claims*

THE DEPUTY SECRETARY OF DEFENSE
Washington, D.C., June 9, 1976.

HON. CARL B. ALBERT,
Speaker, U.S. House of Representatives,
Washington, D.C.

DEAR MR. SPEAKER: On 30 April 1976, I informed the Chairmen of the Armed Services Committees of both Houses by letter of my intent to use the authority of P.L. 85-804 to bring about early remedial action concerning the contract disputes between the Navy and certain of its major shipbuilders. As you know, I believe the impact of these disputes constitutes a major threat to the national defense. Both in hearings before the Senate and House Armed Service Committee and by my letter of 2 April and 11 May 1976, I explained my reasons for proposing to take extraordinary action provided by P.L. 85-804. Likewise, I indicated that by 10 June 1976 I expected to be in a position

to provide the Committees with the principal details of the proposed amendments of the contracts identified in my 30 April letter involving, among other things, new escalation arrangements provided a mutually satisfactory agreement could be reached between the Navy and the affected shipbuilders. I also stated that I would report to the Committees if I failed to reach agreement.

"On 30 March, shortly after making the decision to invoke P.L. 85–804, I appointed an Executive Shipbuilding Committee to guide and monitor all Navy Department actions necessary in implementing this decision. This Committee, chaired by Mr. Frank Shrontz, Assistant Secretary of Defense (Installations and Logistics), and including 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, has been working intensively since early April with the shipbuilders to arrive at contract amendments under P.L. 85–804 which would grant appropriate relief to the contractors and which would be fair and just to the U.S. Government.

I regret to inform you that despite intensive efforts on the part of the Government negotiations 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 priciple 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 P.L. 85–804 approach I proposed to the Congress.

While two of the shipbuilders have accepted the Government proposal in principle, our plan contemplated an 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 30 April of my intent to invoke P.L. 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 FY 77 authorization the funds identified in the President's FY 77 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 (FY 76 and prior) and clearly hampers the planning and programming for an enlarged shipbuilding program in FY 77 and the out years.

Sincerely,

W. P. CLEMENTS.

ITEM 50.—*June 8, 1976—Wall Street Journal article entitled "Shipbuilder Claims Greatly Exaggerated, Admiral Rickover Says"*

WASHINGTON.—The $1.9 billion in contract claims that major shipbuilders are filing against the Navy are "greatly exaggerated and overstated," Adm. Hyman Rickover told a congressional subcommittee.

Adm. Rickover, director of the Navy's nuclear-propulsion program, criticized a Defense Department plan to settle the claims, made under 11 contracts covering 70 ships. "I believe the Navy should insist on compliance with its contracts—in federal court if necessary," Adm. Rickover told a subcommittee of the Joint Economic Committee.

He also said the government shouldn't pay any claims until it had audited them to determine whether they are valid. The claims have been filed by Newport News Shipbuilding & Dry Dock Co., a unit of Tenneco Inc.; the Ingalls Shipbuilding division of Litton Industries Inc.; the Electric Boat division of General Dynamics Corp., and National Steel & Shipbuilding Co., a unit of Kaiser Industries Corp. and Morrison-Knudsen Co.

The Defense Department says disputes over the claims against the Navy are slowing its shipbuilding program. To clear up the disagreement, it has proposed to invoke extraordinary legal powers to settle the claims by paying the shipbuilders $500 million to $700 million.

Adm. Rickover said such a settlement would set a bad precedent. '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," he asserted.

He was particularly critical of Newport News Shipbuilding, which has filed $894 million in claims against the Navy. Shortly after the Tenneco unit filed its largest single claim, $221 million for work on two nuclear aircraft carriers, the company began pressuring the Navy to reach a quick settlement by threatening to stop work on one carrier, Adm. Rickover charged.

He said the company encountered delays and other problems because it didn't hire enough skilled workers for its Navy contracts, yet is trying to blame the problems on the Navy.

A spokesman for Newport News Shipbuilding said delays caused by the government's inability to furnish certain equipment on time, plus Navy orders changing ship specifications, "have hampered both training and recruitment of personnel," leading to shortages of workers at certain times. The spokesman said the change orders from the Navy have been time-consuming and costly and are a major reason for the additional claims.

William C. Caldwell, a former Newport News Shipbuilding employee who was dismissed from his job Feb. 11, testified that he helped draw un inaccurate construction schedules for nuclear attack submarines the company was building for the Navy. Mr. Cardwell said that in a schedule submitted to the Navy the company promised to build one submarine in two and a half years even though the company "knew we couldn't keep up" with the plan because "we didn't have enough skilled labor to do it."

As a result, he said, the company kept two schedules, one for the Navy and a slower, more realistic schedule for internal use. "We knew when we were going to deliver the ship and it wasn't what the master construction schedule that went to the Navy showed," Mr. Cardwell told the subcommittee.

The company spokesman conceded that the published construction schedules haven't always reflected the actual progress on a ship but said that in every case the Navy is aware of these deviations. "There is no such thing as a duplicate set of books," one containing public schedules, the other private, the spokesman said.

ITEM 51.—*June 8, 1976—Washington Post article entitled "Shipbuilders Cost Claim Hit"*

(By Morton Mintz)

A former official of a major shipbuilder charged yesterday that the firm's claim for $894 million in cost overruns on Navy ships would be "ripping off the government" if it collects.

The Virginia firm, Newport News Shipbuilding and Drydock Co., has blamed the government for virtually all of the overruns, including $430 million for delays attributed to Navy change orders.

But the delays were "solely the responsibility of the shipyard." William C. Cardwell said in sworn testimony at a congressional hearing. "I don't think there were any delays caused by Navy changes, if the truth were known."

In Newport News, a company spokesman denied the charges, saying, "We are not interested in a ripoff or a bailout. All the company wants is the equity that it presumably was entitled to under the contracts . . ."

Cardwell was a surprise witness the Joint Economic Subcommittee on Priorities and Economy in Government headed by Sen. William Proxmire (D-Wis.).

The subcommittee is investigating a Pentagon plan to invoke a national-emergency law to settle an undetermined portion of claims for $1.8 billion from four shipbuilders, including Newport News. Unless Congress disapproves before late July, the Defense Department will settle for a tentative $747 million.

The claims have not been audited and include about $400 million worth that have yet to be filed. The Pentagon says a setlement is neccessary to overcome shipbuilders' reluctance to bid on Navy contracts.

The only listed witness at yesterday's session, Adm. Hyman G. Rickover, was as harsh as Cardwell on some of the claims for reimbursement made by Newport News, which is owned by Tenneco, Inc., a Houston-based conglomerate.

"I think this could be one of the biggest ripoffs in the history of the United States," Rickover testified.

Cardwell, 43, who said he went to work for Newport News 18 years ago, was a senior program analyst. He was assigned to a 50-member claims team in late 1974, and was among the more than 200 persons in his production-control unit who were dismissed in an economy move last Feb. 11. He now sells real estate.

Proxmire asked his staff to look into Cardwell after he had volunteered information a few weeks ago. The witness is "reliable and truthful" and showed "courage" in agreeing to testify, the senator concluded.

Cardwell said that the company directed the claims team "to find anything, no matter how small, that we could blame the government for." In addition to wanting the team to build up the amount of money allegedly owed by the Navy, the company was trying "to hide our inefficiency and lateness," Cardwell said.

He cited the example of a company assertion that a strike by the supplier of hydraulic pump systems had caused a 14-week construction delay. This was "a complete hoax," Cardwell said. The delay actually was only two or three days, and he said, made no difference in any event, because the pumps lay around "for months" before being installed.

The firm spokesman, however, said that the cumulative time loss caused by Navy change orders and delays was sufficient to build a nuclear cruiser.

Cardwell testified only briefly, reading from handwritten notes on a single sheet of paper. He said he had taken no documents with him when he was abruptly dismissed.

He and Rickover agreed that a major cause of the cost overruns was that Newport News had an inadequate force of skilled labor to execute contracts for ships including two nuclear carriers and seven nuclear submarines. The result was a heavy reliance on inexperienced employees who frequently did defective work that had to be redone, they said.

Th admiral, known as the father of the nuclear Navy, pointed to 64 thick volumes with which Newport News supports its claims for $894 million. He said he hasn't read them—but "neither has anyone else in the Defense Department."

Are any of the claims "fraudulent?" Proxmire asked. Terming that "a legal matter," Rickover said they are "greatly exaggerated and unsupported" and include "vast absurdities," such as:

Newport News has not complied with a Navy regulation to certify claims as accurate, complete and current, with one exception: a $142 million claim for overruns on five subs. The Navy, however, judged the company was owed only $10 million. The firm then almost doubled—but refused to certify—the $142 million claim. The doubled claim actually had been prepared last August—two months before the original $142 million claim was certified.

The contractor is trying to collect $42,000 for training each person hired to replace an employee recruited by the Navy shipyard in Norfolk, at the same time that the firm tries to hire away employees of the Navy facility.

The firm said it was slowed down by 2,000 Navy inspectors, but 2,000 of them actually were crewmen awaiting completion of a carrier.

ITEM 52.—*June 9, 1976—Deputy Secretary of Defense Clements letter to the President of the Senate informing him of the inability of Government negotiators and shipbuilding representatives to reach an agreement under Public Law 85–804. Mr. Clements withdraws his April 30, 1976 formal notification to the two Armed Services Committees of his intent to invoke Public Law 85–804*

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C., June 9, 1976.

HON. NELSON A. ROCKEFELLER,
President of the Senate,
Washington, D.C.

DEAR MR. PRESIDENT: On 30 April 1976, I informed the Chairmen of the Armed Services Committees of both Houses by letter of my intent to use the authority of P.L. 85–804 to bring about early remedial action concerning the contract disputes between the Navy and certain of its major shipbuilders. As you know, I believe the impact of these disputes constitutes a major threat to the national defense. Both in hearings before the Senate and House Armed Services Committee and by my letter of 2 April and 11 May 1976, I explained my reasons for proposing to take extraordinary action provided by P.L. 85–804. Likewise, I indicated that by 10 June 1976 I expected to be in a position to provide the Committees with the principal details of the proposed amendments of the contracts identified in my 30 April letter involving, among other things, new escalation arrangements provided a mutually satisfactory agreement could be reached between the Navy and the affected shipbuilders. I also stated that I would report to the Committees if I failed to reach agreement.

On 30 March, shortly after making the decision to invoke P.L. 85–804, I appointed an Executive Shipbuilding Committee to guide and monitor all Navy Department actions necessary in implementing this decision. This Committee, chaired by Mr. Frank Shrontz, Assistant Secretary of Defense (Installations and Logistics), and including 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, has been working intensively since early April with the shipbuilders to arrive at contract amendments under P.L. 85–804 which would grant appropriate relief to the contractors and which would be fair and just to the U.S. Government.

I regret to inform you that despite intensive efforts on the part of the Government negotiations 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, 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 P.L. 85–804 approach I proposed to the Congress.

While two of the shipbuilders have accepted the Government proposal in principle, our plan contemplated an 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 30 April of my intent to invoke P.L. 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 FY 77 authorization the funds identified in the President's FY 77 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. President, 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 (FY 76 and prior) and clearly hampers the planning and programming for an enlarged shipbuilding program in FY 77 and the out years.

Sincerely

W. P. CLEMENTS.

ITEM 53.—*June 10, 1976—The Transcript of News Conference By Deputy Secretary of Defense Clements and Assistant Secretary Schronz Regarding Collapse of the Public Law 85–804 Negotiations*

Mr. Hullen: You have a letter that was sent late yesterday from Secretary Clements to the President of the Senate; an identical letter was sent to the Speaker of the House and copies were furnished to the Chairmen of the Senate and House Armed Services Committees. Here with us this morning to discuss the shipbuilding claims problem is Deputy Secretary (William P. Clements and Assistant Secretary (Frank A.) Shrontz.

Secretary Clements: Thank you, Tod. I think that you have just been handed copies of the letter that I sent to the Speaker and the Vice President; copies of that same letter went to the Chairman of the House Armed Services, Mel Price, and also to Senator Stennis. I have met with Chairman Price and also Chairman Stennis, and have discussed this with them at some considerable length in a further explanation of the letter.

I would only say to you that I am disappointed, and this breakdown, if that's what it is, represents a failure on our part to succeed in the plan that we had in mind. I repeat, I'm disappointed, but that's the way it is. We could not bridge the gap between what we were trying to do and what the shipyards wanted. I would remind you of two things: that what we were proposing was acceptable to two of the yards, General Dynamics and National; it was not aceptable to Newport News and Litton. The fact that the two largest problems. Newport News and Litton, found this unacceptable, and we could not bridge the gap, certainly dispells anyone's idea that this represents a bailout as has been stated in some quarters—which I resent.. Anyone that knows me very well knows I'll have no part of such a procedure that could be so labeled. So, if anything, the breakdown in the negotiations would certainly indicate that this label of a bailout is inappropriate and certainly not true. With that, I'll be happy to respond to any questions that you might have in this regard.

Q. What happens now, Mr. Secretary?

A. Well, there are several things that could happen. I would hope that with this strenuous effort by the Committee which Mr. Shrontz chaired, which had Navy representation, of course, that with that strenuous effort that they've put forth, where we have fully explored the possibilities of settlement under the plan that I put forward to the Congress, that now the yards will regroup, so to speak, and reconsider their position and will take an initiative on their part. Up until now, we have tried to take the initiative and break this logjam that represents a serious accumulation of the past several years of these claims, as well as the deterioration of the contractual relationships between the shipyards and the Navy. So we took the initiative; we felt that it was important in the spirit of national security to do this. I still feel it's important in the spirit of national security that we bring about a correction to this particular situation. The Navy must have these ships. We have every reason to believe that we're going to have an expanded Naval construction program, and, if we are, this climate must be better. It must be a more harmonious relationship, a working relationship, if you will, and, to achieve that, there are going to have to be some corrections because it certainly doesn't exist now.

Q. What influence or weight has the Congressional opposition to the plan to resort to this extraordinary procedure had on your decision to abandon it, and have you abandoned it just for this session of Congress, and will it possibly go up to the Hill next year with the same proposal or is it out forever?

A. I'm really pleased to respond to that because this is very pertinent to what we are doing. It needs to be said that if we had gone forward with a plan to the House this morning—the House Armed Services Committee—and subsequently to the Senate Armed Services Committee, and subsequently to the floor for approval, if that would be required—I have no question at all that we would be given Congressional support in order to cure this problem. I have every reason to believe that, and I do believe it. In answer to your question, therefore, consideration of the opposition that has been somewhat vocal—not very vocal frankly—but somewhat vocal, that opposition played no part at all in our actions in this respect. If we had been able to reach what we would consider an equitable adjustment to these contracts, we would have put it to the Congress, and I am convinced that we would have received the support that we needed. As a matter of fact, and I'm not going to get into names and circumstances, but for your information, I was told this by very senior members of the Congress.

Q. Would you answer the second part of that, whether perhaps next year you might resubmit this proposal to use this law to settle the claims?

A. I'm not sure what's going to happen next year.

Q. It's out for this year?

A. No, I wouldn't say that at all. To the contrary, I think that several things can happen with respect to these claims and the negotiations. Negotiations, per se, at this moment have ceased. However, we are open to suggestions, and I am hopeful, as I've already said, that any one of these yards can come back in here with an initiative and put it on the table and we'll talk about it. We're certainly not going to put anything forward. We expect our ships to be built; we have contracts in being, and we want that construction program in toto—all the construction programs to proceed in a status quo situation.

Q. So exercising the 804 option is still a live possibility if they'd come forward with something that would justify your going back out——

A. I withdrew the 85–804 without prejudice. That means that we have that option to put forward again at any time that we would deem it appropriate.

Q. Mr. Secretary, don't you have some authority under the law which you could use in wartime and other periods of emergency of requiring a shipyard to build for the Navy if necessary?

A. Yes, I think that those are generally referred to as emergency powers, and there are such avenues that are open, ar available to us under an emergency condition. I felt confident that this question could well come up this morning. I have not briefed myself, nor has Mr. Shrontz, on the detailed provisions of these emergency powers. I can't really comment about them.

Q. Do you see any possibility that an emergency of that sort could arise in the next few months?

A. It's possible. I wouldn't rule it out. You know, down at Newport News, for instance, under CLGN–41 contract, we are working under a federal court order now. Now, what can happen with respect to either Newport News or Litton with respect to the current contracts, I'm not sure. I have been trying to impress upon everyone the seriousness of this problem. A whole lot of people, not only in the public sector, but also in the media, the news group, as well as the Congress, did not realize that we were actually building a ship at Newport News under a federal court order. And that came as something of a shock to a lot of people.

Now, what happens at this point, I'm not sure. The judge ruled that a decision should be accommodated by I believe it's August of this year, so that particular instant is almost upon us.

Now, in addition to what we have another problem down there which has to do with the CVN 70, the Vinson, and just exactly how that work is going to be carried forward in a reasonable fashion where work proceeds in a timely manner, I'm not sure.

And we have been put on notice by Mr. Diesel in Newport News that this is under serious consideration by Newport News as to what actions they will take in regard to the CVN contract. It remains to be negotiated on mutual terms. And those negotiations have resulted in zero at this point.

Q. How far away were you from agreement with Newport News? When will you talk about it? Have you come anywhere near being close to an agreement?

A. Well, you know, when you start talking about close and you start talking in terms of almost $2 billion in claims, it's a relative term of what is close. We're talking about literally not tens of millions but hundreds of millions of dollars.

Q. (Inaudible.)

A. I'm coming to that. You remember I asked the Congress for their forebearance, if you will, of proceeding on a basis of something between five and $700 million in toto. In the case of Litton, our difference was significant, and, by that, I mean significant in terms of close to $200 million difference.

Q. How much (inaudible)?

A. Now, I don't want to get into, for very good reasons, specifics in this regard, and I don't want you to pursue this. These negotiations broke down, but they may not be over, and, in addition to that, there is always the possibility that the recourse will eventually be in the courts, either through the Armed Services Court of Contract Appeals or claims or then moving into some other court of jurisprudence.

Q. You mean if the Navy doesn't, the Defense Department will take these matters to court?

A. It could work either way. To enforce our contract, we might take it into a court procedure, but, on the other hand, to pursue their claims, which are at this point approximately $2 billion, they may choose this route. As a mater of fact, they have already started down that track, as you well know, because they represent claims.

Q. Don't they sort of have you over a barrel? You want the ships . . . ?

A. I can assure you I'm under no barrel. And you can quote me on that. I'm not either under it or over it.

Q. Either you need to eliminate this atmosphere because if you don't settle the claims by the end of the year Litton might not be able to deliver the ships? If you go to court you won't get the ships, so where do you stand?

A. I'm not sure that that's right. You've already mentioned your question with respect to the emergency powers, and this Government, in a sense of national security, doesn't intend to do without a Navy.

Now, one way or another, we intend to get these ships, and I would like to do it in a harmonious atmosphere, in full working partnership of cooperation with the shipyards.

And I know that's what they want too. It's not one-sided, we both want that. Now, just how we're going to get there is a problem.

Q. How about Rickover's idea of nationalizing those yards that * * *

A. I reject that completely, and I've already said that, and this is one of these honest differences of opinion between Admiral Rickover and myself. And let's not leave any misunderstanding about that.

Q. Would you repeat about how far apart you are from (inaudible) Newport News?

A. Now, so far as Newport News is concerned, we were closer than we were with Litton, but still the difference was significant again. We're talking in terms of something just under a $100 million apart, and it just wouldn't stretch. There was no way that we could take our plan and fit it to those kinds of circumstances.

So, you know, you have to start over again, and I mean that seriously. Let's not misunderstand each other. We don't take the little bits and pieces with which we are in agreement and put that into a new deal and start with a plus on one side and start negotiating from that point. When your negotiations cease, under the terms that we started with, we're back to zero.

Q. Do these figures mean that you offered $300 million in the case of Litton, about $700 million in the case of—Newport News?

A. Now, I said that we are not going to discuss these things in great detail, and I mean it.

Q. Mr. Secretary, would you say that you are faced with a strike by these two large companies?

A. A strike?

Q. Yes.

A. I hadn't thought of that, and I wouldn't really use that term in connection with this problem.

Q. It's in effect the same thing as a labor strike might be in another area.

A. I don't want to make that because I hadn't even thought of it before, and I wouldn't want you to put words in my mouth.

Q. Mr. Secretary, would you consider it remarkable that Litton's estimated losses more than doubled from early May to the present time? Does that have something to do with—the breakdown?

A. I do think that that is remarkable, and I don't understand it.

Q. Well, do you believe they miscalculated?

A. I wouldn't really be in a position to talk about their calculations and the details of what you are referring to, because we really haven't received those details. Would you care to comment on that, Frank?

A. No. We just haven't got those details.

Q. But you are aware of them, aren't you?

A. I've already acknowledged that I thought it was remarkable.

Q. Well, you must have gotten details * * * ?

A. On the contrary, I got just what I said, I got the numbers with no details. So I do think it's remarkable.

Q. Is the Defense Department in essence, agreeing with part of what Rickover's been saying with regard to Newport News, when he says that their claims are inflated and exaggerated and misrepresented, and all the other things he said the other day?

A. I think Admiral Rickover's comments with respect to this are overstated, and I don't think that Admiral Rickover has yet come to grips with what the real problem is at Newport News.

Q. Which is what?

A. It primarily has to do with delay, and, of course, the position of the yard is that there is a significant amount of that delay that is Government caused, for one reason or another. Admiral Rickover is extremely sensitive to this because it could well be that a lot of that delay comes under his responsibility.

Q. Well, he claims that there's only five percent of that that's due to the Navy, and he invites and insists that there be a complete audit of all of those claims before anybody starts to pay them.

A. Well, you know, that's a misleading statement in itself, because Admiral Rickover full well understands that when he starts talking about claims certification, the contract itself carries that same provision, and those claims have to be valid claims in that sense and there can be nothing misrepresented. Any claim that is carried forward carries the kind of certification that he's talking about in a very real sense and he knows that.

In addition to that, when you start talking about audit of these numbers, those numbers are audited, not once, but several times, and are looked at by various groups of accountants and comptroller types and financial management people.

Now, those numbers are what I would call thoroughly massaged, and if we're not satisfied with the results of our own internal and our own audit investigations, and if we feel we need additional help from outside certified public accountants, such as Haskins and Sells, or Arthur Anderson, Price Waterhouse, and so forth, there are many of them, we feel completely free to call on their services to audit those accounts.

And as a matter of fact we have already used, in some of these instances, those kinds of outside services, so you know, there is one thing we have plenty of and that's auditors. There's no lack of them.

Q. Sir, isn't their certification procedures on these claims—according to testimony before the Senate committee, a lot of the shipyards have refused to certify their claims.

A. Not really. This is a misunderstood—Frank, would you care to comment on that?

A. Well, so far, the new contracts do contain requirements for certification. Contracts which are currently in existence in many cases do not.

But I am not aware of any specific case where a shipbuilder who is negotiating a final settlement for his claim, has absolutely refused certification. Now you can get into the issue of what kind a certification is acceptable in the absence of the contractual requirements. I think that, as Secretary Clements has said, is greatly an overstated issue. And it certainly didn't play any part in our discussion.

A. It plays no role whatsoever in these discussions, and that's a false issue.

Q. Mr. Secretary, you were heavily critical of the Navy in the way they had managed this problem before you started to—before you decided to step in——

A. Now, I don't remember saying any such thing as that.

Q. Well, I could quote your letter where you said that, about this management of the Navy's shipbuilding problem, and we can argue whether it was critical or not, but——

A. Yes, let's not use the wrong words.

Q. I'd be happy to quote that sentence, but I don't think many people would dispute it.

A. I have said, and I want to say this right now, I have said there is enough blame to go around to everybody concerned, and I'll repeat that. Certainly, the Navy has been at fault. Certainly, the shipyards have been at fault. Now, I do not want under any circumstances to get into a posture of pointing fingers on a basis of it's all one or the other's fault, because that is not true.

Q. My question is, given the fact that you were not entierly satisfied, to use the mildest terms, with the Navy's management of the shipbuilding job * * *

A. You are exactly right, I am not entirely satisfied, and I still am not.

Q. You said so rather bluntly. Now that you've had a chance to work the problem, and it still hasn't been resolved, what is the heart of the difficulty as you now see it? You've had a chance to work the same problem that they were not able to solve. Here you are today saying we couldn't get together, so what is it? The intransigence of the shipbuilders? Is it not enough time? What's the heart of the problem as you see it?

A. Well, there are probably several. One is that we're trying to correct a problem that had its roots back in the mid- to late 1960's under those fundamental contracts or basic contracts that were let at the time.

Now, as all of you know, a basic document like the original contract is almost to be termed a sacred instrument between the parties, and this is for the protection of both parties—in this instance the Navy on one hand and the shipyards on the other, regardless of which shipyard it might be.

Now, when you start tampering with that basic document, you've got problems, and this is not easy to do. It's not easy to do, if you will, on a current basis, as the problems first arise. But certainly when you try to retrofit, if you will, a contract that is eight years old, that is tough.

And during the intervening period, much has been lost in the corporate memory. Perhaps it wasn't even properly documented in the first place; perhaps it wasn't looked upon as the serious problem we now view it as, at the time.

In some instances—perhaps in this remarkable claim sequence that we're talking about with Litton—in some instances, it's a case of trying to play catch-up where heretofore not thought of claims suddenly seem to be pertinent to the problem, and they are resurrected from years gone by.

The documentation of those kinds of claims for the shipyards is extremely difficult, and without that kind of documentation, it becomes impossible for us to accept the claims, or in due course any court of jurisdiction.

So we're at a point where we're going to have to come to grips, and when I say we I'm speaking collectively. The Congress, the shipyards, the Navy, the Office of the Secretary of Defense—we're going to have to come to grips with this problm as a national security issue.

We can't go on indefinitely on this basis. And I don't think the shipyards can. There's going to have to be some give. All right?

Q. How about the other two shipyards? As I understood it, you reached an agreement with two of the shipyards, but not the other two.

A. That's right?

Q. Why couldn't you proceed with those two?

A. We started out under these extraordinary powers of 85–804 in good faith with the four yards, and they understood that, and so did the Congress. That was what we told both the Senate and the House. And under the circumstances, in our judgment, all of us agree on this, it would not be appropriate to attack it in bits and pieces, and settle one without doing all four.

Q. Are you saying you're not going to settle with General Dynamics?

A. That is correct, we are not.

Q. Even though they're willing to settle?

A. That's right, we're not going to do that.

Q. That seems a little difficult to understand because you've been seemingly * * *

A. It has to do with a precedent, and we don't want to establish that precedent.

Q. You wouldn't have to settle with them under the law you were seeking to invoke; you could settle with them normally, presumably?

A. Well, those alternatives still exist, and it could be that we will do that. But you asked me what we were going to do under the plan as presented to the Congress, and I'm saying we're not going to settle with them under PL 85–804 as presented to the Congress.

Q. Do you anticipate a quick settlement with those two companies? I notice you say here that * * *.

A. You know in this particular problem I wouldn't anticipate a quick settlement of anything.

Q. Well, you do say here an agreement in principle can be obtained to retrofit a total of three contracts with the new escalation clause referring to General Dynamics and National Steel, which indicates that a settlement may be relatively imminent.

A. What you missed is that I told you that we might not want to do that under the procedures that we were moving forward with that have to do with the escalation clauses in reforming the contract in that spirit.

If they want to pursue their claims in the normal course, which is a completely different issue, we of course have that avenue open to us, and I would hope that they would move forward in as fast a manner, an accelerated manner, as is possible. But you have to remember that what the heart of our solution was to retrofit or reform those contracts as it relates to an inflation clause.

Q. And you want to have it uniform?

A. We absolutely do, and we don't want to establish the precedent of doing it for this one or these two, and not having the same thing accepted by these other two.

Q. In terms of settling these disputes, if normal courses were followed, this could take years, or say a year to go through, and then there would be the promise of court action, appeals, etc. after that. You have strongly indicated that it won't take that long because, as you just said a minutee ago, there's a national security interest involved, and that could lead the Department to unilateral action. I take it that you're indicating that that is the more likely course, and we're not going to see this problem lasting for years and years as we go through very slow and detailed examination and resolution of claims?

A. You've explained my case very well.

Q. Well, how soon can we anticipate that?

A. I wouldn't anticipate, I really wouldn't. I think that under the circumstances of this failure to achieve the objective that we were trying to get, I think that we may hear more from these contractors. Hopefully. You know, that may be an optimistic note on my part. Maybe I'm wishfully thinking, I don't know.

Q. When you launched this effort, you described this bitterness that developed in dealings with the shipyards. Now I must say your comments are remarkable for an absence of bitterness, it seems to me. You've gone through negotiations that failed, is the situation better or worse?

A. You know, I want to make one thing abundantly clear. I did not ever mean to give off any signals of bitterness.

Q. No, you said that there were bitter disputes.

A. Yes, that's different. You know, I'm not bitter about this. To the contrary, I'm a manager, and my objective here is to try to bring the parties, of which I happen to be one, together in a businesslike atmosphere of negotiating an equitable settlement. And there is no bitterness in this.

There is a recognition that this problem has very serious implications to the national security issue of where our Navy is and where it wants to go, and I certainly intend to pursue that theme. That's not going to be dropped. I think that the shipyards have a good understanding of that. They understand it as well as anyone that we are not getting the ships built in the timely manner that we should. Therefore, I think that they may very well reconsider their position.

There is also, and you must also remember this, there is also a motivating factor with the yards that, in these claims which are in dispute, there are sizable amounts of money invested by these yards in those claims. And they have a real incentive to settle this issue and not go through this procedure to which you refer, which would be the contract board of appeals and so forth and so on, that would take years and years to do.

Q. What is the law under which you could act unilaterally?

A. It's the national war powers act, which carries with it certain emergency measures. I don't have a reference on that. Tod, would you get that for them?

Q. Well, what happens, you just don't * * *.

A. I don't want to get into that because I don't know. I told you early on that I hadn't explored that.

Q. Very simply, it would involve payment of some sort, obviously.

A. Well, you say that. I don't know that. I haven't explored this, I just can't comment. You can get the act and read it for yourself, because I haven't read it. Now, I don't want to sit here and interpret something I haven't even read.

Q. Can we box this in in time, though? Before you indicated that if it came to that you would do something, the contractors would be made to build those ships. When do we reach this time of decision?

A. I want you to understand, they're still building them. They haven't quit building them.

Q. Is it before the end of the year or the next two months, three months? When do we reach a point * * *.

A. As long as they're building ships, why should I take some kind of an emergency action?

Q. Well have they indicated by the end of the year? I've heard that Litton has said that they couldn't—wouldn't be able to go beyond the end of the year.

A. They haven't told me that.

Q. You have no date in mind then?

A. No, I wake up every morning and see what's going to happen that particular day, and I don't mean that facetiously. Because this is that kind of and issue, and it would be wrong, probably, for these yards to play their hand, shall we say, by exposing what they intend to do in the morning, or the next day, or the next week. I don't really know. I think that's a fair answer to you. I just don't know.

Q. You said the ships are being built?

A. Sure, they're being built. No one has stopped construction at this point.

Q. They're not being built in a timely fashion, is that what you said?

A. Well, there have been delays that I would hope that in the future, because of contract reformation and so forth, that we can improve the relationship and help the time schedules. But these delays, to which I referred a while ago in answer to another question, have primarily to do with what we call GFE—government furnished equipment—which in some instances was late; and the yards are claiming legitimate delays to the contract because of equipment that the government was supposed to furnish. That's one of their claims. This is well understood and well known.

Q. Including nuclear power plants, right?

A. Sure, and equipment related thereto.

Q. Admiral Rickover, a professional military man, has looked at the problem, and he thinks that there's no time emergency involved, that it can be resolved through the normal procedure. When you sent your public law measure to Congress, you indicated that there was an urgency necessary. Could you explain to us lay people why there's such a divergence of minds on this critical issue?

A. Yes, that's a good question. In the case of Newport News, we have been told by Newport News that they have a cost at this point in Navy work in excess of $230 million, I believe, where payment has been delayed for one reason or another, and this represents a financing of Navy work by Newport News which they never contemplated. Now, this is an oversimplification, but this is what it amounts to. Through progress payments under the terms of the contract and so forth, they are supposed to be reimbursed for funds in a current manner, and certainly they never contemplated getting into the position where the shipyard was in effect financing the United States Governmnet to the tune of approximately a quarter of a billion dollars.

Q. How did that happen?

A. May I finish the other question? Now, the same thing has happened to a more or less degree according to, again, and I want to emphasize that point, according to the shipyard management at Ingalls, and also at General Dynamics Electric Boat Division.

And these shipyards are just saying that the time has passed when we are going to tolerate this kind of a burden on the resources that we have available to us, and that we can't afford it. We don't have these kinds of funds that are available to use for these kinds of purposes. We've reached the end of our string, so to speak.

Now, under those circumstances, you start impacting on the availability of corporate funds for all kinds of other things; start talking about negative cash flows; and you start talking in terms of the burden of carrying a multibillion dollar shipbuilding program forward into future years. And it is a most difficult equation for a corporate body to solve. Now, that's at the very root of this problem. Now, why have these delays occurred? Well, it gets mixed up in claims; it gets mixed up in change orders that are unpriced as it relates to both the material side as well as the delay and disruption side. And it turns into a controversy. And this is at the very heart of the problem.

Frank, do you want to comment on that?

Mr. SHRONTZ. Well, I think it's adequately covered. I think basically the problem shipbuilders feel they have is the climate of being unable to promptly adjudicate or negotiate out their differences, whether those differences arise from delay due to government-furnished equipment, or other actions. That causes their corporate funds, obviously, to be tied up until those issues are finally resolved. And the claim backlog has now built to the point where the corporate investment, until those items are resolved, is such that their willingness to continue in terms of keeping their own funds, I think, is a question mark. And that's what's causing all of this great concern about the willingness of the shipyards to continue with the program.

Q. Excuse me, on this point, the figure you used of a quarter of a billion dollars for Newport News, you said that they have done work for the Navy and haven't been paid. I take it that what's in dispute is how much they should be paid by the Navy?

A. That's right.

Q. They feel that they have done the work and there is something that is owed; that you feel they may be billing too much or it just hasn't been determined whether the bills are in fact legitimate?

A. Well, some of these charges represent direct cost to that particular ship, which is not—and I'm talking about direct cash cost, which is a relatively easy item to audit. We talked about audit a while ago, and this is done through vouchers and there's no problem about certification or whatever you want to call it. But, on the other hand, you get into overhead allocations, and you get into delays and disruptions that impact on other work in the yard because of the necessity to be shifting people and resources around within the yard because of a delay here, and you have to do something else that throws a schedule over here, on another vessel, out of kilter.

Now, this is not an unusual issue. It comes up all the time. But settling those issues is most difficult, and that's the heart of the problem.

Q. First of all, has President Ford been briefed on this, what you call national security problem, namely the breakdown in the negotiations; and, secondly, is there any inclination on your part, or perhaps the President's part to have some kind of a White House summit meeting with the shipbuilders to resolve this thing, which has sometimes been done in the past when you get an impasse?

A. Well, let me answer the last first. As discussions have taken place in the White House, it has never been brought up, the advisability of a summit meeting as you're using that term. That's a thought, and I'm grateful to you. That might have salutory effect. I'll try that idea on.

Q. Is that called jawboning?

A. No, I'm afraid that we're way beyond something of that kind.

Q. How about the first part, namely have you had a chance to brief the President on this problem?

A. Suffice it to say, that the President is aware of our actions in this regard, and no later than this morning I discussed it again with the White House.

Q. And has he taken any personal role such as telephoning shipbuilders or anything like that?

A. I'm not going to get into that.

Q. What was the Litton claim and Newport News claim?

A. Frank, would you help me on this?

Mr. SHRONTZ. The Litton claim that's in at the moment that we have been looking at, it's on the LHA contract for $504 million. We've been advised by Litton that there are further claims to come, but we have not yet received them.

Q. From the LHA?

A. Well, it probably would be a cross claim plus the impact of the LHA and perhaps a destroyer.

Mr. CLEMENTS. In an amount of a magnitude of about——

Mr. SHRONTZ. Two hundred million perhaps.

Mr. CLEMENTS. This is what we've been told, George.

Q. Approximately $504 million.

Mr. CLEMENTS. That's what we've been told.

Q. But that's not included now in the $1.9 billion total figure.

A. It is not.

Mr. SHRONTZ. And then there are other claims, the most significant of which from Litton, is an issue that's not been formally submitted in the form of a claim, but it relates to start-up costs on their yard in Pascagula, which they feel the Navy should be reimbursing them for in the cost of the claims, but that essentially is the Litton situation.

Q. The start up costs are over and above the $200 million.

A. Yes.

Q. The $200 million, that doesn't jibe with the figure with which you can't agree, does it?

A. Beg your pardon?

Q. That is not included in the negotiations which failed?

Mr. SHRONTZ. Well, it would be included to this degree, that in consideration, if you will, for our willingness to go in and work with the problems to retrofit escalation clauses, we would have expected that the shipbuilders withdraw current claims and agree to release us from claims due to actions which occurred prior to that date of settlement. So it would have in fact deferred the submission, I suspect, of these additional claims, which are not yet in hand.

Q. So that total would be $704 million?

Mr. SHRONTZ. You're getting too precise.

Mr. CLEMENTS. I wouldn't get into trying to get definitive numbers on this.

Mr. SHRONTZ. In the order of magnitude of $504 million now, plus something additional.

Q. But the $200 million in disparity in which you could reach agreement, was that in the context of $504 or is that the $200 million?

Mr. CLEMENTS. We're not going to get definitive in this. Now, I told you that, and I don't want you needling Frank to get from him what you couldn't get from me.

Mr. SHRONTZ. Bill, I'd like to say one other thing. We (inaudible) are trying to settle the claims. We made that clear in the beginning to this group, we made it clear to Congress, that we are trying to retrofit a clause that we felt was more appropriate at covering escalations. The claim withdrawal was a by-product of that, not the negotiations. Specific answer to your second question is, $894 million claims at this point in time from Newport News.

Q. That's what, on the nuclear job?

Mr. SHRONTZ (inaudible). It's on a series of contracts broken down. We can get you those.

Q. I want to ask if you really meant it (inaudible).

A. Yes, I really do, because I'm not up here saying anything I don't really mean.

Q. You said that the late GFE is primarily responsible for delays of ships.

A. I don't believe I said that. It's certainly a root cause.

Q. I'm quite certain you did say it, sir, but regardless of that, I want to ask you because you bracketed it with, nuclear power plants. The GAO gave the House Armed Services Committee a list of perhaps a dozen reasons for these claims, and late deliveries of ships. I mean, I thought the whole claim situation stemmed from a delay of one to four years delivery of ships?

A. I beg your pardon?

Q. I said I thought the whole claims situation arose from the delay in delivery of the ships? I mean, there wouldn't have been escalation had the ships been delivered on time.

Mr. CLEMENTS. I don't agree with that.

Q. No, but this is certainly a large part of what you've been telling Congress.

Mr. CLEMENTS. Well, I'm telling you that the track that we were moving forward on, that one of the principal reasons of the problems within the shipyards has to do with escalation, and therefore that escalation clause should be reformed, and therefore this was the track that we wanted to take. And that's still a true statement. You agree with that, Frank, I'm sure.

Mr. SHRONTZ. Yes, indeed.

Q. My question is if the GFE is in any large way responsible, then the Government is responsible, and I don't understand why you can't come to terms. My second question is, of course, Litton is not building nuclear powered ships so you can't really hang that on Rickover?

A. Well, I'm not trying to hang anything on Rickover. I have said time and again—now, let me make this absolutely clear in here—I have said time and again that I have great respect for Admiral Rickover, he's a personal friend of mine, I have an affectionate regard for him, but at the same time I don't agree with him on everything that comes up. And in this instance I don't agree with him. Now, if you are talking about, do the shipyards in the case of both Newport News and Litton claim, underline claim, that GFE is a root cause of the problem, then you're wrong, because they do. That is at the very heart of some of their more serious claims. You would agree with that, Frank.

Mr. SHRONTZ. Yes, sir. We have not yet reviewed the degree to which they're a part.

Mr. CLEMENTS. That's right.

Q. No, what I was asking about is the degree to which you accept that that is a reason * * *

A. Look, I want to make it very clear. I am not up here at this microphone settling claims this morning, and particularly with you people. If I want to settle claims I'll get with the shipyards. I'm up here trying to explain to you what the problem is, and the problem from the shipyard standpoint has a direct relationship, not only with inflation, but also with government, furnished equipment, be that equipment nuclear powered plaints, be it plans and specifications, be it engines, be it materiel of any kind. Now, you want to add anything to that, Frank?

Q. Wasn't it just said you haven't yet determined the extent to which these delays contributed?

A. That's right, that's exactly right. We haven't.

Q. So you don't know if it major or minor?

A. No, to the contrary. I use the word significant, and it is significant, it is a big, big part.

Q. It's a big, big part, but the extent to which it's a big, big part has not been determined. I don't understand.

A. That's right.

Mr. SHRONTZ. Well, once again, we are not approaching the negotiations with shipbuilders with the idea of settling claims they have outstanding. They may have some idea as to what the value of those claims are, from their point of view. We have not completed our analysis and our review of the claims. We started the exercise with the idea that, in order to avoid the time process, the expense of going through an actual claim negotiation, perhaps litigation, we would offer certain shipbuilders contracts to put a new, improved escalation clause in it.

We felt this would have forward looking effect by providing more adequate escalation protection for future delays; we retrofitted it backwards, and in the process of that and resolving other issues, we would have expected the shipbuilders to withdraw their claims.

But not to sit down and try to analyze specifically what we felt the content of the claim value was, vis-a-vis the escalation clause incremental gain to them. We never entered into it on that basis.

Q. But it was claims which proved the stumbling block, which ended the negotiations. Is that correct?

Mr. CLEMENTS. Not necessarily. There were several issues involved. The claims, certainly. The rate of inflation or the index formula of the inflation clause that would be reformed to the contracts, that was an issue.

Q. Well, if a new escalation clause was the primary objective of the negotiations, let's talk about how far apart you were on that, rather than the

claims which you want to cast in a secondary role. What was the point of disagreement, or can you give us an area of disagreement, on the new escalation clause, the rate, or however you want to phrase it? If that was the primary thing at issue rather than the claims differences which you——

A. Well, we're not going to get into the details of how and why and what amounts broke down, because these negotiations will be ongoing in one form or another, in my opinion. I've already made that clear.

And in addition to that, they have a strong likelihood of ending up in a court of one form or another, and under those circumstances it would be inappropriate for us to get into the kind of details that you're talking about.

Q. Mr. Secretary, right now the Navy shipyards aren't building any ships, is that correct?

A. That's correct.

Q. And your feasibility study request with Secretary Middendorf on the possibility of using those shipyards?

A. That's right.

Q. And you haven't got that report yet?

A. Not yet. It's a little bit late, but not seriously so. I asked for it by the first of June, and I talked to Secretary Middendorf yesterday and I expect it shortly.

Q. What is shortly, two or three days?

A. Yes, I think so. Right away. Well, I don't know whether it's going to be tomorrow or the next day, but within the next few days I expect the report.

Q. You mentioned that the ships that the civilian operations—not building—you're not getting the ships in timely manners, they're not being built in timely manners, is this feasibility study to look into the Navy's possible building of its own ships? Has your request for that study been prompted by this delay.

A. No, I'm glad you asked that question because there is a possibility of misunderstanding here. Two years ago I guess it was, with Admiral Kidd, I testified before Mr. Bennett in the House on various Navy matters, and, in that testimony, I told Chairman Bennett that I felt it was highly desirable that the Navy start a process wherein they would take on some new Navy construction to a limited degree.

And he asked me what I meant by limited degree, and I said, well, there are two aspects of it. First of all, in a gross sense you asked me for a number; it shouldn't be in excess of 10 percent of Navy ship construction.

And we should start in a simply construction form, such as support vessels, tenders, oilers, this type of thing, because Navy has not been building new construction for years. And it takes a while to build up the expertise and experience and a cadre of management that is related to new construction, as opposed to maintenance and repair.

Now, under those circumstances, over time they would move from the more simple construction to more sophisticated construction. I would remind you that, in years gone by, for instance, we have actually within the Navy built atomic submarines, so the capability is there, but it will take several years to develop that capability.

So let's not have any misunderstanding; what might be done in Navy shipyards in no sense is a substitute for the private yard capability carrying the burden of our Navy program. There is no change contemplated there, under any circumstances.

Now, why do we need—why do we need to put some new construction in Navy yards? First of all, it gives us a yardstick to measure what is done in the commercial yards, and this is very important. We won't get there immediately because our learning curve, if you will, will take some time, and we will be perhaps as much as two or three years getting up to speed where our unit cost of production for even this more simple construction will take that time to be on a competitive basis with commercial yards.

Now, more important that that yardstick—and that's what I'd call it, a yardstick of new construction in our yards, Navy yards versus commercial yards—far more important than that, is to build up within the Navy over time a cadre of people who are architects, who are engineers, who are construction people, who are actively engaged in the financial management problems of new ship construction, who, in turn, will provide the kind of base management in the years ahead to enable the Navy to have project managers

in various shipyards, superintendents of construction in various shipyards. and who will give the expertise that's needed to give management overview to our commercial yards who are building the 90 plus percent of new construction.

We have lost that kind of expertise in the Navy. There is no substitute for that hands-on experience of actually doing something of this kind. And we are hopeful that with the President's additional request from the Congress, and the planned expansion of the Navy, and the building program that we have in mind, that we are going to have a sizable, significant increase in the Navy construction program over the next 10 years.

And we need a cadre of these people. And that's the place to get them, in Navy shipyards. And they will provide the management for the Navy in the future.

ITEM 54.—*June 11, 1976—Senator Proxmire letter to Navy General Counsel Lewis acknowledging Mr. Lewis' letter of June 8, 1976. Senator Proxmire suggests that the claims filed against the Navy by Newport News Shipbuilding "may be based on fradulent representations"*

JUNE 11, 1976.

Mr. E. GREY LEWIS,
General Counsel,
Department of the Navy, Washington, D.C.

DEAR MR. LEWIS: Thank you for your letter of June 8, 1976 concerning the statements made by Admiral H. G. Rickover in the hearings on shipbuilding claims.

You stated that Admiral Rickover inaccurately portrayed the ability of your office to carry out its duties and that the legislation he supports which would authorize the Navy to hire outside counsel to represent it with disputes in government contractors, is unnecessary. Let me assure you that I intend to study your views and the material you forwarded.

In the meantime, you may be aware that the testimony we received in the June 7 hearing on shipbuilding claims strongly suggests that the claims filed against the Navy by Newport News Shipbuilding in the amount of $894 billion may be based on fraudulent representations.

The testimony showed that the claims contain inflated figures, supported allegations, attempts to charge the Navy with the costs of commercial activities and possible double counting.

These are serious charges which I feel confident your office will want to immediately investigate.

You may also know that on two prior occasions I asked the Navy to investigate possible fraud in shipbuilding claims. On both of those occasions the Navy forwarded the claims to the Justice Department for criminal investigations following the Navy inquiries.

I have enclosed a copy of the letter I sent to Secretary Middendorf requesting a formal Navy investigation of the Newport News claims. I look forward to your early response.

Enclosures may be found in Navy Department files.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 55.—*Jue 11, 1976—Letter from Senator Proxmire to Secretary of the Navy Middendorf concerning testimony from Admiral H. G. Rickover and Mr. William C. Cardwell during the June 7, 1976, Joint Economic Committee hearings, Senator Proxmire requests a formal investigation to determine whether the shipbuilding claims filed by Newport News Shipbuilding may be based on fraudulent representations*

JUNE 11, 1976.

Hon. J. WILIAM MIDDENDORF II,
Secretary of the Navy,
The Pentagon, Washington, D.C.

DEAR MR. SECRETARY: This is to request a formal investigation to determine whether there is substantial evidence that the shipbuilding claims filed by Newport News Shipbuilding may be based on fraudulent representations.

As you may know, the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee held hearings on Monday, June 7, 1976 concerning the shipbuilding claims. Testimony was received from Admiral H. G. Rickover and Mr. William C. Cardwell, a former official at Newport News.

The evidence received by the Subcommittee strongly suggests a possibility that the claims may be based on false or fraudulent representations.

The testimony shows that the claims contain inflated figures, unsupported allegations, attempts to charge the Navy with the costs of commercial activities, and possible double counting. According to the sworn testimony of Mr. Cardwell, although the company has blamed the Navy for most of the delays and disruptions that took place in the construction of the ships, the company itself was responsible for most of the delays and the disruptions. Mr. Cardwell testified that Navy change orders were considered to be very costly for purposes of the claims when, in fact, they were not.

You may also know that on two prior occasions I have requested the Navy to investigate the possibility of false claims. In both cases, involving Lockheed and Litton, the claims were referred to the Justice Department for criminal investigation following inquiries by the Navy.

Sincerely,

WILLIAM PROXMIRE.

ITEM 56.—*June 11, 1976—Newport News President Diesel letter to all Newport News employees. Mr. Diesel states: "I can assure you that our claims are reasonable and well-documented. These claims represent sizable sums of money owed to us by the Navy for work you have already performed over the last ten years"*

PRESIDENT'S LETTER

JUNE 11, 1976.

DEAR FELLOW EMPLOYEE: The current negotiations over claims between our Company and the U.S. Navy are of the utmost importance to each and everyone of us, because their outcome will affect our future and the number of jobs available to us.

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 to us by the Navy for work that you have already performed over the last 10 years.

Unfortunately, our business dealings with the Navy have now become a political issue. Reason has been replaced by emotion, and certain individuals are using the hardships we face as a Company and the hardships you face as individuals—to further their own selfish interests or political career.

When the claims negotiations first gained widespread publicity, I made the deliberate decision that we would not take our case to the news media. I will not dignify with a response statements made by those who consider themselves "instant" claims experts, but who are really interested only in publicity—not problem-solving.

I will not be goaded into a publicity battle involving a matter of such critical importance to you, your Company, our suppliers, our stockholders and our community. This matter ultimately will be settled at the negotiating table or in the courts—not in the newspapers.

I am greatly concerned by the impact of this publicity on you and your families. Our critics claim that the reason Newport News cannot build Navy ships on time and for the contract price is that you are poorly trained, inefficient and incompetent!

That charge is ridiculous and cannot go unchallenged!

Inefficient people don't earn for Newport News Shipbuilding the reputation for technological leadership and pride of craftsmanship. Incompetents don't produce a long and proud series of shipbuilding firsts that are the envy of every yard in the world. Poorly trained employees could not deliver five of the eight nuclear-powered ships the Navy has received in the last two years and deliver this year the lead ships of two new classes.

Newport News Shipbuilding is the best yard in the world. You know it. I know it, the shipbuilding industry knows it and the U.S. Navy knows it. We are the best in the world because you are!

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 four 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.

The response of a laid-off employee can be based understandably upon emotion, *not fact*. Unfortunately, I cannot excuse such misstatements when they so vitally affect our future. You can count on our legal representatives taking every opportunity to explore such responses in court—under oath—to separate emotion from fact.

I will not subject your future to emotional and politically motivated allegations.

I am continuing to pursue all possible approaches to a just and fair settlement with the Navy, but not at your expense. I must tell you that our best efforts have met only with failure. Rancor and recrimination have been the only results. If this continues to be the response, I seriously doubt whether our Company and the Navy can ever again achieve a productive and satisfactory relationship.

Regardless of the outcome, Newport News will still possess unique production capabilities, industrial technology and highly skilled people. I am confident that we also possess the firm resolve to control our future—even if a change of priorities and direction is necessary.

I appreciate the support that you have given me throughout this difficult period.

JOHN P. DIESEL.

ITEM 57.—*June 11, 1976—Wall Street Journal article entitled "Pentagon Fails to Settle Contract Claims From Shipbuilders, Adding to Strains"*

WASHINGTON.—The Defense Department has failed in its efforts to settle $1.9 billion in contract claims from ship builders, further complicating the Navy's strained dealing with the companies.

In April, the Defense Department, invoking a law that gives it extraordinary powers to rewrite contracts, announced plans to liberalize the cost-escalation clauses in 11 contracts with four ship builders if the companies agreed to settle their $1.9 billion in claims. The Pentagon said the settlement could cost it about $700 million.

But Deputy Defense Secretary William Clements told Congress yesterday that two of the companies—Newport News Shipbuilding & Dry Dock Co., a unit of Tenneco Inc., and the Ingalls Shipbuilding division of Litton Industries Inc.—didn't accept the Pentagon's proposal. Two did agree: the Electric Boat division of General Dynamics Corp. and National Steel & Shipbuilding Co., jointly owned by Kaiser Industries Corp. and Morrison-Knudsen Co. But the Defense Department wants to reach a common agreement with all companies, so it has broken off negotiations with all four.

OLD CONTRACTS

The claims relate to old contracts to build 70 ships, some of which are years behind schedule. Companies charge that the Navy, by the tardy delivery of crucial equipment and by numerous changes in design and specifications, slowed the shipbuilding programs and forced up costs. Some Navy officials, notably Adm. Hyman Rickover, director of the Navy's nuclear propulsion program, have blamed the cost overruns on what they call the inefficient operations of the shipyards.

Regardless of the cause, the acrimonious contract disputes have soured relations between the Navy and the ship builders, leading Mr. Clements to assert that the "impact of these disputes constitutes a major threat to the national defense." Newport News Shipbuilding has threatened to halt work on a nuclear aircraft carrier unless it receives more money from the Defense Department.

In announcing the failure of the Pentagon's efforts to resolve the disputes quickly, Mr. Clements warned that the Defense Department would, if necessary, invoke emergency powers to force the contractors to complete the ships. But he refused to specify what action the government might take. There are laws that allow the government to manage companies in certain emergencies.

WIDENS LOSS ESTIMATE

Even though the ship builders, particularly the Litton and Tenneco units, claim they are incurring large losses on the contracts, Mr. Clements said, "We expect ships to be built; we have contracts."

Litton initially said it would have a loss of $207 million on two contracts to build 35 ships, but it recently widened its expected loss to $544 million. Asked if he could explain the revision, Mr. Clements said, "I do think that's remarkable and I don't understand it." He said Litton hadn't given him any details on the loss estimate. Adm. Rickover and several Congressmen have said the claims are inflated.

Mr. Clements didn't blame the Tenneco and Litton units for the failure to reach a settlement, but he emphasized that the next move is up to the companies. Asserting that the Pentagon moved first to resolve the dispute, Mr. Clements said he hopes the yards will "regroup, reconsider their position and make an intiative."

Although Mr. Clements wouldn't discuss the negotiations in detail, he said that the Ingalls division of Litton demanded about $200 million more than the Pentagon was willing to pay and that Newport News wanted nearly $100 million more than the Pentagon offered. Ingalls has filed claims for $504 million and expects to claim about $200 million more. Newport News has claimed $894 million.

The Pentagon's standard procedures for resolving contract disputes often takes years. Mr. Clements indicated that the Defense Department doesn't want to wait that long and that it will take some unspecified "exraordinary" action to speed up the process if the companies don't come forward with an acceptable plan.

Regardless of what action the Defense Department takes, Mr. Clements said there is "a strong likelihood" the disputes will ultimately be resolved in court.

ITEM 58.—*June 11, 1976—Federal Contracts Report article, "Contract Adjustment: Negotiations Fail With Two of Four Shipbuilders on Major Claims; Clements Drops Public Law 85–804 Plan"*

Informing Congress that Defense Department negotiators have failed to reach agreement in the contract claims dispute with two of four key shipbuilders, Deputy Defense Secretary William P. Clements has cancelled his plans to utilize the extraordinary contract adjustment authority provided by PL 85–804 to make a quick settlement of $1.4 billion in claims.

Clements, who had been scheduled Thursday to report to the House Armed Services Committee on his plans to settle the current and prospective shipbuilding claims amounting to $1.7-$1.9 billion largely through the use of PL 85–804 (634 FCR A–11, etc.), instead cancelled his appearance and informed the chairmen of the Senate and House committees of the failure of the negotiations and withdrawal of his notification that he intended to use the 1958 act.

He said he is taking 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," which he has described as a matter of national security.

For the present, he said in his letter, 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." He explained to reporters Thursday that this means that he might decide again to use PL 85–804 if the situation is right.

He told the chairman that with the Electric Boat Division of General Dynamics Corp. and the National Steel and Shipbuilding Co., "an agreement in principle can be obtained to retrofit a total of three contracts with the new escalation clause."

Since DOD has not been able to reach agreement with the other two shipbuilders, Ingalls Shipbuilding Division of Litton and Newport News Shipbuilding and Dry Dock Co. of Tenneco, Inc., "we are 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 PL 85–804 approach I proposed to the Congress."

Continuing to stress his view of the importance of achieving a "more harmonious relationship" with the shipbuilders, Clements told a news briefing that despite some criticism that has been leveled by some in Congress and elsewhere of his plan to use PL 85–804, he thinks he would have gotten Congress to support his plan. "Congressional opposition has not been a factor in this decision" (to drop the PL 85–804 plan). He said that he had been assured of congressional support "by very senior members of Congress. Had DOD been able to reach a reasonable agreement, the plan would have proceeded."

As to the degree of difference between the Government and the Litton and Newport News negotiators, Clemnts said that the diffrence with Litton "was significant, close to $200 million." The Government negotiators were something less than $100 million apart from Newport News, he added.

Litton only recently jumped its estimated loss on two contracts for 35 ships from $207 million to $544 million and has filed $505 million in claims against the Navy. Clements said that he finds the sudden jump in the Litton estimates "remarkable and "I don't understand it."

Newport News is said to face about $127 million in losses on six contracts for 16 ships and submarines, and has filed claims totaling $894 million against the Navy. Thus, between Litton and Newport News nearly $1.4 billion in claims await settlement.

It is understood that under the PL 85–804 proposal Litton would receive about $240 million that would have given it a $22 million profit; Newport News would have received under the proposed new escalation clause, an estimated $32 million profit, according to Clements. The Navy has estimated that the proposal would have cost the Navy about $747 million and would have assured continuation of work on ships for the Navy's dwindling fleet.

Clements explained to Congress that, "While two of the shipbuilders have accepted the Government proposal in principle, our plan contemplated an overall approach which would yield a solution to the problems of the four shipbuilders." He explained to newsmen that it would not be "appropriate to attack this problem in bits and pieces," that the Pentagon was concerned about setting a precedent in future situations of this sort.

Admitting that negotiations have broken down with the shipbuilders, Clements said that, "We are open to suggestion. We're certainly not going to put anything forward, but one way or another, we intend to get those ships." The next step might be to take the problems to the Armed Services Board of Contract Appeals or to the courts, a step some firms already are taking, he noted.

He said, "I reject completely" Admiral Rickover's suggestion that the Government take over the private yards if an equitable settlement cannot be reached. As to the other charges leveled earlier in the week by the Navy's nuclear propulsion chief, Clements said that he found them "overstated," and thinks that Rickover "hasn't yet come to grips with the problem of delays, certification and auditing of contractor claims."

It is a "greatly exaggerated thing" about certification, he added. So far as blame for the current shipbuilding claim situation, he is "certainly not satisfied with the Navy's management of the problem," but, "there is enough blame to go around for all concerned."

Senator William Proxmire (D–Wis) applauded the decision to drop the PL 85–804 approach, and called on the Secretary of the Navy to investigate the validity of the Newport News claims.

RICKOVER TESTIMONY

It was only three days earlier that Rickover had warned that the proposed use of PL 85–804 in the shipbuilding claims case "could be one of the biggest ripoffs in the history of the United States."

Testifying before the Joint Economic Subcommittee on Priorities and Economy in Government, Rickover fired his latest broadside at the shipbuilders, charging their unsettled claims against the Navy for cost overruns were largely fraudulent.

"The fact that they are willing to settle for half, shows that these are not valid," he said, referring to 64 volumes of claims from Newport News on

display at the hearing. He said that he had not read them, but "neither has anyone else in the Defense Department."

He then fired a salvo at the U.S. conglomerates that have taken over most of the key U.S. shipyards: "The conglomerates are as interested in making ships as they are in manufacturing horse collars."

He complained that 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.

He went on:

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.

"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 cumulative or ripple effect of changes."

The Navy is contractually obligated to equitably adjust contract price and delivery date to reflect the effect 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."

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, he contended.

"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 energy to evaluating the claim. I believe the company's claims are substantially overstated."

Rickover said, "Some people say I have no business to become involved in or to criticize the contracting or other methods of the Defense Department. They say if any criticism is needed it should be left to those whose job it 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."

A surprise witness, former Newport News official William C. Cardwell, also charged that the firm's $894 million claim would be "ripping off the government" if it collects.

Cardwell, 43, said he went to work for Newport News 18 years ago, and was a senior program analyst assigned to a 50-member claims team in late 1974 before being laid off in an economy move last February 11.

He described as a complete hoax a company assertion that a strike by a supplier of pump systems had caused a 14-week construction delay. The delay, he said, was actually for only two or three days, and, he added, made no difference in that the pumps lay around "for months" before being installed.

He claimed that the delays referred to by the company as the Navy's responsibility actually were "solely the responsibility of the shipyard. I don't think there were any delays caused by Navy changes if the truth were known."

Company spokesmen denied the charges, saying, "We've prepared these current claims using the same techniques and methods used for previous requests for equitable adjustments. In the past, the Navy has been able to process our claims and in every instance has found them to be a satisfactory basis for negotiation. We see no reason why these current claims should be regarded in any different light. We aren't interested in a rip-off or a bailout. All we want is the equity that we presumably were entitled to under the contract we signed."

The spokesman said that Cardwell was a "production scheduler", who had been with the firm for 18 years until laid off last February during a reorganization of his department.

ITEM 59.—*June 14, 1976—Newport News President Diesel letter to Deputy Secretary of Defense Clements rejecting the Navy offer to settle outstanding Newport News claims using Public Law 85–804*

NEWPORT NEWS SHIPBUILDING,
Newport News, Va., June 14, 1976.

Hon. WILLIAM P. CLEMENTS,
Deputy Secretary of Defense,
Washington, D.C.

DEAR SECRETARY CLEMENTS: Confirming our discussion on June 2, the negotiations between Newport News Shipbuilding and the Shipbuilding Executive Committee have reached a stalemate. By separate letter this date to Admiral Michaelis, I am reviewing the status of the outstanding nuclear shipbuilding contracts and our proposed course of action.

I had hoped that the parties concerned would fully embrace your concept that there is enough fault to go around for everyone. More specifically, I had expected that the Navy was prepared to propose a solution which would provide for the Government taking responsibility for certain inflation—amounting to some $200,000,000 in current estimates. On the other hand, the Company was prepared to be responsible for the other cost growth and therefore would release our claims—amounting to substantially more than $200,000,000. This would have resulted in a break even situation for Newport News for constructing $2.5 billion worth of nuclear ships for the Navy. This solution has not been reached, and our offer to do so is withdrawn.

From my point of view, the root of the problem is that the Navy's offer does not compensate Newport News for escalation costs to the same degree as would be anticipated under a new Navy shipbuilding contract or perhaps under other existing contracts with other shipbuilders. I recognize that the Committee has offered a clause that is, in form, substantially the same one contained in the recent contract for Destroyer Tenders. However, two principal features of this clause are (i) that the rate of compensable escalation stops at the contract delivery date, and (ii) that the amount of escalation stops when the unescalated costs of the contractor reach the ceiling price. Thus, in order for the clause to be equitable, both the delivery dates and the ceiling prices must be realistic.

This needed realism was not present in the Committee's proposal to Newport News. The Committee's offer cuts off escalation growth at existing contract delivery dates which, in some cases, have already passed. In addition, it cuts off escalation compensation at the current contract ceiling which in all cases, except the Carrier contract, is unrealistically low as a benchmark for escalation.

We have offered every manner of compromise which would alleviate the constraints of these two items but so far have been unsuccessful. If, for example, as I discussed with you and as is the case with Electric Boat, our 688 class claims were settled prior to including escalation, the result would have been acceptable.

I wish to also point out that the Committee proposal had numerous other features that we found objectionable.

For example, the treatment of the pricing of change orders—although contained in some escalation clauses currently in effect—works a severe inequity in our situation. It compounds the delivery date and ceiling price problems already referred to, as well as reverses certain equitable price adjustments that have already been made to our contracts.

In addition, the release language is particularly onerous and bears no relationship to the ordinary and reasonable dealings between the Navy and its contractors—or even to the release language set forth in the Armed Services Procurement Regulation.

Another feature of the proposal is to settle outstanding changes without consideration of any additional delays which could occur. This, in effect, not only absolves the Navy of responsibility for those change orders involving the whole issue of "cumulative impact," but also fails to recognize several major change orders involving critical design deficiencies by the Government that have had direct delay impact and that will cost tens of millions of dollars in lost time.

Finally, we find unacceptable the proposal's attempt to directly involve the Navy in the basic right of management to allocate manpower.

The problems I've addressed so far involve essentially formal contractual matters. But there is another basic issue about which I am equally concerned—the significant and serious deterioration of day-to-day relationships between the Navy and our Company. The Navy has failed to establish new contract provisions that would eliminate, or at least minimize, in the future the lengthy disputes which have characterized the past. A clause for full escalation would, of course, alleviate the disputes.

I see no evidence to indicate a more reasonable approach by the Navy to our mutual problems. I see only the grim prospects of a continuation of the current adversary relationship, with the attendant grave implications not only for the Company but also for the Navy, the defense industry as a whole and, importantly, for our thousands of employees.

Our best efforts to date have met only with failure. Rancor and recrimination have been the only results obtained, and this raises the serious question of whether our Company and the Navy can ever again achieve a productive and mutually satisfactory relationship.

A great deal has been said about the problems attendant to a timely evaluation of our claims, although we have emphasized that the subject matter of these claims has generally been raised with the Government as the problems arose during the construction period. Perhaps the most prudent step for the Navy would be to have a one-year hiatus in the nuclear Naval shipbuilding program which would give the Navy time to straighten out its affairs. In addition, hopefully it would afford them access to the funds necessary to properly fund their existing obligations.

Notwithstanding the efforts at the very highest level of the Department of Defense, there is no progress towards curing the underlying problems. In the face of that fact, I have reluctantly reached the conclusion that continued one-sided contract performance by Newport News subjects this Company to irreparable damage. I consider that there exists a fundamental breach on the part of the Navy of its obligation to provide equitable compensation for its actions. This includes not only *full* compensation, but *prompt* compensation.

I have today sent to Admiral F. H. Michaelis a summary of the status of our Nuclear Naval shipbuilding contracts, including a brief statement of our proposed course of action with regard to each of them. Included in that letter is a description of a method to achieve an orderly withdrawal from our continued participation in the Nuclear Naval shipbuilding program if we are unable to promptly reach a reconciliation. This proposal includes cooperation in transferring the CVN70 to Puget Sound Naval Shipyard and of the follow-on SSN711–715 ships to Mare Island Naval Shipyard. We anticipate that our position is correct with regard to DLGN41 and that it will be cancelled.

This will enable me to redirect the efforts of our Company to enterprises which at least hold out the promise of mitigating our damages and shorten the time frame in which we will be exposed to that continued Navy conduct which now threatens our survival. I trust you will use your good offices to make this transition as amicable as possible.

Yours very truly,

J. P. DIESEL, *President.*

ITEM 60.—*June 14, 1976—Newport News President Diesel letter to Chief of Naval Material Michaelis stating the company's position with respect to each major contract and other outstanding contractual issues in view of the inability to reach a settlement under Public Law 85–804*

NEWPORT NEWS SHIPBUILDING,
Newport News, Va., June 14, 1976.

ADMIRAL F. H. MICHAELIS, JR.,
Naval Material Command Headquarters,
Washington, D.C.

DEAR ADMIRAL MICHAELIS: As you are aware, the efforts of the Shipbuilding Executive Committee to resolve the contractual impasse between the Company and the Navy have been unsuccessful. It is our impression that this committee has been, in fact, disbanded and that no further action at that level is contemplated. Additionally, we understand that the Department of Defense and the Navy now consider that we have the initiative to present ways to resolve our mutual problems. I do not at this time have any new ideas or dif-

ferent proposals for an overall resolution. However, I believe that a summary of our current situation and our recommended action, is in order. Such a summary follows, and I have grouped the matters for ease of handling rather than any relative priority.

ACTIVE NUCLEAR SHIP CONSTRUCTION CONTRACTS:

Our active contracts are encumbered by many open issues. However, the major underlying problem is the inability of the Navy to promptly recognize its share of responsibility for delays in construction schedules and the resulting equitable adjustments in price and delivery dates. Our position is that the fact that the Navy has not come to grips promptly with matters for which the Company is entitled to additional compensation pursuant to the changes clause is so severe and so serious that it constitutes a breach of your obligations to us under those respective contracts. This underlying problem transcends personalities but is compounded by the dogged interference by Admiral Rickover and his staff in the orderly resolution of any matter under the contracts with which he or his people do not agree. We remain willing, and indeed anxious, for a mutually acceptable resolution.

a. *Aircraft Carrier Construction.*—CVN68 is delivered. CVN69 is well along. We believe that the Navy's position on our request for equitable adjustment, submitted February 19, 1976, is essentially already predetermined by its original correspondence on the matters put together in the claim. Accordingly, we request your final offer within 90 days. If we accept, fine. If not, please issue a formal final decision so that we may pursue our other rights.

With regard to CVN70, as indicated above, we consider the Navy's failure to respond equitably to the many problems caused by extra Government work leaves us with a situation that we regard as an anticipatory breach on the CVN70, and that we see no course of action in the absence of a resolution of these underlying matters, other than not building the ship here. A separate letter is being forwarded on this matter.

b. *Submarine Construction.*—The Request for Equitable Adjustment under the contracts for SSNs 688, 689, 691, 693 and 695 has received substantial review within the Navy. We request that you forthwith reduce the results of this review to a final offer which, if we accept, fine. If not, please issue a formal final decision so that we may pursue our other rights.

With regard to the contract for SSN711–715, it is our position that this contract has been breached as a result of the Navy's failure to fulfill its promise with regard to action on the request for equitable adjustment on the earlier ships, which was a condition of our performance of this contract. A separate letter is being forwarded on this subject.

c. *Frigate (Cruiser) Construction.*—The requests for equitable adjustment for DLGN's 38, 39 and 40 have been with the Navy for extended periods. We request your immediate attention to this. It is pointed out again that recognized delays on DLGNs 38–40 will impact DLGN41 and thereby perhaps be useful in resolving the delivery and price issues on that ship. In any event, we want your final offer promptly which, if we accept, fine. If not, please issue a formal final decision so that we may pursue our other rights.

With regard to the DLGN41, from our point of view, since the court order, the Navy systematically refused to attempt to compromise any of the issues between us but has carried on a delaying action as we had anticipated. (So far you are still insisting on a contract delivery date that is impossible.) We need to know what steps the Navy will take to try and resolve this outstanding matter. In the interim, we intend to seek to have the court order vacated so that work on the CGN41 will cease until the matter is resolved. We particularly call your attention to the fact that we still do not believe you have adequate funding for this ship and we consider that your disclosures, both to the court and to the General Accounting Office, have been less than full. A separate letter is being forwarded on this matter.

COMPLETED NUCLEAR SHIP CONSTRUCTION CONTRACTS

All claims submitted by this Company on ships without nuclear power have been negotiated and settled. No claim for construction of a nuclear powered ship has been settled, although some claims on such ships have been submitted since June of 1973. We request your personal assistance to reduce the time required in processing our submitted claims to an absolute minimum.

a. *DLGN36 and DLGN 37.*—Our informal offer to settle the entire matter for $36,585,366 is withdrawn. The Navy will do us a great service if it will simply reduce its final position with regard to the claim which was submitted in 1973 to a final offer. We will then immediately advise you as to whether we can accept that offer or reject it and proceed to obtain whatever measure of relief is available to us through the Armed Services Board of Contract Appeals.

b. *SSN686 and SSN687.*—We acknowledge that the formal claim for these ships was not submitted until March, 1976. However, the delay in submitting that claim was because of our misunderstanding with the Naval Sea Systems Command while working toward a mutual resolution of our submarine construction program. Among the reasons we delayed in submitting that claim was the desire to prevent the possible dilution of NAVSEA resources which were heavily committed to resolution of our pending SSN688 class claim, and as a result, the SSN686/687 claim was about a year old when it was actually submitted. We have been working toward an update of the claim, but we do not expect the end result to substantially change the submitted documents. Based on the information available to us, it appears that the Navy has already determined that claim to be substantively without merit. I therefore simply request that a final decision to that effect be issued so that we may assert our rights in the Armed Services Board of Contract Appeals and the courts.

COLLATERAL ISSUES

There are three other matters which need to be addressed: the affidavit issue in the Navy yard question; and the change order problem.

1. *Affidavits.*—With regard to the affidavit issue, we have been willing from the outset to submit an appropriate affidavit with regard to our requests for equitable adjustment. Such an affidavit will be promptly submitted by separate letter. We would refer you to the voluminous record with regard to this issue and request that if the affidavit we forward is not acceptable to you, simply issue a final decision so that we may litigate this matter.

2. *Navy Yards.*—We offer to cooperate fully with you in making arrangements to have carriers, including the CVN70, and submarines, including the SSN711–715, constructed at Naval shipyards, even though the record shows it is not necessary. We believe the DLGN41 will be cancelled because of funding problems. Rather than informal inquiries or contacts, it would be preferable to handle these matters on the basis of a formal contractual————

Accordingly, we propose that the Navy develop the details of its requirements and incorporate them into a scope of work which could serve as the basis for contracting. Upon your completion of this action, you could initiate the formal procurement process for such effort on the part of this Company to provide the information and assistance that the Navy may desire.

3. *Change Orders.*—We consider that the Navy has forfeited its rights to unilaterally direct extra work under our nuclear shipbuilding contracts because of its systemic failure to equitably adjust price and delivery dates. We intend to invoke a much more rigid aproach to undertaking extra work for the Navy's account. We will communicate further on this matter.

Let me emphasize again that the recommendations above are not our desired course of action. Rather, we consider that we have no alternative to do otherwise in view of the Navy's continued breach which exists under all of our current nuclear shipbuilding contracts.

Yours very truly,

J. P. DIESEL, *President.*

ITEM 61.—*June 15, 1976—Deputy Secretary of Defense Clements letter to Senator Proxmire forwarding Newport News President Diesel June 14, 1976 letter to Deputy Secretary of Defense Clements. In that letter, Mr. Diesel explains his reasons for rejecting the Public Law 85–804 settlement offer*

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C., June 15, 1976.

Hon. WILLIAM PROXMIRE,
U.S. Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: The attached are forwarded for your information in connection with our recent discussions on Navy Shipbuilding Claims.

Sincerely,

Enclosures.

W. P. CLEMENTS.

[EDITOR'S NOTE.—Mr. Clements' letter contained two enclosures. For enclosure, see item 59 above. Enclosure 2 follows:]

LITTON INDUSTRIES,
Beverly Hills, Calif., June 9, 1976.

Hon. FRANK A. SHRONTZ,
Assistant Secretary of Defense (I&L),
Washington, D.C.

DEAR Mr. SECRETARY: On June 4, 1976, Litton submitted its proposals to you which were specifically aimed at settling all of the issues outstanding between us on the LHA and DD963 contracts. You informed us in your conversation of today that the Department of Defense would not accept either of our settlement offers and that negotiations are concluded.

Litton Industries, therefore, withdraws its June 4, 1976, offers of settlement. Litton appreciates your efforts in attempting to achieve a resolution of these matters, and urges you to continue to seek a solution to the very serious situation which exists between the Shipbuilders and the Navy.

Sincerely,

FRED W. O'GREEN.

ITEM 62.—*June 18, 1976—Letter from the Vice President of Newport News to the Chief of Naval Material submitting a Newport News affidavit for each of its claims against Navy shipbuilding contracts and requesting prompt and appropriate action by the Navy with respect to the claims. This letter states: "The Navy's refusals to review our requests without the affidavits enclosed herein, or without any affidavits whatsoever, constitute continuing material breaches of the contracts involved. We reserve our rights for the damages which the Navy has caused to date"*

NEWPORT NEWS SHIPBUILDING,
Newport News, Va., June 18, 1976.

ADMIRAL F. H. MICHAELIS, JR.,
Naval Material Command Headquarters,
Washington, D.C.

DEAR ADMIRAL MICHAELIS: In our letter of June 14, 1976, Mr. Diesel indicated that the Company would submit an appropriate affidavit in connection with its requests for equitable adjustment. The affidavits promised are enclosed herewith for each of the requests for equitable adjustments which have been submitted to the Navy.

You are again requested to take prompt and appropriate action with respect to our claims. We understand evaluation of our claims has been held up for extended periods of time in the absence of an agreed upon affidavit. You are specifically requested to insure that the necessary evaluation of our claims proceeds forthwith.

Enclosed you will find in Book form a Chronology of events re the affidavit issue which demonstrates the complete unreasonableness of the constantly shifting and inconsistent Navy positions.

The Navy's refusals to review our requests without the affidavits enclosed herein, or without any affidavits whatsoever, constitute continuing material breaches of the contracts involved. We reserve our rights for the damages which the Navy has caused to date.

It is requested that you assure us by the end of next week that you are taking the action requested.

Sincerely,

F. H. CREECH,
Vice President.

Enclosures.

AFFIDAVIT

I, J. P. Diesel. the responsible senior official authorized to commit the Newport News Shipbuilding and Dry Dock Company, being duly sworn, do hereby depose and say, with respect to its claim dated Feb. 13, 1976 filed by Newport News Shipbuilding and Dry Dock Company under Contract N00024–68–C–0355 for the DLGN36 and DLGN37, on information and belief, that:

(a) My subordinates have thoroughly investigated the facts surrounding this claim.

(b) Based upon this investigation and on information and belief the facts contained therein are true.

(c) I have instructed my subordinates to systematically correct any errors or omissions in this claim as they may be discovered upon our continuing reviews.

This the 19th day of June, 1976.

J. P. DIESEL.

Sworn to and subscribed before me this the 19th day of June, 1976.
Virginia R. Adams,
Notary Public.

AFFIDAVIT

I, J. P. Diesel. the responsible senior official authorized to commit the Newport News Shipbuilding and Dry Dock Company, being duly sworn, do hereby depose and say, with respect to its claim dated March 8, 1976 filed by Newport News Shipbuilding and Dry Dock Company under Contract N00024–71–C–0270 for the SSN689, 691, 693 and 695, on information and belief, that:

(a) My subordinates have thoroughly investigated the facts surrounding this claim.

(b) Based upon this investigation and on information and belief the facts contained therein are true.

(c) I have instructed my subordinates to systematically correct any errors or omissions in this claim as they may be discovered upon our continuing reviews.

This the 19th day of June, 1976.

J. P. DIESEL.

Sworn to and subscribed before me this the 19th day of June, 1976.
Virginia R. Adams,
Notary Public.

AFFIDAVIT

I, J. P. Diesel. the responsible senior official authorized to commit the Newport News Shipbuilding and Dry Dock Company, being duly sworn, do hereby depose and say, with respect to its claim dated March 8, 1976 filed by Newport News Shipbuilding and Dry Dock Company under Contract N00024–70–C–0269 for the SSN688, on information and belief, that:

(a) My subordinates have thoroughly investigated the facts surrounding this claim.

(b) Based upon this investigation and on information and belief the facts contained therein are true.

(c) I have instructed my subordinates to systematically correct any errors or omissions in this claim as they may be discovered upon our continuing reviews.

This the 19th day of June, 1976.

J. P. DIESEL.

Sworn to and subscribed before me this the 19th day of June, 1976.
Virginia R. Adams,
Notary Public.

AFFIDAVIT

I, J. P. Diesel. the responsible senior official authorized to commit the Newport News Shipbuilding and Dry Dock Company, being duly sworn, do hereby depose and say, with respect to its claim dated August 8, 1975 filed by Newport News Shipbuilding and Dry Dock Company under Contract N00024–70–C–0252 for the DLGN38, 39 and 40, on information and belief, that:

(a) My subordinates have thoroughly investigated the facts surrounding this claim.

(b) Based upon this investigation and on information and belief the facts contained therein are true.

(c) I have instructed my subordinates to systematically correct any errors or omissions in this claim as they may be discovered upon our continuing reviews.

This the 19th day of June, 1976.

J. P. DIESEL.

Sworn to and subscribed before me this the 19th day of June, 1976.
Virginia R. Adams,
Notary Public.

AFFIDAVIT

I, J. P. Diesel, the responsible senior official authorized to commit the Newport News Shipbuilding and Dry Dock Company, being duly sworn, do hereby depose and say, with respect to its claim dated Feb. 19, 1976 filed by Newport News Shipbuilding and Dry Dock Company under Contract N00024–67–C–0325 for the CVAN68 and CVAN69, on information and belief, that:

(a) My subordinates have thoroughly investigated the facts surrounding this claim.

(b) Based upon this investigation and on information and belief the facts contained therein are true.

(c) I have instructed my subordinates to systematically correct any errors or omissions in this claim as they may be discovered upon our continuing reviews.

This the 19th day of June, 1976.

J. P. DIESEL.

Sworn to and subscribed before me this the 19th day of June, 1976.

Virginia R. Adams,
Notary Public.

AFFIDAVIT

I, J. P. Diesel, the responsible senior official authorized to commit the Newport News Shipbuilding and Dry Dock Company, being duly sworn, do hereby depose and say, with respect to its claim dated March 8, 1976 filed by Newport News Shipbuilding and Dry Dock Company unedr Contract N00024–79–C–0307 for the SSN686 and SSN687, on information and belief, that:

(a) My subordinates have thoroughly investigated the facts surrounding this claim.

(b) Based upon this investigation and on information and belief the facts contained therein are true.

(c) I have instructed my subordinates to systematically correct any errors or omissions in this claim as they may be discovered upon our continuing reviews.

This the 19th day of June, 1976.

J. P. DIESEL.

Sworn to and subscribed before me this the 19th day of June, 1976.

Virginia R. Adams,
Notary Public.

ITEM 63.—*June 21, 1976—Business Week article entitled "The Shipbuilders Balk at 40 Cents on the Dollar"*

Deputy Defense Secretary William P. Clements Jr.'s bold plan to settle $1.9 billion of shipbuilding claims against the Navy for "between $500 million and $700 million" may be falling flat. "The odds are only about 50–50," Clements acknowledged this week. "The shipyards are giving me trouble."

On Apr. 30 Clements informed both the Senate and the House Armed Services Committees of his unusual plan to clear up long-pending claims, which he said are largely responsible for the "acrimonious and adversarial environment that now marks Navy-shipbuilders business relations." He promised the legislators a progress report on June 10. At the same time, he predicted privately that he would have the claims situation wrapped up by that date.

The settlements would be under terms of Public Law 85–804, enacted by Congress in the early 1960s to enable the Defense Dept. to modify contracts when it is in the interest of national defense. The law was amended in 1973 to require that Congress be notified prior to use of the law for any modification exceeding $25 million and be given 60 days to disapprove.

Clements intended to use this program to bypass traditional, drawn-out appeals board procedures and to wipe the slate clean of the massive extra dollar amounts demanded by shipbuilders to compensate them for such things as Navy-ordered design changes, late delivery of government-furnished equipment, and higher-than-anticipated inflation rates. But at midweek Clements was far short of his goal. The two shipyards with the bulk of the outstanding claims were reluctant to accept his offer of roughly 40¢ on the dollar in immediate cash.

A lot of money. Tenneco Inc.'s Newport News Shipbuilding & Dry Dock Co. filed the largest of the outstanding claims—some $894 million. After meeting Wednesday morning with Clements, Newport News President John P. Diesel said: "We have failed. We can't get together on money, and the Navy has not done a damn thing about changing contracting procedures."

The second-largest claim is from Litton Industries Inc.'s Ingalls Shipbuilding Div.—for almost $600 million. That claim remains unsettled. "We are not going to give away the store," Litton's President Fred W. O'Green said. "Last week we gave them our final position, and the Navy gave us their final position, and we are quite a ways apart."

Charged with hammering out the settlements is the Assistant Secretary of defense for installations and logistics, Frank A. Shrontz. He met with Litton's chairman and chief executive officer, Charles B. "Tex" Thornton, until late Tuesday trying to reach an agreement. Most of the rest of the disputed claims—about $300 million—is held by General Dynamics Corp.'s Electric Boat Div., and reportedly an agreement has been reached. National Steel & Shipbuilding Co. has a small claim.

An impasse? Navy sources close to the situation privately doubt that Clements' bid to clear the slate is going to work. Says one source: "I think Clements painted himself into a corner by publicly setting a date with Congress. The yards have got him in a squeeze play, and they are using it."

If the Clements approach does not work, the question is, what next? Neither side was making progress under the Navy's traditional settlement system. Litton's O'Green says the solution must contain two things: "One thing is money, and the other is a better method of contracting." As it stands, he says, "the risks are unacceptable" to contract for Navy ships.

Clements' approach does not have total approval within the Navy. Venerable Admiral Hyman G. Rickover, for one, blasted it as potentially "one of the biggest rip-offs in the history of the U.S." Early this week, in what one Navy officer termed a "love fest," Rickover testified before the Joint Economic Committee's subcommittee on priorities and economy in government, chaired by Senator William Proxmire (D-Wis.), the only legislator present. Between the chairman and the witness, the shipyards were castigated on the whole claims issue. Clements retorted the following day, "They are talking from ignorance."

ITEM 64.—*June 21, 1976—Federal Contracts Report article entitled, "Claims: Newport News Charges Navy With 'Fundamental Breach'; Sees Only 'Grim Prospect' of Continuing Adversary Relationship"*

"Rancor and recrimination" have been the only results of negotiations between the Navy and the Newport News Shipbuilding to settle the shipbuilder's contract claims, John P. Diesel, the firm's president, has told Secretary of Defense William P. Clements.

Clements had already notified Congress of the failure to reach an agreement with two of the four key shipbuilders—Newport News and Ingalls Shipbuilding Division of Litton—and has cancelled his plan to use P.L. 85-804 authority to settle the $1.4 billion in claims (635 FCR A-11).

Confirming the fact that negotiations reached a stalemate, Diesel questions whether Newport News and the Navy "can ever again achieve a productive and mutually satisfactory relationship." He charges the Navy with a "fundamental breach" of its obligation to provide equitable compensation for its actions.

The main reason for the failure in negotiations, from Diesel's point of view, is the fact that Navy's proposal does not cover Newport News escalation costs as fully as would be anticipated under a new shipbuilding contract, or perhaps under existing contracts with other shipbuilders.

The principal feature of Navy's proffered clause are (1) that the rate of compensable escalation stops at the contract delivery date, and (2) that the amount of escalation stops when the unescalated costs have reached the ceiling price. Thus, in order to be equitable, both the delivery dates and the ceiling prices must be realistic.

However, the Navy's offer cuts off escalation growth at existing contract delivery dates which, in some cases, have already passed. Moreover, it cuts off escalation compensation at the current contract ceiling which in almost all cases is unrealistically low as a benchmark for escalation.

There are other objectionable features to the Navy's proposal, Diesel continues.

The treatment given to the pricing of change orders—while contained in some escalation clauses currently in effect—works a severe inequity in Newport News' situation. It compounds the delivery dates and ceiling price problem and reverses certain price adjustments have already been made in the contracts.

The release language is "particularly onerous," Diesel states. It bears no relationship to the ordinary and reasonable dealings between the Navy and its contractors—or even to the release language set forth in the Armed Services Procurement Regulation.

Further, the proposal would settle outstanding changes without any consideration of additional delays that could occur. This not only absolves the Navy of responsibility for change orders involving the issue of "cumulative impact," but also fails to recognize that several change orders involving the Government's design deficiencies have had a delay impact and will cost "tens of millions of dollars in lost time."

Finally, Diesel objects to the proposal's attempt to "directly involve the Navy in the basic right of management to allocate manpower."

These are the formal contractual problems; but another basic issue is the "significant and serious deterioration of day-to-day relationships between the Navy and our company, the Newport News executive states.

"The Navy has failed to establish new contract provisions that would eliminate or at least minimize, in the future the lengthy disputes which have characterized the past." A clause for full escalation would alleviate these disputes, he adds.

Diesel sees no evidence of a more reasonable approach by the Navy, only the "grim prospects" of a continuing adversary relationship.

There has been a great deal said about the problems regarding a timely evaluation of these claims, the shipbuilder official states, adding that the subject matter of the claims has generally been raised with the Government as the problems occurred. Perhaps the "most prudent step" would be for the Navy to have a one-year hiatus in the nuclear shipbuilding program so that Navy would have time to "straighten out its affairs."

Despite efforts at the highest level of the Defense Department, there has been no progress toward curing the underlying problems. Accordingly, Diesel states, he has decided that "continued one-sided contract performance" by Newport News subjects the company to irreparable damages. "In consider that there exists a fundamental breach on the part of the Navy of its obligation to provide equitable compensation for its actions. This includes not only *full* compensation, but *prompt* compensation."

In a letter to Chief of Naval Material F. H. Michaelis, Diesel outlines his company's proposed course of action with regard to each of its contracts, including a plan for its "orderly withdrawal" from the Navy's nuclear shipbuilding program "if we are unable promptly to reach a reconciliation."

While DOD apparently believes that Newport News now has the iniative for presenting ways to resolve the problems, Diesel tells Michaelis, at this point the shipbuilder has no "new ideas or different proposals for an overall resolution."

The major problem is seen as Navy's inability to promptly recognize its share of responsibility for delays in construction scehedules and resulting equitable adjustments in price and delivery dates. While this problem "transcends personalities," it is compounded by the "dogged interference of Admiral Rickover and his staff" in the orderly resolution of any matter with which they disagree, the Newport News president asserts.

With regard to the active nuclear ship contracts—which include aircraft carrier, submarine, and frigate construction contracts—Newport News asks the Navy to send its final offers on the firm's requests for equitable adjustments and if these are rejected, to then issue formal, final decisions "so that we may pursue our other rights.

As to the completed contracts, Diesel points out that no claim for construction of a nuclear powered ship has been settled although some were submitted as long ago as June 1973. He requests Michaelis' "personal assistance" in reducing the time required to process the claims already submitted.

With regard to change orders, Newport News thinks that the Navy "has forfeited its rights to unilaterally direct extra work under our nuclear ship-

building contract because of its systemic failure to equitably adjust price and delivery dates. We intend to invoke a much more rigid approach to undertaking extra work for the Navy's account."

ITEM 65.—*June 24, 1976—Secretary of the Navy Middendorf letter to Senator Proxmire responding to his June 11, 1976 request for a formal investigation of Newport News claims. The Secretary states that "if there should be indication of fraud, the matter will be referred to the Department of Justice"*

DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., June 24, 1976.

Hon. WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities & Economy in Government, Joint Economic Committee, Congress of the United States, Washington, D.C.

DEAR SENATOR PROXMIRE: This is in response to your letter of June 11, 1976, in which you request a formal investigation to determine whether there is substantial evidence that claims filed by Newport News Shipbuilding may be based on fradulent representations.

The Navy is now evaluating the recently submitted Newport News claims. Employment of our detailed multidisciplined team approach in evaluating these claims, it is believed, will uncover evidence of any fraud. The team will be particularly mindful of the testimony given by Mr. Cardwell before your subcommittee. I can assure you that if there should be indication of fraud, the matter will be referred to the Department of Justice.

Sincerely,

J. WILLIAM MIDDENDORF II,
Secretary of the Navy.

ITEM 66.—*June 24, 1976—Reply to Senator Proxmire's letter of May 27, 1976 by Secretary of the Navy Middendorf asking about the extent of involvement of Mr. Thomas Corcoran and Tenneco in the Navy's decision to extend Admiral Rickover*

THE SECRETARY OF THE NAVY,
Washington, D.C., June 24, 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: This is in reply to your letter of May 27, 1976, concerning the retention of Admiral Hyman G. Rickover, U.S. Navy (Retired), on active duty. Admiral Rickover is currently serving on active duty under an extension which was approved in October, 1975; this extension was for a two-year period— from January, 1976, until January, 1978.

Your letter posed several questions concerning Admiral Rickover's extension. I will attempt to provide answers in the order which you posed the questions.

1. "Did you or anyone else in the Navy or Defense Department ever contact Mr. Corcoran to ask his advice on how you could get Admiral Rickover 'out of the hair of the shipbuilders?'" I have queried the members of the Navy Secretariat to ascertain whether any such advice was ever sought, and all answers were in the negative. I have asked the Chief of Naval Operations to conduct a similar inquiry, and he advises me that no member of his staff requested such advice from Mr. Corcoran. Since your question applied to the entire Defense Department, I queried Deputy Secretary Clements' office similarly. Based on their replies, I am able to assure you that, to the best of my knowledge and belief, no senior official of the Department of Defense or the Department of the Navy contacted Mr. Corcoran to ask his advise on how to terminate Admiral Rickover's active-duty status. In view of this conclusion, the remaining questions under your paragraph number 1 are not applicable.

2. "Did Mr. Corcoran or other representatives or officials of Newport News or Tenneco express their views on the advisability of giving Admiral Rick-

over a different assignment to you or any other Navy or Defense Department officials?" There has been considerable contact between representatives of the Navy and Newport News/Tenneco. Admiral Rickover has, himself, had contact with officials of Newport News and other shipbuilders in the private sector. In the course of discussions between Navy Department officials and the shipbuilders, the subject of Admiral Rickover undoubtedly surfaced many times.

It is certainly possible that conversations took place during which representatives of the nuclear shipbuilding industry suggested that relationships with the Navy would be improved if they did not have to deal with Admiral Rickover. Both Admiral Holloway and I had separate conversations with Mr. Corcoran during which Mr. Corcoran suggested that Admiral Rickover be assigned as Superintendent of the Naval Academy. These conversations occurred in November, 1975.

In question 2, you also ask, "Were there any company actions suggested, such as a refusal to do Navy work or take additional Navy business, if Admiral Rickover were reappointed." During the conversations Admiral Holloway and I had with Mr. Corcoran, he made no suggestions concerning probable company action if Admiral Rickover were to be reappointed. It is noted that these conversations occurred after the October 1975 approval of Admiral Rickover's extension.

I will note that, in 1975, the Navy found it necessary to initiate action in the Federal courts to ensure that Newport News continued work on certain nuclear-powered ships then under construction. However, I have no evidence to suggest that the refusal of Newport News to continue the work—such refusal precipitating the Navy's taking legal action—was connected specifically to Admiral Rickover's reappointment.

In question 3, you ask, "Have you or other Navy or Defense Department officials had any discussions with Mr. Corcoran or any other lobbyist, representative or official of Newport News or Tenneco about the difficulties Newport News is experiencing with its Navy shipbuilding contracts? If so, please state the date and location of such discussions and briefly describe them." The answer to this question is, obviously, yes. I suspect that there have been many conversations between representatives of the Defense and Navy Departments and representative of Newport News or Tenneco about difficulty Newport News has experienced with shipbuilding contracts. I, myself, had telephone conversations with Mr. Corcoran on the DLGN–41 and –42. These conversations were an attempt on my part to convince Newport News that we, in the Navy, wanted the company to move out and build the DLGN–41 and –42. I know that many officials have had similar conversations with other representatives of Newport News. However, I am simply unable to reconstruct the record and advise you of the date, locations, and substance of the conversations.

If you have any more specific subjects with dates and participants, I will make every effort to obtain what information we have. However, I am unable to provide anything more specific at this time.

Sincerely,

J. WILLIAM MIDDENDORF II.

ITEM 67.—*June 26, 1976—Washington Post article entitled "Admirals Dispute Pentagon in Shipbuilding Claims"*

(By Dan Morgan)

Two retired admirals and a third on active duty yesterday disputed the view of their Pentagon bosses that Navy shipbuilding contracts had been so unfair as to justify claims for $1.8 billion in cost overrun reimbursements.

Their testimony before Congress' Joint Economic Committee differed sharply from that of Deputy Secretary of Defense William P. Clements Jr., who said national security could be jeopardized if the government failed to settle the claims quickly.

"I see no reason why shipbuilders or other government contractors should be excused from the terms of their contracts," said retired Rear Adm. Kenneth L. Woodfin. He said the Navy's contracts had provided numerous pro-

tections for the companies against inflation and other problems that raised the cost of building ships.

His testimony was backed by Adm. Robert C. Gooding, commander of naval sea systems and director of shipbuilding programs, and by retired Adm. Stu Evans, who until recently was chief of naval procurement.

Gooding acknowledged that shipbuilders' claims often are overstated and exaggerated, and Evans testified that the Navy's contracts were "extremely equitable."

Yesterday's hearing was called by Sen. William Proxmire (D-Wis.) to review a Pentagon proposal to use emergency powers to rewrite contracts with shipbuilders to pay from $500 million to $700 million in company claims.

That plan was withdrawn in May, and Clements said yesterday he would not settle with the firms without congressional approval. But he refused to promise Proxmire that the claims would be handled "in strict accordance with Navy procedure."

Newport News Shipbuilding Co., at Newport News, Va., and the Ingalls Co. at Pascagoula, Miss., have filed cost overrun claims totaling $1.4 billion. The Electric Boat Division of General Dynamics in New London, Conn., has not formally filed a claim but reportedly seeks $400 million.

Under order in those yards are nuclear submarines, nuclear carriers, nuclear cruisers and helicopter carrier vessels.

In a letter released by the committee, a Newport News official warned the Navy June 18 that unless the government provided reasonable assurances that claims would be met, "we will reserve the right to suspend work" on the CVN70 nuclear attack carrier as of yesterday.

A company spokesman said late yesterday that work was proceeding normally.

Proxmire lashed out at the company for "pressure tactics," and said the government could not let a private company "dictate terms on which it will continue doing business."

During repeated verbal sparring with Proxmire and Rep. Otis G. Pike (D-N.Y.), Clements declared he was "sensitive as hell to the charge of bailing out the shipbuilding industry," but asserted that "if we proceed the way we're going, the Navy won't get the ships, or if we get them, they'll cost far, far more."

Clements said that attacks on the shipbuilding industry by such officials as Vice Adm. Hyman G. Rickover, head of the Navy's nuclear propulsion program, had created an "acrimonious atmosphere."

ITEM 68.—*June 26, 1976—Newport News Daily Press article entitled "Claims Spark Hearing Fury"*

(By Ross Hetrick)

WASHINGTON.—Newport News Shipbuilding in a June 18 letter set a deadline of June 25 for the Navy to "provide reasonable assurances" that certain claims disputes will be settled or work on the U.S.S. Carl Vinson (CVN70) might be stopped.

In a letter to Adm. R. C. Gooding, commander of Naval Sea Systems Command Shipyard Vice President F. H. Creech outlined problems encountered by the yard, such as cost escalation and interference by the Navy, and said, "We therefore ask that you provide reasonable assurances, with appropriate documentation and reference to funding documents, that the Navy will cure all of the matters set forth above.

"If such assurances are not provided by June 25, 1976," Creech wrote, "we reserve the right to suspend work until such assurances are provided."

No work stoppage has been ordered at the shipyard according to a Newport News Shipbuilding spokesman.

A Navy spokesman said:: "The final form of the Newport News letter was delivered to the Navy on June 23 and it does not contain any indication that the company plans to stop work on CVN 70. The Navy is considering the information in the letter as part of the normal dialogue and the continuing

negotiation with Newport News. To the Navy's present knowledge, the company has not stopped work on CVN 70."

The letter was released by Senator William Proxmire (D-Wis.), whose subcommittee on Priorities and Economy in Government of the Joint Economic Committee held a hearing Friday on the Department of Defense's plan to settle $1.5 billion worth of backlogged claims by four shipyards. Newport News' claims amount to $894 million.

The plan, which envisioned the use of Public Law 85–804 to settle the claims by rewriting contracts to provide money for escalating costs, was dropped June 9 after the Defense Department could not reach agreement with Newport News and Ingalls Point Shipyard of Litton Industries over the amount of claims to be paid.

Friday's hearing was characterized by sharp exchange by Proxmire and Deputy Secretary of Defense William P. Clements, who was defending the attempt to settle the claims.

"I'm sensitive as hell," Clements told Proxmire when he asked his reaction to accusations the plan is a bailout.

"I want to emphasize that in proposing to invoke the extraordinary powers of P.L. 85–804," he told the committee, "we were not seeking a quick and easy method of claims settlement. We are not trying to bail our contractors who have been inefficient and guilty of mismanagement."

Rather, Clements said the Pentagon was trying to solve problems which "currently handicap the construction of naval ships currently building and which threaten to seriously impair planned additional new construction."

He added that the situation "constitutes a serious threat to the national defense."

However, Proxmire was not convinced. "It's certainly a permissive and soft way of dealing with the shipyards," he said at one point.

Proxmire kept hammering away that few of the claims, especially for Newport News, have been audited. "It would be improper, as a general proposition, for the government," Proxmire said, "to pay any claim by a private firm or individual that has not been audited.

"In light of the evidence which has been brought forth to this committee, from an examination of the claims documents as well as testimony from witnesses, it would be grossly improper to pay these claims prior to a complete audit and evaluation," he said.

"You're trying to relate an elephant to a flea," Clements said answering Proxmire's concern about the validity of the claims. Clements stressed the claims themselves were not being settled, rather the contracts, which cover about 70 ships, would be re-written to compensate the yards for cost overruns.

The old contracts allowed for cost escalations compensation as long as the ships were delivered on time. After that point, escalations would be absorbed by the yard.

Clements said under this plan yards were reluctant to bid for contracts and were having difficulty making any profit.

Rep. Otis Pike, a member of the subcommittee, asked Clements if the Navy was able to move partially completed ships to another yard.

Newport News has threatened to stop work on all Naval shipbuilding if their claims are not settled promptly.

"We're not over a barrel, under a barrel—we are no way related to a barrel," Clements responded to Pike.

While saying the Navy is not "totally dependent on any one shipyard," Clements did say the moving of the Eisenhower would be a very difficult and costly task.

Though not at the hearing, one of the most talked about persons during the hearing was Adm. Hyman G. Rickover, head of the Navy's Nuclear Propulsion division and a severe critic of the claims proposal.

Clements said he objected to Rickover's statement when he earlier appeared before the subcommittee and said the conglomerates which own the shipyards would just as soon be manufacturing "horse turds" as ships, as long as they were making a profit.

"He (Rickover) casts an atmosphere over the whole negotiations (with that comment) and impunes their (shipyards) integrity," Clements said.

Proxmire said, however, Rickover is a man of "enormous experience" and should be listened to.

ITEM 69.—*June 30, 1976—Deputy Secretary of Defense Clements' letter to Senator Proxmire forwarding the following copies of correspondence from Litton Shipbuilding: (1) June 28, 1976, letter from Chairman of the Board of Litton Industries to Deputy Secretary of Defense Clements; (2) June 28, 1976, letter from the President, Litton Systems, Inc. to the Deputy Commander for Contracts, Naval Sea Systems Command; and (3) June 29, 1976 letter from the President, Litton Systems, Inc. to the Assistant Secretary of Defense (Installations and Logistics) and the Chief of Naval Material*

LITTON INDUSTRIES,
Beverly Hills, Calif., June 28, 1978.

Hon. WILLIAM P. CLEMENTS, Jr.,
Deputy Secretary of Defense, Department of Defense, The Pentagon, Washington, D.C.

DEAR MR. SECRETARY: I wish to express my appreciation for your efforts to solve our country's shipbuilding contract problems. I also wish to express my regrets that your efforts did not result in a resolution of these problems. Notwithstanding the fact that Litton Systems and the Deparment of Defense were unable to reach an agreement in this recent effort, it remains obvious that an equitable current resolution is necessary and that such resolution will require a new approach with substantial compromise by all parties.

Unfortunately, the position of Litton Systems, Inc. and its Ingalls Shipbuilding Division continues to be critical and time has run out. The claims on the LHA contract are more than four years old and their resolution is nowhere in sight. Due to the size of the contract and rate of performance, together with our current estimated cost at completion, the company would be obliged to finance literally hundreds of millions of dollars to complete performance under existing conditions. This result is not possible nor permissible, particularly when viewed in the light of the hundreds of millions the parent company has already invested, or obligated itself to pay, in a facility now devoted entirely to Government work.

Our claims have been presented and represented in various formats and forums in efforts to expedite their resolution. For the past six years, the very form, procedure and makeup of the contract itself has been disowned by the Department of Defense as unworkable and inequitable. For much of that time and continuing to this date the contract has been inadequately funded through appropriations and obligations.

Our stockholders, directors, supporting financial institutions, management and employes cannot reasonably be expected to provide continuing support to the program in light of the pervasive problems and the lack of any concrete evidence of potential solutions.

I informed you on March 31, 1976 and again on June 8, 1976 that unless prompt funding was forthcoming from the Government performance would have to be discontinued. Litton Systems, Inc. is furnishing the contracting officer on this date a notice that performance of the LHA contract will be discontinued on August 1, 1976. A copy is enclosed for your information.

This action is taken with great regret, especially in view of the effort which you made to solve this major problem and the extraordinary investment of manpower and material which we have already committed to the program.

It is most unfortunate that we were not able to accept either the method or amount which your plan for settlement encompassed. We realize the advantages which a uniform plan for settlement of all shipbuilding claims would have engendered. However, the plan simply did not resolve the technical, contractual or financial problems of the LHA contract. Unlike the contracts of the other shipbuilders involved in your proposed plan, the LHA contract was Total Package Procurement. The use of this form of contract for the LHA was a mistake by the Department of Defense. One year after contract award the Department of Defense recognized this type of contract as unworkable and banned its further use. But nothing was done to relieve Litton of the consequences of the mistake and Litton has been laboring under the burden of those consequences ever since. Trying to perform under this type of contract as administered by the Navy was a disaster from the very beginning. Mistakes were made by both the Navy and the contractor in attempting to make this unfortunate form of contracting work. But the Navy's attitude has been to place total blame on the contractor for all delays and to respond in a highly legalistic manner to every problem.

You have indicated that further initiatives to resolve the shipbuilding claims should come from the contractors. We have given careful consideration to all means which reasonably would enable our company to continue or resume and complete the program. We believe that any such means must provide adequate contemporaneous funding and must insure complete resolution of all outstanding problems.

The notice to the contracting officer of discontinuance of performance poses two possible alternatives which we believe are viable and worthy of serious consideration. One of these alternatives would call for the conversion of the contract from a Total Package Procurement to cost reimbursement. This action would conform the contract to present Navy shipbuilding policy, at least if the design and construction of the first ship are converted to cost reimbursement. If this were done we would agree to a negotiated fixed loss if that appears to be the only thing that can be done under all the circumstances.

The second alternative which we have posed would provide current funding on a provisional basis while the disputes are being negotiated or litigated, with any overpayment to be refunded with interest by the company. As you yourself have testified before the House Armed Services Committee, in this type and size of contract the traditional method of requiring the contractor to finance construction during the long drawn out disputes procedures is "impossible".

I would conclude by stating that while the company cannot consider continuation of the program beyond August 1, 1976 under the present conditions, we are willing and anxious to find a means to complete the program.

We are prepared to meet with you and personnel of the Department of Defense and the Department of the Navy to pursue the alternatives we have suggested or any others which would offer an equitable result.

Sincerely,

CHARLES B. THORNTON.

LITTON SYSTEMS, INC.,
Beverly Hills, Calif., June 28, 1976.

Re notice of intent to discontinue performance—contract No. N00024-69-C-0283 (LHA).

Vice Adm. R. C. GOODING,
Contracting Officer,
Naval Sea Systems Command,
Washington, D.C.

DEAR SIR: It is with sincere regret that we must inform you that as a result of the Navy's breach of the LHA contract and other actions or failures to act on the part of the Department of Defense and the Navy it is our company's intention to discontinue performance of the contract after 12:01 AM, August 1, 1976. This situation has been brought about by the Navy's use of the wrong form of contract, Navy design interference, delay, changes, and late and inadequate Government furnished design information. The company has already financed performance of the contract by more than $100 million. Continuation of performance on the present basis could ultimately require the company to finance this Navy shipbuilding work in an amount in excess of $400 million in cash. In addition, the Navy has failed to obtain funds to pay for these obligations and therefore the "Anti-deficiency Act" requires the contractor to cease performance.

Our decision in this regard follows over five years of sustained effort by the company to continue performance pending resolution of the contractual and financial issues which have arisen and which have plagued the contract from its outset. Unfortunately, we have now reached a point where continued performance is no longer commercially practicable for the company and is no longer legally required or permitted. We hope you will realize that we have left no stone unturned in trying to avoid this decision and we have reached it only after all reasonable alternatives have been exhausted.

With the withdrawal of the DoD effort to obtain Congressional agreement to resolution of the claims, it would appear now that none of our current efforts can succeed. The DoD effort, moreover, indicated that appropriated funds are presently lacking to implement current contract performance. It is significant, however, that the DoD effort brought out again, at least par-

tially, before Congress and the public, the gross inequity of the LHA contract and the inadequacies of the procedures which the Navy has adopted for the resolution of claims under that contract.

We are obliged to echo Secretary Clements' advice to Congress that performance of contracts such as the LHA cannot be expected without current and equitable resolution of the financial obligations of the Navy. This is unfortunately particularly true of the LHA contract claims which have been pending for more than four years.

This action is being taken to protect the company's assets and the interests of the company's 150,000 stockholders. The Navy's actions in connection with the LHA contract have delayed and increased the cost of other shipbuilding work of the company and threatens the financial viability of the company's extensive investment in its new West Bank facility. The company cannot financially extend itself further under the LHA program even to accommodate a valued customer. To protect the company's contractual, financial, legal and investment position and to insure satisfactory performance of other work and the overall operation of the shipbuilding facilities, it is necessary that the company assert its rights to discontinue performance of the LHA contract. We hope you will realize that we have attempted every reasonable means to avoid this decision and we have reached it only after exhausting all reasonable alternatives.

I

The LHA contract was the product of a new and far-ranging program by the Navy to induce the shipbuilding industry to create new, modern shipbuilding facilities by offering a large multiship, multiyear contract for the design and construction of major combatant ships. With the prospect of major multiship Navy programs (including the Fast Deployment Logistics ship program, which was awarded to the company but was later not funded by Congress), the company responded to the Navy's expressed desires and in 1968 undertook construction of a new modern shipyard at enormous cost, including long-term financial commitments and expenditures in excess of $300,000,000. That yard is now engaged wholly in Navy shipbuilding programs.

The LHA contract was awarded in May of 1969 as a Fixed Price Incentive Fee (Successive Targets), Multiyear, Total Package Procurement. This was the Navy's first contract to procure the design and construction of ships using Total Package Procurement concepts. Facts revealed since award indicate that this form of procurement was bitterly opposed by many responsible, experienced Naval personnel and it is clear now that no real commitment within the Navy ever existed to make that method of procurement succeed. It is a well documented fact that the use of this procurement technique for the LHA was a serious mistake in procurement judgment by the Department of Defense. Even the Navy's LHA Program Manager recommended the use of a cost reimbursement type contract to permit the Navy to exercise unlimited control over the ship's design. Your own testimony before the House Appropriations Committee on March 11 of last year and again before the House Armed Services Committee recently together with Secretary Clements' testimony less than one month ago again confirms the fact that the LHA method of procurement was improper, inequitable and wholly unsuitable.

Officials of the Department of Defense recognized that this method was unworkable even before the LHA contract was signed, and in May of 1970, one year after award of the LHA contract, the Department of Defense banned further use of this procurement method. Litton was then left with six or more years of performance on a billion dollar contract, the concept of which had been found unworkable by the Department of Defense. Worse yet, the administration of the contract was left to Navy personnel who neither understood the procurement concept nor had any intention of making it work.

The basic premise underlying the LHA contract—that the contractor's firm design assumptions were acceptable to the Government—was violated by the actions of the Navy, commencing immediately after award. The critical relationship between the Navy and the company under which the company was to be accorded complete freedom to develop the detail design of the ship to meet the expressed performance needs had been wholly abandoned by the Navy in favor of a "reengagement" concept under which the Navy wrested control from the contractor over the design of the ship and thus over the performance of the contract. By the late summer of 1970 it had become ap-

parent to the company that without a substantial change of direction on the part of the Navy, plus a complete review of the contract terms, conditions and price, continued performance by the company could have disastrous results.

These facts were expressed to the Navy both orally and in writing throughout the remainder of 1970. In April of 1971, in recognition of these facts, the Navy and the company entered into a Memorandum of Agreement under the terms of which the Navy agreed to:

1. An extension of the performance period covering the delays thus far identified;

2. A reorganization of the terms of the contract to avoid the Navy's continued interference in performance;

3. The submission by the company and the consideration by the Navy of the company's claims growing out of the Navy's interference in performance; and

4. A proviso that all previous contract modifications and all contract modifications executed during the time of the Agreement would be "provisional" and therefore subject to further adjustment for contractor's claims.

The underlying assumption at the time of this Memorandum of Agreement was that the company would submit, in a consolidated set of documents, (1) a proposal covering the adjustment necessary as a result of the cancellation of four ships; (2) the adjustment necessary to cover the "reset" of the contract target price under the terms of the contract; and (3) a claim for an increase in the contract price and time for performance based on the Navy's actions to date.

In March of 1972 the consolidated presentation, known as the "Reproposal", was submitted to the Navy in the form requested by the Commander of NavShips. The proposal incorporated all of the objectives established by the Memorandum of Agreement and called for an increase in the contract ceiling price which, with escalation, would have resulted in a total increase of approximately $470,000,000. This reset proposal was followed, in July of 1972, by a documented request for extension of the contract performance period. By letter dated June 23, 1972, you rejected our Reproposal. We responded by letter dated July 21, 1972 and in an accompanying memorandum we noted the Navy's continuing breach of the LHA contract. We then added:

The contractor has continued to commit resources, manpower and management talents to the LHA contract on a rapidly increasing basis, efforts which, to a large extent, have been directed toward mitigating the cost and schedule impact of Government actions. By this action the contractor has in no way, however, waived or relinquished its rights under the contract resulting from the continuing breach of the LHA contract by the Government.

As you know, Article IV(c) was extended for six months to February 28, 1973 by contract modification P00010 which expressly provided that the contractor's rights would not be waived by continued performance. However, all other features of the detailed presentations made by the company in March and July of 1972 were summarily rejected by the Navy in a contracting officer's decision dated February 28, 1973, even though the Chief of Naval Material had advised his superiors that the company was entitled to substantially more than the amounts included in the decision.

This decision was appealed by the contractor to the Armed Services Board of Contract Appeals and thereafter both parties commenced lengthy preparations for a trial of many of the matters before that Board. It was obvious that the Board could not hope to resolve satisfactorily the major problems of this program, nor could it hope to resolve them in time to prevent a severe financial impairment of this company.

Since July, 1972, the company has conducted discussions with the Navy and DoD officials in which it has protested the failure of the Government to make adequate and timely payment of amounts due to the company on the LHA contract and other contracts. Litton officials have repeatedly advised the Navy over the past four years that unless additional funds were made available on the LHA contract on a timely basis, there would come a point in time when performance could no longer continue.

In the fall of 1975 the point of discontinuance of performance on the LHA contract was fast approaching. Litton Industries, Inc. had by the end of FY 1975 (July 31) lent to Ingalls Shipbuilding, over and above the investment

of more than $300 million which the company already had in the yard, $135 million dollars to sustain the Ingalls operations. This huge investment was required because of nonpayment by the Navy of amounts due Ingalls. At that time Ingalls had pending before the ASBCA approximately $644 million in claims against the Navy, comprised of $504 million on the LHA contract and $140 million on Navy contracts for submarines and other ships previously delivered. These claims had all been improperly denied by the Navy Contracting Officer operating under the burdensome and unrealistic claims handling procedures of the Navy. In two cases totaling more than $100 million, the Contracting Officer had arbitrarily refused to consider the claims, would not render a decision, and Ingalls was forced to take the cases to the ASBCA. Provisional payments on these claims have heretofore been denied.

Also, in the fall of 1975, the company notified the Navy that the continuing drain on cash by Ingalls for the LHA program could not continue. At the Navy's request, independent auditors verified Litton's statements. There followed a series of meetings and negotiations in November and December of 1975 culminating in the agreement between the Navy and the company on January 7, 1976 called the "Plan of Action".

The Plan of Action agreement was entered into in furtherance of the LHA contract and in recognition of the financial impairment of the company and its Ingalls Division which that contract was creating. Its express purpose was to alleviate that condition and to maximize the probability that the LHA and DD963 contracts could be completed. In light of the commitments made by the Navy in the agreement, the company continued performance on the LHA contract. The undertakings of the parties in the Plan of Action are, therefore, an essential and integral part of the LHA contract. Any breach of the Plan of Action is a breach of the LHA contract itself. Under such circumstances, well-settled law affords the contractor the right to discontinue work.

In the Plan of Action agreement the Navy specifically acknowledged that continuation of the LHA program without new sources of funds would result in an additional negative cash flow, which between August 1, 1976 and July 31, 1977 would exceed $200 million. It also recognized that this would present a financial "problem of serious proportions" to Litton. The Navy therein recognized the company's immediate need for funds during FY '76 and later during FY '77. By signing the Plan of Action the Navy also recognized that the LHA litigation could never be expeditiously resolved before the ASBCA. (Indeed, in recent testimony the Department of Defense has publicly recognized that in major shipbuilding contracts the usual Navy procedures for resolving disputes are "impossible").

Accordingly, the contractor agreed to suspend its litigation in ASBCA 18214, and attempt to negotiate the matter in controversy. This "Plan of Action" agreement also provided in paragraph 3 that if ". . . sufficient cash does not become available from all sources on a timely basis to adequately fund the LHA program on a satisfactory production schedule," . . . then the company "reserves all rights existing at the date of the Plan of Action".

Since January, 1976 pursuant to the "Plan of Action" agreement we have resubmitted to the Navy's new evaluation team, in the format desired by them, detailed written claim items including marked up engineering drawings and detailed cost estimates covering 125 separate items and additional analysis and documentation demonstrating Navy responsibility for at least 23 months of delay in performance. These resubmissions to date have a value of over $200 million.

Thus at this point in time, of the company's half-billion claim which has been pending for four years, the current round of company proposals has covered more than $200 million, and yet the Navy has authorized an increase of $20 million, of which it paid $16 million. No further provisional payments have been made and the company is unaware of any additional LHA appropriations which would be available to the Navy from which to make any further adjustments to the contract. In fact, DOD statements to Congress make it clear that funds are not available to pay for contract performance without additional appropriations.

On April 16, 1976, the Armed Services Board of Contract Appeals rendered its decision in ASBCA–17717 finding Ingalls entitled to an equitable adjustment of $17,360,000 for actions of the Navy which occurred in 1968 and 1969 on the contract for the SSN's 680,682 and 683. The Plan of Action agreement, entered into January 6, 1976, expressly provided that the Navy would pay any amount determined by the Board. However, the Navy has refused to execute the contract modification and refused to pay the amount due thereunder.

This is a clear and unequivocal material breach of an express obligation of the Navy under the "Plan of Action" and therefore another material breach of the Navy's obligation under the LHA contract. For this and other reasons, including the Anti-deficiency Act violation, it is clear that the Plan of Action has been breached and repudiated by the Navy, and that the contractor is entitled to invoke the provisions of paragraph 3 of the Plan of Action.

Unfortunately, it appears that the Navy has been unable, for whatever reasons, to implement any program which would result either in the expeditious resolution of the claims with the concomitant additional funding, or even provisional relief pending the outcome of the litigation. It is simply not possible for the company to proceed on a basis of hopes of future funding or temporary stopgap cash flow relief where the ultimate result would appear to be a gigantic negative cash flow condition for the company.

As we are sure you are also aware, for some period of time the DD963 contract, as a result of its progress, has provided positive cash flow. Rather than repay its debt, Ingalls has used these funds to continue performance on the LHA contract to mitigate damages caused by the Navy's breaches. This situation can no longer continue, because during July the combined cash balance on the two contracts will turn negative. We had hoped during this period of time that the Navy would find some means to avoid the actions which we are now obliged to take. To this end we have cooperated wholeheartedly in every plan of action, negotiation, discussion and opportunity that has been raised or brought forward. Moreover, we have, we believe, made every conceivable suggestion for resolution of this problem.

The unfortunate capstone of this picture is that the LHA contract delays and disruptions in performance which are the principal subject matter of the LHA claims have and will continue to impact seriously the DD963 performance to a point where the DD963 deliveries have been delayed and the costs of performance very substantially increased. Thus, the rolling effect of the Navy's actions is still surfacing in continuing work in the shipyard and the ultimate effect, although very substantial, may not be known for some time. In light of these facts, it should be clear that the company is in no position to provide significant funds for the continued financing of the work.

II

We are providing herewith formal notice to you that the Navy has breached its contract, No. N00024–69–C–0283 (LHA) by the acts enumerated below, many of which acts have been the subject of earlier notices and reservations of rights. The contractor has attempted to mitigate its damages from such breaches by continued performance, but continued performance has now become commercially impracticable. Therefore at 12:01 AM, August 1, 1976, the contractor will discontinue performance under the subject contract.

The Navy's acts breaching the subject contract and the Navy's other acts in connection with the subject contract each of which constitutes continuing legal grounds for discontinuance are as follows:

1. Use by the Navy of a "Total Package" type contract which the Navy and the Department of Defense had already determined was inappropriate for the development and production of the LHA and which type of procurement had been determined to be unworkable. Since award of this contract the Department of Defense and the Navy have consistently acknowledged publicly that this type of contract, and the LHA contract in particular, was improper, unworkable and inequitable.

2. Violation by the Navy of the Anti-deficiency Act in failing to obtain adequate appropriations for the contract and otherwise in failing to commit sufficient funds.

3. Failure and refusal on the part of the Navy to make payments in accordance with the terms of the contract and the Plan of Action and in amounts sufficient to fund reasonably the required work, including: (a) Failure and refusal to pay the award of the Armed Services Board of Contract Appeals in ASBCA–17717 as required by the Plan of Action; (b) Refusals to make payments covering additional costs for changes and delays; (c) Reduction in payment, recoupment, and set-off imposed by the premature "crossover" from Article IV(c) to Clause 7; (d) Refusal to grant a deferment agreement relating to the referenced "crossover"; (e) Reduction in progress payments based on an improper interpretation of contractually binding progress payment

practices, and refusal to recognize Navy responsibility for cost growth in such re-weighting determinations; and (f) Refusal to provide cancellation costs in amounts reasonably required under the contract.

4. Failure to disclose material facts affecting the design of the LHA and the contractor's proposed design of the LHA prior to the award of the contract, which facts were known only to the Navy and which facts would have materially affected the contractor's design, the proposed period of performance, and the contract price. The company was substantially delayed in performance as a result and its costs of design and construction were materially increased.

5. Failure of the Navy, prior to award, to obtain concurrence of all Naval elements in the company's LHA design, resulting in time consuming design reviews and changes by those elements after award, even though the company's design met fully all of the contract requirements.

6. Breach of the underlying conditions of the Total Package Procurement contract providing that the contractor would have substantial rights and latitude in determining the design and method of construction of the ships and would suffer no significant interference in performance. These acts included material and continuing interference in the design of the ships and the administration of the design phase of the contract resulting in substantial delays and changes in the work, including the design. As a result of the breach of these conditions and the Navy's interference, the company has incurred significantly increased costs and delays.

7. Repudiation, breach and other actions inconsistent with the terms and understandings of the Memorandum of Agreement between the Navy and the contractor, dated April 23, 1971, including the failure on the part of the Navy to negotiate in good faith the contractor's change orders and claims.

8. Imposition of changes in design, delays and changes in conditions for performance, so significant as to amount to cardinal changes and breach of the contract.

9. Failure of the Navy to furnish Government Furnished Information regarding Government Furnished Property known by the Navy to be essential to the completion of the contractor's design and which the Navy knew, or should have known, prior to contract award that it could not provide in a timely manner to support contractor's design schedule.

10. The breach by the Navy of other contracts with the Ingalls Shipbuilding Division, principally by the failure and refusal to make payments when reasonably due, the effect of such breaches having material adverse financial impact on the performance of the LHA contract and amounting to a cumulative breach of the LHA contract. Such acts of breach include nonpayment for delays and changes under the SSN 680 contract and those contracts encompassed by the pending ASBCA–17579 litigation.

In addition to the Navy actions described above which constitute continuing and material breaches of the LHA contract, the Navy has failed to provide adequate funds through appropriations. This failure to obtain adequate appropriations and to allocate funds to the contract has resulted in violation of the Anti-deficiency Act (31 U.S.C. 665) and has rendered the contract void and not subject to further performance.

Evidence available to the company indicates that inadequate appropriations have been made to cover all LHA Program costs including: :(a) the basic LHA contract; (b) other Navy LHA Program costs; and (c) the amount of company claims to the extent recognized by the Navy.

The Comptroller General has ruled as recently as February 27, 1976, in Newport News Shipbuilding and Drydock Company, *B–184830* (unpublished), that in the absence of definitive calculations, the best estimates of program costs which gave rise to Government liability must include contractor claims. Such claim-inclusive estimates must be considered as an obligation against Congressional appropriations. See also Decision of the Comptroller General, *B–132900* dated February 19, 1976 and *B–133170*, dated January 29, 1975, in which the Comptroller General stated that current agency cost estimates constitute an appropriate standard for determining applicability of 41 U.S.C. 11.

When in 1974 the LHA claims amounted to $375,000,000, as then calculated, the Navy requested from Congress additional funding of at least $100,000,000 to cover these claims. These claims now total in excess of $500,000,000. Substantial documentary evidence has recently been discovered which together with prior Congressional testimony of Navy officials clearly demonstrates that the Navy's best current estimates of the Litton LHA claims require in-

terim appropriations of at least $100,000,000 as partial funding for the claims. Thus, in the absence of appropriations to cover these amounts, the LHA contract now clearly violates the provisions of the Anti-deficiency Act.

In view of the fact that the U.S. Navy has requested from Congress $100,000,000 to cover the Navy's own best current estimate of partial funding of the Litton LHA claims, and in view of the fact that the Congress has not appropriated such funds, Litton must conclude that sufficient funds are not available and have not been appropriated for the LHA Program. *Any* continued performance would necessitate that some "unfunded" work be performed concurrently with "funded" work. Such performance would, in the company's opinion, be improper. The company therefore must cease performance, for any continuance of work would be contrary to law.

III

While the company will not under any circumstances consider continuation or resumption of performance on the LHA contract in a manner which would require it to finance further such performance, the company is willing to consider continuation or resumption of performance under the terms of a written agreement which would provide for full funding and payment of the remaining costs until completion of performance or final settlement, and which would further provide for the expeditious resolution of the existing differences and a determination of the appropriate contract price.

The company is also willing to consider the conversion of the contract to cost-reimbursement, with the determination of the amount of any fee (positive or negative) to be based on an agreed upon resolution of the existing contract differences. We are formally submitting a petition under Public Law 85–804 covering a conversion of the contract. This petition has previously been submitted informally both to the Naval Sea Systems Command and to Secretary Clements' staff. In all events, however, this resolution must be accompanied by provision for current funding.

The company is further willing to consider any reasonable suggestions, including the establishment of any arrangements which would ensure that performance of the LHA contract is currently funded, and that the company is not obligated to finance further the construction of the ships until a final settlement or determination can be achieved.

As we have described previously, we have attempted over many months to mitigate the effects of the Navy's actions and to insure delivery of the LHA ships. We wish you to know that we stand ready to continue such an effort or restart such an effort if any reasonable means can be found to do so. We hope you will understand, however, that we cannot sit back on our rights in light of the Navy's actions and at the same time assume a burden of financing Navy ship construction which would ultimately total hundreds of millions of dollars. The long range promise of ultimate resolution through litigation serves little purpose in financing over several years such large sums. Since we believe these sums are legally and equitably owed to the company, we believe that the burden of providing support of the ship construction programs properly lies with the Navy.

We are naturally willing and most anxious to discuss this matter with you and to attempt to find some solution. We hope that you will find a means to avoid the loss to the Navy and the country of the enormous human and material resources which have already been committed to the program.

Very truly yours,

F. W. O'GREEN, *President.*

LITTON SYSTEMS, INC.,
Beverly Hills, Calif., June 29, 1976.

Hon. FRANK SHRONTZ,
Assistant Secretary of Defense (Installations & Logistics),
The Pentagon,
Washington, D.C.

Adm. FREDERICK H. MICHAELIS,
Chief, Naval Material Command,
Washington, D.C.

GENTLEMEN: We are most appreciative of your efforts to utilize PL 85–804 to solve the major disputes between the Navy and the shipbuilders. We are deeply disappointed by the failure to reach a settlement. This is only another failure after more than four years of continuing effort already expended at-

tempting to settle our shipbuilding claims and occurs in the face of a most urgent cash funding requirement in the Ingalls Shipbuilding Division.

The cash requirements of Ingalls and the inequities resulting from unpaid obligations have been explained countless times. We have, in addition, made clear to senior management of the DoD and Navy our inability, unwillingness and lack of obligation to further fund the Navy shipbuilding programs. Our continuing extended exhaustive efforts with the Navy and DoD have failed on every turn to alleviate this problem.

We are presently forced to fund from Litton sources 75 cents (as compared to the Navy's 25 cents) of each dollar spent on the LHA construction program. Once again our efforts with the Navy have failed to provide a much needed equitable correction of this condition.

Based on our past experience in negotiations with the Navy and with no evidence of change exhibited in recent efforts, we must conclude that resolution of disputes would be on an extended time scale. We presently have no indication, much less an assurance or guarantee, that the Navy would provide adequate funding for the construction program during this extended period required for resolution.

Since the future holds no assurance of timely corrective action by the Navy, we can only depend on our own resources. To avoid further financing of the Navy program, we are left with no alternative other than to stop work on the LHA program. We are, therefore, on this date submitting to the contracting officer our formal notice of stop work on the LHA contract, effective 12:01 am on 1 August 1976.

While we are forced to take this action to protect our shareholders, we particularly regret its necessity and are hopeful that the Navy and DoD will take actions available to them to rectify these contractual deficiencies, thus avoiding either a cessation of performance or an adversary continuation of the program.

We remain convinced that a practical solution to our complex contract disputes is achievable. We believe that solution can achieve Mr. Clements' basic intent as stated in his request to the Congress to provide for more equitable escalation, settle the claims, and create an improved working relationship between the shipbuilders and the Navy, by reforming the contracts through PL 85–804 action. We further believe that solution can be totally consistent with reasonableness and equity and will conform to the authority provided in PL 85–804 and the contract.

Recent negotiations with the DoD Shipbuilders Executive Committee proved the need to provide to the Committee the availability of sufficient funds to support a settlement as opposed to fund availability dictating a settlement short of the intended goals of the parties.

In accord with these convictions we will submit a request for contractual actions and for actions under PL 85–804 to reform the LHA and DD contracts to:

1. Correct acknowledged escalation inequities;
2. Reform the LHA and DD contracts to correct for wrong contract form and resulting inequities;
3. Provide for the equitable settlement of the disputes;
4. Provide for necessary cash to fund the construction programs, both short- and long-term, during the time required to reach a negotiated or litigated settlement of the disputes.

This proposed plan or alternates will lead to a settlement which is clearly in the best interest of the Navy, the contractor, our national defense posture and the public. We believe it is encumbent on the Department of Defense to achieve that settlement and secure necessary Congressional approvals to carry out the program.

LHA and DD ships of excellent quality are now being built and delivered by Ingalls. The physical facility and the social and economic structure needed for the 24,000 Ingalls workers involved in that construction program is in place after years of hard work and investment by Litton and the State of Mississippi to provide this capability, which is a recognized national asset. The nationwide subcontractor team required to meet the construction program has been established and is functioning.

Litton expects to meet with members of the Navy and DoD to pursue vigorously these alternatives or others which may present themselves in seeking a prompt equitable solution to these urgent and complex matters.

Sincerely,

FRED W. O'GREEN, *President.*

ITEM 70.—*July 2, 1976—Senator Proxmire's speech to the Senate, "Admirals Dispute Clements on Shipbuilding Claims"*

Mr. PROXMIRE. Mr. President, important differences between the Navy and Deputy Defense Secretary William P. Clements, over the issue of how to handle nearly $2 billion in shipbuilding claims, are beginning to emerge as Navy officials are given an opportunity to comment on the facts and voice their views.

Despite concerted efforts by some of the larger shipbuilders and Secretary Clements to divert attention from the merits of the claims, more and more questions are being raised about the claims as the facts come to the surface.

Last Friday, on June 25, 1976, the Subcommittee on Priorities and Economy in Government received testimony from Secretary Clements, Adm. Robert C. Gooding, Adm. Stu Evans (retired), and Adm. Kenneth L. Woodfin (retired).

Earlier on June 7, 1976, the subcommittee heard testimony from Adm. H. G. Rickover and William Cardwell, a former official at the Newport News Shipbuilding Division of the Tenneco Co.

NEED FOR AN AUDIT OF THE CLAIMS

Among the major facts established in the hearings thus far are the following:

First, none of the pending shipbuilding claims have been fully audited, analyzed or evaluated by the Navy.

Second, there have been serious allegations by persons familiar with the Newport News claims that they are based on inflated figures, unsupported allegations, attempts to charge the Government with the costs of commercial activities and possible double counting.

Third, at least two of the shipbuilders, Newport News and Litton, have gone to extreme lengths to apply political pressure on the Navy and the Defense Department to extract payments without regard to legal entitlement.

POLITICAL PRESSURE TACTICS

Among the tactics employed by the shipbuilders has been direct communication with top level Pentagon officials in an attempt to circumvent the Navy's claims review process, harsh personal attacks against Navy officials who have attempted to examine the merits of the claims, and threats to stop work on Navy projects unless the claims are immediately paid.

Unfortunately, Secretary Clements has played into the hands of the shipbuilders. He has agreed to deal with the contractors personally and has thereby undercut the responsible Navy officials who have attempted to resolve the disputes with the shipbuilders.

In doing so, Secretary Clements has perpetuated a myth that the claims in question are of long standing and that the Navy has failed to make progress with them. The facts are that most of the claims filed by Newport News were received by the Navy only in the past few months and that Litton began providing the Navy with documentation for its claims only in the past few months.

ADMIRALS SAY CONTRACTS FAIR

Secretary Clements has also tended to lend substance to the allegations by the shipbuilders that their contracts are inherently inequitable and therefore should not be enforced. The facts are, as four Navy admirals have now testified, that the contracts with the shipbuilders are fair and generous, and not inequitable.

CLEMENTS PROPOSES A BAILOUT

What Secretary Clements and the shipbuilders have been attempting to present to Congress has familiar characteristics. Many of my colleagues have seen the tracks of this animal before.

It walks like a bailout, it sounds like a bailout, it looks like a bailout, and I dare say that those of my colleagues who look closely at this specimen will conclude with me that it is a bailout.

Another corporate bailout, in the tradition of Penn Central and Lockheed, hardly seems an appropriate or logical action for the Government to take at a time when there is continued concern with inflation and unnecessary Gov-

ernment spending, and during a period of growing awareness of false claims and other fraudulent misrepresentations designed to unjustly enrich individuals and business firms at the expense of the taxpayers.

TESTIMONY OF ADMIRAL WOODFIN

One of our witnesses last Friday, Adm. Kenneth L. Woodfin, presented testimony in direct conflict with the assertions of the shipbuilders.

Admiral Woodfin stated that "shipbuilding claims figures can be misleading and should not be accepted at face value. Typically shipbuilding claims are greatly exaggerated and viewed by many contractors simply as a starting point for negotiation."

Admiral Woodfin disagrees with the view that the shipbuilding contracts are inequitable and that therefore the contracts are unenforceable. Admiral Woodfin was also critical of the shipbuilders' pressude tactics and of the devices they have employed to shortcut the normal claims review procedures.

Admiral Woodfin stated:

"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 seem to be acceptable to the GAO)."

I ask unanimous consent that the prepared testimony of Adm. Kenneth L. Woodfin be printed in the RECORD at the close of my remarks. I also ask unanimous consent to have printed in the RECORD at the close of my remarks an article in the Washington Post, June 26, 1976, by Dan Morgan entitled "Admirals Dispute Pentagon on Shipbuilding Claims," an article from the Newport News-Hampton Daily Press, June 26, 1976, by Ross Hetrick, entitled "Claims Spark Hearing Fury," and an article from the Washington Post, June 29, 1976, by Marquis Childs, entitled "Rickover and the Carter Connection."

There being no objection, the material was ordered to be printed in the RECORD, as follows:

STATEMENT OF REAR ADM. KENNETH L. WOODFIN, BEFORE THE SUBCOMMITTEE ON PRIORITIES AND ECONOMY IN GOVERNMENT, JOINT ECONOMIC COMMITTEE

I am Rear Admiral Kenneth L. Woodfin, Supply U.S. Navy Retired. 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. June 1976. I resigned from NASA and accepted a position as Vice President for Business Management, 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). During that period I consider that real progress was made in resolving the Navy's shipbuilding claim 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 P.L. 85–804 to correct the so-called inequities quickly and thereby promote better relations between the shipbuilders and the Navy and facilitate carrying out the Navy's new shipbuilding program. This is a unique approach since, as I recall, the use of P.L. 85–804 requires that all 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 P.L. 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 and should not be accepted at face value. Typically shipbuilding claims are greatly exaggerated and viewed by many contractors simply as a starting point for 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 actually 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 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 claim settlement depends on what kind of a claims release is obtained so any proposed settlement should be carefully reviewed in this regard.

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.

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 through 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. Unfortunately, some shipbuilders have refused to price changes in order to retain these entitlements as a backbone for future claims.

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 contracts 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.

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 shipbuilder 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 turnover problems, 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. I cannot recall any situation where the Navy knowingly outwitted and out-negotiated 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.

Some shipbuilders complain to high levels of the Defense Department and to 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 fact-finding process, recent data indicates that even complex claims could be settled in approximately a year. Fact finding remains the key, particularly in the complex shipbuilding atmosphere, and I can visualize no real short-cuts to the process of determining what acts or inacts of the Government have caused the basis for a contract change.

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 the obvious overruns on the 1967–1971 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 multi-year 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 shipbuilder's 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.

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 the money is due. It is also obvious that senior Defense officials have authority, subject to Congressional approval, to apply P.L. 85–804 for this purpose. I recognize also that it is, of course, possible that a P.L. 85–804 settlement could be obtained under certain circumstances that would be equitable to the Government. However, by announcing publically that the Navy contracts are

inequitable, announcing a decision to provide extra-contractual relief, setting a date for competition 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 establishing Navy procedures (which seem to be acceptable to the GAO). Thus, I cannot accept the theory that by use of P.L. 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 ensuring that our new contracts do not create the same bases for claim assertion.

Thank you, Mr. Chairman, that concludes my statement.

KENNETH L. WOODFIN,
Rear-Admiral, SC, U.S.N. (Ret.).

RICKOVER AND THE CARTER CONNECTION

(By Marquis Childs)

In his autobiography, "Why Not The Best?" Jimmy Carter writes of his admiration for Admiral Hyman Rickover whom he rates as an influence on his life second only to that of his parents. The title of the book comes from a question Rickover put to him when Carter was about to assume new responsibility in the development of nuclear propulsion for submarines which Rickover had pushed against the resistance of traditional-minded admirals.

With Rickover still on active duty at 76 and as articulate and outspoken as ever, the Carter connection could prove important should the peanut farmer from Georgia become President. The spunky admiral's latest crusade is directed at the cost overruns in shipbuilding contracts. Just this month testifying on the Hill he said that the Defense Department's proposal to settle shipbuilders' claims could become "one of the biggest ripoffs in the history of the United States."

Both Secretary of Defense Donald Rumsfeld and Deputy Secretary William P. Clements Jr. recently stressed the need to settle the claims promptly without regard to merit. Earlier this year Rickover had testified:

"Unfortunately contractors appear to be submitting claims in amounts that are based on what they need to make their desired profit, regardless of their own mistakes or inefficiency, rather than that to which they are legally entitled."

The Rickover charges are part of an extensive study by the Center For Defense Information on weapons cost overruns. The Center estimates the cost overruns for current systems at $55 billion. The figures come in part from a report to Congress by the General Accounting Office.

The amounts are so stupendous as to be almost beyond imagination. The total baseline cost estimate, normally used prior to making full production decisions, was $121 billion. The current estimate for these major systems is $176 billion, a growth of just under $55 billion.

Despite the fantastic rise in costs, only a small part of it attributable to inflation, the Ford administration is ordering production go-aheads. The stellar example is the B–1 Bomber which the President himself ordered into production even though the new plane is still in the research and development phase. The cost of the bomber has risen 84 percent above the baseline estimates of 1970 while performance requirements have been lowered, according to the Defense Center.

Competitive bidding is virtually non-existent as the major defense firms share out the contract plums. Here again Rickover's testimony of two years ago is pertinent:

"About 88 percent of the defense contract dollars today are placed under other than truly price competitive situations. Design competition, or the so-called competitive negotiated contracts, are not really price competitive.

"Further, it is generally the same contractors who do defense business year after year. It is about as hard for new defense contractors to enter the busi-

ness as it is for new firms to enter the automobile industry. The investment is so large that many contractors practically become appendages to the government which the government has to support."

It was Ernest Fitzgerald, a civilian employee of the Air Force, who first blew the whistle on the staggering overrun costs. He took as the most conspicuous example the C–5A plane which had advanced in cost from an initial $3.4 billion to $5.3 billion by 1968. Congressional investigation showed that thousands of parts had been left off supposedly completed C–5As and the plane was notoriously inefficient.

In striking testimony before a Senate hearing Fitzgerald said that in effect the big defense contractors had become part of government. They were akin to the state corporations Mussolini had created in Italy, combining the worst features of private monopoly and government bureaucracy.

In his autobiography, Carter describes how Rickover asked him about his standing in his class at Annapolis. He swelled his chest with pride as he replied that he had been 59th in a class of 820. Rickover was not impressed, following up with the question, "Did you do your best?" Tense with his desire to make the best possible impression, the young naval officer finally gulped and said, "No, I didn't always do my best." As he turned away Rickover asked, "Why not?" and, describing himself as white and shaken, Carter left the room.

Such a close and hero-worshipping connection should mean a lot if Carter becomes President. He will surely turn to the crusty admiral for counsel on his dealings with the military.

[EDITOR'S NOTE.—The two other news articles submitted for the record by Senator Proxmire are items 67 and 68 above.]

ITEM 71.—*July 2, 1976—Memorandum from the Chief of Naval Material to the Commander, Naval Sea Systems Command, which states that the Chief of Naval Operations has directed the establishment of a three-man Navy Claims Settlement Board which is not to be subjected to outside pressures, influences, and unsolicited advice*

DEPARTMENT OF THE NAVY,
HEADQUARTERS, NAVAL MATERIAL COMMAND,
Washington, D.C.

MEMORANDUM FOR THE COMMANDER NAVAL SEA SYSTEMS COMMAND

Subj: Navy Claim Settlement Board.
Encl: CNO memorandum Ser 00/500174 of 1 July 1976.

1. By enclosure (1), the Chief of Naval Operations has directed establishment of a Navy Claim Settlement Board, essentially shaped along the lines of the ad-hoc negotiation board that was recommended by the Deputy Commander for Nuclear Power, Naval Sea Systems Command at a meeting on 29 June. The substance of the discussion of that meeting is attached as an enclosure.

2. The Navy Claim Settlement Board is in process of charter at this time. It is a forward step and I intend that the Board receive whatever support is necessary to enhance the probability of its success.

3. 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 embue your organization with the necessity for thorough and rapid response when called upon for input to the Board for 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.

F. H. MICHAELIS.

Enclosure.

MEMORANDUM FOR THE SECRETARY OF THE NAVY

Subj: Meeting with Deputy Secretary of Defense and Admiral Rickover.

1. At 1330, Tuesday, 29 June 1976, I attended a meeting with Deputy Secretary of Defense Celements and Admiral H. G. Ricksover. Radm Carr

and I were the only other persons present. The purpose of the meeting, which had been called by Secretary Clements was to discuss the resolution of Shipbuilding Claims. In the course of the discussion, Secretary Clements pointed out that the Navy's highest priority must be to settle the outstanding claims with the shipbuilding industry. Admiral Rickover volunteered that in his opinion the objectives of prompt claim settlement could well be served by the establishment of a special three-man ad hoc negotiating team for the sole purpose of processing claims and that sole authority for making the government's decisions on the claims be vested in this small group. He added that it was essential that the shipbuilders conduct negotiations solely through this negotiating team, and scrupulously avoid bypassing them to discuss the claims or negotiate directly between top managements. Admiral Rickover said that neither he nor any members of his organization should be a board member. He said that he and his organization would continue to supply information and advice as required for technical evaluation of matters involving nuclear reactor propulsion plants.

2. I stated that Admiral Rickover's proposal was in full agreement with the concept which Admiral Michaelis (Chief of Naval Material) had been considering as the Navy's approach to the next phase of claims settlements negotiation. Admiral Michaelis' proposal would involve within the total package, a three-man Navy claims negotiating team, constituted for the specific purpose of resolving claims on an accelerated basis. I fully agreed that to have this approach work properly, it is essential that both sides have full confidence in the Navy's negotiating team, and this can only be achieved if the members retain the full authority and responsibility for negotiations, and that their efforts not be preempted by discussions, appeals, or decisions outside of this channel.

3. With your approval, I have directed Admiral Michaelis to proceed with the establishment of his ad hoc, dedicated, three man negotiating team approach to accelerated shipbuilding claims settlement. Admiral Michaelis will include in the implementation procedures the proviso that persons other than those three designated to serve on the ad hoc negotiating team disassociate themselves from the direct negotiations with Newport News, and limit their activity to resonding to requests from the negotiating team.

J. L. Holloway III,
Admiral, U.S. Navy,
Chief of Naval Operations.

Item 72.—*July 6, 1976—Memorandum from the Chief of Naval Material to the Commander, Naval Sea Systems Command directing him to instruct the Navy's claim analysis teams for the six Newport News shipbuilding claims to "proceed promptly with analysis of these claims, notwithstanding the absence of affidavits meeting the regulations and desires of the Navy"*

Department of the Navy,
Headquarters Naval Material Command,
Washington, D.C.

Memorandum for the Commander, Naval Sea Systems Command

Subj: Newport News Claims Affidavits.

1. During recent months the Navy and Newport News Shipbuilding and Dry Dock Company have conducted extensive discussions with regard to the submission of claims affidavits as set forth in NPD 1-401.55. This is an issue which has existed between the parties for several years. The Navy has insisted that the requirement for the affidavit falls within its rights to establish reasonable procedures for handling major claims. Newport News, on the other hand, has asserted that it is unreasonable to expect a single corporate official to become sufficiently knowledgeable of the details of a large, complex claim to be able to affirm, under oath, that the submitted data is "current, complete and accurate." The contracts in issue predate the Navy's NPD claims procedures and contain no express requirement for submission of an affidavit. Newport News has cited this as the basis for its position that it is not contractually obligated to submit an affidavit in the NPD prescribed form as a condition precedent to Navy analysis of its claims.

2. Under cover letter of 18 June 1976, Newport News submitted six affidavits. While I consider this a valuable step forward, these affidavits contain significant qualifications, and do not meet the current NPD requirement. In my judgment it is important to now move ahead to analyze the merits of the Newport News claims themselves in order that the Navy Claims Settlement Board not be delayed in accomplishing their considerable task. Accordingly, I have decided and hereby direct that you instruct the claims analysis teams for the six Newport News Shipbuilding claims involved to proceed promptly with analysis of these claims, notwithstanding the absence of affidavits meeting the regulations and desires of the Navy.

3. A fundamental purpose of the NPD affidavit is to afford the Navy additional assurance that claims analysis can begin and proceed in reliance upon complete, up-to-date documentation and not thereafter be disrupted by submission of information which should have been furnished at the outset. That remains a vital concern during the claims evaluation and settlement process. If you find during the analysis process that revisions to the claims documentation are threatening the continuity of the evaluation process, I wish to be promptly advised so that I may take appropriate action.

4. The foregoing direction is limited to the specific Newport News Shipbuilding claims for which Newport News Shipbuilding submitted an affidavit, and does not constitute a change in policy governing future matters as to this or any other contractor.

5. I will continue efforts to obtain appropriate affidavits and to improve working relations with Newport News, and request that you pursue actively the same goals.

F. H. MICHAELIS.

ITEM 73.—*July 8, 1976—Memorandum from Deputy Secretary of Defense Clements to the Deputy Secretary of Defense Ellsworth; the Director of Defense Research and Engineering; the Assistant Secretaries of Defense; General Counsel; and the Assistants to the Secretary of Defense. This memorandum endorses the approach taken by the July 2, 1976 Memorandum of the Chief of Naval Material with regard to the independent operation of the three-man Navy Claims Settlement Board and requests the addressees and their staffs to be subject to the same constraints in their relationship with the Board*

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C.

Memorandum for: Deputy Secretary of Defense Ellsworth, Director of Defense Research and Engineering, Assistant Secretaries of Defense, General Counsel, Assistants to the Secretary of Defense.

Subject: Navy Claims Settlement Board.

The Navy has proposed and I have approved the establishment of a special three man board to process the claims from Newport News Drydock and Shipbuilding Company. This Navy board has been delegated the authority for making the Defense Department's determinations on these claims, subject only to the contractor's appellate rights to the Armed Services Board of Contract Appeals. In order for this board to be effective it must be able to operate independently without external pressures or influence. I endorse completely Admiral Michaelis' approach as stated in the enclosure to this memorandum. In this regard, I also expect your total cooperation with the board and want you to remain informed in your areas of responsibility. You and your staff should support, but not interfere; keep informed, but participate only as requested by the board. The three man board is the single point of contact for the Defense Department in matters dealing with Tenneco or Newport News shipbuilding claims. Additionally, neither you nor any members of your staff should attempt to provide guidance or direction to the board. If the board should seek advice and assistance from you or your staff you are directed to cooperate and provide such assistance as requested.

W. P. CLEMENTS, Jr.

ITEM 74.—*July 8, 1976—Letter from the Vice President of Newport News to the Deputy Commander for Contracts, Naval Sea Systems Command which provides Newsport News' response to the Navy's plan to establish a three-man Claims Settlement Board for accelerated claims processing*

NEWPORT NEWS SHIPBUILDING,
July 8, 1976.

Adm. L. E. HOPKINS,
Department of the Navy,
Washington, D.C.

DEAR ADMIRAL HOPKINS: Thank you for meeting with me yesterday and for describing the proposed course of action of the Navy. I am sure you are aware that since our meeting I have discussed the matter within the Company and Mr. Diesel has discussed it with Admiral Michaelis.

With regard to our Requests for Equitable Adjustment, the essence of the proposed action by the Navy is to create an independent claims settlement board. It will be chaired by a Navy flag officer. This board will provide an accelerated claims analysis. It is to be under the direction of the Chief of Naval Material, who will insure continuing top Navy management review in cooperation with Newport News. An important feature is that as the analysis verifies to the board's satisfaction that entitlement exists, provisional payments will be made. Pending such action by the board you have requested the Company to forebear from any rights it may otherwise have and to continue with construction of the ships without any adjustment in compensation. Thus if the Navy board is not satisfied, there will be no compensation adjustment short of litigation, which is to be deferred until the board reaches a final decision.

The other items which were discussed were also important and may be the subject of further discussion.

The six contracts at issue involve the construction of sixteen nuclear-powered warships. Five of these ships have been delivered and are in the fleet and two more are scheduled to join the fleet this year. The contractor's cost thru May has been approximately $2,000,000,000. Payments to date have been $1,860,000,000. This discrepency of $140,000,000 is being financed by the Company.

We are willing to accept the general approach which you suggest on two conditions. First, while awaiting for this new initiative of the Navy to bear fruit, we request that we be paid our costs and an interim fee thereon under the conditions set forth in the attached modification. In addition, we request that the initial Request for Equitable Adjustment on the SSN688 and the first four follow boats be processed so as to be settled before the end of August 1976.

Please advise us immediately whether the foregoing is acceptable to you.

Sincerely,

F. H. CREECH,
Vice President.

ITEM 75.—*July 9, 1976—Memorandum from Admiral H. G. Rickover to the Secretary of the Navy recommending that action be initiated through the Department of Justice, or through other appropriate channels, to arrange for the Navy to obtain assistance from outside legal counsel in the evaluation and processing of the present shipbuilding claims and other legal matters*

DEPARTMENT OF THE NAVY,
NAVAL SEA SYSTEMS COMMAND,
Washington, D.C.

MEMORANDUM FOR THE SECRETARY OF THE NAVY

Subj: Hiring Outside Legal Counsel.
Ref: (a) My May 17, 1976 ltr to Congressman Aspin. (b) Navy General Counsel memo to CNM dtd May 1976. (c) Navy General Counsel ltr to Chief Counsel, Senate Armed Services Committee dtd 4 June 1976.

1. In reference (a), I responded to Congressman Aspin's request for my comments regarding the shipbuilding claims problem. In that letter I mentioned the need to hire outside legal counsel to assist in the evaluation and processing of these claims; something I have recommended consistently for over five years.

2. In references (b) and (c) the Navy General Counsel, Mr. E. Grey Lewis, commented on my letter to Congressman Aspin. He states that he does not favor hiring outside legal counsel. Mr. Lewis denies that there is an imbalance in legal resources being applied by the Navy and Newport News currently in the CGN 41 option litigation. He challenges my statement that Newport News "has thus far charged to the Navy contract over $155 thousand of outside legal fees on the CGN 41 option dispute . . ." He also alleges that my recommendation to hire outside counsel is based on sinister motives. The purpose of this memorandum is to set the record straight in regard to Mr. Lewis' comments and to solicit your continued support in efforts to obtain outside legal counsel to assist in evaluating shipbuilding claims. This would facilitate the accelerated processing of shipbuilding claims by the Navy which, I believe, would be in accordance with Secretary Clements' wishes.

3. Mr. Lewis denies that there is an imbalance of legal resources being applied in the CGN 41 litigation. However, I believe the contractor is better staffed for this job than the Navy, through no fault of the Navy attorneys actually handling the case. In addition to in-house counsel, Newport News has at least five private law firms working on its shipbuilding claims problems. Newport News and its parent, Tenneco, are represented by nationally prominent attorneys with years of experience. For example, the former deputy assistant to President Eisnehower was one of the attorneys representing Newport News in court on the CGN 41 case. Mr. Thomas G. Corcoran is another well-known attorney representing the company. Another firm, headed by a former member of the Armed Services Board of Contract Appeals, two years ago hired the former Naval Sea Systems Command Deputy Counsel for Claims. A member of this firm recently stated they are representing shipbuilders including Litton and Newport News and the similarity of legal arguments being used by these two companies would seem to confirm this. While all five outside law firms may not be directly involved in the CGN 41 case, they are all involved to some extent in the Newport News claims problem, of which the CGN 41 case is a part.

4. As I pointed out in reference (a), one attorney two years out of law school, was bearing the brunt of the Navy's legal work for the CGN 41 case at the time I wrote Congressman Aspin. Moreover this was not his sole assignment. The Navy General Counsel is correct in pointing out that other Navy attorneys have been involved in this case at times. For example, when the Navy was forced to go to court by Newport News stopping work on the CGN 41, and when the Navy had to submit its position regarding availability of funds to the General Accounting Office, there was a short term infusion of additional Navy legal effort. To meet such crises, legal resources have to be siphoned from other projects to the detriment of those projects. Much of the work and direction then tends to be taken over by attorneys who have not been involved in the case on a continuing basis and who may not be sufficiently familiar with the background facts and details necessary to prepare the best case for the Navy. The two senior Navy attorneys who were most familiar with the CGN 41 matter, Mr. John J. Phelan, Jr., former Deputy General Counsel for the Navy, and Mr. David W. James, Jr., former NAVSEA Counsel, have subsequently left the Navy.

5. As priorities change, legal resources are diverted from one crisis to another. As a consequence, on individual cases, Navy technical personnel often must be relied upon to provide continuity. Frequently they have to take the lead in developing strategy, organizing and directing the claim analysis, preparing and answering interrogatories, drafting correspondence and so on—actions which properly are the functions of the legal staff. On several occasions, I have had the opportunity to observe the performance of private law firms in cases where prime contractors are defending the Government's interest in lawsuits by subcontractors. My experience has been that private law firms actually take the initiative and relieve the technical personnel of the burden of preparing for litigation to a far greater degree than do Navy lawyers.

6. The second statement in reference (a) which Mr. Lewis challenged, reads: "Newport News . . . has thus far charged to the Navy contract over $155 thousand of outside counsel fees on the CGN 41 option dispute plus a seven percent profit to Newport News." Mr. Lewis states: "Newport News has only *attempted* to charge these fees; they have not been allowed by the DCAA auditors, and the fees will almost certainly be disallowed."

7. I do not understand why Mr. Lewis disputes my statement. The Defense Contract Audit Agency (DCAA) has reported that Navy payments to Newport News through 13 May 1976 included $154,272 for account D.3406-0027, and there is also a 7% profit on that amount. All except $6,275 of this amount, identified as "Other", was paid by Newport News to three law firms—Hamel, Park, McCabe & Sounders; Sullivan, Beauregard & Clarkson; and Ferguson & Mason. Not until nearly a month after my letter to Congressman Aspin, were these payments suspended by DCAA and deducted from other payments due. Therefore, contrary to the impression left by Mr. Lewis' letter, my statement was correct.

8. In reference (c), Mr. Lewis states: "The truth of the matter is that there is no need to hire outside counsel. I believe what is really involved is the desire of Admiral Rickover to obtain his own law firm which he can then use against Newport News or any other corporation or person he chooses, or even against legal positions taken by my Office or the General Counsel for the Department of Defense."

Mr. Lewis' characterization of my motives for recommending outside counsel is wrong, as he should well know from the record of correspondence on this matter over the past 5 years. The record is clear that I have recommended that the Navy hire outside counsel to help with claims in order to better defend the Government's interests and to lighten the load these claims place on the Navy. Two years ago, Mr. Lewis himself agreed to adopt this recommendation on a trial basis for certain claims at Newport News. His lawyers drafted, and he approved, a proposed contract for outside counsel. This contract would have placed direction and control of the work under Mr. Lewis's organization, not mine. I agreed that outside counsel should work for the Navy lawyers. Never have I suggested that outside counsel should work for me or my organization. Accordingly there is no basis for Mr. Lewis's allegation that I have been seeking to obtain my own law firm.

9. As you may recall, the contract for outside counsel was never awarded. A brief chronology follows:

In August 1974 Mr. Lewis agreed to the hiring of outside counsel to help with the shipbuilding claims and instructed Counsel, Naval Sea Systems Command (NAVSEA) to proceed.

By memorandum dated 21 October 1974 to the General Counsel, Department of Defense, Mr. Lewis set forth his plans to hire outside legal services. He stated that he had discussed the matter with the Deputy Assistant Attorney General and concluded that hiring outside counsel would be lawful. He submitted a list of 16 law firms that he considered qualified for this work.

On December 4, 1974, Congressman Charles E. Bennett of the House Armed Services Committee wrote you supporting the hiring of outside counsel and inquiring if and when the Navy intended to do so.

By letter dated January 10, 1975, you replied to Congressman Bennett that 'The Navy intends to adopt the proposal on an experimental basis . . . subject to approval of the Department of Justice."

By letter of January 15, 1975, you again assured Congressman Bennett the Navy intended to hire outside counsel on an experimental basis and for a limited purpose subject to approval of the Department of Justice.

On 20 January 1975, the General Counsel of the Department of Defense wrote the Acting Attorney General seeking his advice in interpreting certain statutes and requesting his opinion concerning the Navy's authority to take the proposed action.

On 26 March 1975, the Justice Department reveresed its previous position and ruled that the Navy could not hire outside counsel.

To my knowledge, the Navy made no attempt to reclama the Department of Justice ruling. Mr. Lewis subsequently reversed his position and now opposes the hiring of outside counsel.

10. The final item of Mr. Lewis' memorandum on which I wish to comment reads: "Admiral Rickover and his assistant, David Leighton have told me

and former Under Secretary David Potter the major reason for seeking outside counsel is their desire to obtain the services of an attorney with a national reputation (the name William Rogers was mentioned) to show Newport News that the Navy meant business and to lobby in Congress. We assumed that he wanted a person to counter Tenneco's Thomas G. Corcoran. Lobbying by the Executive Branch is prohibited by statute and I will have nothing to do with it."

It is true that both Mr. Leighton and I, on various occasions, strongly recommended that the Navy retain the services of a top-flight, well-established law firm, knowledgeable of the intricacies of Government. Contractors hire such firms to help them prepare and prosecute their claims. The Corcoran firm is but one example. My point is that the Navy should hire firms of comparable qualifications and experience to defend its interests. I have not—and Mr. Leighton assures me that he has not—ever advocated that the Navy hire an outside law firm to "lobby in Congress" or engage in any other activity which is prohibited by statute. In regard to the CGN 41, we both supported the recommendation of Rear Admiral S. J. Evans, who was then Deputy Chief of Naval Material (Procurement & Production) and head of the Navy's CGN 41 negotiating team, that the Navy hire a firm that could bring to bear, on a full time basis, talent comparable to that of the attorneys representing Newport News. It was specifically pointed out that Newport News was well represented by Mr. Gerald D. Morgan. I am sure that you will recall that Mr. Morgan, who died recently, had a long and distinguished career including that of assistant legislative counsel for the House of Representatives and deputy assistant to President Eisenhower. Admiral Evans cited the firm of William Rogers as an example of the type of firm the Navy should consider and Mr. Leighton and I agreed that that firm should be one of those considered.

11. Mr. Lewis comments that "There is no need to hire outside counsel." Yet the situation today seems to be worse than it was when he previously concluded his staff was saturated and needed assistance from outside counsel. Specifically:

In September 1974, one month after Mr. Lewis agreed that he should obtain outside counsel to assist with shipbuilding claims, NAVSEA reported outstanding claims totaling $1128.1 million. (This figure includes Armed Services Board of Contract Appeals cases, as well as claims in NAVSEA.)

The latest NAVSEA report indicates claims totaling $2032.5 million as of March 1976. Since then the Electric Boat Division claim of $200 million was settled.

In October 1974, Mr. Lewis made the following statements concerning the workload imposed on the Navy legal staff by claims: "Within the past few years the filing of massive claims arising out of the Navy's contracts has strained the ability of the various Command Counsel not only to provide the normal day-to-day legal services but also to investigate, analyze, and marshal the Navy's defense against these large claims. This strain was most noticeable in the late 1960's and early 1970's when the massive shipbuilding claims began to accumulate. This strain was substantially relieved by the 1973 augmentation of the NAVSHIPS legal staff with additional attorneys both in Washington and at field activities devoted solely to the analysis of massive claims. At some point, however, even the augmented Office of Counsel for the Naval Sea Systems Command reached a saturation point. That is, the number and complexity of existing claims now exceed the time of the available attorneys to devote to handling such claims."

He also wrote: "Regarding the existing ceiling on the number of claims attorneys, Counsel has been advised that although the 39-billet ceiling for NAVSEA Office of Counsel is not to be diminished in Fiscal Year 1975, it most probably will be cut in Fiscal Year 1976, and most certainly will not be augmented further."

Today the NAVSEA legal staff is 42, an increase of less than 10%. However, the dollar amount of the claims backlog is over 50% greater than it was in the fall of 1974.

Of perhaps greater significance to the NAVSEA situation, the "active claims" being handled by its legal staff (that is, eliminating the ASBCA cases which are handled primarily by the Contract Appeals Division lawyers rather than NAVSEA lawyers) has grown from $421.3 million in September 1974 to about $1500 million at present.

Newport News has threatened work stoppages and legal actions against the Navy. Litton has also threatened to stop work if their shipbuilding claims are not resolved promptly. In addition, Litton recently filed suit against the Navy in Federal Court.

The Navy has been directed to accelerate its claims settlement efforts for its shipbuilding claims.

12. From the above, it is apparent that the claims load on the Navy has grown substantially since the time that Mr. Lewis, himself, concluded that Office of Counsel, NAVSEA had "reached a saturation point."

13. Government lawyers traditionally have opposed hiring outside law firms on the basis that the Government lawyers do an adequate job; that they are less expensive than private law firms; that hiring outside counsel would demoralize Government lawyers because they may be paid less than their counterparts in private practice; and that hiring of outside counsel would imply that Government lawyers are not capable. These are not valid arguments.

14. A decision to get outside help need not entail the abolition of an in-house capability. For example, I have developed a strong in-house technical capability for design of naval nuclear propulsion plants. However, I would never have Government engineers try to perform all the design, engineering and manufacturing work for these plants. The job is too big. Therefore, most of that work is performed by contractors under the close technical direction and surveillance of my staff. The fact that the cost, including overhead and profit, for a manhour of work by a contractor engineer exceeds the hourly wage of a Government engineer is not the determining factor in deciding who should do the work. I do not believe the people in my organization feel slighted when the Navy contracts with private firms for the work which they supervise even in cases where the contractor employee is better paid. They recognize that the contractors can help them get their jobs done. In like manner, I believe the Navy could benefit greatly if its Office of General Counsel would take advantage of outside counsel to assist in the processing of claims.

15. Based on the above, I strongly recommend that you initiate action through the Department of Justice, or through other appropriate channels, to arrange for the Navy to obtain assistance from outside counsel.

H. G. RICKOVER.

ITEM 76.—*July 10, 1976—Newport News Times-Herald article entitled "Navy Lawyer Knocks Rickover Efforts"*

(By Stu Henigson)

The Navy's top lawyer has accused Adm. Hyman G. Ricksover of trying to obtain "his own law firm" to do battle with Newport News Shipbuilding over its contract disputes with the Navy.

In a letter to the Senate Armed Services Committee, E. Grey Lewis, Navy general counsel, charged Rickover pushed for outside lawyers to counter the lobbying effort of Tenneco, Inc., the yard's parent company, and possibly even to fight Lewis over legal decisions.

Lewis wrote the letter at the request of committee counsel T. Edward Braswell during joint House-Senate consideration of a House-passed measure authorizing the outside counsel to help resolve about $1.9 billion in disputed contract claims against the Navy by Newport News and two other major shipyards.

Senate conferees eventually prevailed on House conferees to drop the provision for outside lawyers in the final version of the fiscal 1977 defense authorization bill passed last week.

Lewis' letter responded to a widely publicized letter from Rickover to Rep. Les Aspin, D-Wis., that alleged the Navy was being represented largely by one inexperienced lawyer in its contract fight with Newport News over construction of the nuclear guided-missile crusser CGN41.

The yard stopped work on the cruiser last August but went back to work on it under a court order arising from a Navy lawsuit.

In his letter to Aspin in May, Rickover said Newport News has charged the Navy $155,000 for outside counsel in the case, while the Navy was relying on its own lawyers.

"The brunt of the Navy's legal work on (the CGN41) case is currently being handled by one lawyer, two years out of law school, who is handling the case as one of several assignments," Rickover wrote.

"It is interesting to me that I have been unable to get the Navy to hire outside counsel to help the Navy prepare its case, but the Navy is paying Newport News for its outside counsel," he added.

But in advising the committee against hiring the outside lawyers, Lewis claimed the Navy had seven lawyers on the CGN41 case, and only the one mentioned by Rickover had less than 10 years experience.

"I believe what is really involved is the desire of Adm. Rickover to obtain his own law firm which he can then use against Newport News or any other corporation or person he chooses, or even against the legal positions taken by my office or the general counsel for the Department of Defense," Lewis wrote in a passage of the letter releasd by the Navy Friday afternoon.

"Adm. Rickover and his assistant, David Leighton, have told me and former (Navy) undersecrtary David Potter that a major reason for seeking outside counsel is their desire to obtain the services of an attorney with a national reputation (the name of William Rogers was mentioned) to show Newport News that the Navy meant business and to lobby in Congress.

"We assumed he wanted a person to counter Tenneco's Thomas G. Corcoran (reputed to be one of Washington's most powerful lobbyists).

"Lobbying by the executive branch is prohibited by statute, and I will have nothing to do with it," Lewis added.

Rickover's setback in the conference committee coincided closely with reports that last week he was, in effect, ordered to stay out of the contract claims dispute by Deputy Defense Sec. William P. Clements.

Rickover has criticized openly Clements' plan to circumvent the Navy's normal claims review process in an effort to resolve the claims dispute. Rickover says the plan could turn into "one of the biggest ripoffs in history."

In a copyrighted story, The New York Times reported Clements told the 76-year-old admiral his epithet, "father of the nuclear Navy," would be overshadowed by charges he blocked more nuclear ships by continuing to fight a stepped-up settlement of the claims of Newport News, the Navy's principal nuclear shipbuilder.

Rickover has maintained the Navy should stick to the original contracts and the normal claims settlement process, despite threats from Newport News and Litton's Ingalls Shipbuilding Division that they will stop work on Navy ships unless the claims are quickly settled.

"I try to resist the giving away by the Navy of money that contractors are not legally entitled to," Rickover testified recently on his position on the claims.

ITEM 77.—*July 13, 1976—Chief of Naval Material issues NAVMAT Notice 4365 which "establishes a Navy Claims Settlement Board within the Headquarters, Naval Material Command, appoints the members of the Board, and establishes the organization, responsibility, authority, and operating relationships of the Board"*.

DEPARTMENT OF THE NAVY,
HEADQUARTERS NAVAL MATERIAL COMMAND,
Washington, D.C., July 13, 1976.

MAVMAT NOTICE 4365

From: Chief of Naval Material.
Subject: Navy Claims Settlement Board (NCSB); establishment of.
Enclosure: (1) Charter of Navy Claims Settlement Board.

1. *Purpose.* This Notice establishes a Navy Claims Settlement Board within the Headquarters Naval Material Command, appoints the members of the Board, and establishes the organization, responsibility, authority, and operating relationships of the Board, enclosure (1).

2. *Background.* Certain claims for equitable adjustment filed under contracts with Newport News Shipbuilding for the construction of major Navy ships will assigned to the NCSB for adjudication. It is essential that these Claims be resolved expeditiously and solely on their merit. To that end, this Notice establishes extraordinary procedures for the resolution of such claims.

3. *Action.*

a. The Navy Claims Settlement Board is hereby established as set forth in enclosure (1).

b. The following are appointed as members of the NCSB:

(1) Rear Admiral F. F. Manganaro, USN is appointed chairman and contracting officer with the powers and authority set forth in enclosure (1).

(2) Captain W. J. Ryan, SC, USN is appointed as member for business and contractual matters with the functions set forth in enclosure (1).

(3) Mr. P. Moed is appointed as member for legal matters with the functions set forth in enclosure (1).

c. An Executive Secretary will be provided with the functions set forth in enclosure (1).

d. The members and Executive Secretary of the NCSB are hereby assigned to the staff of the Chief of Naval Material to perform this function. During the performance of the mission of the NCSB, the NCSB members are relieved of all other duties to the extent that such other duties may interfere with the performance of the NCSB's functions.

e. The NCSB shall be governed by the Charter, enclosure (1).

f. All Naval Material Command components shall cooperate fully with the NCSB as requested by the Board.

4. *Cancellation.* This Notice is cancelled upon completion of the mission of the NCSB and the disestablishment of the NCSB and is cancelled for record purposes 31 July 1977.

F. H. MICHAELIS.

Enclosure.

CHARTER OF THE NAVY CLAIMS SETTLEMENT BOARD

1. INTRODUCTION

The combination of critical national security considerations, substantial long-standing contractual disputes, and intense interest at high Government levels—Executive and Legislative Branches—necessitates the establishment, at this time, of a special Navy Claims Settlement Board (NCSB) chartered by the Chief of Naval Material to adjudicate assigned claims against shipbuilding contracts. In execution of assigned duties, the NCSB will operate as an independent claims settlement authority devoid of outside pressures, influence or unsolicited advice.

2. MISSION

The primary mission of the NCSB is to oversee the evaluation of the claims; and to review and adjudicate such claims either through negotiated agreement with the contractors or through issuance of final contracting officer decisions or through a combination of the foregoing.

3. AUTHORITY AND RESPONSIBILITY

The Chairman, with the advice and assistance of other board members shall:

a. Promulgate, in coordination with the Commander, Naval Sea Systems Command, and Newport News Shipbuilding, an overall schedule for the evaluation of asisgned claims.

b. Identify to the Chief of Naval Material those NPD deviations required in order to permit efficient execution of the board duties consistent with their charter.

c. Oversee and redirect, as necessary, the scheduling and execution of the tasks necessary to accomplish the evaluation of the assigned claims and the establishment of Government positions suitable for the conduct of negotiations and/or the issuance of contracting officer decisions.

d. During the course of evaluation of the assigned claims, continuously review the technical, legal and cost/pricing documentation and issue such direction and instructions as are necessary to obtain a sufficient basis for proceeding with adjudication of the claims.

e. Conduct negotiations with contractors with respect to the assigned claims and upon settlement of the claims execute the necessary contractual modifications.

f. In the event and to the extent settlements are not obtained through negotiation, the Chairman, NCSB, shall render final contracting officer decisions pursuant to the "disputes" clauses of the pertinent contracts.

g. Prepare and submit such reports, as may be required by the Chief of Naval Material, on the progress of the adjudication of the assigned claims. Report any outside actions which would influence the performance of the NCSB as an independent claims settlement authority.

4. OPERATING RELATIONSHIPS

a. The Chief of Naval Material will assign claims to the NCSB for action and provide administrative support in the execution of the Board's functions and responsibilities under this charter. He will provide policy guidance but not exercise review or approval authority over any settlement or final contracting officer decision rendered by the Chairman, NCSB.

b. The Commander, Naval Sea Systems Command, shall designate an individual to serve as point of contact for the NCSB. The duties of such designee shall be to receive all communications from the NCSB related to the performance of the assigned claims evaluation and to coordinate the implementation within the Naval Sea Systems Command of all directions issued by the NCSB pursuant to the authority granted by this charter relating to the conduct of such evaluation.

5. ORGANIZATION

a. The NCSB shall be composed as follows:

(1) A member to serve as Chairman and Contracting Officer.

(2) A member who shall serve as a business and contractual adviser to the Chairman and alternate Chairman.

(3) A member for legal matters.

b. An Executive Secretary will be provided to assist the Board.

c. The members of the NCSB shall have the following functions:

(1) The Chairman and Contracting Officer—This member alone shall exercise the contracting authority granted in 3e and 3f. He is the member primarily responsible for the discharge of the duties and responsibilities of the NCSB.

(2) The member for business and contractual matters shall serve as the principal adviser to the Chairman in contractual and business matters. He will serve as Chairman in the latter's absence, but may not while so acting, exercise the Chairman's contracting authority.

(3) The member for legal matters is responsible for providing advice to the NCSB relating to the exercise of the authorities and discharge of the responsibilities of the NCSB.

(4) The Executive Secretary will coordinate the activities of the NCSB and arrange for the implementation of its decisions.

6. RESOURCES

a. Manpower. The Chairman, NCSB, shall inform the Chief of Naval Material of personnel required by the NCSB to accomplish the functions described above.

b. Funding. Funding necessary for the accomplishment of the responsibilities of the NCSB will be provided by the Chief of Naval Material.

ITEM 78.—*July 13, 1976—Letter from Gordon W. Rule to Senator Proxmire providing his personal reactions to the June 25, 1976 Joint Economic Committee hearings. Mr. Rule characterizes Deputy Secretary of Defense Clements as the only man in the hearing room who voiced any affirmative ideas or plans to restore proper and necessary working climate between the shipbuilders and the Navy*

July 13, 1976.

HON. WILLIAM PROXMIRE,
U.S. Senate,
New Senate Office Building,
Washington, D.C.

DEAR BILL: Since 1969 we have exchanged views relative to claims handling, bailouts, inefficiency in government and industry, Navy procurement practices, etc. These exchanges have always been completely candid on both

our parts and while not always agreeing, I have maintained the integrity of your purpose and the value of your periodic hearings to those in the executive branch of our government with similar overall views and objectives.

I value those discussions and shall always consider the opportunities thus accorded me a real privilege.

In the same spirit of mutual respect that has characterized our previous exchanges of views, I desire your indulgence once again. In short, I would like to give you my personal reactions to the hearings held on 25 June 1976 by the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee of which you are Chairman.

I sat through that entire session and have asked myself many times since, what the purpose and objective of those hearings could have been.

If the purpose or objective was to obtain firsthand the views of Deputy Secretary of Defense Clements with respect to this proposed use of P.L. 85–804 in an attempt to normalize relations between the shipbuilders of this country and the Navy, you achieved that objective.

I suggest that whether or not his views were acceptable to you, it should be recognized that he was the only man in that hearing room who voiced any affirmative ideas or plans to restore a proper and necessary working climate between the shipbuilders and the Navy.

No one else, including yourself Bill, made any affirmative contribution or suggestion concerning the basic issue involved. Claims are not the issue, they are only one manifestation of the basic problem.

If, on the other hand, the purpose or objective was to record and document the Navy's disagreement with the efforts of Mr. Clements, you singularly achieved that objective also. But why would that be an objective? What possible constructive purpose could be served by the scenario of three Admirals, in the presence of the Chief of Naval Material, being orchestrated to directly contradict the prior testimony and views of the Deputy Secretary of Defense?

I was and still am literally stunned by the performance of those Navy flag officers at that hearing on 25 June 1976. The Navy is much too fine an organization, in my opinion, to be subjected to the spectacle these men presented, ostensibly speaking of a Navy position. To those who know the present and former positions held by those three men, their testimony came as no surprise, but their being there at all, I suggest, was counterproductive to the best interests of the Navy.

Those are my reactions to your hearing and I don't think it helped in any way, shape or form to get at the guts of the problem facing the Navy, the DOD and our country.

In my opinion, what is urgently required is less criticism of those who are trying to solve this problem and a great deal more thought and assistance given to finding the right answers.

I suggest that both you and your able assistant, Dick Kaufman, have the brains and the mechanism to render a tremendous service in connection with the existing relationship that exists between the Navy and the shipbuilders if you are of a mind to so contribute, and if you will be fair to all parties involved.

You and I know that there are two sides to every question or problem and that none of the parties to the problem facing the Navy today are 100% right. You and I also know that regardless of bruised feelings, this shipbuilding problem must be solved promptly. I hope you will agree that any philosophy predicated on our future nuclear shipbuilding programs being performed under court orders is unacceptable.

I therefore respectfully urge you to put a little distance between yourself and the principals to this unfortunate Navy state of affairs and affirmatively supply some constructive solutions to this problem.

I urge you Bill, to take the lead in minimizing crititcism and maximizing possible solutions to the problem so important to our national defense, namely, where and under what terms and conditions will our Navy obtain the ships required and approved by the Congress?

As you know, the ultimate responsibility lies with you and your colleagues because Article 8 of the U.S. Constitution clearly assigns to the Congress the obligation "to provide and maintain a Navy".

With kindest personal regards,

Sincerely,

GORDON W. RULE.

ITEM 79.—*July 15, 1976—Times Herald article entitled "Rickover Defends Use of Lawyers"*

(By Stu Henigson)

Adm. H. G. Rickover, head of the Navy's nuclear propulsion program, has denied charges leveled by the Navy's top lawyer that Rickover sought "his own law firm" to take on Newport News Shipbuilding.

In a July 6 memo to the secretary of the Navy, released Wednesday, Rickover argued that, contrary to assertions of Navy General Counsel E. Grey Lewis, outside attorneys are required to supplement the Navy's lawyers in dealing with shipbuilding claims and contract disputes of Newport News and other shipbuilders.

Rickover had convinced the House of Representatives in May to authorize a five-year trial use of the lawyers, but the provision was dropped from the fiscal 1977 defense bill after Lewis advised the Senate Armed Services Committee against it.

In advising senators to block the measure, Lewis charged that Rickover wanted control of a law firm to fight Newport News and, possibly, Lewis' own decisions, and to illegally lobby in Congress.

Rickover maintained, however, that Lewis knew the general counsel's office would control the outside lawyers, and the 76-year-old admiral denied he intended any illegal use of the attorneys.

"I have not ever advocated that the Navy hire an outside law firm to 'lobby in Congress' or engage in any other activity which is prohibited by statute," Rickover wrote.

The outside lawyer issue, which Rickover said he raised five years ago, now centers largely on the contract dispute over the nuclear cruiser CGN41. Newport News has been building the ship under a court order since August.

Tuesday, the yard filed a motion asking to be allowed to stop work because the Navy won't negotiate better contract terms.

Rickover has said the "brunt" of the legal work on the CGN41 case is being handled by one lawyer who has been out of law school only two years.

In his memo Rickover conceded more lawyers—included Lewis—are applied to the case during "crises," but he said their transfer leaves other, important projects understaffed.

In contrast, Rickover wrote, Newport News is represented by three outside law firms in the CGN41 case and has other firms working in the general contract claims area.

Lewis had contested Rickover's May 17 statement that the Navy had paid $155,000—plus seven per cent profit—to Newport News for lawyers on the CGN41 case, saying the Pentagon had not allowed the charge.

But Rickover pointed out the payment was made to the yard May 13 and then subtracted one month later—after Rickover told the House Armed Services Committee of the payment.

(A yard spokesman said today the yard feels it has a strong case for being reimbursed for its legal fees in this case and intends to fight the Pentagon over the question.)

Rickover quotes Lewis as saying in 1974, "The number and complexity of existing claims now exceed the time of the available attorneys to devote to handling such claims."

Two years later, wrote Rickover, the legal staff has been increased from 39 to 42, while the value of the claims it must handle had increased by more than 300 per cent.

"It is apparent," Rickover wrote, "that the claims load on the Navy has grown substantially since the time that Mr. Lewis, himself, concluded that Office of Counsel, (Naval Sea Systems Command) had 'reached a saturation point'."

"Based on the above," Rickover concluded, "I strongly recommend that you initiate action to arrange for the Navy to obtain assistance from outside counsel."

ITEM 80.—*July 17, 1976—Newport News Daily Press article entitled "Probe of Shipyard Is Considered by FBI"*

(By Ross Hetrick)

The FBI is considering an investigation of Newport News Shipbuilding, according to the current issue of Business Week.

In an article about investigation into Litton Industries and Lockheed Aircraft Corp., William B. Cummings, U.S. attorney for the Eastern District of Virginia, is quoted as saying the FBI will decide on whether to investigate the yard "within the next 10 days."

Contacted Friday night, Cummings would not go into any details of the possible investigation and would only say the decision will probably be made "sometime next week."

"The whole thing might wash out," Cummings said, adding the agency is assigning no great priority to the case. The agency has been considering the move for a couple of weeks, he said.

Newport News is presently feuding with the Pentagon over the settlement of $894 million worth of claims. The yard also has a suit pending in Federal District Court over whether the yard has the right to stop work on the $337 million nuclear powered guided missile cruiser CGN–41. The yard has threatened to pull out of the Navy shipbuilding program unless these claims are settled promptly.

Currently a three-man Navy board is reviewing claims for possible settlement.

During Congressional hearings into a previous plan to settle the claims, Newport News was accused of overstating and making fraudulent claims.

Sen. William Proxmire in a Senate speech June 1 called for an investigation of the claims. In announcing the investigation request he made to Navy Secretary J. William Middendorf Jr., Proxmire alluded to the testimony of former yard claims analyst William Cardwell, who said Newport News is responsible for most of the delays and disruptions in building Navy ships under the contested contracts.

A shipyard spokesman said Friday the yard has not been notified of a possible investigation. "We have nothing to hide," he added.

ITEM 81.—*July 19, 1976—Federal Contracts Report article entitled "Outside Legal Counsel"*

In a detailed memorandum to the Secretary of the Navy, Admiral Rickover has commented on his proposal to hire outside legal counsel to aid in the processing of the nearly $2 billion in shipbuilding contract claims, defending it and taking issue with the criticism of his position voiced in a letter from Navy General Counsel E. Grey Lewis to the Senate Armed Services Committee. (635 FCR A–29)

He observed, for instance, that although Lewis denied that there is an imbalance of legal resources being applied in the Newport News litigation with the Navy over the contract for construction of the CGN–41 cruiser, "I believe the contractor is better staffed for this job than the Navy, through no fault of the Navy attorneys actually handling the case," He added that in addition to in-house counsel, Newport News has "at least five private law firms working on its shipbuilding claims problems."

As to the Lewis charge that Rickover is seeking to obtain "his own law firm," the admiral said that the record of correspondence over the past five years makes clear that he has recommended the Navy hire outside counsel to help with claims "in order to better defend the Government's interests and to lighten the load these claims place on the Navy." He noted too that two years ago Lewis himself agreed to adopt Rickover's recommendation on a trial basis for certain claims at Newport News.

The proposed contract for outside counsel would have called for the outside lawyers to be under the direction and control of Lewis' office, "not mine. I agreed that outside counsel should work for the Navy lawyers. Never have I suggested that outside counsel should work for me or my organization. Accordingly, there is no basis for Mr. Lewis' allegation that I have been seeking to obtain my own law firm," Rickover said.

Continuing his chronology of the proposed contract for outside counsel, he said that the Justice Department had indicated in late 1974 that it would be lawful for the Navy to hire outside counsel, then, in March 1975, reversed its previous position and ruled that the Navy could not hire outside counsel.

While the NAVSEA legal staff is now 42, an increase of less than 10 percent over two years ago, the dollar amount of the claims backlog is over 50 percent higher than in the fall of 1974, the admiral noted, and "of perhaps greater significance" to the NAVSEA situation, the active claims being handled by its legal staff (eliminating the ASBCA cases which are handled primarily by the Contract Appeals Division lawyers rather than NAVSEA lawyers) has grown from $421.3 million in September 1974 to about $1.5 billion today.

A decision to hire outside counsel need not entail the abolition of an in-house legal capability. "For example, I have developed a strong in-house technical capability for design of naval nuclear propulsion plants. However, I would never have Government engineers try to perform all the design, engineering and manufacturing work for these plants. The job is too big. Therefore, most of that work is performed by contractors under the close technical direction and surveillance of my staff. The fact that the cost, including overhead and profit, for a manhour of work by a contractor engineer exceeds the hourly wage of a Government engineer is not the determining factor in deciding who should do the work.

"I do not believe the people in my organization feel slighted when the Navy contracts with private firms for the work which they supervise even in cases where the contractor employee is better paid. They recognize that the contractors can help them get their jobs done. In like manner, I believe the Navy could benefit greatly if its Office of General Counsel would take advantage of outside counsel to assist in the processing of claims."

Newport News: It was after Rickover's memorandum was prepared that Newport News, in a move expected to further complicate the shipbuilding claims problem, asked a federal court for approval to halt work on the nuclear powered cruiser. It claimed that the Navy has stalled attempts to negotiate resolution of the various disputes involving the ship.

It follows by only a week a similar court action by Litton Industries, Inc., seeking a decision dissolving the Navy contract for construction of LHA ships. Also, it was just a year ago that Newport News was obliged to accede to a court order to continue work on the cruiser. The court action at that time committed the Navy and Newport News to negotiate an acceptable profit figure and resolve the issue.

Newport News senior vice president Charles Dart stated that, "Our position is that the Navy has consistently refused to negotiate all the issues that divide the parties, including those of delivery date and a ship construction schedule."

ITEM 82.—*July 20, 1976—Letter from Senator Proxmire to Mr. Gordon W. Rule in response to Mr. Rule's July 13, 1976 letter criticizing the Joint Economic Committee hearings. Senator Proxmire urges the Navy to follow the spirit as well as the laws enacted by Congress and to observe its own rules and procedures in its procurement programs, including those requiring a comprehensive audit, technical analysis, and a memorandum of legal entitlement*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., July 20, 1976.

Mr. GORDON W. RULE,
NMAT; Crystal Plaza 5,
Arlington, Va.

DEAR MR. RULE: In your letter of July 13, 1976 you raised questions about the purpose and objective of the June 25 hearing by the Subcommittee on Priorities and Economy in Government.

The June 25 hearing was a continuation of the inquiry begun on June 7 when the Subcommittee received testimony from Admiral H. G. Rickover and Mr. William Cardwell. One of our principal purposes is to inquire into the substantive issues in the dispute over approximately $2 billion in shipbuilding claims filed or about to be filed against the Navy. The claims involve both nuclear and conventionally powered ships.

Many if not most of the statements made by spokesmen of the Department of Defense have neglected to deal with the substantive issues such as the merits of the claims. Instead, Defense Department spokesmen and the contractors have avoided these issues by making personal attacks and alluding to the "inequitable" contracts and the need to rewrite them so as to allow for greater reimbursement than is provided for in the current contracts.

Of course, if the contracts are rewritten the effect will be to reimbuse the shipbuilders for hundreds of millions of dollars in cost overruns, whether rewriting the contracts is viewed as "equitable adjustments" or claims settlements.

Such an action would seriously increase the Navy's costs for the ships in question and could have even larger consequences for the Navy's future ship construction program. In addition, the decision in this controversy could adversely influence defense procurement generally.

A decision to reimburse the shipbuilders for their cost overruns made prior to a determination of responsibility for the cost overruns, would be a disastrous precedent for anyone interested in economy in government. It is, therefore, essential that the merits of the claims and the question of legal entitlement be thoroughly aired.

To argue that shipbuilders might refuse to build Navy ships if they are not paid for their overruns begs the question of legal entitlement. It is important that the Navy have a good working relationship with its contractors. But such a relationship cannot be based on a policy of paying for unaudited or unjustified claims.

You will recall that during the June 25 hearing I asked Secretary William Clements whether the Navy could get its ships built if the contractors carried out their threats to stop work and whether steps were being taken to meet that contingency. I was satisfied with Secretary Clements' assurances on these points.

Any decision to pay defense contractors' claims against the government prior to an audit would be improper. The possibility that contractors were simply bailed out of their own financial difficulties could never be erased if such a procedure were followed before a final decision is made.

As you point out, Congress has the responsibility, under the Constitution, to provide and maintain a Navy. In accordance with this fundamental guideline, Congress annually authorizes and appropriates funds for this purpose. Congress also passes laws expressing public policy, requiring accountability for monies expended, and providing rules to be followed by the Defense Department and the Navy.

The responsibility of the Navy in carrying out its programs is to follow the policies and laws set down by Congress in accordance with good management practices. The Navy has adopted a great variety of procurement rules and procedures toward this end. Had Congress' wishes and the Navy's own rules and procedures been followed by the responsible officials, the shipbuilding claims problem might have been avoided. A resumption of orderly procedures is the only hope for a lasting resolution of the current controversy.

I strongly urge the Navy to follow the spirit as well as the laws enacted by Congress and to observe its own rules and procedures in its procurement programs. There are specific, detailed Navy rules for handling shipbuilding claims. The Navy should follow those rules. They provide, you will recall, for a comprehensive audit, a technical analysis, and a memorandum of legal entitlement.

If these rules and procedures are followed, and if the contracts are properly enforced, the Navy will have done its duty. Should the government then be faced with contractors who refuse to live up to their responsibility and demand instead extra-contractual relief from their contractual obligations, Congress may be required to step in.

Secretary William Clements' original proposal to resolve the controversy through PL 85–804, was ill-advised and I am pleased that he has withdrawn

that proposal. The proper course is for the Navy to enforce its contracts, to pay contractors for claims that can be substantiated and to refuse to pay for unsubstantiated claims.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 83.—*July 21, 1976—Senator Proxmire letter to Deputy Secretary Clements asking whether Admiral Rickover or the President of Newport News, Mr. John P. Diesel, had been ordered to "step aside" as indicated in a July 2, 1976 New York Times article entitled, "Pentagon Showdown"*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., July 21, 1976.

Hon. WILLIAM CLEMENTS,
Deputy Secretary of Defense,
The Pentagon, Washington, D.C.

DEAR SECRETARY CLEMENTS: The July 2, 1976 issue of the *New York Times* carries a John Finney article entitled "Pentagon Showdown: Clements Asserts He Spiked Rickover on Shipyards." In the article you are quoted as having had a showdown meeting with Admiral Rickover. The article states "as described by Mr. Clements, he succeeded in silencing Admiral Rickover in his criticism of the Navy's shipbuilders, in particular the Newport News Shipbuilding Company which builds most of the Admiral's nuclear-powered warships."

In testimony before the Joint Economic Committee, Admiral Rickover testified that the Newport News claims were inflated and that these claims should be audited and settled on their legal merits. The article quotes you as ordering Admiral Rickover "to step aside and keep his silence as the Navy attempted to work out its claims problems with the Newport News, Virginia company, a subsidiary of Tenneco, Inc."

"Mr. Clements said he had come to the conclusion that, if the claim procedure were to work, it was necessary to remove the two parties that have been providing most of the acrimony—namely Admiral Rickover and John P. Diesel, president of Newport News."

I need not elaborate on the serious implications of the article if it accurately portrays what you have actually said and done. However, I recognize that press accounts are sometimes inaccurate. Therefore, I would appreciate answers to the following questions:

a. Have you in fact ordered Admiral Rickover to "step aside and keep his silence" as the Navy attempts to resolve the Newport News claims? If so, how do you justify such a gag order?

b. How have you in fact ordered Mr. John P. Diesel, president of Newport News, to disassociate himself from the claims? If so, by what authority are you able to take such action?

c. Why have you gone out of your way to imply that Admiral Rickover is a major cause of the shipbuilding claims problem, when most of the Navy's shipbuilding claims in the past five years have been submitted by shipyards that are not involved in construction of nuclear ships? How could he have contributed to the Litton claims problem when that firm is building only nonnuclear ships?

I would also appreciate it if you would either confirm or deny the accuracy of the *New York Times* article. Any specific statements in the article which you consider to be either inaccurate or misleading should be identified and clarified.

I notice that Gordon Rule has been placed in charge of the negotiations of the CGN–41 contract dispute with Newport News. I have enclosed an exchange of letters between Gordon Rule and myself in which there is some discussion of the responsibilities of Congress and the Navy with regard to the Navy's shipbuilding program.

Part of the Navy's responsibility is to enforce the contracts it awards and to follow established procedures in accordance with good management practices. The CGN–41 contract dispute falls under the same principles.

Government bailouts of large corporations have taken many forms in the past several years. One form has been to simply not enforce government contracts. The effect, as in the case of payments for unsubstantiated claims is to confer valuable benefits on contractors in return for inadequate or no consideration.

I am encouraged by the recent establishment of the Navy claims settlement board which has been given authority to act independent of outside pressure in accordance with the established procedures for auditing and reviewing claims. It should be understood that it is just as important to negotiate contract disputes in accordance with normal procedures as it is to negotiate claims. Any decision in the CGN–41 case should avoid setting a bad precedent just as decisions on claims should avoid setting a bad precedent.

I would like to have your assurances that no action will be taken in the CGN–41 case which will set a bad precedent concerning the enforcement of government contracts or which will have the effect, directly or indirectly, of bailing out the contractor.

I am looking forward to your prompt response.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 84.—*July 29, 1976—Christian Science Monitor article entitled "U.S. May Apply Pressure on Navy Shipbuilding Tie Up."*

(By Guy Halverson)

WASHINGTON. With the U.S. Navy and key shipbuilding companies locked in a controversy over shipbuilding costs, a question being asked by lawmakers here is: how best to get new U.S. ships built—and on time?

Three top shipbuilding companies say they have filed claims of up to $2.4 billion for cost overruns. One major contractor, Litton Industries, has threatened a massive job walkout at a shipbuilding facility Aug. 1, if claims for payments are not met.

For the U.S. Navy—seeking to upgrade its combat readiness in the wake of a growing Soviet fleet—the issue "build—and now."

Solutions being privately discussed:

Stepped-up government pressure against the shipbuilders. This is underscored by this week's court actions by the U.S. Justice Department in Los Angeles and Mississippi against Litton. The government is seeking an injuction blocking a walkout.

Nationalizing the shipyards. This position has in part been broached by Adm. Hayman G. Rickover, who wields trenmendous clout in Congress.

Closer long-range scrutiny of the way that Navy contracts are negotiated with private shipbuilders—particularly pegging payments at higher rates to avoid cost escalations.

SHIPBUILDERS INVOLVED

Many congressional aides expect the issue of how best to negotiate shipbuilding claims to carry over to next year. If that happens, it would land square on the desk of a new administration.

The three large Navy shipbuilders involved in the cost controversy are the Electric Boat Company of Groton, Connecticut, the Newport News Shipbuilding and Drydock Company, and Ingalls division of Litton Industries of Pascagoula, Mississippi. They claim their costs have soared because of expenses not covered in contracts with the Navy. The Navy has proposed a settlement of $500,000 to $700,000, a position that Admiral Rickover blasted as a "rip-off"—instead urging a government take-over of the shipyards.

The Navy's clash with Litton underscores the seriousness of the cost-escalation controversy. Last June, Litton threatened to halt work at its Pascagoula, Mississippi, shipyards, pending a favorable settlement of back claims against the Navy. The government has sought an injunction against such a walkout, which would halt work on new helicopter-amphibious assault ships.

Both Litton and Tenneco—which controls the large Newport News (Virginia) shipyards—have indicated that they are prepared to press ahead with

court actions for their cost overruns regardless of what settlements the Defense Department proposes.

HOW ARGUMENTS GO

The contractors argue that Navy contracts were written "low"—without taking into account the high inflation of the past several years. Moreover, while the Navy has made modifications in ship designs, payments have often been late—forcing the shipbuilders to turn to their own funding to keep construction going.

"What is most needed is nothing less than firm presidential leadership on this to get the ships built," argues a legislative spokesman.

ITEM 85.—*July 29, 1976—Senator Proxmire letter to Attorney General Levi requesting the Attorney General to designate a team of investigators within the Justice Department to review the transcript of the Joint Economic Committee hearings and other evidence and to interview individuals who may have additional information to determine if the Newport News claims are based on fraud*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., July 29, 1976.

Hon. EDWARD H. LEVI,
Attorney General, Department of Justice,
Washington, D.C.

DEAR MR. LEVI: On June 7 and June 25, 1976 the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee held hearings concerning certain claims made by shipbuilders against the Navy.

In the course of our hearings a significant body of testimony and evidence was developed which I believe raises a clear possibility that the claims of one of the shipbuilders, Newport News Shipbuilding, a division of Tenneco, may be based on fraud. The purpose of this letter is to formally request that you designate a team of investigators within the Justice Department to review the transcripts of the hearing and other evidence and to interview individuals who may have additional information, including present and past employees of the firm, to determine if the claims are based on fraud.

On June 1, 1976, I wrote to the Secretary of the Navy requesting a formal investigation into this matter. I do not believe there is any likelihood that the Navy will conduct such an investigation, based on the response I received from the Navy.

As you may know, Newport News has filed six claims against the Navy for a total of $894 million.

Admiral H. G. Rickover, who is responsible for part of the procurements on which the claims are based and who is familiar with the claims documents, testified to the Subcommittee that the claims are "greatly exaggerated and unsupported," that they are based on inflated figures, unsubstantiated allegations, attempts to charge the Navy with commercial costs and possible double counting. Admiral Stuart J. Evans, recently retired, testified that after reading the documents supplied by Newport News in support of one of its claims, he found "no connection in the claims itself between the recitation of facts and the consequences that the company alleged flowed from the facts."

Finally, Mr. William Cardwell, who was employed at Newport News for eighteen years prior to being laid off early in 1976 testified that at least part of the claims were prepared with exaggerated, unsupported or inaccurate figures, and that this was accomplished at the direction or with the knowledge of the company. Mr. Cardwell had been a member of the team assigned to prepare one of the claims.

I believe that anyone who reads the 64 volumes of documentation supplied by Newport News to the Navy in support of its claims will conclude that major portions of the claims are not only exaggerated but that they are based on absurd theories. As an illustration the company asserts that the Navy owes the company nearly $100 million as reimbursement for the low productivity of its own work force. Citing "Parkinson's Law," Newport News argues that

their workers' motivation declined when the delivery dates for the ships were extended by the Navy.

I have been holding hearings on shipbuilding claims against the Navy since 1969. The Newport News claims raise the most serious questions of possible fraud than any of the claims I have seen.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 86.—*Aug. 2, 1976—Jack Anderson article entitled "Shipbuilding Scandal."*

WASHINGTON.—Shipbuilding Scandal: Senate investigators have uncovered evidence that the Newport News Shipbuilding Co. may have committed criminal fraud in filing an $894 million claim against the Navy.

Sen. William Proxmire, D-Wis., chairman of an economy-in-government subcommittee, is asking the Justice Dept. to investigate. The shipbuilding complex, part of the politically powerful Tenneco conglomerate, has denied the charge.

The evidence was extracted from 64 huge volumes of data, which the company submitted to Proxmire's staff. The volumes are as expensive as some of the small ships that Newport News builds. Bound in gold metallic covers with rich imitation leather backing, the volumes cost a cool $2 million to research and publish. The cost, of course, was added to the taxpayers' bill.

What the staff found between the golden covers may add up to a far greater loss to the taxpayers. In a confidential report to Proxmire, the staff declares bluntly: "The claim could be overstated by $200 million or more . . . The evidence we have received raises a strong possibility that the elements of fraud may be present."

For example, Newport News dunned the Navy for nearly $100 million to reimburse itself for the low productivity of its own shipyard workers, the memo charges.

It also cites the sworn statement of a former company official, William Cardwell, that he had used "exaggerated, unsupported or inaccurate figures." He had acted under "the direction or the knowledge" of the company, he disclosed.

Proxmire's investigators report the Navy is conducting no special inquiry into the possibility of fraud and that "without a mandate from the top, no one will be willing to touch the issue of fraud."

Because "the Navy and the Defense Department appear to have no taste for this kind of first-hand investigation," the staff recommends calling in the Justice Department. Proxmire has now agreed to ask Atty. Gen. Edward Levi to "assign a team of investigators to go through the evidence that has been gathered."

Under pressure from Proxmire, meanwhile, the Navy has also appointed a three-man board to evaluate the claims of shipbuilding companies. At a closed session of the Senate Appropriations Committee, Proxmire pushed through a bill which would require the three-man board and other Pentagon officials to report back to four different congressional committees before paying out a nickel to the shipbuilders.

ITEM 87.—*Aug. 6, 1976—Letter from Deputy Secretary of Defense Clements to Senator Proxmire in response to the Senator's July 21, 1976 letter regarding the New York Times article. Mr. Clements states he has not ordered Admiral Rickover or Mr. Diesel to step aside or be silent*

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C., August 6, 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 21, 1976 refers to an article which appeared in the New York Times on July 2, 1976 and requests certain information.

In reply to the questions on page 2 of your letter, I have not ordered Admiral Rickover or Mr. Diesel to step aside or to be silent. Each of them occupies a position of authority in which they have specific responsibilities. I expect them to exercise the authority vested in their positions and to act in a responsible manner. I have not "gone out of my way" to imply that Admiral Rickover is a major cause of the Navy's shipbuilding problem.

We are working diligently to resolve our problems with the Navy shipbuilding contractors. I do not believe they can be solved by newspaper articles or other news media. It will take firm resolve by both parties in a spirit of mutual interest and with firm determination to achieve the end result. That end result must be a settlement of the claims on an equitable basis—equitable to both parties.

As I advised you when I appeared at the hearing on June 25th, "I am positively not bailing out anybody." And, we are proceeding "to bring about an accommodation with the shipyards based on the merits of the situation and in the interests of national security."

Sincerely,

W. P. CLEMENTS.

ITEM 88.—*Aug. 16, 1976—Assistant Attorney General Thornburgh letter to Senator Proxmire in response to the Senator's July 29, 1976 letter requesting investigation of the possibility of fraud in connection with Newport News shipbuilding claims*

DEPARTMENT OF JUSTICE,
Washington, D.C., August 16, 1976.

Hon. WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government, Joint Economic Committee United States Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The Attorney General has asked me to reply to your letter dated July 29, 1976 concerning the validity of cost claims filed in relation to construction of ships for the Department of the Navy by Newport News Shipbuilding, a division of Tenneco.

Since you believe testimony and evidence developed by the Subcommittee raise the clear possibility of fraud, you request that a team of Justice Department investigators review the results of the Subcommittee inquiry and conduct any additional indicated interviews. I have designated Mr. Calvin B. Kurimai, an attorney in the Fraud Section, to make the initial contact and confer with representatives of your staff. Upon completion of a preliminary evaluation of the inquiry, the Department can better determine an adequate commitment of personnel to pursue the matter to a logical conclusion, including Federal Bureau of Investigation involvement or grand jury exploration, if that seems in order.

Your interest in writing is very much appreciated.

Sincerely,

RICHARD L. THORNBURGH,
Assistant Attorney General,
Criminal Division.

ITEM 80.—*Feb. 12, 1977—Newport News Daily Press article entitled "Navy Settles Portion of Yard Claims"*

The Navy has settled a $155 million claim by Newport News Shipbuilding on two cruisers for $44.3 million, it was announced Friday.

While the shipyard is pleased by the announcement, it pointed out that there are many more unsettled claims which total about $742 million.

The claims concern the USS California (CGN 36) which was delivered in February 1974 and the USS South Carolina (CGN 37) delivered November 1974. The claims were filed in two parts, one in June 1973 and the other in February 1976.

The $44.3 million includes a $15 million provisional payment made to the yard in December 1974, according to a Navy spokesman.

The settlement is the product of a special three-man Navy board set up in July 1976 to concentrate on Newport News claims.

The shipyard will not receive all the money designated because of a special sharing provision in the Navy contracts with the yard.

The 31 per cent settlement is below the average rate of settlement for the past eight years which has been around 54 per cent.

In a release handed out to workers as they left the yard Friday, shipyard President John P. Diesel said, "We're obviously pleased that our company and the Navy were finally able to reach a compromise agreement on these claims, which have been pending for nearly four years.

"Although this particular matter now has been resolved there still are five other shipbuilding claims on 12 vessels that require resolution. I hope these issues also can be settled through good-faith negotiations."

Some observers see the settlement as the turning point in the relations between the Navy and the shipyard over the claims problem.

In the last year, relations between the yard and the Navy have deteriorated to the point that the yard was threatening to stop work on Navy ships.

Rep. Paul Trible, interviewed prior to his talk to the Tenth Virginia Soybean Conference at Sheraton-Inn Coliseum Friday night, said, "I think today's announcement is an indication that both the Navy and the shipyard are committed to reaching an equitable settlement.

"As a member of the House Armed Services Committee, I personally will continue to encourage the Navy to press forward in promptly resolving these contractual matters."

ITEM 90.—*February 14, 1977—Federal Contracts Report article "Claims: Navy, Newport News Shipbuilding Settle $150 Million Cruiser Claims, Dropping Total to $742 Million"*

As recently forecast by outgoing Navy Under Secretary David R. MacDonald, the Navy and Newport News Shipbuilding and Dry Dock Co. agreed at the week's end on a contract modification that settles all outstanding claims by the company for construction of two cruisers (CGN–36 and 37) that were delivered in 1974 (662 FCR A–20).

As a result of this settlement, the total face value of outstanding claims that have been submitted by Newport News Shipbuilding (NNS) has been reduced from $892 million to $742 million.

Two claims under the 1968 contract were submitted, one in June 1973 and the other in February 1976, which together requested an increase in ceiling price of the contract of over $150 million. The agreement finally settles the two claims in the contract for an increase of approximately $44.3 million, the Navy said. This amount includes $45 million which the Navy paid the shipbuilding firm in the form of a provisional payment in December 1944. The settlement was negotiated by Rear Admiral F. F. Manganaro, chairman of the Navy Claims Settlement Board, and C. E. Dart, executive vice president of NNS.

In a statement from NNS president John P. Diesel, the company said: "We are pleased that Newport News and Navy finally could reach agreement on these claims which have been pending for nearly four years. Although this particular matter has been resolved, there are still five claims on 12 vessels that require resolution. We hope these can also be settled through good faith negotiations."

MacDonald in his last day in office a week earlier had told newsmen that the settlement appeared imminent and that it could mean breaking a logjam and lead to clearing up a huge NNS package of shipbuilding claims which have clouded the future of nuclear ship construction at the Newport News yards. Much of the dispute has revolved around company claims for additional payments because of unanticipated inflation and Navy change orders in the construction of cruisers, submarines and aircraft carriers at the yards.

However, he indicated the expectation that still unresolved claims totaling about $841 million by Litton Industries, Inc., builder of the new LHA helicopter assault ships for the Navy, will end up in the courts.

He also said that a new procedure will be adopted for handling future contract claims as a companion move to liberalized escalation payments. The procedure, he said, will involve prompt payment of those claims that are well documented while those that are not ("hard vs. soft") will be subject to arbitration under the new procedures. NNS officials commenting on his statement appeared at a loss as to what new procedures MacDonald had in mind.

Meanwhile, President Carter's nominee for Secretary of the Navy has indi-

cated the propsect that he is likely to be tough with some of the shipbuilders who have filed over $2 billion in shipbuilding contrat claims with the Navy.

W. Graham Claytor, Jr., former Southern Railway president, last week told the Senate Armed Services Committee at a hearing on his nomination that while he does not believe that it would be in the best interests of the country to force any contractor into bankruptcy, it might be."

He said that the shipbuiding claims were among the first things to which he will give personal attention. The claims have delayed delivery of a number of new warships. It could be on the basis of a monetary settlement or it could be on the basis of forcing this thing through until a contractor goes into bankruptcy," he told the Senate panel.

ITEM 91.—*Mar. 19, 1978—Newport News Times Herald article entitled "Navy Disposes of Yard Claim, Seeks Refund of May Payment"*

(By Stu Henigson)

The Navy officially disposed of the second Newport News Shipbuilding contract claim Monday with a final decision that the $90-million claim was worth only $2.9 million.

A shipyard spokesman called the Navy's contracting officer's decision "grossly inadequate" and said the shipyard would appeal the decision to the Armed Services Board of Contract Appeals.

To make matters worse, the Navy paid the yard $3 million as a provisional payment on the claim last May. With Monday's decision, the Navy asked the yard to refund the difference of $65,430 between the $3-million provisional payment and the $2,934,570 settlement ruling.

The shipyard filed the claim for $92.1 million in March 1976 on a 1969 contract for $96.8 million to build two nuclear-powered attack submarines, the L. Mendel Rivers and the Richard B. Russell (SSN-686 and SSN-637).

The claim alleged the Navy owed the yard the additional money because Navy actions or inactions caused the yard to perform extra work. The claim was revised downward to $90.4 million in August 1976.

The shipyard had been negotiating with Adm. F. F. Manganaro, head of the Navy's claim settlement board, over the claim since August 1977. The negotiations broke down in December when the shipyard rejected Manganaro's final offer and demanded Manganaro issue a contracting officer's decision.

The contracting officer's decision is required before the shipyard can put a claim before the appeal board.

The shipyard spokesman said the yard had been negotiating with Manganaro over a significantly" higher figure. However, contracting officers' decisions are based on a very narrow interpretation of what the Navy owes a contractor, while a negotiated settlement can include additional money for "litigative risk," or the value of avoiding litigation over the claim.

The shipyard will probably fare much better before the appeal board—if the experience of other shipbuiders is a measure—but it will probably take several years for a decision.

If the yard is not satisfied with the board's decision, it can appeal it to the federal courts.

The Navy's issuance of a contract officer's decision on the claim reduces the backlog of local shipyard claims before the Manganaro board to four, with a face value of $652 million.

Manganaro settled the first of the latest batch of claims in February 1977. That $142-million claim on two nuclear cruisers was settled for $44 million.

A month later, before a congressional subcommittee studying Navy ship procurement, shipyard Chairman John P. Diesel said the yard was "certainly satisfied" with Manganaro's claims settlement efforts.

ITEM 92.—*Mar. 9, 1978—Newport News Daily Press article entitled "Yard Will Appeal Settlement Offer"*

The Navy offered Wednesday to pay about 3 percent of a disputed $90 million claim by Newport News Shipbuilding.

A shipyard spokesman said the company will appeal the Navy's offer to the Armed Services Board of Contract Appeals.

The Navy proposed giving $2.9 million to settle claims valued by the shipyard at $90.4 million for construction of two submarines, the USS L. Mendel Rivers and the USS Richard B. Russell.

The shipyard spokesman called the Navy's proposal "grossly inadequate." He added the company had been offered a higher settlement in the negotiations which began in August.

"We rejected even that (earlier) figure because it in no way reflected the actual cost of the additional work," the spokesman said.

Since the Navy and the shipyard were unable to settle their differences on the submarine contracts, the matter went to a contracting officer three months ago.

"The contract requires such a contracting officer's final decision when the parties do not reach agreement on a negotiated settlement," a Navy spokesman said.

The shipyard spokesman said the Navy's low, final bid was expected by the company.

"We can now take the next step toward resolution of this matter by appealing it to the Armed Services Board of Contract Appeals," the shipyard spokesman said.

ITEM 93.—*Mar. 19, 1978—Washington Star article entitled "A Fraud Probe on Ship Contracts"*

(By Gregory Gordon)

The Justice Department is investigating the possibility that three major shipbuilders committed criminal fraud in their filings of huge contract claims against the Navy, official sources report.

Justice Department officials are looking into a number of fraud allegations among the $2.7 billion in claims lodged by Litton Industries, Newport News Shipbuilding and Drydock Co. and the Electric Boat Division of General Dynamics, the sources said.

Electric Boat, which has pending claims of $544 million, has threatened to halt construction of 16 submarines April 12 if it is not paid. The Navy offered the company a settlement, but it was rejected.

Adm. Hyman Rickover testified before Congress that he believes the claims are "grossly exaggerated" and has alleged fraud.

One high Justice Department official indicated the investigation by the department's fraud section may extend beyond the three companies, but said the number of firms involved in the review "does not exceed six."

Joseph Wornom, spokesman at Electric Boat in Groton, Conn., said, "We're not aware or have any knowledge at all of any such investigation."

The Navy's general counsel's office, which referred the cases to the Justice Department, and the FBI will assist in checking for possible fraudulent claims where a company:

Submitted bills for work never performed;

Falsely described the nature of the work and inflated the charges;

Or used cheaper parts than called for in the contract and charged for the prescribed parts.

An official explained the billing disputes between the government and defense contractors result mainly because most contracts are negotiated at a fixed price. He said the Navy often later alters its order when it learns of new technology, and there are disagreements over the cost of changing the specifications.

One source close to the investigation said there are "a whole host of suggestions or allegations" of fraudulent billing.

"But if they are true," he said, "how much money they amount to, I don't know."

APPENDIX B

Documents relating to Lockheed and Avondale shipbuilding claims

CONTENTS

ITEM 1.—*May 7, 1971—Letter from Gordon W. Rule, Chairman, Contract Claims Control and Surveillance Group to Commander, Naval Ship Systems Command criticizing the Naval Ship Systems Command for its actions in the case of Lockheed and Avondale shipbuilding claims. Mr. Rule emphasizes the need for a memorandum of legal entitlement and analysis by the Supervisor of Shipbuilding prior to negotiating claim settlements*

DEPARTMENT OF THE NAVY,
Headquarters Naval Material Command,
Washington, D.C., May 7, 1971.

From: Chairman, Contract Claims Control and Surveillance Group.
To: Commander, Naval Ship Systems Command.
Subject: Lockheed and Avondale Shipbuilding Claims.

Ref: (a) CNM ltr MAT 022/GWR of 2 Dec 1970 to NAVSHIPS. (b) NAVMAT 022/GWR ltr of 2 Apr 1971 to NAVSHIPS. (c) NAVMAT 022/GWR ltr of 19 Apr 1971 to NAVSHIPS. (d) COMNAVSHIPS ltr 00:NS:jd of 26 Apr 1971 to CNM.

1. References (a), (b) and (c) requested certain information to be supplied the Contract Claims Control and Surveillance Group (CCCSG) to support subject claim negotiations.

2. Reference (d) furnished some of the requested information but because it declines to comply with two of the most important requests and further because of the distortions and inaccuracies contained therein, it is considered essential that the record be set straight.

3. The GAO, the Congress and Admiral Rickover have quite recently spoken out on the proper and prudent settlement of shipbuilding claims against the Navy and the CCCSG is determined to negate future criticism of the way the Navy settles these claims, either procedurally or substantively.

4. The purpose therefore of this letter is to:

a. record the concern of the CCCSG regarding the delays in submission of fully documented and supported business clearance covering subject claims.

b. obtain for the record precise information regarding procedures followed by NAVSHIPS in the negotiation of subject claims settlements.

c. make clear for the record the refusal by NAVSHIPS to furnish certain requested information pertaining to the Lockheed claim proposed settlement.

d. record for the record the proper role of the legal member of any claim settlement team, as distinguished from his role in the normal procurement function.

5. Concern of CCCSG re Delays in Submission of Subject Claims Business Clearances.

a. The latest NAVSHIPS report on the status of shipbuilding claims of $5 million and over, dated 1 May 1971, shows that the Avondale claims for the DE 1052's and DE 1078's were negotiated and agreement reached with the contractor on 2 December 1970. Since that date NAVSHIPS has apparently been attempting to substantiate the agreed upon figure. The fact that as of 6 May 1971 a legal memorandum of entitlement had not been finalized is the cause of considerable concern to the CCCSG.

b. Similarly, the Lockheed DE 1052 and LPD claims were negotiated and agreement reached with the contractor on 29 January 1971. A business clearance was brought to the CCCSG on 25 March 1971 without any legal memorandum for the LPD portion of the proposed settlement, which is the major part of the agreed upon figure ($48.4M of the proposed $62M settlement). The fact that as of May 1971, over three months have elapsed with no finalized memorandum of legal entitlement for the LPD's is the cause of considerable concern to the CCCSG.

c. It would appear that something is basically wrong in both of these cases. As a minimum, it seems rather obvious that at the point in time when agreement was reached with both contractors on the proposed settlement figures, *no memorandum of legal entitlement for the amounts negotiated, had been finalized by the legal member of the settlement team.*

d. When NAVSHIPS forwarded to the CCCSG their revised settlement procedures in mid-1970, it was recognized that these new procedures could enable the Commander, NAVSHIPS to establish a pre-negotiation position (Command Decision) without benefit of a final written memorandum of legal entitlement having been prepared and submitted to him. *Neither the CCCSG nor the Office of General Counsel interposed objection to the revised procedures at that time despite the fact that the previous procedures approved by ASN (I–L) and CNM required a memorandum of legal entitlement before the pre-negotiation position was established, because it was never envisaged that this newly minted procedure could also permit negotiations to be concluded by the COMNAVSHIPS with a contractor on a claim against the Navy, in the absence of a memorandum of legal entitlement having been finalized for his guidance.*

e. *Patently, if no memorandum of legal entitlement—draft or final—is in being at the time the Command Position is established, nor at the time of negotiation of a dollar agreement with a contractor, the originally approved NAVSHIPS settlement procedures have been effectively perverted, with the result that the legal memorandum of entitlement is being used to justify, after the negotiation, the dollar figure negotiated, rather than have this basic document form the basis of what can legally be negotiated and hopefully substantiated.*

6. Information Desired Regarding Procedures Followed by NAVSHIPS in the Negotiation of Subject Claim Settlements.

a. In order to establish for the record precisely what was done, the following information is requested:

(1) What was the date of the Command Dicision for the Lockheed DE 1052 and LPD claim?

(2) What was the amount of that decision?

(3) Was there *any sort* of legal memorandum of entitlement in writing and available to the COMNAVSHIPS on that date? If yes, please provide a copy.

(4) On 29 January 1971 when agreement with Lockheed was reached, was there in being and available to COMNAVSHIPS, a finalized legal memorandum of entitlement covering the DE 1052's and the LPD's? If yes, please provide a copy.

(5) Why has no legal memorandum of entitlement for the LPD portion of the Lockheed proposed settlement been submitted to the CCCSG six weeks after the incomplete business clearance was submitted on 25 March 1971 and three months after negotiations were concluded?

(6) What was the date of the Command Decision for the Avondale claim?

(7) What was the amount of that decision?

(8) Was there *any sort* of legal memorandum of entitlement in writing and available to the COMNAVSHIPS on that date? If yes, please provide a copy.

(9) On 2 December 1970, when agreement with Avondale was reached, was there in being and available to the COMNAVSHIPS, a finalized legal memorandum of entitlement? If yes, please provide a copy.

(10) Why has no business clearance with legal memorandum of entitlement been forwarded to the CCCSG five months after agreement was reached on 2 December 1970?

b. In connection with the above requested information, paragraph 1.9.(2) of reference (d) states in part as follows:

"2. As stated above, the claims [Lockheed] were processed in accordance with procedures previously furnished to NAVMAT. Under those procedures the pre-negotiation position (Command Position) is determined on the basis of the *facts developed by each member of settlement team.* These findings of fact are, however, *in preliminary draft form* and are not formalized as completed documents at that time." (Italics added)

The lawyer assigned to each claim settlement team by NAVSHIPS is obviously a member of that team within the meaning of the above quote; and if this quoted statement is entirely accurate and not something else, a preliminary draft form of the team lawyer's input was available to the Commander, NAVSHIPS at the time he decided the Command Position in both the Lockheed and Avondale cases and should be readily available as requested.

7. *Refusal by NAVSHIPS to Furnish Certain Requested Information Pertaining to the Lockheed Proposed Settlement*

a. References (a), (b) and (c) requested that certain additional information relating to the Lockheed proposed settlement be provided. Paragraph 5 of reference (b) states as follows:

"It is appalling that for a sixty-two million dollar proposed claim settlement, NAVSHIPS would permit business clearances of three pages each, to be submitted for review, and clearly indicate that if anyone wants rationale, documentation, etc., go and dig it out yourself from some voluminous exhibit or attachment. This type of business clearance is an insult to any reviewing authority in an ordinary claim case but in the Lockheed case one would think the Commander, Naval Ship Systems Command would insist upon the fullest and most complete discussion and documentation in the business clearance."

In reply, paragraph 1.c. of reference (d), the Commander, NAVSHIPS again tells the CCCSG members to go dig out of the exhibits what they want and that the requested full discussion of the proposed settlement in the business clearance would be redundant. Imagine, if one can, any reviewing court, board or group being denied a brief or similar document, fully outlining and discussing the issues presented for review and the course of action recommended.

b. Paragraph 8 of reference (b) repeated the previously made request for the written views by the cognizant SUPSHIP concerning the proposed settlements. Paragraph 1.e.(2) of reference (d) states as follows:

"COMNAVSHIPS does not consider the request of reference (a) for the written views of the Supervisor of Shipbuilding to be appropriate."

c. These two requests by the CCCCG and refusals by COMNAVSHIPS in reference (d) place the COMNAVSHIPS in a most untenable position.

d. The Commander, NAVSHIPS, either by reason of his present position and/or his previous positions in NAVSHIPS, is responsible for the existence of subject claims. Additionally, in his present position as COMNAVSHIPS, he is responsible for the revised settlement procedures which we now realize have emasculated the team lawyer's timely role in subject proposed claim settlements. Finally, COMNAVSHIPS personally took the leading part in the negotiations which culminated in the agreements reached with Lockheed and Avondale.

e. Now we find this same COMNAVSHIPS deciding what information he will or will not provide the CNM established claim settlement review group—the CCCSG—for purposes of their review.

f. *The refusal to obtain and provide the requested written views of the cognizant SUPSHIP on proposed shipbuilding claim settlements and provide full discussion of the proposed settlements in the business clearance submitted to the CCCSG is indefensible and regrettable. Who, other than the SUPSHIP should know as much about the merits of a claim from a yard under his cognizance? The fact that members of a claim settlement team set up in Washington draw upon the knowledge of the SUPSHIP is not enough, in the opinion of the undersigned.*

8. *The Role of the Legal Member of a NAVSHIP Claim Settlement Team*

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

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

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

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

c. Reference (d) reiterates the role of the negotiator and contracting officer but fails to indicate a realization that claim settlements are vastly different than procurement. It is suggested that this distinction be recognized and understood in the interest of future claim settlements by NAVSHIPS.

9. The information requested in paragraph 6. above will be appreciated.

GORDON W. RULE,
Chairman, Contract Claims Control and Surveillance Group

ITEM 2.—*July 23, 1971—Letter from Gordon W. Rule, to Commander, Naval Ship Systems Command disapproving a proposed settlement of Avondale claims on DE1052 and 1078 contracts*

DEPARTMENT OF THE NAVY,
HEADQUARTERS NAVAL MATERIAL COMMAND.
Washington, D.C., July 23, 1971.

From: Chairman, Contract Claims Control and Surveillance Group.
To: Commander, Naval Ship Systems Command.
Subject: Avondale Shipyards, Inc. Claims on DE 1052 and 1078 Contracts (NAVSHIPS Clearances SH 10969.1 and SH 10798.1).

1. Subject proposed claim settlements in the amounts of $25,620,000 and $47,900,000 respectively, were received by the Contract Claims Control and Surveillance Group (CCCSG) on 16 June 1971 for review action. These two claims were negotiated as a single package on 1 December 1970 for a combined total of $73.5 million of which $27.3 million represents unadjudicated changes and $1.6 million for warranty liability of Avondale on the seven ship 1052 contract.

2. Five different claim proposals were filed beginning in January 1969 on the seven ship DE 1052 contract and three on the twenty ship DE 1078 contract beginning in September 1969. The various proposals add items and dollars, shift the theory of the claims and were prepared by a special claim team composed of the vom Baur law firm and accountants from Arthur Anderson and Company, rather than by Avondale's regularly retained counsel and accountants.

3. The basis of the CCCSG review of this proposed settlement has been the contents of the business clearances, the TAR's (Technical Advisory Reports), the AAR's (Advisory Audit Reports), the Memoranda of Legal Entitlement, all documents submitted with the clearances, conferences with the special negotiating team members, the Resident DCAA Auditor, the Project Manager and others.

4. The object of the CCCSG review was not to determine what the claim settlement amount should be—ours is a review function, not a negotiating function—but to determine if the $73.5 million figure negotiated by COMNAVSHIPS has (i) complete substantive merit and (ii) is adequately supported by evidential demonstration. The best interests of the government and the taxpayers so dictate. These tests of substantive merit and adequate evidential demonstration are by design rugged tests to meet, especially when applied to claims against the government that have been ascertained, prepared, brochured and processed by highly paid special claim nurturing legal and accounting combines.

5. Before these two tests can be objectively applied and results evaluated however, it is necessary to ascertain certain basic facts in any claim review. These required facts are as follows:

a. What is the objective sought by the claimant?

Answer: Page 16 of Audit Report No. 103–03–0–0634 on the 1052 claim contains the following statement: "Contractor personnel candidly admit that the concept for determining the hours and amounts claimed was based on the premise of repricing the total contract labor by estimating the total hours and costs at completion of the contract less the value of the basic contract plus adjudicated change orders." The object of a claim should be the identification and payment of those additional *costs* incurred, or to be incurred, by the contractor which are demonstrably caused by government action or inaction. Thus, the theory of this contractor's claim is contra to what it should be with consequent difficulty to the ascertainment of reasonable governmental responsibility and liability.

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

Answer: The team engineer has testified there is such evidence.

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

Answr: The DCAA reports complain of generalities and estimates with supporting data NOT prepared but in the "brains" of the engineers.

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

Answer: The basic areas in the 1052 claim stayed relatively constant while the areas in the 1078 claim did not. As one claim theory would get shot down a new proposal would shift to a new theory on the 1078 claim. Indeed the original five volume Avondale 1078 claim proposal for $97,871,956 was characterized by the COMNAVSHIPS in a letter to the contractor dated 9 April 1970 as "not supportable", "erroneous", "no basis in fact, for the claim that late GFE had impacted your building schedules", "the claim of damage in such a circumstance appears to be spurious and unwarranted."

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

Answer: The claimant has refused to prepare certain manhour breakdowns requested by the engineer and required the DCAA personnel to deal only through the specially retained Arthur Anderson and Company claim accountants.

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

Answer: The claimant has definitely not carried the burden of proof of his claimed items, particularly in the areas of alleged ripple effect of government actions relating to the 1052 contract over to the 1078 contract and shock and dynamic analysis.

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

Answer: None whatsoever. On the contrary, it appears that claimant was building a claim on the 1078 contract long before the claim was submitted in September 1969.

h. Has the claimant been responsible for bringing unreasonable outside pressures on the Navy for the settlement of these claims?

Answer: The claimant has not only threatened to do so but has actually done so to such an unreasonable extent that one begins to wonder about merits of the claim.

i. Has claimant threatened to stop work?

Answer: Yes, in writing.

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

Answer: There is clear evidence that the contractor's claim for alleged ripple effect on the 1078 contract was documented by the team engineer—not the contractor.

6. The factual answers to the above questions recreate the climate in which the claim was prepared, investigated, processed and negotiated. These factual answers also impacted the credibility of the claim which was considered by the CCCSG in reaching a final decision.

7. The negotiated figure of $73.5 million for both claims cannot be approved by the CCCSG if any of the principal elements making up that figure fail the two basic claim tests set out in paragraph 4 above. After removing the unadjudicated change order amounts—which actually should not be a part of this claim settlement proposal—from both the 1052 and 1078 claims and the amount for warranty liability in the 1052 contract from the $73.5 million figure there remains $44.6 million of claim dollars.

8. The largest dollar items that make up this $44.6 million remaining claim figure are approximately as follows:

a. Shock and Dynamic Analysis on 1052, $3.9M.
b. Shock and Dynamic Analysis on 1078, $6.4M.
c. Escalation on 1052, $3.59M.
d. Escalation on 1078, $6.541M.
e. Profit on 1052, $2.09M.
f. Profit on 1078, $5.784M.
g. Ripple Effect on 1078, $6.181M.

9. As the result of individual and collective analysis, discussion, and consideration of all information received in support of the proposed settlement of $73.5 million and pursuant to the charter of the proposed settlement of $73.5 million and pursuant to the charter of the CCCSG, the undersigned Chairman of the CCCSG determines as follows:

a. The amount proposed for payment to Avondale for shock and dynamic analysis on the 1078 contract for twenty ships lacks evidential documentation.

b. The proposed profit allowances on both the 1052 and 1078 claims as computed on DD Form 1547 cannot be justified—especially in view of the poor quality of the 1052 ships.

c. The escalation dollars contained in the proposed settlement result from a theory contrary to the escalation formula contained in the contracts, which different theory is clearly designed to pay the contractor more dollars than the contracts provide and is not supported by evidential documentation as being in the best interests of the Navy.

d. The amount contained in the proposed settlement for so-called ripple effect of government action relating to the 1052 contract, alleged to carry over to the 1078 contract, is entirely without evidential documentation. This particular element of the contractor's claim is theoretically enticing and interesting but quite specious in actuality, as sought to be made a major element of the 1078 claim. The CCCSG cannot and will not approve payment of many millions of dollars to any contractor on the basis of information presented which does not fully support this element of cost entitlement.

e. The sample concept employed in the 1052 claim, whereby 70 of the 147 claim items were evaluated in-depth, with the resulting percentages of allowance applied to the non-sampled items is not sound claim settlement procedure. Obviously, the sample technique serves to expedite analysis and TAR preparation, but claims against the government and the taxpayer had best suffer prolongation of resolution than fall victims of undue haste and questionable evaluation. The message must be transmitted to all claim minded contractors and individuals that there is no short cut to their burden to prove every dollar claimed.

10. Accordingly, subject business clearances for the settlement of the Avondale claims against the Navy 1052 and 1078 contracts, in the total amount of $73.5 million, are disapproved and returned to NAVSHIPS with the recommendation that a contracting officer's decision be made which will require the contractor to prove to the satisfaction of the ASBCA or GAO every dollar of entitlement for action or inaction resulting in increased costs, alleged to be the responsibility of the government under both the 1052 and 1078 DE contracts. The $27.3 million for unadjudicated changes on both contracts may be susceptible of a separate approval by NAVSHIPS.

11. The above determinations and action of the Chairman of the CCCSG are unanimously concurred in by the membership of the CCCSG and Counsel to the CCCSG.

12. That some increased cost on the seven ship 1052 contract is the responsibility of the government is not disputed. Likewise some small portion of the claimed increased cost on the 1078 contract. The contractor however—or rather the contractor's professional claims purveyors—have, in their presentations to the Navy, so intermingled those elements of the claims that have merit with those elements which are wholly without merit, that the burden of proof should be placed squarely upon them to prove every dollar to which they feel or contend they are entitled.

GORDON W. RULE,
Chairman, Contract Claims Control, and Surveillance Group.

ITEM 3.—*July 30, 1971—Gordon W. Rule memorandum for Commanders of various Naval Systems Commands stressing the need for a memorandum of legal entitlement, technical and audit analysis of claims*

DEPARTMENT OF THE NAVY,
HEADQUARTERS NAVAL MATERIAL COMMAND,
Washington, D.C., July 30, 1971.

Memorandum for Radm T. R. McClellan, Commander, Naval Air Systems Command; Radm J. E. Rice, Commander, Naval Electronic Systems Command; Radm W. M. Enger, Commander, Naval Facilities Engineering Command; Radm M. W. Woods, Commander, Naval Ordnance Systems Command; Radm N. Sonenshein, Commander, Naval Ship Systems Command; Radm K. R. Wheeler, Commander, Naval Supply Systems Command.

Subject: Claims against the Navy requiring review by the Contract Claims Control and Surveillance Group (CCCSG)—Guidance concerning.

Reference: (a) Charter for CCCSG dated 20 October 1969.

1. Paragraphs 4(e) and (f) of reference (a) authorize the Chairman of the CCCSG to prescribe the form and scope of pre and post negotiation business clearances on claims and to provide guidance and assistance to the Systems Command and their delegated representatives in connection with the processing of claims.

2. Pursuant to that authority, enclosure (1) is forwarded for guidance and assistance in the preparation and processing of claims business clearances. Enclosure (1) is the first major claims clearance to be disapproved by the CCCSG and the contents of the disapproval may be helpful to the Systems Command.

3. Enclosure (1) provides the general format for future action decisions eminating from the CCCSG and special attention is invited to the two basic tests set out in paragraph 4 and some of the collateral facts to be determined, as set out in paragraph 5.

4. The questions posed by paragraph 5(a), (c) and (e) of enclosure (1) are required knowledge by members of a claim team within a Systems Com-

mand and also the reviewing activity. For example, with respect to the claims covered by enclosure (1) the file shows that the president of the company involved made the following comments to the Secretary of the Navy on 27 October 1969:

"Mr. Carter complained that the claims review team was asking too many questions and that they did not understand the reason for all the legal and contract personnel involved in the contract and that they were ready to sit down and *negotiate. Mr. Carter stated that the way to settle the claim was to negotiate on a broad picture judgment rather than trying to assess a monetary value to each event or detail.* He stated that this might take as much as a year and that Avondale was not able to show the impact on each event taken individually."

Patently, when faced with this kind of personal and corporate mentality regarding multimillion dollar claims against the Navy, the danger flag is up and extraordinary caution is clearly indicated.

5. It should be noted that the determinations contained in paragraph 9 of enclosure (1), in this particular case, are entirely *substantive in nature, as distinguished from procedural.* Because of the abundance of substantive deficiency in this case, it was unnecessary to base the negative decision on procedural deficiencies or irregularities.

6. Obviously, review action should be bottomed—if at all possible—on *substantive grounds.* This is not to say however, that the required procedural aspects of analyzing, negotiating and reviewing claims are not important. *Indeed, the failure to follow required procedures can be grounds for disapproval of a claim clearance. For example, in the claims covered by enclosure (1) the ComNavShips personally negotiated the settlement figure without having any written memorandum of legal entitlement, without having a completed technical or audit report and without the DCAA audit people ever having seen the technical report. In short, a figure was negotiated and then it took over six months work attempting to justify that figure with the written legal, technical and audit data that are required to be in existence prior to negotiations.*

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

8. Additionally, *in the future of the CCCSG will not accept a claim clearance on shipbuilding contracts unless accompanied by a thorough analysis and recommendations from the cognizant SupShip of the claim or claims. The omission of this supporting information on shipbuilding claims will be considered a fatal defect.*

9. A further procedural irregularity noted by the CCCSG is that of the contracting officer or others circumscribing the DCAA audit review. This practice will not be tolerated by the CCCSG. *Every bit of advice and assistance —without reservation—is required to properly analyze and evaluate a claim* and to tell the auditor to confine his review to labor rates and overhead is unacceptable and may lead to delay while the auditor is permitted to perform his normal review of the claim and the technical report.

10. Finally the following guidelines for settlement of delay claims have recently been provided by the GAO.

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

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

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

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

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

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

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

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

11. It may be helpful to the Systems Comands to be aware of what the undersigned has written regarding the role of the lawyer in claims.

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

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

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

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

Reference (d) reiterates the role of the negotiator and contracting officer but fails to indicate a realization that *claim settlements are vastly different than procurement.* It is suggested that this distinction be recognized and understood in the interest of future claim settlements by NAVSHIPS."

12. There is clear evidence in the enclosure (1) case, that *the Navy strained to find adequate justification for an already negotiated figure. Assisting a claimant in any manner whatsoever to substantiate or document a claim against the Navy should be grounds for disciplinary action. If a claimant cannot carry the burden of proving his own claim, that claim should be returned rejected rather than direct or permit Navy personnel to work full time trying to make the contractor's claim for him.*

13. It is hoped the above will be beneficial to the SysComs and please do not hesitate to call upon us for any assistance we can provide.

GORDON W. RULE,
Chairman, Contract Claims,
Control and Surveillance Group.

ITEM 4.—*Sept. 6, 1971—Jack Anderson article entitled "Navy Almost Taken: Millions More Asked for Ships"*

WASHINGTON—We recently told how four congressional leaders helped badger the Navy for $73.5 million in unsubstantiated claims.

Henry "Zack" Carter, the genial president of Avondale Shipyards, claimed the Navy owed him more money for 10 destroyers he had built. Yet he cavalierly refused to furnish the required proof.

Nevertheless, he almost squeezed $73.5 million out of the Navy—thanks to the political wallop of House Armed Services Chairman F. Edward Hebert, House Majority Leader Hale Boggs, Senate Appropriations Chairman Allen

Ellender and Senate Finance Chairman Russell Long, all Louisiana Democrats.

Only the stubborn opposition of a civilian watchdog, Gordon Rule, kept the Navy from paying the unproved claims. Now Sen. William Proxmire, D–Wis., the scourge of the Pentagon, has taken an interest in the case and will hold hearings.

Meanwhile, we have studied a sheaf of highly secret Navy memos, which charge:

The Louisiana shipyard purposely underbid to get the contract for the destroyers, then hit up the Navy for an additional $151 million. This was trimmed down to $73.5 million, which the Navy was about to pay before Rule intervened.

The Navy privately helped Avondale to document some of its claims, which is a little like the prosecutor helping the defendant prepare his case.

It will take at least a year's paperwork before the Navy can weed the legitimate from the unwarranted claims. Yet Avondale brought "unreasonable outside pressures on the Navy" for a quick settlement.

Although 7 of the 10 destroyers are "poor quality," Avondale has insisted on making a handsome profit on them.

In a secret report dated last July 23, Rule explained bluntly why he wouldn't approve the claims. Avondale, he wrote, "has refused to prepare certain manhour breakdown." The contractor "has definitely not carried the burden of proof of his claimed items." Indeed, some claims are "spurious and unwarranted."

At least one claim was documented, but Rule charged: "There is clear evidence that the contractor's claim * * * was documented by the (Navy) engineer—not the contractor."

After underbidding to get the contract, the shipyard would file large claims, then "threaten to stop work" until the claim was paid, Rule alleged.

"As one claim theory would get a showdown, a new proposal would shift to a new theory," he reported. Avondale's arguments were "prepared, brochured and processed by highly paid special claim-nurturing legal and accounting combines."

Rule's conclusion: *"The message must be transmitted to all claim-minded contractors and individuals that there is no short cut to their burden to prove every dollar claimed."*

Rear Adm. Nathan Sonenshein, the Naval Ships commander, seemed more impressed with the congressional pressure than with Rule's objections. He assigned a deputy, Rear Adm. K. L. Woodfin, to review Rule's report.

But Woodfin, a tough salt trained under vinegary Adm. Hyman Rickover, submitted not a whitewash but a verification of Rule's finding. Woodfin agreed that Avondale's claims were "inadequate * * * unsound * * * inconsistent * * * unsupportable * * * limited * * * deficient * * (and) lack of substantiation."

Footnote: Admiral Sonenshein said he endorsed the $73.5 million settlement not because of the political presusre but because Avondale was in "serious financial straits" and the Navy needed the ships. "Zack" Carter politely declined any comment. And Rule, just as hot on the telephone as he is in his memos, demanded to know: "How in the hell did you get that thing? Let the record show it didn't come from me." It didn't.

ITEM 5.—*Apr. 20, 1972—Wall Street Journal article entitled "The Claimsmanship Game"*

Former Deputy Defense Secretary David *Packard last month issued a plaintive appeal for reform in the manner the Pentagon does business with defense contractors.* He addressed himself to the way contractors buy into contracts and the way they are bailed out after they get into difficulties: *"We are going to have to stop this problem of people playing games with each other. Games that will destroy us, if we do not bring them to a halt."*

Sen. William Proxmire, chairman of the Joint Economic Committee of Congress, has been conducting hearings on the military procurement system, and the House Armed Services Committee this week has been examining specific contract controversies. One case examined at length by Sen. Proxmire's committee has been especially rvealing and to the point, indicating a need for reform clearly exists.

It involves *Avondale Shipyards*, Inc., a division of the Ogden Corp., which a decade ago contracted with the Navy to build seven destroyer escorts for $81.8 million. Two years ago, Avondale put in a *claim for another $158.3 million* it said would be needed to complete the ships. A year ago, the Navy negotiated a *tentative settlement of $73.5 million on this claim.*

That should have ended it, except for a civilian claims review group under Gordon W. *Rule*, the Navy's civilian director of procurement control. The Avondale settlement was the first the Rule group *refused to recommend* in its three years of existence. It argued the claim lacked substantiation. Whereupon the Avondale-Ogden lobby campaigned to get the $73.5 million anyway. The Louisiana congressional delegation—a mighty group that includes the chairmen of the Senate Appropriations and Finance committees, the chairman of House Armed Services Committee, and the House Majority Leader—put the pressure on.

Mr. *Rule publicly complained about this congressional interference*, without success. First, the Navy Material Command peeled off $23.5 million to keep the ships abuilding while negotiations continued. *Then*, when Admiral I. C. Kidd took over the Command, *the company announced it had stopped work on the ships and wouldn't proceed until it got more money.* Mr. Rule pleaded with the admiral to resist, to hold Avondale to its contract. But the admiral finally said the *Navy* needed the ships, and *peeled off another $25* million. *Avondale went back to work.* Mr. Rule, told his group was going to be "reorganized," resigned from it.

It would be useless now to criticize the personalities involved in this Avondale affair and hope that next time they would try harder to serve the public interest. Clearly, the system itself has to be changed, as Mr. Packard so strongly argued.

Sen. Proxmire thinks he sees a solution: Take procurement away from the Pentagon and create a separate civilian agency to handle the contracting and claims settlement for the military. Then, at least the service chiefs—who go caps in hand to Congress for weapons and manpower—will not be put in the position of having to say "no" to a member of Congress when asked to "expedite" a claims settlement.

It may yet come to that. But there should be less severe moves that could have the same effect. Mr. Rule, for example, suggests that instead of horse-trading on claims, the Pentagon should independently assess the worth of a claim, accept it, reduce it, or reject it. If the contractor is dissatisfied, he would have to go through an appeals process carrying the burden of proof. Throughout, Mr. Rule proposes treating these claims "as an adversary proceeding just like a case in court."

He would also invest those proceedings with the stature and dignity of litigation. "There should be a canon of ethics in the Bar Association," he says, "that should preclude lawyers running to Congress, calling up the Secretaries, doing a lot of things they wouldn't do for a case in court." He suggests a similar rule for the House and Senate, making it "improper for members of Congress as they are doing today to call constantly, to have meetings, call people up to the Hill, go down and sit with the Secretary, to talk about claims while they are being adjudicated."

These are reasonable proposals. Not that they would eliminate all the jockeying for advantage bound to take place where big contracts are at stake, but they would at least be a good start toward some reasonable rules for the claimsmanship game.

ITEM 6.—*June 14, 1973—Contracting Officer's decision in the Lockheed case involving DE1025 and Amphibious Transport Dock (LPD) shipbuilding contracts. (A copy of the decision is included in the Miscelleaneous Documents appendix)*

ITEM 7.—*Sept. 5, 1973—Defense Space Daily article entitled "Proxmire Charges Admiral With Gross Misfeasance"*

Sen. William Proxmire (D–Wis.) has charged Rear Admiral Nathan Sonenshein with "gross misfeasance" in the settlement of a Lockheed shipbuilding claim during the period when Sonenshein was in charge of the Naval Ship Systems Command.

Proxmire and Sonenshein agreed in 1971 to settle for $62 million, claims filed by Lockheed in 1968 and 1969 totaling $158 million above the agreed contract prices for 5 destroyer escorts and 7 amphibious transport dock ships "despite the fact that the normal evaluations which should be performed prior to settlement of a claim against the government had not been completed at the time."

Following his settlement decision, Sonenshein, Proxmire said, authorized provisional payments to Lockheed totaling $49 million although "there had been no audit of the claim, no technical evaluation and no memorandum of legal entitlement." Recently, Proxmire said, the Navy's contracting officer formally decided to pay only $6.8 million on the Lockheed claim, or "about 14 percent of what the admiral actually had the Navy pay out."

Proxmire said he was formally requesting the Navy take disciplinary action against Adm. Sonenshein and that an investigation be conducted "to determine whether fraud was committed in the filing of the claim."

ITEM 8.—*Sept. 23, 1973—Senate speech by Senator Proxmire entitled "The Lockheed Shipbuilding Claims Affair—I"*

Mr. PROXMIRE. Mr. President, 2 years ago Rear Adm. Nathan Sonenshein, as head of the Naval Ship Systems Command, personally negotiated a $62 million tentative settlement of several shipbuilding claims filed by Lockheed Shipbuilding and Construction Co. In 1968 and 169 Lockheed had presented the Navy with claims totaling $158 million for five destroyer escorts and seven amphibious transport dock ships. Recently the Navy, after a thorough review of the claims and the tentative settlement entered into by Admiral Sonenshein, made a formal determination to pay only $6.8 million of the $158 million originally claimed by Lockheed.

The Navy's final decision in this case raises serious questions about Admiral Sonenshein's decision to enter into a tentative settlement for $62 million and about the legitimacy of major portions of Lockheed's claims. I am convinced from the testimony that has been given before the Subcommittee on Priorities and Economy in Government and other facts surrounding this matter, that Admiral Sonenshein was guilty of gross misfeasance in entering into the tentative settlement and in authorizing the payment to Lockheed of provisional pyaments on the claims. As a result of Admiral Sonenshein's actions $49 million in provisional payments were actually paid out to Lockheed.

DISCIPLINARY ACTION NEEDED

I am therefore formally requesting that the Navy take disciplinary action against Admiral Sonenshein and that an investigation be conducted to determine whether fraud was committed by Lockheed in the filing of the claim.

My suspicions about the tentative settlement were first aroused when I learned that Admiral Sonenshein had agreed to it despite the fact that the evaluations which should be performed prior to settlement of a claim had not been completed at the time of his decision. Normally, at least three critical steps are taken before tentative settlements are entered into on major shipbuilding claims. First, a team of experts makes a technical evaluation of the claim. Second, an audit is performed. Finally, the General Counsel prepares a memorandum of legal entitlement.

NO BASIS FOR TENTATIVE SETTLEMENT

None of these steps had been completed at the time of Admiral Sonenshein's decision that Lockheed's claim was worth $62 million. There had not been a complete technical evaluation of the claim, there had not been an audit, and no memorandum of legal entitlement had been prepared. On what basis then did Admiral Sonenshein decide that the claim was worth $62 million? And on what basis did he authorize provisional payments to be made to the contractor while the Navy was still reviewing the claim?

This question was given greater force by the most recent decision by the Navy that the claim was worth only $6.8 million rather than $62 million. I want to quote passages from the contracting officer's letter to Lockheed informing it of his decision to explain why my earlier suspicions about Admiral Sonenshein's activities have now been confirmed.

According to the contracting officer, Lockheed denied his authorized representatives access to much directly relevant cost and pricing data, refused to disclose information to support the claims, and failed to cooperate with the Navy.

FACTUAL INADEQUACIES AND LACK OF SUBSTANTIATION

In 1971 Admiral Sonenshein submitted the proposed $62 million settlement for approval to the Contract Claims Control and Surveillance Group, the duly constituted reviewing authority for such claims. The Surveillance Group, as the contracting officer points out in his decision, after several weeks of review and deliberation concluded that the proposed tentative settlement "could not be approved because of factual inadequacies" in the area of legal entitlement and because of a "lack of substantiation of quantum with respect to the entire claim."

LOCKHEED WITHHOLDS INFORMATION

Subsequently, a team was set up in the Navy to try to obtain substantiation of the proposed settlement but for the most part Lockheed "declined to disclose information "relevant to the support and substantiation of these claims."

The following excerpts from the contracting officer's letter give further emphasis to the lack of cooperation on the part of the Lockheed Shipbuilding & Construction Co., referred to as LSCC:

"In support of its allegations, LSCC has submitted little or no historical cost, production and management data to substantiate its estimates. The contracting officer and his authorized representatives have requested relevant historical cost, production and management information but, with rare exceptions, such information has not been provided. The last such request was made on 20 March 1973, at which time the Navy stated its preliminary position in writing to LSCC on each of the claim allegation issues and requested any additional comments or available supporting data LSCC might have. LSCC has not responded to the Navy position or request."

Again, the contracting officer voices his complaint over Lockheed's uncooperative attitude and its unwillingness to give the Navy full access to the information necessary to determine the real value of the claim:

"All ships procured under the instant contracts have been delivered; cost, performance and management data is now historical and should have been used to price the requested equitable adjustments. LSCC has effectively refused to use all of the available data, and, in fact, has denied authorized representatives of the contracting officer access to much directly relevant cost and pricing data."

PROVISIONAL PAYMENTS DESPITE LACK OF SUBSTANTIATION

These facts cast a dark shadow over Admiral Sonenshein's decision to pay $62 million for this claim. If he had no completed technical evaluation, no completed audit and no completed memorandum of legal entitlement, and if the claim itself contained factual inadequacies and lacked substantiation, and if Lockheed would not even cooperate with the Navy, or allow access to such cost and pricing data, then on what basis did Admiral Sonenshein decide that the Navy should pay $62 million for this claim? And on what basis did he authorize that $49 million actually be paid over to Lockheed as provisional payments on the claim?

Lockheed has appealed the Navy's decision to pay only $6.8 million to the Armed Services Board of Contract Appeals. While the appeal is pending Lockheed will retain the $49 million already paid. If it loses the appeal or is required to refund all or any part of the $49 million it will probably not have to pay interest on the unearned portion from the time the payments were received to the date of the contracting officer's decision. It can also be anticipated that pressures to allow Lockheed to keep the $49 million will build up as the case nears completion. There may very well be an effort to bail out Lockheed, as has been done before, rather than endanger the company's financial condition by requiring it to pay back the $49 million.

GROSS MISFEASANCE

The evidence shows beyond any doubt that Admiral Sonenshein's actions amounted to gross misfeasance and that he failed to properly exercise his responsibility over the taxpayer's money entrusted to him.

These are sad times for the Government and for the Department of Defense. Scandals are being uncovered with unprecedented frequency. The public is losing confidence in and respect for its own Government. One way for the Government to win back confidence and respect is to correct abuses that have been uncovered and to take appropriate action against responsible officials.

NAVY SHOULD INVESTIGATE POSSIBILITY OF FRAUD

The Navy is to be commended for its final decision on the Lockheed claim. But it needs to take two additional steps. I urge the Navy: (1), to clean its own house in the matter of Admiral Sonenshein and the Lockheed giveaway; and (2), to investigate the possibility that the claim was based on fraudulent representations.

I ask unanimous consent, to print in the Record the full text of the letter dated June 14, 1973, from the Navy contracting officer to Lockheed informing it of the Navy's final decision.

[The letter follows:]

DEPARTMENT OF THE NAVY,
Washington, D.C., June 14, 1973

LOCKHEED SHIPBUILDING AND CONSTRUCTION CO.
Seattle, Wash.

GENTLEMEN: 1. In November 1968 and in January and February 1969 Lockheed Shipbuilding and Construction Company (hereafter LSCC), formerly the Puget Sound Bridge and Drydock Company, initially submitted consolidated claims for equitable adjustments under four Bureau of Ships (currently Naval Ship Systems Command, or NAVSHIPS) contracts, NOBs–4785, NObs–4660, NObs–4765 and NObs–4902. The amounts claimed have been revised several times; the most recent revision being that accompanied by DD Forms 633–5 dated May 5, 1971, for a cumulative amount of $139,572,006. Other LSCC correspondence at various times stated these claims in an amount totaling as much as $158,018,440.

2. The DE 1052 Contract and Claim. Contract NObs–4785 is for the construction of five DE 1052 class ocean escort vessels. It was awarded to LSCC on July 22, 1964 as a result of formal advertising. The solicitation provided for a split award. LSCC was fourth low bidder; the three lower bidders received contracts for seven other DE 1052 class vessels each, with a balance of five vessels awarded to LSCC. Contract NObs–4785 had an initial fixed price of $60,285,000 and also provided for escalation; its specified original and amended delivery dates are as follows:

Vessel	Original delivery date	Amended delivery date [1]	Actual delivery date
DE–1057	September 1968	May 1970	May 8, 1970
DE–1063	December 1968	June 1971	June 22, 1971
DE–1065	March 1969	December 1971	Dec. 30, 1971
DE–1069	June 1969	April 1972	Apr. 28, 1972
DE–1073	September 1969	August 1972	Aug. 11, 1972

[1] Bureau modification No. 3 of Feb. 8, 1965, extended these 5 vessels' delivery dates each for 5 months because of late delivery of Government-furnished equipment, viz: AN/SQS–26 sonars. Subsequent modification Nos. A–239 of July 3, 1967, and A–556 of Feb. 27, 1970, made further extensions resulting in the final amended delivery dates enumerated bove, but reserved the parties' rights as to respective responsibilities for that balance of the vessel delays.

3. Since the DE 1052 class vessels constitute a new vessel class for which previous DE working plans were inapplicable, NAVSHIPS, on December 6, 1963, awarded Contract NObs–4715 to Gibbs & Cox, Inc., to prepare DE 1052 class working plans and other data. The DE 1052 vessel construction solicitation (which resulted in the split award to four shipyards) advised bidders of the lead ship (DE1052) construction contact, the lead ship builder—which turned out to be Todd Shipyards Corporation, Seattle—was to subcontract to Gibbs & Cox for the NObs–4715 work, whereafter NObs–4715 was to be nullified. The DE 1052 vessel construction solicitation also informed bidders that on lots excluding vessel DE 1052 the standard NAVSHIPS working plan practice would be followed, namely, that such other construction contractors could either purchase working plans at the cost of reproduction from the lead ship builder or they themselves could prepare their own working plans.

4. On November 19, 1968, LSCC submitted a claim for a $30,783,460 equitable adjustment under Contract NObs–4785; by May 5, 1971, that amount had been revised to $45,181,080.

5. The LPD Contracts and Claims. The last three contracts enumerated in paragraph 1 are for the construction of amphibious transport dock (LPD) vessels, and were awarded as follows:

Contract No.	Vessels	Date awarded	Price	Method	Claims
NObs–4660	LPD 9 and 10	May 23, 1963	$50,445,000	Negotiated [1]	35.1M
NObs–4765	LPD 11, 12, and 13	May 15, 1964	69,774,000	Formal Adv	31.1M
NObs–4902	LPD 14 and 15	May 17, 1965	48,395,000	Formal Adv	28.2M

[1] Awarded without discussion on basis of initial price. All 3 contracts are fixed price with escalation.

6. The original and amended contract delivery dates, and the actual delivery dates, for these LPDs are:

Contract No. and vessel	Original contract date	Amended contract date	Actual delivery date
NObs–4660: LPD–9	Sept. 30, 1966	Oct. 18, 1968 [1]	Oct. 18, 1968
NObs–4660: LPD–10	Dec. 31, 1966	July 7, 1969 [1]	July 7, 1969
LPD–11	Apr. 15, 1967	May 1970 [2]	May 15, 1970
NObs–4765: LPD–12	July 15, 1967	Dec. 1970 [2]	Dec. 4, 1970
NObs–4765: LPD–13	Oct. 15, 1967	Dec. 26, 1969 [2]	Dec. 26, 1969
NObs–4902: LPD–14	June 17, 1968	Feb. 1917 [3]	Feb. 12, 1971
NObs–4902: LPD–15	Sept. 17, 1968	June 1971 [3]	June 25, 1971

[1] By NObs–4660 modification No. A–738 of Mar. 9, 1970.
[2] By NObs–4765 modification No. A–737 of Mar. 16, 1970.
[3] By NObs–4902 modification No. A–499 of Mar. 9, 1970.

In none of the three foregoing modifications did the parties agree upon an apportionment of respective responsibilities for these delays in deliveries.

7. a. On January 20, 1969, LSCC submitted a claim for $24,151,451 under Contract NObs–4660; this amount was subsequently revised to $35,067,992 on May 5, 1971 on a DD Form 633–5 price proposal.

b. On February 6, 1969, LSCC submitted a claim for $24,991,341 under Contract NObs–4765; the May 5, 1971 revision increased this amount to $31,137,308.

c. On February 7, 1969, LSCC submitted a claim for $20,198,260 under Contract NObs–4902; the May 5, 1971 revision increased this amount to $28,185,626.

8. *The Course of Claim Investigation and Aborted Settlement Negotiations.* In February 1969, NAVSHIPS established a nucleus Special Task Force to investigate the three LPD claims. A different nucleus team was established to investigate the DE–1052 claim. Numerous visits to LSCC's Seattle facility were made in the course of these investigations. Commencing in December 1970 the parties sought to negotiate a settlement of these four claims. The following subparagraphs describe the events relating to the abortive settlement negotiations:

a. By Revision No. 7, of January 30, 1970, to the Navy Procurement Directives, a new paragraph 1–401.55 was added. It established requirements that NAVSHIPS (among other Navy activities) report major claims and obtain the approval of the Assistant Secretary of the Navy (Installations and Logistics) before making any commitment to a claimant on a settlement exceeding $5,000,000.

b. On December 30, 1970, then Deputy Defense Secretary Packard wrote to Senator John Stennis that,

" * * * the remaining claims (referring to Lockheed's LPD and DE 1052 claims), totaling $159.8 million, have been the subject of intensive negotiations between the Navy and Lockheed. To settle these claims, the Navy has offered Lockheed $58 million. I am hopeful that a settlement of these claims can be reached. Generally speaking, all negotiations regarding this program have also been concluded. The single remaining issue is Lockheed's acceptance of this offer."

c. On January 5, 1971, Lockheed wrote to Mr. Packard:

"With reference to the ship construction claims, we are not prepared to accept the Navy offer of $58 million. It is our belief, however, that if both parties continue to pursue negotiations diligently a mutually acceptable solution can be achieved within a reasonable period of time."

d. Negotiations continued and on January 29, 1971, a final negotiating meeting was held with Rear Adm. N. Sonenshein, Capt. A. Holfield and Mr. R. Bates representing NAVSHIPS and Mr. R. Osborn and Mr. A Folden representing LSCC. A tentative settlement agreement of $62 million was reached with the understanding that it was subject to required approval of higher authority. For reasons detailed below such approvals were never received.

e. On February 1, 1971, Lockheed President D. J. Houghton wrote to Lockheed shareholders: " * * * last week we reached *tentative* agreement with the Navy to settle our ship construction claims for $62 million . . ." (emphasis added).

f. In a NAVSHIPS memorandum to the Assistant Secretary of the Navy (Financial Management) dated February 12, 1971, the Acting Commander, NAVSHIPS, stated:

"b. Tentative settlement—$62 million.

"c. Provisional price increases made to date against these claims total $28.4 million.

"d. Additional provisional price increases of $21 million are in process. Provisional increases require documentation in the form of technical analysis, audit verification and legal determinations to safeguard the Government's interests, and NAVMAT approval in accordance with NPD 1–401.55(e). Hence, the authorization of provisional increases involves essentially all the steps required in final settlement.

"e. Final Settlement Date—15 March 1971. This date is largely theoretical. It is based upon completion of the extensive documentation required for each of the four contracts involved (including finalization of the Technical Advisory Reports (TAR's), DCAA final audit reports and formal legal memoranda) and submission of the post-negotiation business clearance by 10 March 1971 to NAVMAT and ASN (I&L) for approval in accordance with NPD 1–401.55 * * * ."

g. On February 24, 1971, NAVSHIPS and Lockheed executed a modification to the four contracts involved in these claims for the LPDs and DE 1052s, to provide Lockheed provisional price increases on account of the claims. The modification states unequivocally that the settlement agreement of $62,000,000 was subject to approval by "* * * higher Government authorities in accordance with applicable regulations * * *" and continued:

"The parties agree that neither the above provisional increases in the contract price nor the above mentioned tentative settlement of $62 million shall be construed as an acknowledgment of the validity of any of the specific claims included in the Contractor's claims submissions under these contracts nor does the Government admit the correctness of any of the facts alleged in these submissions. Furthermore, these provisional increases in the contract prices and the proposed settlement of $62 million shall not be considered to represent the value of the Contractor's claims if the Contracting Officer shall find, in the event the supplemental agreements in corporating the proposed settlement are not executed, that the Contractor is entitled to equitable adjustments in the contract prices totaling less than the provisional increases in contract prices made to date or less than the proposed settlement of $62 million on account of the facts alleged in his claims submissions."

h. On May 20, 1971, then Defense Secretary Laird reported to Chairman Hebert of the House Armed Services Committee:

"Claims under on-going contracts for DE 1052's and LPD's totaling $159.8 million have been *tentatively* settled for $62 million. The LPD settlement has been approved and paid; the DE 1052 agreement is still in the process of review by the Navy." (emphasis added).

i. Secretary Laird's confusion about the status of review of the LPD claims by the Navy—which, incidentally, were not handled separately from the DE 1052 claim—was corrected by then Deputy Defense Secretary Packard's statement to the Secretaries of the Army and Air Force in a memorandum dated June 4, 1971:

"In June 1970, Lockheed's claims totaling $46 million for work under the five completed ship contracts were settled for $17.9 million. The settlement was reached through the Department of the Navy's established procedures for negotiating ship claims. Likewise, claims under four on-going contracts for DE 1052's and LPD's totaling $159.8 million have been *tentatively* settled for $62 million. *The LPD and the DE 1052 agreement is still in process of review by the Navy.* However, if it is assumed that a settlement of the $159.8 million claim wil be for $62 million on these four contracts, the total Lockheed loss before taxes on all nine contracts will be approximately $89.6 million." (emphasis added).

j. On January 2, 1973, Lockheed prepared a four-page briefing paper on these claims, stating on page 2:

" * * * LSCC and NAVSHIPS renewed and increased negotiation efforts on the remaining claims, and on January 29, 1971 Lockheed Aircraft Corporation Group Vice President R. J. Osborn, LSCC's President A. M. Folden and the Commander, Naval Ship Systems Command N. A. Sonenshein arrived at a settlement figure of $62 million. Subsequently, supplemental agreements were executed which committed LSCC to that settlement amount as of that date, and committed the Navy likewise upon approval "by higher Government authorities in accordance with the applicable regulations."

Since the date of the "hand-shake" agreement on January 29, 1971, made in the spirit and within the parameters of Secretary Packard's plan, there has been virtually no progress by the Navy in finalizing the settlement agreement. . ."

9. *Navy Review Actions.* With respect to the LSCC consolidated LPD and DE 1052 claims, the Navy took the following review actions:

a. On March 25, 1971, NAVSHIPS submitted the proposed $62 million settlement sum for the consolidated Lockheed claims for review and hopefully for approval by the duly constituted reviewers in the Naval Material Command; that group was named the "Contract Claims Control and Surveillance Group" (or CCCSG). The CCCSG, after several weeks of review and deliberation, concluded that the proposed LSCC claims tentative settlement could not be approved because of factual inadequacies in LSCC provided information in the area of legal entitlement for certain claim elements and for lack of substantiation of quantum with respect to the entire claim. Accordingly, on August 3, 1971, NAVSHIPS withdrew the proposed settlement from CCSG consideration.

b. Thereafter, in August 1971 NAVSHIPS requested the Superior of Shipbuilding, Conversion and Repair, 13th Naval District (SUPSHIP–13), whose office is the cognizant contract administration office with respect to the four LSCC contracts, to assemble a team to obtain improved substantiation of the proposed settlement in certain areas. For the most part, as described in greater specificity in paragraphs below, LSCC declined to disclose cost or pricing data to support its DD Form 633–5 price proposals for these claims, and other contract performance and production information relevant to the support and substantiation of these claims.

c. Notwithstanding the foregoing lack of cooperation from LSCC, on June 9, 1972, NAVSHIPS once again submitted the proposed LSCC claims settlement to the Naval Material Command for review and approval. On this occasion the NAVMAT reviewers were designated the NAVMAT Claims Board. On June 20, 1972, the DE 1052 portion of the submission was supplemented with the LPD portion of the submission. After six months review and consideration of these submissions, the NAVMAT Claims Board determined that the settlement was unsupported and not susceptible of approval. Accordingly, on January 24, 1973, NAVSHIPS once again withdrew the submission from NAVMAT consideration.

10. The foregoing recapitulation of events in paragraphs 8 and 9 surrounding the tentative claims settlement agreement of January 29, 1971, and the submission and resubmission of the proposed settlement to higher authority for review and approval, and the two determinations not to grant approval by NAVMAT, lead to the unavoidable conclusion that in fact both LSCC and

the Navy understood that the $62 million claims settlement was not unconditional. It required review by higher authorities and approval by the Chief of Naval Material and by the Assistant Secretary of the Navy (Installations and Logistics), in accordance with Navy Procurement Directives, paragraph 1–401.55. Such approvals were never received because the NAVMAT Claims Board perceived certain general and specific inadequacies in LSCC's claims support and substantiation. Three major claim items were identified as inadequately documented in the SUPSHIP 13 letter serial 130–2904 of October 17, 1972, to LSCC. Further, in NAVSHIPS letter serial 90–02 of 26 December 1972 to LSCC the Navy stated:

"We have completed a preliminary review of this additional data submitted by your company, which, though responsive in some respects, still fails to present a clearly discernible 'cause and effect' relationship between alleged Government-responsible actions, on the one hand, and the claimed resulting increased costs to LSCC, on the other. The paucity of data showing such relationship applies also to the other elements of the LPD claims, as well as to the DE 1052 Class claim.

"To ensure consideration in this Command's final consideration of your claims, you are invited to submit to this Command, via the Supervisor, any material establishing the above-noted relationship, including any incisive rationale, supported by historical cost data."

For the foregoing reasons the tentative January 29, 1971, NAVSHIPS settlement did not receive the higher level approvals required by applicable Navy directives. Similarly, the provisional payments NAVSHIPS made to LSCC on account of these claims—for details, see paragraphs 14–15 below—were premised upon an exposition of a portion of the claim facts, specifically, LSCC's claim assertions and representations taken at their face value, without regard for a full and complete evaluation of other contemporaneous events in the performances of these contracts, many of which were later found to be attributable to non-government responsible causes. Those provisional payments were also influenced by anticipated LSCC cost overruns projected from costs incurred and to be incurred to complete contract performances as of January 1971. Accordingly, the provisional payments were found to be subject to the same deficiecies in support and substantiation as was the tentative $62 million settlement of January 1971.

11. *LSCC Claim Itemization.* LSCC has broken down its claims into subject areas of alleged Government-responsible causes of additional costs which are said to constitute entitlement to equitable adjustments in the countracts' prices. Enclosure (1) sets forth the Contracting Officer's determinations and findings related to these various allegations. For convenience only, some allegations common to all contracts have been treated in the same section of the determinations and findings. Each contract, however, has been treated as a separate entity. Enclosure (2) lists and classifies alleged improper rejections of LSCC work discussed in enclosure (1). Enclosure (3) lists the change orders included in the consolidated claims; determinations and findings relative to them are included in enclosure (1).

12. In support of its allegations, LSCC has submitted little or no historical cost, production and management data to substantiate its estimates. The Contracting Officer and his authorized representatives have requested relevant historical cost, production and management information but, with rare exceptions, such information has not been provided. The last such request was made on 20 March 1973, at which time the Navy stated its preliminary position in writing to LSCC on each of the claim allegation issues and requested any additional comments or available supporting data LSCC might have. LSCC has not responded to the Navy position or request.

13. All ships procured under the instant contracts have been delivered; cost, performance and management data is now historical and should have been used to price the requested equitable adjustments. LSCC has effectively refused to use all of the available data, and in fact, has denied authorized representatives of the Contracting Officer access to much directly relevant cost and pricing data.

Since LSCC has been unable to support adequately many elements of its claims, it appears that an impasse has been reached. Accordingly, the Contracting Officer deems it necessary to make a unilateral determination of the amount due LSCC by way of equitable adjustment in the prices of the four contracts. In considering the claims as originally asserted, the Contracting

Officer finds in some subject areas that there is no data to support a determination of entitlement; in other areas, when entitlement has been established, the equitable adjustments must be based on Navy-developed estimates. The Navy-developed manhour estimates have been priced using Defense Contract Audit Agency-developed composite historical contract labor rates.

14. The Contractor has previously received provisional price increases on each contract on account of these consolidated claims as follows:

NObs	Mod[1]	Payment
4660	8	$14,435,000
4765	7	13,128,000
4785	12	10,081,158
4902	7	11,387,000

[1] These modifications were embodied in a single supplemental agreement, executed on Feb. 24, 1971, effective Jan. 29, 1971; this modification incorporated the provisional payments made by earlier modifications and set forth in the cumulative provisional payments for each LPD contract. The cumulative DE–1052 contract provisional payment of $10,081,158 was not stated in Mod. 12 to contract NObs–4785 but rather in field Mod. No. A–742 issued Feb. 5, 1971.

15. Paragraph 4 of each of the foregoing modifications provides that upon final resolution of the claim, if the equitable adjustment resulting from such resolution is less than the provisional increase, the contract price as provisionally adjusted shall be reduced by the amount of equitable adjustment, and the balance shall immediately be refunded to the Government, or credited to the Government against existing unpaid invoices. The equitable adjustments resulting from the Contracting Officer's determinations and findings in enclosure (1) are summarized by contract in enclosure (4) and totals brought forward below. Accordingly, inasmuch as the total adjustment in the prices of contracts NObs–4660, 4675, 4902 and 4785 as determined herein do not exceed the provisional payments previously made, pursuant to paragraph 4 of the modifications cited above, the contracts' prices are hereby adjusted as follows and demand is made for the balance due:

NObs	Provisional payment	Equitable adjustment	Balance due U.S. Government
4660	$14,435,000	$1,796,805	$12,638,195
4765	13,128,000	1,832,191	11,295,809
4785	10,081,158	821,892	9,259,266
4902	11,387,000	2,334,661	9,052,339
Total	49,031,158	6,785,549	42,245,609

Notice is hereby given that, in accordance with the General Provision No. 42 of each contract "interest", commencing thirty (30) days from receipt of this Final Decision, an interest charge at the rate of six percent (6%) per annum will be assessed on any unpaid balance.

16. LSCC's Premature May 24, 1973 "Appeal" Letter. On May 24, 1973, Mr. F. Trowbridge vom Baur, counsel for LSCC, wrote a letter to the Secretary of the Navy, with a copy to the Armed Services Board of Contract Appeals, purporting to "appeal" the LSCC claims on the DE 1052 and LPD contracts. Two bases were presented: that the Navy has not honored the January 29, 1971 contract modification settling these claims for $62 million, that Navy failure to issue a final decision of the Contracting Officer constitutes an appealable action. The factual misconceptions inherent in the first basis are rebutted in paragraphs 8, 9 and 10. With respect to the second basis, on March 20, 1973, NAVSHIPS sent LSCC a detailed 71 page explanation of the Navy's position on each element of the consolidated LPD and DE 1052 claims. That March 20th letter stated:

"You are requested to carefully review the Navy's position and to provide any comments or additional data you may have prior to April 20, 1973. Your comments will be carefully weighed and considered prior to formalization of any further settlement offer or any final decision of the Contracting Officer. Should you desire, a meeting can be arranged to allow further discussion of these matters."

By letter of April 13, 1973, LSCC requested that "* * * no further action be taken with regard to * * *." the Navy's March 20, 1973 letter. Thus although LSCC specifically requested that a final decision on this matter be held in abeyance, NAVSHIPS received no further communication from LSCC until receipt of the foregoing May 24, 1973 "appeal" letter from Mr. Vom Baur. These facts clearly indicate that the "appeal" by Mr. Vom Baur is premature.

17. This is the final decision of the Contracting Officer. Decisions on disputed questions of fact and on other questions that are subject to the procedure of the Disputes clause may be appealed in accordance with the provisions of the Disputes clause. If you decide to make such an appeal from this decision, written notice thereof (in triplicate) must be mailed or otherwise furnished to the Contracting Officer within thirty days from the days you receive this decision. Such notice should indicate that an appeal is intended and should reference this decison and identify the contract by number. The Armed Service Board of Contract Appeals is the authorized representative of the Secretary for hearing and determining such disputes. The Rules of the Armed Services Board of Contract Appeals are set forth in the Armed Services Procurement Regulation, Appendix A, Part 2.

W. E. SHULTZ,
Commander, Supply Corps, U.S. Navy,
Contracting Officer.

ITEM 9.—*Oct. 3, 1973—Telegram from former Deputy Secretary of Defense David Packard to Deputy Secretary of Defense William C. Clements, Jr., urging Mr. Clements to request the Navy to settle with Lockheed for $62 million. Attached are letters from Mr. Packard to Senator Stennis, Chairman of the Senate Armed Services Committee and Congressman Hebert, Chairman of the House Armed Services Committee*

Hon. WILLIAM C. CLEMENTS, JR.,
Deputy Secretary of Defense, The Pentagon,
Washington, D.C.

Yesterday I testified at the trial at which Lockheed is attempting to obtain a settlement of their claim with the Navy in regard to the overall Lockheed agreement I worked out in 1970. I had not until yesterday been familiar with all of the details of the issue.

On December 30, 1970 I promised an overall settlement for all of the Lockheed problems in a letter to Senator Stennis. I intended this to be a package deal. Prior to this date the Navy had offered Lockheed $58M in settlement of shipbuilding claims. It was my understanding at the time the $58M had been arrived at by the Navy in accord with the established practices. Lockheed did not accept the $58M and after further negotiations the Navy and Lockheed agreed on a tentative settlement of $62M. Thereafter in my discussions with Lockheed, with the bankers and with the congressional committees I used the $62M figure with the understanding that it was acceptable to the Navy. I considered the other details of the overall Lockheed settlement were implemented with the understanding the Navy would settle with Lockheed at $62M. Subsequent disputes within the Navy apparently raised questions as to whether the $62M figure had been determined through established procedure for dealing with shipbuilding claims. Whether the $62M figure was or was not arrived at through established procedures I consider to be a matter internal to the Navy, and I believe there is both a legal and a moral obligation for the Navy to settle with Lockheed at $62M.

It is my understanding that about $49M of the $62M has already been advanced against the claim, leaving only about $13M to settle the matter as I intended it should have been settled.

I urge you to request the Navy to settle with Lockheed at the $62M figure and, if necessary, you should direct them to do so. I am sending a copy of this wire to Senator Stennis and Chairman Hebert in case you wish to discuss the matter with them before directing a settlement.

In further testimony at the trial next monday I intend to urge the judge to rule in Lockheed's favor, because all of my testimony and discussions with Lockheed and Bankers and the Congress during 1971 were based on my understanding that the Navy would settle for $62M and I believe there is a firm

obligation to do so. It will be better for all concerned to settle this issue and avoid further waste of time and money on litigation.

DAVID PACKARD.

HEWLETT-PACKARD CO.,
Palo Alto, Calif., October 3, 1974.

Hon. JOHN D. STENNIS,
U.S. Senator,
Senate Office Building,
Washington, D.C.

DEAR MR. CHAIRMAN: Sometime in 1973 it came to my attention that the shipbuilding claims of Lockheed discussed in my letter of December 30, 1970 to you had not yet been settled. I had known there was some problem within the Navy about the $62M settlement of the shipbuilding claims which was accepted by Mr. Haughton on January 29, 1971, but I learned about the details only within the past few weeks. I am enclosing a copy of my wire to Secretary Clements urging him to direct the Navy to settle for the figure we agreed to in 1971. If you have any questions about my advice to Secretary Clements I would be pleased to discuss the matter with you at your convenience.

Sincerely,

DAVID PACKARD.

HEWLETT-PACKARD CO.,
Palo Alto, Calif., October 3, 1974.

Hon. F. EDWARD HEBERT,
U.S. House of Representatives,
Washington, D.C.

DEAR MR. CHAIRMAN: Sometime in 1973 it came to my attention that the shipbuilding claims of Lockheed discussed in my letter of December 30, 1970 to you had not yet been settled. I had known there was some problem within the Navy about the $62M settlement of the shipbuilding claims which was accepted by Mr. Haughton on January 29, 1971, but I learned about the details only within the past few weeks. I am enclosing a copy of my wire to Secretary Clements urging him to direct the Navy to settle for the figure we agreed to in 1971. If you have any questions about my advice to Secretary Clements I would be pleased to discuss the matter with you at your convenience.

Sincerely,

DAVID PACKARD.

ITEM 10.—*Nov. 27, 1974—New York Times article entitled "Proxmire Scores Ex-Pentagon Aide"*

PROXMIRE SCORES EX-PENTAGON AIDE

(By Richard Witkin)

Senator William Proxmire criticized David Packard, a former Deputy Defense Secretary, yesterday for "actively lobbying" in the Pentagon and Congress in an effort to force the Navy to pay the Lockheed Aircraft Corporation what the Wisconsin Democrat described as an "inflated" $62-million shipbuilding claim.

Senator Proxmire also said he had been told that Lockheed and Textron, Inc., had given the Pentagon an ultimatum to approve the $62-million award or the two companies would not go through with their plan for rescuing Lockheed from its financial troubles.

"Mr. Packard was a fine Deputy Secretary of Defense and served his country well," the Senator said in a statement released by his Washington office. "But his support of Lockheed at any price like a classic buddy system between Pentagon officials and retired military executives in the defense industry."

PENTAGON CAREER

Mr. Packard served in the Pentagon from 1969 through 1971. He then returned to Hewlett Packard, a California electronics company he had helped found, and is now chairman of the board.

Mr. Packard could not be reached immediately for comment.

Mr. Proxmire made public an executive memorandum sent last month to his successor in the Pentagon, saying he had worked out an over-all settlement of several "with the understanding" that the Navy would pay Lockheed the $62-million on the shipbuilding contract.

In the memorandum, Mr. Packard said he believed that the Navy had "a legal and a moral obligation" to make the settlement, and he urged the current Deputy Secretary of Defense, William P. Clements Jr., to urge the Navy to pay and, if necessary, to order it.

Also released were copies of letters Mr. Packard sent to the chairmen of the Senate and House Armed Services Committees, enclosing copies of the memorandum to Mr. Clements and offering to discuss the issue with them.

PROXMIRE OBJECTS

Sen. Proxmire objected strongly to Mr. Packard's writing to the committee chairmen, Senator John C. Stennis, Democrat of Mississippi, and Representative F. Edward Hebert, Democrat of Louisiana.

Senator Proxmire, a leading critic of Pentagon procurement practices, said the claims issue was still before the Armed Services Board of Contract Appeals. Noting that the two armed services committees exercised large control over the Pentagon budget, Mr. Proxmire said:

"Mr. Packard's contracts with the powerful committee chairmen could be interpreted as an effort to use political influence to alter the outcome of the administrative proceedings. The mere outcome that the letters were sent, and distributed within the Pentagon, would be enough to create pressure to settle the claim for an amount that could not be justified on the facts."

Senator Proxmire acknowledged that the dispute was complicated by what he called a "tentative agreement" that Rear Adm. Nathan Sonenshein, then head of the Naval Ship Systems Command, had made with Lockheed to pay the $62-million. But the Senator added that Admiral Sonenshein was not authorized to commit the Navy, which he said later decided that the claim was worth only $6.8-million.

$400-MILLION IN LOSSES

This view clashed with that of Mr. Packard, who has often been accused of being extremely tough on Lockheed in the over-all 1971 Lockheed-Pentagon agreement. Under that agreement, the aerospace company absorbed losses of more than $400-million on the C-5A cargo plane and three other Pentagon projects, including the disputed ship program.

In the memorandum to his successor, Mr. Packard said that, during negotiations with the company, its bankers and Congress, he had always used the $62-million figure for the ships claim "with the understanding that it was acceptable to the Navy."

On the Proxmire charge about a Textron-Lockheed ultimatum to the Defense Department, neither company had any immediate comment.

ITEM 11.—*Dec. 2, 1974—Senate Speech by Senator Proxmire entitled "The Lockheed Shipbuilding Claims Affair—II"*

THE LOCKHEED SHIPBUILDING CLAIMS AFFAIR—II

Mr. PROXMIRE. Mr. President, on September 21, 1973, I made a Senate speech on the Lockheed Shipbuilding Claims Affair. In that speech I pointed out that the Lockheed Shipbuilding and Construction Co. had filed a vastly inflated claim against the Navy totaling $158 million. The claim allegedly covered costs legitimately incurred on various shipbuilding contracts awarded to Lockheed. In fact, the evidence shows that Lockheed ran up huge cost overruns, mostly because of its own inefficiency, and is attempting to get reimbursement from the Navy.

I also stated in my earlier speech that before the Navy's claims review team fully investigated the claim a naval officer by the name of Adm. Nathan Sonenshein entered into a tentative agreement to pay Lockheed $62 million for the claim.

ADMIRAL SONENSHEIN'S TENTATIVE SETTLEMENT

Admiral Sonenshein was not authorized to commit the Navy to the tentative agreement and, in fact, it was later rejected by the Navy. In my judgment Admiral Sonenshein acted improperly in entering into the tentative agreement because the legal, technical, and audit analyses which are supposed to be done by the Navy before a claim is settled had not been performed at the time Admiral Sonenshein entered into the tentative agreement.

Subsequently, after the Navy's review team investigated the claim the Navy formally decided that the claim was worth only $6.8 million. Among other things, the review team found that the claim contained factual inadequacies, lacked substantiation, and that Lockheed failed to cooperate with the Navy investigators.

Lockheed appealed the decision to the Pentagon's Armed Services Board of Contract Appeals where the case is now being litigated.

DAVID PACKARD ENTERS THE PICTURE

A new factor has now complicated this strange case. David Packard, former Deputy Secretary of Defense, is now actively lobbying the Pentagon and Capitol Hill to force the Navy to pay Lockheed the larger, unwarranted sum for the shipbuilding claim. He seems to have taken the position that the Government should use the taxpayers' money to pay Lockheed the $62 million figure tentatively negotiated by Admiral Sonenshein regardless of what the facts demonstrate.

Mr. Packard is applying pressure wherever he can, in an attempt to reverse the Navy's decision that the claim is worth less than $7 million.

A few weeks ago Mr. Packard testified at the Pentagon's appeals board hearing in behalf of Lockheed.

Mr. Packard has also written letters in Lockheed's behalf to William C. Clements, Jr., Deputy Secretary of Defense, Senator JOHN C. STENNIS, and Representative F. EDWARD HEBERT.

In his letters he urges Secretary Clements to request the Navy to settle for the higher, inflated figure, and offers to discuss the matter personally with Senator STENNIS and Representative HEBERT.

Mr. Packard was a fine Deputy Secretary of Defense and served his country well. But his support of Lockheed at any price looks like a case of classic "buddy system" between Pentagon officials and retired military executives in the defense industry.

By communicating directly with the chairmen of the House and Senate Armed Services Committees, Mr. Packard appears to be trying to interfere with the administrative proceedings being conducted by the appeals board.

The appeals board is an arm of the Pentagon. The Armed Services Committees exercise a great deal of control over the Pentagon's budget.

Mr. Packard's contacts with the two powerful committee chairmen could be interpreted as an effort to use political influence to alter the outcome of the administrative proceedings.

The mere fact that the letters were sent and distributed within the Pentagon could be enough to create pressure to settle the claim for an amount that cannot be justified on the facts.

THE TEXTRON MERGER

Textron, another large defense contractor, has made overtures to merge with Lockheed and senior Pentagon officials would like the merger to take place.

I am informed that Textron and Lockheed have given the Pentagon an ultimatum to settle Lockheed's claim for the higher amount or the merger is off.

If my information is correct, Lockheed and Textron are engaged in a squeeze play against the Pentagon that could cost the taxpayer as much as $55 million.

It is no secret that Lockheed is in deep financial difficulty and could be forced into bankruptcy if it does not merge with another firm or obtain a new source of funds.

I ask unanimous consent to have printed in the RECORD the full texts of the letters referred to in my remarks.

There being no objection, the letters were ordered to be printed in the RECORD as follows:

[EDITOR'S NOTE.—The letters appear under item 9.]

ITEM 12.—*Dec. 18, 1974—New York Times article "Lockheed Faces Fraud Questions"*

(By Richard Witkin)

The Navy has asked the Justice Department to look into the question of possible fraud in connection with a multimillion-dollar ship-building claim by the Lockheed Aircraft Corporation.

The disclosure was made yesterday by Senator William Proxmire and later confirmed by Navy spokesmen. It could be a new impediment to consummation of the ambitious deal under which the long-troubled aerospace giant would be financially restructured, chiefly through a $100-million investment by Textron, Inc.

Senator Proxmire repeated a contention that Navy payment of $62-million to Lockheed on disputed ship-building contracts was a condition for conclusion of the Lockheed-Textron deal. The Wisconsin Democrat urged that administrative proceedings on the claim be "suspended pending the outcome of the Justice Department investigation."

Officials of both corporations had hoped the deal could be finally ratified at a stockholders' meeting in February. Knowledgeable observers said experience showed that a Justice Department inquiry was likely to take many months.

Navy officials declined to specify what evidence had prompted them to ask for an inquiry into possible fraud. Industry sources said, however, that what appeared to be involved was the accounting for about $2-million in materials used by Lockheed to build either destroyer escorts or amphibious ships.

The Navy concern was said to have developed from testimony given in hearings on the disputed claim conducted by the Armed Services Board of Contract Appeals.

Senator Proxmire, long critic of Pentagon procurement practices, said: "The government should not obligate itself to pay one red cent in unwarranted shipbuilding claims, or take any other steps that could force the taxpayer further out on the limb in order to bring about the Lockheed-Textron (deal)."

A Lockheed spokesman said the company had not yet been informed what specific issues were being raised by the Navy. He reiterated a long-standing Lockheed contention that the Pentagon had committed itself to paying the $62-million on what had originally been a claim for about $150-million.

ITEM 13.—*May 13, 1975—Armed Services Board of Contract Appeals decision concerning Lockheed Shipbuilding and Construction Company. The Board ruled that the Navy must pay Lockheed $62 million because of the conduct of the Deputy Secretary of Defense. The Board made no review of the merits of the claim itself relying instead on a theory of estoppel.*

ITEM 14.—*May 13, 1975—Excerpts from Navy brief to the Armed Services Board of Contract Appeals in the Lockheed Shipbuilding case. The Navy brief points out the circumstances surrounding the Deputy Secretary's statements and actions*

POINT VIII.—THE OVERALL SETTLEMENT PLAN THEORY TO INCLUDE THE SHIPBUILDING CLAIMS IS AN AFTERTHOUGHT

The complaint, in paragraph 34 under its estoppel clause alleges that:

"34. In March 1970, Deputy Secretary of Defense Packard was notified of the differences over the said claims. In response to this notification, Mr. Packard proposed an overall, contractual settlement plan; and, in response thereto, the Congress enacted the Emergency Loan Guarantee Act . . . officials of the Department of Defense then represented to the said Majority Banks and the said Board that the said claims had been finally settled in form or substance."

It will become apparent that the seed of the overall settlement plan was planted in Mr. Packard's mind by Lockheed counsel and "has every earmark of having originated in the active mind of counsel, not in the perhaps more rigid thinking of the Pentagon" (cf. *Bethelehem Steel Corp.* v. *United States*, 191 Ct. Cl. 141 at p. 151).

On 10 August 1973, the Director of the Contract Appeals Division of the Office of General Counsel of the Navy forwarded to Mr. Packard a copy of the complaint in this action and informed him that the Government in preparing its defense proposed to establish that since the tentative settlement was subject to approval by higher Government authority in accordance with applicable regulations, no such approval by higher Government authority was given. (Tr.Exh. G-2; Tr. pp. 49, 50). A proposed affidavit was submitted to him for execution, and he was informed that it was staffed through DOD counsel's office; that an examination of the DOD files indicated no such approval was given; that Mr. Shillito was contacted and confirmed this, and three documents, all from DOD files (not from Navy as they did not involve Navy) were attached to the proposed affidavit to refresh his recollection.

After he received this letter he talked to Mr. Shillito on the telephone who told him the affidavit was substantially correct and it was all right for him to sign it. (Tr. pp. 50, 51). He reaffirmed as correct, the categorical statement of his affidavit that "I did not give approval to the said tentative settlement of $62 million and to the best of my information and belief, neither did the Secretary of Defense, Mr. Laird." (Tr. pp. 52, 53).[1]

Mr. Shillito was similarly sent a proposed affidavit and he undertook to revise paragraph 4 by adding some detail after the categorical statement that he did not give approval to the tentative settlement. (Tr. pp. 1250-1252). He reaffirmed every paragraph of his affidavit as still being his testimony (Tr. pp. 1253-1255) and added that *"throughout the entire Lockheed negotiations, it had been our plan that the SRAM contract and the shipbuilding contract would be handled in accordance with those services internal services procedures, and that is indeed the intent here*[2] *as far as the Navy shipbuilding claim negotiation is concerned.* That is correct."[3] (Emphasis added.)

In this connection it should be noted that Mr. Packard testified he never directed the Secretary of the Navy to change the Navy's review procedures. (Tr. p. 609).

About a year after Mr. Packard executed his affidavit (Tr.Exh. G-1 for Iden), he met Mr. Haughton at a social function in Los Angeles (on July 23, 1974) and Mr. Packard brought up the subject of the ship claims. (Tr. p. 611).[4] He told Mr. Haughton that "I had learned that the ship claims had not been settled, and if there was anything I could do to be helpful, I'd be glad to have him let me know."

At the reception it was agreed that an appointment would be arranged "for Mr. Coburn and Mr. Gussman to go to see Mr. Packard at his office in Palo Alto." (Tr. p. 317). This was 23 July 1974.

On 6 August 1974 at a meeting with Deputy Secretary of Defense, Clements and Assistant Secretary of Defense (I&L) Mendolia, and Fred Ross of Bankers Trust, Ron Ross of the Bank of America, Ralph Murray, Counsel to the banks, Roy Anderson and John Cavanagh of Lockheed, the Textron-Lockheed restructuring agreement was discussed in relation to the present appeal and the Defense Secretaries were advised that as a condition to the financial restruc-

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[1] Mr. Leary testified however that Mr. Packard told him he approved the $62 million settlement (Tr. pp. 13-92).

[2] Refers to his testimony before Congressional Committee when he stated: "So these claims have not been finalized and have been signed off. If the tentative agreements are incorrect, they will be modified." (Tr. p. 1255)

[3] Refers to the question which asked by his statement before the Congressional Committee if he intended that the analysis of the claim as to whether any figure is supportable "would be done by the Navy through the established procedure calling for review." (Tr. p. 1256)

[4] Mr. Haughton testified: "Mr. Packard also asked me about the claim. I opened the conversation." (Tr. p. 313). Mr. Haughton thought Packard's approach was prompted by the fact that Lockheed's attorneys had asked for a date to take his deposition. (Tr. p. 317)

turing of Lockheed the claims had to be settled for the full $62 million[5] and Lockheed was therefore "pushing hard to settle without litigation" (Tr.Exh. G-14). This was conveyed to Mr. Packard by Mr. Haughton's letter to him on 10 August 1974.

At the 6 August 1974 meeting with the Defense Secretaries a memorandum entitled "1971 Settlement of Lockheed Ship Claims" was given to them (Tr.Exh. G-14, G-15). That memorandum (Tr.Exh. G-15) was prepared by Mr. Coburn, Mr. Ralph Murray, Fred Leary, Ron Ross, John Cavanagh and Roy Anderson (Tr. p. 321). A copy of that memorandum was sent to Mr. Packard. Here is the Lockheed lawyers rationale placed before Mr. Packard of the overall settlement plan theory a week before Mr. Coburn and Mr. Gussman met with Mr. Packard (Tr.Exh. G-14, para. 3) for the discovery deposition which was scheduled for 5 September 1974. Mr. Packard's deposition was taken as scheduled and a week later *Mr. Haughton* wrote to Mr. Clements, in which he sent him a copy of Mr. Packard's deposition, also summarized the principal points made by him and flatly stated to Mr. Clements "We (Lockheed) reached this total settlement with Mr. Packard, the Deputy Secretary of Defense" (Tr.Exh. G-19; Tr. pp. 327–336). Lockheed's attorneys also sent copies of Packard's deposition to other potential witnesses, including Mr. Shillito, Admiral Sonenshein, Mr. McCullough, Mr. Spratt and Mr. Leary. (Tr. pp. 1640, 1917).

Mr. Packard in his efforts to be helpful to Lockheed and to remove the impediment of settlement of the shipbuilding dispute to a consummation of the pending Textron deal, overextended himself. To make the Navy a full partner to his overall settlement plan, he first brought in Mr. Chafee. His testimony was as follows:

Mr. Coburn on direct (Tr. pp. 27, 28):

"Q. Mr. Packard, did you—can you tell us if you had discussion with the Service Secretaries in connection with formulating your plan and obtaining their comments on it?

A. Yes, I had discussions with all three of the Service Secretaries, because in each—in the case of each of these programs the Service Secretary is the one that had to implement whatever was agreed to, and I had most of the discussions, of course with the Air Force Secretary, because the C-5 program was the largest one. We had discussions with the Secretary of the Army. They were very anxious to get this Cheyenne development. They thought it was an important weapon program. *And I had discussions with the Secretary of the Navy* * * *

Q. *Did you have the assurance of the Secretary of the Navy as to any particular dollar level of settlement on the shipbuilding claims?*

A. I indicated when I sent that letter to Senator Stennis that we could keep the program together with $58 million, and I felt that that was the minimum that was necessary to handle the job. *And I'm sure the Secretary of the Navy understood that very well and, in fact, he was helpful in getting this advance of that $20 million that was needed to keep the company going. He knew why that was needed*[6] * * * (Italics added.)

The Secretary referred to was identified as Mr. Chafee (Tr. p. 28), and Mr. Packard added that the discussions were both with the Secretary and with Mr. Warner, Under Secretary of the Navy (Tr. p. 29):

"Mr. Warner was the Under Secretary of the Navy at this time, and I'm quite sure he was very familiar with this matter. He subsequently became the Secretary of the Navy.

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[5] Leary testified that he discussed with Mr. Clements the Lockheed-Textron proposed agreement in relation to the issues involved in this appeal, and "that we saw no way that the Textron–Lockheed deal could be consummated without settlement of the ship claims in the amount of $62 million at least." (Tr. pp. 1919, 1920).

As we indicated at the trial, we agree with Judge Bird's observation that the Lockheed–Textron proposed agreement is not relevant to the issues on this appeal (Tr. pp. 323, 324). And we do not understand why Appellant in his brief calls upon this Board to render a decision by the end of February because of the pending Textron deal. (Appellant's Brief at p. 11). How can the Government's liability in the Appeal No. 1 issues be affected by a Textron–Lockheed deal, or any other financial arrangements Lockheed may make particularly when the Credit Agreement of 30 August 1971 (R4, A–72) specifically imposed an obligation on Lockheed to pursue merger additional capitalization and related adjustments to improve its financial situation (Anderson, Tr. pp. 453–454).

[6] Mr. Packard corrected this statement later and testified he did not direct anyone in the Navy to make a provisional payment to Lockheed. (Tr. p. 534).

Q. Did you discuss the $62 million settlement either with Secretary Warner or Secretary Chafee?

A. *I don't recall of a specific discussion we had.* After I made this proposal and we had the $62 million figure, *I felt that I had the assurance of the Secretary that they would support that,* and I didn't feel it necessary to spend any further time on that aspect of the matter." (Italics added).

The 30 December 1970 letter to Stennis was not cleared with the Navy (and he did not recall whether he discussed the letter with them). (Tr. pp. 72–76). Nor could he recall when he discussed it with the Secretary of the Navy (Tr. p. 114). His discussions with Mr. Chafee and Mr. Warner on the subject were pursued in cross examination and only brought forth a response that he met with the Secretary or Under Secretary every week at lunch and "we discussed all matters that the Navy was involved in, and I certainly discussed this issue" (Tr. p. 553). He admitted that he never told Mr. Chafee or Mr. Warner that they should pay $58 million based on his alleged agreement with Lockheed (Tr. pp. 554, 555). He knew that there was some problem with the Navy how the shipbuilding claims were going to be supported but he didn't know the nature of the problem (Tr. p. 583). Nor did he ever suggest to the Navy that their procedures be modified and corrected so that claims be approved and finalized without supporting documentation (Tr. p. 586). He knew of the criticism voiced before Congressional Committees that the Navy was settling claims by bargaining without documentary backup (Tr. 588–589) but he did not give much consideration to the Navy's established procedures, whether they were bargaining, whether there were legal memoranda—he didn't think it was his concern. He did expect the Navy to "double check" the $62 million tentative settlement to ascertain that the claim was "supportable in the light of all the facts and conditions involving that claim." (Tr. p. 593).

Mr. Chafee, in his letter to Senator Proxmire on 28 May 1971 specifically spelled out the review procedures that were being applied to the tentative settlements made by NAVSHIPS. A copy of that letter went to Shillito. If Mr. Chafee had given Mr. Packard the assurance in December 1970 that the Navy agreed to a $58 million settlement (as Mr. Packard alleges), why would he send as important a letter as that of 28 May 1971 which completely negates the fact that he agreed to such figure as a part of a package plan. As to this letter, Mr. Warner testified (Tr. p. 2030) "Mr. Chafee handled this rather exclusively with Mr. Sanders and the office of the General Counsel of the Navy." Mr. Warner further testified that "in the administration of these claims to the extent I was involved, I required meticulous conformity to the procedures laid down by Mr. Chafee" (Tr. pp. 2049, 2052).

Now to explore further, Mr. Packard's assertion that Mr. Warner is the one who assured him the $58 million figure is a Navy commitment.

Admiral Freeman testified that Mr. Warner told him that Mr. Packard had asked him to agree to a figure for the shipbuilding claims, and that Mr. Warner replied to Mr. Packard he could not do so because the tentative settlement had not been reviewed by the Gordon Rule Group or the Assistant Secretary of the Navy (I&L). (Tr. pp. 953–957). Admiral Freeman testified that he was informed by Mr. Warner of the position he took in his discussions with OSD "that he should not utilize any specific figure in proposed settlement, since we didn't have the facts at my (Admiral Freeman's) level. Mr. Warner related back to me that he had in fact taken these positions and given due caution to the OSD level" including Mr. Packard (Tr. pp. 954–956). Mr. Warner confirmed that (Tr. p. 2046). On this subject, Mr. Warner testified that it was hard for him to believe that he was the source of the $58 million figure that Mr. Packard stated he relied on. He would not have done so without consulting "very carefully with Mr. Sanders, Mr. Ill, probably Admiral Sonenshein, certainly Mr. Freeman, likely Gordon Rule;" (Tr. p. 2049) and his work habits were such that that he would not have given a figure unless he made a study which he did not do (Tr. p. 2050), and "all this leads me to believe that probably others were more intimately involved in the aspect of the $58 million figure than I was." (Tr. p. 2051).

We turn now to Mr. Packard's testimony in which he identified Admiral Sonenshein as the representative of the Navy who gave him personally the assurance that $58 million was the "Navy" figure for the overall settlement plan. He was asked on cross examination whether with respect to the ship-

building claims he relied on the information he received from Mr. Shillito or Mr. McCullough as to the factual situation. He answered (Tr. p. 39): "No. I also met with Admiral Sonenshein, who was the one who was doing the negotiations, and I did this because I felt it was important to be sure that the fellow in the Navy who was doing the negotiations." He was then asked to fix the time of his meeting with Admiral Sonenshein and to give the substance of his conversations with him, thus: (Tr. pp. 41, 42)

"Q. Now, I'm limiting my question to Admiral Sonenshein, and my question is with respect to Admiral Sonenshein and conversations you had with him, am I correct in understanding your testimony so far, that these conversations occurred prior to your letter of December 30, 1970 to Senator Stennis.

A. *Yes. I can visualize that he came into my office, and we were sitting on a sofa there in the corner of my office, and I asked him, 'Now Admiral, are you sure this is all right, because I can't go on unless you do.'*

Now, I can't remember the date, but I can remember the substance of that kind of a conversation with him that I had him come up into my office, *because I wanted word from him, not through some third party*, that they had made an offer of $58 million at that time, and I had to be sure that they were going to back it up.

Now, Haughton didn't accept that $58 million offer, *but in any case I had that directly from Admiral Sonenshein. I can't tell you the date, but I can sure remember him sitting right there and talking about it in my office.*" (Italics added.)

He thought that his military aide, Major General Furlong was probably there but "I didn't expect him to keep notes on these matters" (Tr. p. 42). Also Shillito may have been there. He did not recall who else, but "I do recall Admiral Sonenshein." His recollection was that he did not have any conversations with Admiral Sonenshein on the subject after 30 December 1970, nor after January 29, 1971 (Tr. pp. 43, 44). He was further asked (Tr. p. 67) whether on behalf of DOD, he intended to make "an informal commitment for DOD" or did he intend to make "an informal commitment for the Navy." The transcript then shows (at pp. 67, 68):

"A. I intended to convey that the Navy had agreed, that the Navy had made this commitment, which they assured me they had.

Q. And who in the Navy made the commitment—who in the Navy gave you that assurance.

A. Sonenshein * * *

Q. And you equated, did you, Admiral Sonenshein with the Navy, and did you equate * * * the conversation you had with Admiral Sonenshein to be equivalent to a Navy Department Commitment?

A. Well, let me just apply this: I don't know that it makes any difference as far as this particular matter is concerned whether I was right or wrong in relying upon Admiral Sonenshein * * *"

If, as Mr. Packard testified, his overall plan included the shipbuilding claims for $58 million and Mr. Chafee and Mr. Warner approved that figure to him on behalf of the Navy, why would he need further Navy approval for his overall plan from Admiral Sonenshein? The only logical explanation is that he never received from either Mr. Chafee or Mr. Warner approval for the $58 million figure,[7] and so he reached for Admiral Sonenshein as his back up man. His reliance on Admiral Sonenshein was in his testimony, firm and not casual. In addition to his "I can visualize that he came into my office, and was sitting there in the corner of my office, and I asked him, 'Now Admiral, are you sure this is all right, because I can't go unless you do . . . I can't tell you the date, but I can sure remember him sitting right there and talking about it in my office" (Tr. pp. 41, 42), he then rationalized why he called Admiral Sonenshein. Mr. Packard was shown *Tr.Exh. G–31*, (the Lockheed internal "Private Data" document of *April 14, 1970*) *which stated* (Tr. p. 598) that the total Lockheed DOD problem is working to our disadvantage with respect to the shipbuilding claims because the "blue suit" Navy did not regard the Navy claims as being part of the total Lockheed problem; that it will handle these claims itself and wants DOD to keep completely out of its

[7] "I felt that I had the assurance of the Secretary that they would support that" (meaning $62 rather than $58 million) (Tr. p. 29).

affairs in this area, and he was asked (Tr. pp. 598, 599) whether he agreed with the "blue suit" Navy that it wanted DOD to keep completely out of the ship claims area, since the Navy in no way regards this as part of the total Lockheed problem. He answered he did, and intended in his testimony before Congressional Committees to advise them that the Navy and not OSD would be handling the shipbuilding claims (Tr. pp. 589,, 599). He looked upon Admiral Sonenshein as being the "blue suit representative of the Navy that made the offer to Lockheed, and I assumed he had the rest of the 'blue suiters' with him when he made that offer, when he made the handshake deal. What else was I to believe." [8] His testimony then continues:

"Q. Did you at any time—and it (Tr.Exh. G-31) refers to a position sustained by DOD—give any instructions to anybody, indicating that you changed the position of DOD with respect to the Navy 'blue suit' approach to the problem?

A. I thought what we had was a Navy 'blue suit' approach which fitted my program, and I expected that the rest of the Navy 'blue suiters' would back Admiral Sonenshein. He was a member of the club.

Q. And the 'club' and the 'membership' you refer to, you expected them to comply with or work within the framework of the program which is identified on page 9 (of Tr.Exh. G-31) which seems to say it was sustained by DOD?

A. Yes. Well, as a matter of fact, this brings out a very important point. *This is precisely the reason why I wanted to have a private conversation with Admiral Sonenshein, to be sure that the $62 million figure was all right,* because I assumed he had the backup of his fellow club—'blue suit' club members.

Q. And in a conversation you had with him, he made assurances, you say, that were consistent with the 'blue suit' position—which this document indicates was sustained by DOD?

A. I thought it was, and I still think it is. Our problem here is not the 'blue suit' part of the Navy it's the Gordon Rule part of the Navy." [9] (Italics added).

Mr. Packard was not casual about reference to Admiral Sonenshein. Again, why should Mr. Packard go to Admiral Sonenshein for Navy approval of his overall settlement plan, when he had direct lines to his civilian superior officers, Mr. Chafee, Mr. Warner and Mr. Sanders? Could it be that the Admiral Sonenshein episode is an afterthought because Mr. Packard did not get any one at the Secretariat level to O.K. the $58 million figure?

On his second day on the witness stand (Oct. 7, 1974, his first day was October 2, 1974), there was further questioning about his conversations with Admiral Sonenshein (Tr. pp. 532, 549–553) and the last meeting that he recalled with Admiral Sonenshein was the one in his office, when they sat on the couch which he believed was some time prior to December 30, 1970, and he suggested "that if you would like to get these dates, you could probably get the calendar of my appointments * * *" (Tr. p. 532). He was shown a letter from Gordon Rule to Admiral Sonenshein reminding the latter of the requirement for approval by NAVMAT (Tr. p. 561) and was asked whether his conversation with Admiral Sonenshein about the $58 million was prior to that date, and he suggested we consult his "log" which should be at the Pentagon (Tr. pp. 561–63) and which would have a record of the people who came to see him—"If you want to determine when Admiral Sonenshein came in to see me * * * if you want to get those dates * * * get that log * * *"

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[8] The "handshake deal" obviously refers to the 29 January 1971 tentative settlement for $62 million. There was no "handshake" on the $58 million which was made on 27 October 1970 and it is as to the $58 million figure that Mr. Packard testified he got the personal assurances of Admiral Sonenshein (Tr. pp. 560–563). Admiral Freeman testified that he was the Navy "blue suit" representative for the Secretary on procurement matters with respect to DOD (Tr. pp. 958-960). The reference to the $62 million reflects the unconscious impact of the memorandum Lockheed lawyers prepared and sent to him on 10 August 1974 (Tr. Exh. G-14, G-15). This is way beyond the estoppel theory expounded in paragraph 34 of the complaint.

[9] Admiral Freeman testified he agreed with Gordon Rule's group's rejection of the Avondale settlement and he would have approved a formal rejection of the Lockheed tentative settlement and agreed to permit NAVSHIPS to withdraw its submission. Admiral Freeman was Gordon Rule's superior and was the level between the Group and the Chief of Naval Material. The reference to the Gordon Rule part of the Navy in the context of being different from his superiors calls for no further comment.

October 27, 1970 is the date Admiral Sonenshein made the $58 million offer to Mr. Folden, of the Shipbuilding Company. Admiral Sonenshein was asked (Tr. p. 1432):

"Q. * * * did you ever attend a meeting at the Pentagon with Secretary Packard after 27 October 1970, when the subject matter discussed was the $58 million offer to Lockheed.

A. No.

Q. Did you ever attend a meeting with Secretary Packard at the Pentagon where the subject matter of the discussion was a $62 million tentative settlement of the Lockheed claim.

A. No."

(See also Tr. pp. 1434, 1435).

Admiral Sonenshein further testified that he never discussed the subject at any time with Mr. Packard. (Tr. p. 1433).[10] He did attend two meetings at the Pentagon in Mr. Packard's office on two different matters, one the award of the DD 963 class destroyers to Litton Corporation and the other relative to award of the SSN 688 class submarine contracts to General Dynamics and Newport News. (Tr. pp. 1433, 1434). But he did not discuss Lockheed at those meetings.

Mr. Packard's log was located in the Pentagon in the Office of the Secretary of Defense records. Sergeant Holt on duty testified that he was instructed to check the log or diary for the period from October 1970 to February 1971 to see if there was a notation of a meeting between Mr. Packard and Admiral Sonenshein. He found no such entry or notation. (Tr. pp. 1563–1568).

How does Appellant deal with this in its brief? Referring to Mr. Packard's letter of 30 December 1970 to Senator Stennis, the brief states (at p. 314):

"In so formulating the ship-claim portion of his plan of overall resolution, Secretary Packard relied on the *assurances of the Secretary of the Navy and other members of the Navy Secretariat* that the ship claims would be settled at $58 million (and subsequently at $62 million under the normal, established Navy procedures. (Statement of Facts, para. 37).

Let us examine Appellant's version of his "Statement of Facts." Paragraph 37 (Brief pp. 93–107), relies on Mr. Packard's testimony that (at p. 93) "prior to his December 30, 1970 letter, he had received the 'assurance' of the Secretary of the Navy (Mr. Chafee) and of the Under Secretary of the Navy (Mr. Warner) that the Navy under its normal, established procedures *would approve* settlement of the ship claims at $58 million, and subsequently at $62 million," and in support of that, selected excerpts from Mr. Packard's testimony at the hearing is set forth (Brief at pp. 93–96).

With the collapse of the Admiral Sonenshein "alibi," Apellant goes back to the Navy Secretariat. We will undertake to demonstrate that this record does not warrant a finding that either Mr. Chafee, Mr. Warner, or Mr. Sanders, gave Mr. Packard assurance that the Navy had approved or "would approve settlement of the ship claims at $58 million and subsequently at $62 million." The record, we submit calls for a contrary finding.

First, *Mr. Sanders.* In his deposition (Tr.Exh. G–74, pp. 74–76), he testified that when he got a copy of the 30 December 1970 letter, he objected to its contents because it implied negotiations were completed. He testified he probably discussed this with Mr. Warner or Mr. Chafee. He recalled voicing his objections to Mr. Shillito pointing out that the proposals had not been reviewed by NAVMAT for the Secretary. Mr. Sanders, initialled off on the 28 May 1971 letter of Mr. Chafee (ante, at p. 194) and Mr. Warner testified that the claims area was specifically delegated by Mr. Chafee to Mr. Sanders (Warner, Tr. pp. 2030, 2050).

When the provisional payment was approved in February 1971, Mr. Sanders signed off on Gordon Rule's memorandum of 24 February 1971 to Admiral Sonenshein in which it was specifically noted that such provisional payment approval "in no way affects or prejudices the authority to CCCSG" with respect to "the clearance to be submitted to justify overall settlement of these claims." (ante, p. 38).[11]

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[10] See *Admiral Sonenshein's* testimony on 28 September 1971 before Proxmire Committee (R4, C-7-1) at *p. 1263* to the effect that no one ever talked to him about the size of the settlement other than Captain Holfield.

[11] A copy of this document, as we have previously indicated, went to Mr. Shillito.

Appellant's selected excerpts from Mr. Sanders' deposition (Brief, pp. 104, 105) are not a fair reading of his overall testimony. What is *omitted* among other things are the following: Mr. Sanders was asked by Mr. Gussman about discussions with Mr. Shillito (Tr.Exh. G–74, at p. 37)

"Q. What about [discussions with] Mr. Shillito?

A. Yes, but in basically general terms only. Again *the major problems facing Lockheed were not Navy problems;* therefore, we really didn't have that much entry or import.

Q. Did he inquire about the shipbuilding claims?

A. Oh yes, from time to time.

Q. What would be the nature of his inquiry?

A. When are you going to settle them.

Q. *Did he ever ask you what range the negotiations would be in?*

A. *No, definitely not. Unequivocally not. We stayed out of the money area. As I mentioned to you, there was one man on my staff and that was the reason why we set up the control group.*" (Emphasis added).

On 30 April 1970, Mr. Sanders sent a memorandum to Admiral Galantin (R4, B–11; Deposition p. 58) concurring in the recommendation that for the five completed contracts NAVSHIPS proceed "with negotiations leading toward settlement of the claims" and that if agreement is reached it be specifically provided that the "funds derived therefrom will be used solely for completion of Navy ships now under construction at Lockheed."[12] He was asked (Deposition, at p. 58):

"Q. * * * and it says Sonenshein is going to go into negotiations and conclude a settlement. Now was it your intent in this kind of memorandum to reverse such a decision after he goes into it?

A. Oh, very definitely, unequivocally. I would rely completely on the mechanism that we set up to review claims; i.e. the Control Group. This was merely a letter saying that you have my blessing to start negotiations. Always reserved the right for non-approval."

Mr. Sanders was asked why he wasn't interested "prior to negotiations as to what the settlement range is?" (at p. 67), and he replied that with billions and billions of dollars involved in procurement, he must manage by a system of techniques then this colloquy: (at pp. 67, 68):

"Q. When you say that part of the management technique would rely upon personnel, does that include Admiral Sonenshein at this point in time?

A. As far as I am concerned, *as I mentioned four times now,* a review by the Control Group, *and a recommendation by the Chief of Naval Material of any figures* which were going to be presented to me as the Assistant Secretary of the Navy for settlement approval." (Emphasis added).[13]

We consider now Mr. Sanders and the 3 November 1970 memorandum from Admiral Sonenshein that gave a status report on Avondale and Lockheed and advised that NAVSHIPS had offered on 27 October 1970 $58 million. Mr. Gussman is interrogating (Deposition, p. 69):

"Q. * * * As to the 3 November memo, and as to the 6 October memo, do you recall discussing them with Mr. Shillito and Mr. McCullough?

A. No, I don't.

Q. *Mr. Packard?*

A. *No. I am reasonably certain there was no discussion at the Packard level.*

Q. Do you recall doing anything with * * * these memos * * * did you reply to them?

A. Definitely not. They are just informational documents which were presented to me." (Italics added).

Mr. Sanders was then asked about Mr. Packard's 30 December 1970 letter to Senator Stennis (Deposition, pp. 72, 73)

"Q. * * * Sir, during the course of your tenure as Assistant Secretary of the Navy, did you know, or had you heard that Secretary Packard was discussing

[12] cf. Mr. Shillito's report to Mr. Packard of a conversation with Mr. Folden who was complaining that the parent corporation wanted the money for its other uses, not for the completion of the ships (ante, p. 184).

[13] Appellant argues that Admiral Galantin had confidence in Admiral Sonenshein. (Brief p. 391 footnote). The answer is he had similar confidence in Gordon Rule in this area to an extent that he considered Rule could reject a settlement made by Sonenshein, without consulting him (ante p. 64).

various financing and settlement plans with Lockheed or the bankers for Lockheed?

A. I knew he was discussing various and sundry things with the bankers in Lockheed, yes. What they were * * *

Q. Did Mr. Packard hold a meeting of the Assistant Secretaries for Installation and Logistics of the Services in which he reported to you on the status of discussions of Lockheed and the bankers for Lockheed?

A. I don't remember any such thing in that context.

Q. Could it have come up in another context involving Mr. Packard?

A. Anything can come up, any one of a dozen ways."

Then comes the part quoted on page 104 of Appellant's brief, under Statement of Facts that Mr. Sanders testified that the information on the status of the ship claims on the 30 December 1970 letter *"could easily have flowed through me up to them in order just to keep them abreast."*

On the basis of the remark "it could easily have flowed through me up to them just keep them abreast" (which in relation to the part immediately preceding, is we submit, taken out of context), Appellant argues that he establishes proof that Mr. Sanders on behalf of the Navy Secretariat gave Mr. Packard the assurances that the $58 and $62 million settlement would be supported. This is grasping for straws. Reading Mr. Sanders' testimony as a whole and considering the actions taken by him when on 7 January 1971, Gordon Rule and Admiral Freeman called his attention to the Packard letter of 30 December 1970, his condition attached to authorization of the provisional payment in February 1971 and his signing off on the letter of 28 May 1971 on Mr. Chafee's letter to Senator Proxmire, compels the conclusion that he at no time give Mr. Packard *any assurance* that *any figure* was good.

Second, *Mr. Warner.* Appellant's brief (at pp. 99–104) contains selected excerpts of Mr. Warner's testimony in an endeavor to support their argument that it was Mr. Warner and/or Mr. Chafee who gave the assurances to Mr. Packard that the $58 and $62 million settlement would be approved. A reading of *Mr. Warner's* testimony as a whole compels the conclusion that he was not the Secretariat representative who gave the alleged assurances to Mr. Packard. He was asked (Tr. pp. 2049, 2050):

"Q. Would you have recommended any figure to Mr. Packard in advance of being advised what the review by the Navy professional group would be?

A. Again, no specific recollection. But my work habits were such that I relied on certain individuals for this type of information. And *if* it is established that I was the one that made the representation to Mr. Packard, *irrespective of my recollection to the contrary,* then I most certainly would have consulted very carefully with Mr. Sanders, Mr. Ill, *probably* Admiral Sonenshein, *certainly* Mr. Freeman,[14] likely Gordon Rule etc. * * *

Q. Would it be correct to say that you have a firm recollection that you are not the person who assured Mr. Packard * * * that the $58 million figure was supportive?

A. I am not firm in that recollection. I am only firm in the following: That, knowing my work habits and what I had done immediately preceding this time with respect to the S–3 that *had I been asked to provide the answer* I am certain that I would have a recollection of extensive analysis * * * and I just don't have these recollections.[15]

On the other hand, it *may well be* that I participated in conferences at which time certain statements were made to Mr. Packard concerning the $58 million. *I just find it hard to believe that I was the sole source of it, particularly* in the light of subsequent [correspondence] which show that Mr. Chafee etc * * *

All this leads me to believe that probably others were more intimately involved in the aspect of the $58 million figure than I was." (Italics added).

Mr. Warner then testified that Mr. Chafee's letter of 28 May 1971 to Senator Proxmire conformed to his understanding of what the Navy procedure was as to review of claim settlements and (Tr. p. 2052), "I am free to say that certainly I was very very careful to the extent I became involved in the resolu-

[14] Mr. Warner confirmed that Admiral Freeman advised him that he (Freeman) could not confirm any particular figure until he got a report from Gordon Rule's Group (Tr. p. 2046). Admiral Freeman was definite in his recollection that Mr. Warner told him Mr. Packard wanted assurance on a firm figure, and that he (Freeman) told him he cannot give him and Mr. Warner heeded that advice (Tr. pp. 955, 956).

[15] Of having made an analysis or extensive consultation with subordinates (cf. Tr. pp. 1995-1999, 2005).

tion of any claims, be they ships or otherwise, that we adhered to the internal procedures." And he confirmed that Mr. Sanders, as ASN (I&L) was the person who was given jurisdiction for the Secretary of the Navy in the claims area.

Appellant's "Statement of Facts" quoting (at pp. 99–104) excerpts of Mr. Warner's testimony *does not* even mention what we have quoted above. A reading of all of Mr. Warner's testimony, in the light of the testimony of Mr. Sanders and Admiral Freeman, compels the conclusion that it was not Mr. Warner who gave the alleged assurances to Mr. Packard.

But Appellant cites from Mr. Warner's selected excerpts testimony to establish that it was Mr. Chafee who gave the assurances to Mr. Packard. A description by Mr. Warner of Mr. Packard's general work habits (and Mr. Packard called Mr. Warner a few days before his testimony, Tr. p. 2048) hardly rises to the level of proof that Mr. Chafee spoke to him and assured him that he (Mr. Chafee) would support the $58 million figure.[16] Mr. Chafee's letter of 28 May 1971 flatly negates any such inference.

As to Appellant's reliance on the excerpts quoted of Mr. Packard's testimony (Brief, pp. 93–96), we need not detail the omitted portions, as we are sure the Board will consider his testimony as a whole, and it will become apparent that all Mr. Packard had to say was that he "felt" he had Secretarial assurance, but could not establish when or how he got such assurances. And we have indicated elsewhere (ante Point VI) that Mr. Packard's and Mr. Shillito's representations to the Congressional Committees negate such alleged assurances that the Secretariat would approve the $58 and $62 million settlement.

Mr. Packard was asked whether shortly after the 30 December 1970 letter, Mr. Shillito told him that Secretary Sanders called and objected to the letter because it didn't state the Navy position. He replied "I don't recall that he did. Maybe he did." (Tr. p. 76). Had he known about the 7 January 1971 memorandum of Gordon Rule raising questions about his 30 December 1970 letter, he "would have had to have some clarification of what the hell was going on." (Tr. pp. 109–111). At any rate, he was asked:

"Q. Well, did you at any time exempt the Lockheed shipbuilding claims from the Navy procedures?

A. No. * * * I tried to let them get the thing settled with their own procedures * * *

And I talked to Admiral Sonenshein to find whether he thought he was on sound ground, and I had the impression from that discussion that he thought he was, and there was no good reason for me to get into the matter any further at that point." (Tr. p. 111)

He assumed when he spoke to Admiral Sonenshein that the Admiral "had all these matters appropriately processed through procedures within the Navy, and I had no reason to go in and question, whether in fact that had or had not been done." (Tr. pp. 113, also 114–118).

In his correspondence with Senator Stennis and Lockheed, Mr. Packard did not intend to make a direct agreement between DOD and Lockheed with respect to the shipbuilding claims. He expected that the Navy would make the agreement; that the contractual agreement would be "not less than $58 million" but it was not to be a DOD agreement. (Tr. p. 123).

In the light of the above, it is clear that Mr. Packard was mistaken as to his recollection (as to which he was not in doubt) of getting personal assurance from Admiral Sonenshein as to the Navy's acceptance of the package plan to include the shipbuilding claim. But there are some questions that must be asked about Appellant's overall settlement plan theory. Why did Mr. Packard feel that he had to send a dispatch to Mr. Clements and Senator Stennis and Congressman Hebert while he was still a witness at the hearing to get reassurance of his testimony (Tr. p. 527; Tr. Exh. G–28)? Why did Mr. Packard feel that he had to talk to Mr. Warner by phone after he learned he would be a witness (Tr. pp. 2047, 2048)? And why did Appellant's counsel feel that it was necessary to send Mr. Shillito (who was known to be a prospective witness) a copy of Mr. Packard's deposition, Mr. Haughton's letter to Mr. Packard of 10 August 1974 and the memorandum that was submitted to Mr. Clements on 6 August 1974 (Tr. p. 1285) by Lockheed and the

[16] Mr. Warner (at Tr. pp. 2046, 2047) acknowledged that Mr. Packard could have gotten the figures from OSD professional staff without contacting personally the Secretary of the Navy. "I just make the *presumption* that he (Mr. Packard) sought corroboration from the Navy. *But I have no specific knowledge, nor can I produce any documentation that he did so.*" This, too, is omitted from Appellant's excerpts. (Emphasis added).

Bankers on the matter of the Textron deal being subject to a condition of settlement of the shipbuilding claims and this appeal?

We suggest that the explanation is, that Mr. Packard in his desire to help Lockheed get the Textron deal through, adopted the idea conceived by Appellant's counsel of an overall settlement plan as a basis for settling this ship claims dispute. And the evidence does not support any such plan to include the shipbuilding claims.

ITEM 15.—*May 15, 1975—Los Angeles Times article entitled "Lockheed Wins Dispute With Navy On Ship Costs"*

(By Al Delugach)

Lockheed Aircraft Corp., Burbank, Wednesday reported a major victory in its long dispute with the Navy over a $62 million settlement of shipbuilding claims in 1971.

The Armed Services Board of Contract Appeals upheld the full amount of the settlement, on which $13 million was unpaid, Lockheed said.

The magnitude of the triumph for Lockheed is indicated, however, by the fact that a Navy contracting officer in 1973 had ruled that Lockheed Shipbuilding & Construction Co., a subsidiary, was entitled only to $6.8 million.

Since the Navy already had made $49 million provisional payments on the $62 million settlement, the implication in the officer's ruling was that Lockheed had been overpaid by about $42 million.

Some of Lockheed's shipbuilding claims were submitted by the Navy to the Justice Department last December for "further investigation."

However, no details have been made public as to which claims were involved. A Justice Department spokesman told The Times that the investigation was being made by the fraud section of its criminal division.

A Lockheed spokesman, in response to a question, said Wednesday that the company still had not been informed of the exact nature of the matters being probed.

Ironically, it was the unresolved status of the subsidiary's shipbuilding claims that was a major factor in a decision Feb. 28 by Textron Inc. to abandon its plan to invest $100 million in Lockheed.

Despite this setback, Lockheed late last week achieved a major recapitalization through a tentative agreement with its 24 lending banks that is expected to ease the aerospace giant's financial problems.

The shipbuilding claims dispute that led to Wednesday's ruling originated in four contracts that the Seattle-based subsidiary received during 1963–65 for construction of seven amphibious transport dock ships and five destroyer escorts.

The contracts were for $428.8 million and Lockheed claimed $159 million in costs above that figure. In January, 1971, the company and the Navy agreed to settle for $62 million.

According to Lockheed's announcement, the appeals board concluded:

"On all of the facts in the record before us, we hold that justice and basic fairness require that the government be stopped to deny the legal enforceability of the $62 million settlement * * *."

The decision becomes final if the Navy does not file a motion for reconsideration within 30 days.

ITEM 16.—*May 16, 1975—Navy General Counsel E. Grey Lewis memorandum for the Secretary of the Navy pointing out that the Navy strongly objected to the Board's findings; that there was no review of the merits of the claim; that there was a strong dissent by Judge Lane. He states, "This case also demonstrates the need to seek legislation giving the Government the right to appeal to the Court of Claims, a right which the contractor now has, but the Government does not"*

DEPARTMENT OF THE NAVY,
OFFICE OF THE GENERAL COUNSEL,
Washington, D.C., May 16, 1975.

Subject: Decision of the ASBCA in Appeal of Lockheed Shipbuilding & Construction Co., ASBCA No. 18460 (Appeal No. 1).

1. The Board in a 67–page opinion released on 14 May 1975, by a 4 to 1 vote, held that the Navy is obligated to pay Lockheed $62 million on the tentative settlement made on 29 January 1971 of its shipbuilding claims which amounted to $160 million. This claim, as you recall, was referred by us to the Justice Department to investigate apparent fraud aspects. The decision of the ASBCA has nothing to do with that.

2. Before the ASBCA, we took the position that since the tentative settlement (which was formalized in a contract modification), required approval by the Chief of Naval Material and the ASN(I&L), under the applicable regulations, and such approval was not given (in fact, NAVMAT informally rejected the settlement but permitted NAVSHIPS to withdraw its approval request); there was no final contract and no contractual obligation to pay the $62 million. On this point the ASBCA sustained our position. (Pages 45, 46 of attached opinion.)

3. However, the majority of the Board held that the *Government* was estopped to deny "the legal enforceability of the $62 million tentative settlement" because Deputy Secretary of Defense Packard had represented to the Congressional Armed Services Committee an overall plan for dealing with the four DOD programs of Lockheed then in dispute. The four programs were (1) the C-5A contract with the Air Force, (2) the Cheyenne helicopter contract with the Army, (3) the SRAM, (rocket motor short range missile) with the Air Force, and (4) the shipbuilding claims with the Navy. The majority of the Board further held that Mr. Packard represented to Lockheed and its bankers that the settlement of the shipbuilding claims was included in the package deal, and in reliance thereon, the bankers extended credit to Lockheed; with a finding (¶68-1, at p. 43) that the "statements and conduct of Secretary Packard during the critical period of 30 December 1970 to 14 September 1971, [when the guarantee loan of the $250 million above the $400 million, by the Government was executed] the Government [meaning through Mr. Packard] assumed and impliedly promised that the Navy would approve the ship claims settlement for $62,000,000 and intended that Lockheed, its bankers and airline customers, and the Emergency Loan Guarantee Board should act in reliance on this assumption and implied promise."

4. There was a strong *dissent* by Administrative Judge Lane (pages 62-67) who was of the opinion that the "* * * facts require the conclusion that the Government is not estopped from asserting that the $62 million tentative settlement of the ship claims was never approved by higher authorities in accordance with applicable regulations and so is not binding upon the Government. * * * I would not find estoppel against the Government in this appeal. This would not, of course, be a denial of the claims, but at worst would force Lockheed to litigate the ship claims before this Board on the merits."

5. I consider the majority opinion wrong, and its conclusion inconsistent with many of its findings. For example: (at page 6, ¶6. d.) the finding is that Secretary Packard was informed on a current basis by his staff with respect to Lockheed's critical cash flow position

"* * * while the three services were entrusted with the active management of their respective programs. *On this point, Secretary Packard was explicit in testifying that negotiation of a settlement of the ship claims was to be the responsibility of the Navy, that he did not investigate the merits of the ship claims, or ask any of his staff to do so. From the start, appellant was aware that its ship claims were to be handled by the Navy rather than by the Office of the Secretary of Defense (OSD), and that they were not to be treated as merely a part of the total Lockheed problem.*" (Emphasis added)

I find it difficult, in the light of that finding, to understand how the majority arrives at the conclusion that ship claims was part of a DOD package plan.

Another example (at page 42, ¶68,c,d, & f), the findings are:

"c. Lockheed's ship claims, which comprised one of the four DOD claims dealt with in Secretary Packard's overall plan, were *by his express direction left to the Navy to resolve in accordance with its established procedures.* (Emphasis added)

"d. Neither Secretary Packard nor any one on his staff in the Office of the Secretary of Defense, ever evaluated or inquired into the merits of the ship claims, *nor did he ever order the Navy to settle those claims for any particular sum of money.* (Emphasis added)

"f. Representatives of Lockheed as well as Secretary Packard knew that the $62,000,000 tentative settlement of 29 January 1971 was subject to the approval of higher Government authorities in accordance with applicable regulations,

and that such approval had not been given as of 14 September 1971, the date of the closing on the 1971 Credit Agreement."

Again, I find it difficult to understand, in the light of those findings, how the majority can arrive at the conclusion which in effect is a directive by Mr. Parkard (who was ignorant of the merits of the claim) that the Navy pay a particular sum—namely $62 million.

6. But beyond dissecting the majority opinion is the appearance of a disturbing principle that would eliminate the Department of the Navy as an independent agency and has its considered procurement procedures overruled by *ex parte*, informal meetings between higher DOD officials and contractors. Disturbing also is that result which means that Navy shipbuilding appropriations are to be applied for the payment of Lockheed's risk in undertaking the commercial venture of the L–1011, for the credit extended to Lockheed by the bankers and the Emergency Loan Guarantee Act related to protect Lockheed in its commercial investment on the L–1011.

7. I propose to make a motion for reconsideration and for referral of the appeal to the Board's Senior Deciding Group which consists of 13 members (the division heads of each of the ten divisions plus the chairman and two vice-chairmen) as against the Division No. 5, that decided this case (consisting of three members plus the chairman and one vice-chairman). I will ask for oral argument on the motion.

8. This case also demonstrates the need to seek legislation giving the Government the right to appeal to the Court of Claims, a right which the contractor now has, but the Government does not. When a contractor appeals, a decision of the Board on a question of law is not final because traditionally questions of law are reserved for the Courts. Here is an important legal principle pronounced by the majority that a higher official in DOD may by conversation and representations virtually negate a contractual obligation. The final authority on such a question should not and cannot be the Armed Services Board of Contract Appeals.

9. I shall be pleased to discuss this further with you and in the meantime I am enclosing a copy of the Board's opinion.

E. GREY LEWIS,
General Counsel.

ITEM 17.—*May 19, 1975—Federal Contracts Report article entitled "Estoppel: Government Officials Conduct Estops Government From Denying Settlement's Enforceability"*

ESTOPPEL: GOVERNMENT OFFICIAL'S CONDUCT ESTOPS GOVERNMENT FROM DENYING SETTLEMENT ENFORCEABILITY

Issuing the first decision of the approximately $1 billion in ship building claims before it, the Armed Services Board of Contract Appeals rules that the conduct of Government Officials—primarily that of former Deputy Defense Secretary David Packard, led Lockheed reasonably to expect the approval of a tentative $62 million settlement with Navy and, Lockheed having reasonably relied on that expectation, the Government is now estopped from denying enforceability of the settlement, which never did receive the required approval. (Lockheed Shipbuilding & Construction Co., ASBCA No. 18460, 5/13/75)

The issue in the case is "limited," the Board notes, but the record of the appeal is "massive"—19 volumes of Rule 4 documents and 16 of trial exhibits.

Lockheed's claims totaling $160 million under four Navy shipbuilding contracts involved only a part of the overwhelming financial problems in which the company was engulfed during 1970 and 1971. In three other military programs, the company had giant claims against the Government: under its contract with the Air Force for the C-5A transport aircraft, under the Army's development and production contracts for the Cheyenne fixed-rotor helicopter, and for the rocket motor of the short range attack missile (SRAM) for which Lockheed had the subcontract under Boeing Aircraft's prime contract with the Air Force.

In addition Lockheed had a commercial program involving the L–1011 airplane in which it had invested about $700 million. When Britain's Rolls Royce, the engine supplier for the L–1011, announced insolvency in February 1971, that program too was in trouble.

On learning of Lockheed's problems after he became Deputy Secretary of Defense, Packard resolved to develop a solution that would meet DOD's needs, the Board's findings begin.

Deciding that the magnitude and complexity of Lockheed's problems required an overall or company wide solution, he set forth such a plan in December 1970 in a letter to the Chairman of the Senate Armed Services Committee. The letter stated that normal and established procedures were adequate to resolve two of the issues—the SRAM subcontract and the ship claims. Packard reported that the Navy and Lockheed had been negotiating to settle the ship claims. The Cheyenne program and the C-5A, however, would require action under PL 85–804.

In late January 1971, Lockheed accepted the Naval Ships Systems Command offer of $62 million in tentative settlement of the ship claims, subject to the approval of Chief of Naval Material and Assistant Secretary of the Navy (I&L) and shortly thereafter, accepted the overall plan outlined by Packard. Among other provisions, the plan imposed a fixed loss of $200 million in Lockheed, and required it to withdraw two appeals to the ASBCA under the C-5A and Cheyenne contracts.

The Rolls Royce announcement of insolvency interrupted execution of a pending credit agreement that Lockheed had with its banks and put the contractor in a critical cash position. Accordingly, contract modifications were entered into which formalized the Navy's tentative $62 million settlement of ship claims and raised the provisional payments against the settlement to $49 million.

The modifications were expressly conditioned upon the higher approval mandated by NPD1—401.55, which required procuring activities to report contractor claims of over $5 million to the Assistant Secretary of the Navy (I&L). The Chief of Naval Material, who had issued the regulation, had also established as a staff function of his command a board to review the claims submitted—the contract claims control and surveillance group (CCCSG)—of which Gordon Rule was the chairman.

Meanwhile Lockheed's bankers had come up with an interim measure, which permitted the contractor to borrow an additional $50 million, that was to be refinanced under a new permanent agreement to be executed by September 30, 1971. The new agreement contemplated a package of $750 million, $650 million of credit was to be provided by the banks with the amount over $400 million to be secured by a $250 million Government loan guarantee; $100 million of additional financing to be provided by the airlines that had contracted for purchase of the L–1011 aircraft.

In planning the credit agreement with Lockheed, the bankers, with whom Packard was in close touch during 1970 and 1971, had required from the beginning that all of Lockheed's disputes with DOD be settled as a condition to execution of the agreement, and on the basis of their dealings with Packard, the Board states, assumed that the Government would pay Lockheed $62 million in accordance with the settlement that had been reached.

Packard too, uninformed of the details of Navy claims procedures, assumed that the settlement would finally be approved in the amount of $62 million. However, such was not to be the case.

During April and May of 1971, questions were raised, as a result of a General Accounting Office report and criticism by Senator Proxmire, Vice Admiral Rickover, and Gordon Rule, concerning the Navy's claims settlement procedures. The GAO believed that Navy was relying too heavily on personal judgment of its negotiators rather than on historical data in evaluating the claims.

Efforts continued by Secretary Packard and others in DOD and the Treasury Department to resolve Lockheed's financial difficulties. On June 4, 1971, the Cheyenne and C–5A contracts were ordered restructured pursuant to PL 85–804. The SRAM subcontract had already been settled and congressional hearings were continuing on a bill, subsequently enacted on August 9 as PL 92–70, to grant emergency loan guarantees to business enterprises. A sense of urgency was created by the September 30 deadline for execution of Lockheed's credit agreement.

The notion that the ship claims had been settled for $62 million, subject only to a formal finalization, was shared by Packard, Lockheed's officials, the banks, and Secretary of the Treasury Connally, but not by Rule and his committee.

In August 1971, after Rule had rejected for lack of evidential documentation a ship claims settlement with another contractor, NAVSHIPS decided to with-

draw the Lockheed claim settlement proposal from CCCSG and to obtain additional supporting data from Lockheed.

On September 14, the 1971 Credit Agreement and Guarantee Agreement were executed by Lockheed, the banks, and the Emergency Loan Guarantee Board created pursuant to PL 92–70.

The Superintendent of Shipbuilding in Seattle informed Lockheed in November that its claims must be fully supported by definitive tangible evidence. Thereafter, Rule resigned as chairman of the CCCSG and that Board was disestablished and replaced by a General NAVMAT Board with subordinate board to assist it.

By June of 1972, the subordinate NAVSHIPS Claims Board had recommended approval of the settlement, which then required approval of NAVMAT Claims Board. A month later the Superintendent of Shipbuilding had concluded that it was impossible to arrive at specific definite costs that could be definitively documented.

Following the return of the proposed settlements from the NAVMAT Board, the Navy sought further documentation from Lockheed. Not only were those efforts unavailing, but Lockheed's troubles were compounded by a new Navy directive that required strict proof of a contractor's claim "including a demonstration of causal support and documentation of quantum," the Board observes.

Finally in June of 1973, the contracting officer issued a final decision that allowed Lockheed less than $7 million and demanded the repayment of $42 million, the balance of the provisional payments theretofore made.

SETTLEMENT THEORY

Among its other arguments, Lockheed contended that a contract of overall settlement between it and the Government, represented by Packard, controls the tentative settlement embodied in the Navy contract modifications, or alternatively, that the Government is estopped to deny the finality of the settlement under all of the circumstances presented. The Board rejects the first argument and accepts the second.

Packard had an overall plan that embraced the four DOD programs but that plan did not purport to settle the ship claims, the Board finds. These were left to the Navy to resolve in accordance with its procedures. The settlement was tentative and would not become final until higher authorities had approved it. "Since the condition precedent to the taking effect of the tentative ship claims settlement, that is, the approval of higher Government authorities, was never fulfilled, the tentative settlement of 29 January 1971 did not become final or legally enforceable against the Government on 1 February 1971, the date on which Lockheed accepted Secretary Packard's overall plan."

The Board turns to Lockheed's alternative argument, that the Government is estopped to deny legal enforceability of the tentative settlement because of events that occurred between February 1 and September 14, 1971, when the participants became irrevocably committed to the 1971 credit agreement and related documents.

Two threshold conditions must be satisfied before an estoppel may be found against the Government, the Board points out: first, the Government must be acting in its proprietary rather than its sovereign capacity—which it plainly was in this case; second, the Government's representative, whose acts form the basis for the estoppel, must have been acting within the scope of his authority.

Neither party questions the Secretary's authority to approve the settlement or waive the Navy regulation requiring higher approval, but he did not do so. Therefore, a determination as to the second condition turns on whether the regulation was binding on Packard and the Government so long as it remained in effect.

Unlike the termination for convenience clause in G. L. Christian v. U.S., 160 Ct. Cl. 58 (1963), which had the "force and effect of law", the present regulation was a procedural or non-legislative one that was intended for the benefit and protection of the Government, the Board decides.

(Text) In sum, we conclude that the Navy regulation, which established the condition that the tentative $62,000,000 settlement be approved by higher authorities before it became final, was intended solely for the protection of the

Government, and hence could be waived by a Government official having the requisite authority to do so. We also conclude that Secretary Packard and members of the Navy secretariat had the authority to waive the regulation, or, by their representations or conduct, provide a basis for estopping the Government from denying the legal enforceability of the settlement solely because of the application of the regulation. (End Text)

ESTOPPEL

The four elements necessary for an equitable estoppel are present in this case, the Board next decides. The Government knew the facts, it intended that its conduct be acted upon by Lockheed, Lockheed was ignorant of the true facts, and Lockheed relied on the conduct of Government officials to its detriment.

On the question of the Government's knowledge, the Board concludes that statements by responsible Government officials establish that the Government knew that the settlement was subject to approval by higher authorities and that such approval was not a mere formality. Moreover, the Government knew that the condition of further approval had not been satisfied on September 14 when the participants in this case—including the banks, airlines, the British Government, Rolls Royce, the U.S. Government, and Lockheed—became committed to the credit agreement.

On the second element—the Government's intention that its conduct be acted upon by Lockheed—the Board points out that Packard testified at the hearing that he expected the Navy to implement the tentative $62 million settlement. Corroboration of his understanding can be seen in the actions taken by Lockheed's bankers and airlines customers during the critical period after January 29 when the settlement was arrived at.

In planning the agreement, the Board had found, the bankers had required all disputes with DOD to be settled as a condition precedent to executing the agreement and had assumed the Government would pay Lockheed the $62 million in accordance with the settlement. The airlines too had required that all outstanding amounts be paid before they reaffirmed their L–1011 orders. The Emergency Guarantee Board in turn required that the airlines' orders be reaffirmed before any of the guaranteed loan be made available to Lockheed. These actions were well known to Packard and others in Government as events moved toward September 14.

(Text) Given this knowledge, his silence, or failure to advise Lockheed, its bankers, and its airline customers not to act on their assumption of the finality of the ship claims settlement, firmly establishes his intention in the matter and constitutes an implicit promise that the settlement would be finally approved in the amount of $62,000,000. (End Text)

Thus, the Government, through the statements and conduct of Packard, impliedly promised that the Navy would approve the settlement and intended Lockheed to act on this assumption and implied promise, the Board finds.

Turning to the third element—Lockheed's ignorance of the true facts—the Board points out that although aware of the unsatisfied condition, Lockheed's representatives assumed that the approval would be readily given once the necessary documentation was obtained. Thus, Lockheed was ignorant of the "true facts" if the "true facts" are that the settlement would be subjected "to a searching, exhaustive review which existing documentation could not possibly satisfy," the Board states.

Testimony by Lockheed officials indicated that they thought the approval would be given in due course. Corroboration of the reasonableness of that belief may be seen in the reliance placed by the bankers and airlines on Packard's implied promise that the settlement would be approved for $62 million. While it was in Lockheed's interest to foster this reliance, it was fully within the Secretary's power to negate had he desired to do so. The evidence points to the conclusion that he, too, desired to foster that reliance.

Finally, on the question of reliance, the fixed loss of $200 million and the withdrawal of its appeals on the C–5A and Cheyenne programs are sufficient to establish Lockheed's reliance on the conduct of responsible Government officials to its detriment, the Board finds.

In sum, "justice and basic fairness" require that the Government be estopped from denying enforceability of the settlement, the Board states. The views

expressed in the accompanying dissent do not seem to take into account the practical realities of the situation that faced Lockheed. Thus, what Lockheed knew is not as significant as the source of the information, the Board states.

(Text) Our decision is simply this, that although Lockheed was given confused and contradictory information regarding its expectation that the $62,000,000 settlement would be approved, it reasonably relied on the signals ultimately given by and implicit in the conduct of the Deputy Secretary of Defense that he would take any action necessary to assure that his overall plan would be fully executed. Lockheed's reliance on those signals was precisely what Secretary Packard intended. The reliance was reasonable because Secretary Packard held the second highest office in the entire department, and had plenary authority over all of the DOD programs. (End Text)

The Board notes that it has cited the reliance of Lockheed's bankers and airlines customers on Packard's implied promise only to corroborate the reasonableness of Lockheed's reliance. However, the most recent Restatement would afford third parties, such as the banks and airlines, a right to invoke an estoppel against the promisor, or Government also.—Bird, A.J.

Dissent: According to Administrative Law Judge Lane, there is no significant discrepancy between Lockheed's knowledge and Packards' or the Navy Secretariat regarding the substantive nature of the Navy claims review, nor do the facts support a finding of an implied promise to Lockheed that they would overrule or bypass Mr. Rule.

If such an implied promise cannot be found, then the most that can be said is that the Navy Secretariat and Packard conveyed an expectation that the claims could, and would, be documented and that they would be approved. "As a matter of law, I regard an assumption or expectation, even on the part of Secretary Packard or Secretary Ill, as an inherently unreliable basis for Lockheed to act." Lockheed had full reason to know that the assumptions and expectations were overly optimistic, thus reliance upon them was unreasonable.

As to reliance by Lockheed, the Government encouraged Lockheed to accept the agreements to substantial losses on the C–5A and Cheyenne contracts and to drop its appeals as part of a package deal when the Government officials knew or should have known that absent their personal intervention, the $62 million settlement was doomed. However, Lockheed was not misled. The contractor was essentially aware of the problem in obtaining ship claims approval, but with its existence at stake, it could not red flag the problem without jeopardizing the entire credit agreement.

Thus Government officials may have encouraged Lockheed to proceed without forcing the approval issue, "but I believe Lockheed proceeded with full awareness that the ship claims settlement might very well not go through."

Judge Lane notes that he agrees with the majority's "implicit finding" that the shipbuilding subsidiary should be treated as one with the parent.

ITEM 18.—*May 28, 1975—Letter from Senator Proxmire to Secretary of Defense Schlesinger stating that the Armed Services Board of Contract Appeals acted improperly and illegally in the Lockheed case and that neither Secretary Packard nor the Armed Services Board of Contract Appeals had authority to order payment of $62 million to Lockheed without proof the Navy owed this sum unless the Secretary exercised his powers to grant extracontractual relief under Public Law 85–804. Senator Proxmire requests that the Defense Department suspend implementation of this decision and stop payment to Lockheed*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., May 28, 1975.

HON. JAMES R. SCHLESINGER,
Secretary, Department of Defense, Pentagon,
Washington, D.C.

DEAR MR. SECRETARY: I understand that the Armed Services Board of Contract Appeals has recently overruled a $6.7 million contracting officer decision and ordered the Navy to pay Lockheed Shipbuilding and Construction Company $62,000,000 on shipbuilding claims. In so ruling, the Board made no attempt to assess

the merits of the shipbuilding claims themselves. The Lockheed claims in question, are those involved in the infamous backroom settlement involving Admiral Sonenshein, former Commander of the Naval Sea Systems Command. If you recall, Lockheed submitted shipbuilding claims totaling $159 million. * * * A detailed legal review, however, resulted in a contracting officer determination that Lockheed was entitled to only $6.7 million. Lockheed appealed this decision to the Armed Services Board of Contract Appeals. The Navy subsequently observed irregularities in the claim itself and referred it to the Department of Justice where it is presently being reviewed by the Fraud section of the Criminal Division.

I am appalled by the Board's decision. Rather than reviewing the merits of the claims themselves, the Board elected to rule in favor of Lockheed on a legal technicality, an estoppel theory—that "justice and basic fairness require that the government be estopped to deny the legal enforceability of the $62,000,000 settlement." The Board said: "* * * although Lockheed was given confused and contradictory information regarding its expectation that the $62,000,000 settlement would be approved, it reasonably relied on the signals ultimately given by and implicit in the conduct of the Deputy Secretary of Defense that he would take any action necessary to assure that his overall plan would be fully executed. Lockheed's reliance on those signals was precisely what Secretary Packard intended. The reliance was reasonable because Secretary Packard held the second highest office in the entire department * * *"

But as the Board itself points out in its decision, Secretary Packard had no knowledge as to the value of Lockheed's ship claims; he assured Congress that these claims would be double checked "to be sure the claims can be appropriately verified"; and he intended that the responsibility for settling the ships claims was the Navy's. The Board also found that Lockheed was aware that the Navy was responsible for settling the claim and that approval for settling for $62,000,000 was never given by the Navy. The Board's decision that the taxpayers should make good on Mr. Packard's "signals" that Lockheed would get the $62,000,000 is completely unjustified. Moreover, the Board has no authority to even make such a decision.

The Board has acted improperly and illegally in this case. Its decision, in addition to being unfair to the U.S. taxpayer would set an intolerable precedent. The Board is saying that the procedural safeguards that have been established within the Navy to ensure only legal expenditure of public funds can be circumvented by senior defense officials in their private discussions with corporate executives. If the Board's opinion is allowed to stand, the taxpayer can be stuck with the bill for millions of dollars without any proof that the money is properly owing under the contract any time high government officials talk with corporate executives.

If Secretary Packard believed it was in the national interest to give Lockheed $62 million without proof that the Navy owed this sum, his recourse should have been under Public Law 85–804. That law requires public reporting of actions taken under it and in the case of payments in excess of $20 million, Congress has expressly retained the right of review and disapproval.

In the current Lockheed case, the Armed Services Board of Contract Appeals apparently assumed the right to grant extra contractual relief in contravention of the statutory restrictions.

I am very disturbed that an administrative body such as the Armed Services Board of Contract Appeals would decide issues such as this one, with so many millions of dollars at stake, on a technicality. In effect the Board is saying that taxpayers' money can be spent to pay any claim where a high government official says it will bet paid even if the claim is a phony one or worthless on the merits.

Further, I understand that under current rules, the Government may not have any right to appeal this critical decision to a court of law. Thus, Lockheed might never be required to demonstrate its entitlement to the $62 million.

As Secretary of Defense, you are the official responsible for the Armed Services Board of Contract Appeals. In this regard, I request that you suspend implementation of this decision (ASBCA No. 18560 of 14 May 1975) and stop payment to Lockheed on the following basis:

a. The Armed Services Board of Contract Appeals has no authority to grant extra contractual relief such as payments that may be authorized under PL 85–804. The Board's function is to settle disputes under contracts.

b. The Department of Defense has no authority to make payment in accordance with the Board's decision without first complying with the requirements of Law 85–804—including the requirement for prior submittal to Congress of any proposed relief in excess of $20 million. The administrative procedures of the Board cannot be used to circumvent an act of Congress.

c. The Department of Defense has no authority to make payment while the claims are still being investigated by the Department of Justice for possible fraud and it would be improper to make payment in this case. 28 USC 2514 reads in part:

"A claim against the United States shall be forfeited to the United States by any person who corruptly practices or attempts to practice any fraud against the United States in the proof, statement, establishment or allowance thereof."

I would hope that the Board's activities in the future will be confined to reviews of contract disputes and that in cases involving claims it will focus on the merits of the claims rather than on issues which are outside its authority.

I would appreciate being informed promptly of what action you intend to take in this matter.

Sincerely,

WILLIAM PROXMIRE.

ITEM 19.—*June 12, 1975—Navy appeal of Armed Services Board of Contract Appeals decision in the Lockheed case. The Board rejected the Navy's request for reconsideration. (A Copy of the Navy Appeal is included in the Miscellaneous Documents appendix.)*

ITEM 20.—*June 18, 1975—Letter from Department of Defense Counsel Hoffman in response to Senator Proxmire's May 28, 1975 letter to the Secretary of Defense. Mr. Hoffman points out that the Navy has filed a motion for reconsideration and that because of a Department of Justice investigation of possible fraud in connection with these claims, the Department of Justice had advised the Navy not to implement the Board's decision pending completion of the fraud investigation.*

GENERAL COUNCIL OF THE DEPARTMENT OF DEFENSE
Washington, D.C., June 18, 1975.

Hon. WILLIAM PROXMIRE,
United States Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: This is in response to your letter to Secretary Schlesinger of May 28, 1975 in which you request that implementation of the decision of the Armed Services Board of Contract Appeals in the appeal of Lockheed Shipbuilding and Construction Company issued 14 May 1975, (ASBCA No. 18460) be suspended. The principal grounds upon which you urge such action, are (1) that the Board in applying estoppel against the Government in effect undertook to grant extra contractual relief which is beyond its jurisdiction, and (2) that the Department of Defense has no authority to make payment while the claims are being investigated by the Department of Justice for possible fraud.

With respect to the first point, the decision of the Board is not final since its rules authorize a motion for reconsideration. I am advised that the Navy has filed with the Board a motion for reconsideration and for referral of the matter to the Senior Deciding Group, and requested oral argument thereon. The Senior Deciding Group consists of the chairman, vice-chairman and the heads of the Board's divisions and was established to decide significant or unusual cases. In view of the foregoing, it would not be appropriate for me to express my views on points which may be at issue while this matter is still before the Board.

As to your second point, the General Counsel for the Department of the Navy has written to the Justice Department advising them of the Board's decision and calling their attention to the ongoing fraud investigation. He requested an opinion of the Department of Justice as to whether, in light of

the fraud element, the Navy should comply with the Board's decision, should the Navy be unsuccessful on its motion for reconsideration. In its reply, the Department of Justice advised the General Counsel of the Navy not to implement the Board's decision pending completion of the fraud investigation.

Accordingly, pending the Board's decision on the Navy's motion for reconsideration, and completion of the investigation by the Department of Justice, no action will be taken to implement the Board's decision.

Sincerely,

MARTIN R. HOFFMANN.

ITEM 21.—*Aug. 3, 1975—City of San Francisco article entitled "Fraud Investigation May Peril Ford Campaign"*

The appointment on July 8 of Palo Alto businessman David Packard as Gerald Ford's campaign finance chief began as a smart move to undermine the presidential ambitions of former California Governor Ronald Reagan. But it could end up as a major embarrassment for the Ford Administration due to a controversy currently looming over the attempts of Packard, a former deputy defense secretary in the Nixon years, to secure a $62 million cost overrun payment for the Lockheed Shipbuilding Company from the Navy Department. The details of this dispute are currently under investigation by the Justice Department for possible fraud.

The controversy surfaced last winter when Packard appeared in Washington to argue for the $62 million Lockheed claim despite the objections of the Navy Department itself. Packard's support for Lockheed in the conflict—including a letter he wrote to Senate Armed Services Committee Chairman John Stennis (D-Mississippi)—brought on charges from Senator William Proxmire (D-Wisconsin) that Packard's actions were "an effort to use political influence to alter administrative procedures."

Packard's involvement with Lockheed dates back to the major role he played as deputy secretary of defense in 1971 in arranging the U.S. Government rescue of the then financially beleaguered aerospace giant—whose monetary health is of major concern to several of Packard's own business interests. The possibility of conflict of interest in Packard's Lockheed dealings could do serious damage to Ford's reelection campaign.

LOCKHEED'S RESCUE

Starting in the late 1960s Lockheed, the nation's largest defense contractor, has been in perpetual financial trouble. The company's woes came to a head in March 1971 when Lockheed announced that due to the bankruptcy of a subcontractor—Rolls-Royce Company of Great Britain—it could no longer meet its obligations on its primary commercial venture, the L-1011 Tri-star jetliner.

Complicating Lockheed's troubles at the time were large cost-overruns on several major Defense Department contracts held by Lockheed which contributed to a full-scale liquidity crisis for the company. In desperation Lockheed turned to the federal government.

Enter David Packard who in 1971 was a prime engineer in drawing up the package to save Lockheed: a $250 million loan guarantee and the settlement of billions of dollars in outstanding claims and cost-overruns on the contracts Lockheed had with the government.

"OPENED THE MONEY BAGS"

A. Ernest Fitzgerald, a high-level civilian employee of the Pentagon, recalls Packard's role in the Lockheed rescue. "His handling of the Lockheed case was terrible," Fitzgerald told *City*. "He tore up the contracts and let them off the hook. He opened the money bags at both ends."

One of the disputed contracts Packard helped settle was for nine Navy vessels. But after Packard left the Defense Department in December 1971, the Navy began to have grave doubts about the deal that Packard had put together. Gordon Rule, head of a team of civilian analysts working for the Navy, refused to authorize any payments to Lockheed on the overrun, citing the fact that neither an audit nor legal analysis had been done on Lockheed's claim.

As the dispute heated up, Rule and his team were removed from the case and replaced by an all-military panel. Under pressure from Lockheed, which pleaded financial hardship and sought a prompt settlement, Admiral Nathan Sonenschein, a Navy contract officer, again reviewed the claim. Sonenschein promptly approved a provisional settlement requiring the Navy to pay Lockheed $62 million.

PAY, SAYS PACKARD

Sonenschein's solution to the problem came under attack when the Navy's own contracting officers finally completed their audit and concluded Lockheed's claim was worth no more than $12 million—less than twenty-five percent of the provisional settlement granted by Sonenschein. Lockheed protested and immediately took its case to the Defense Department's Board of Contract Appeals.

At this point Packard again entered the fray. Returning to Washington last winter, he said his original 1971 agreement with Lockheed should be honored to the tune of $62 million. He lobbied the case both at the Pentagon and with key Congressional leaders.

The Board of Contract Appeals, despite the Navy audit, then endorsed the payment of the $62 million.

"SMOKE-FILLED ROOMS"

This enraged Senator Proxmire who, as then Chairman of the Joint Economic Committee of the Congress, protested to Defense Secretary Schlesinger. Proxmire charged Packard with railroading the board into granting Lockheed's claim. The senator was angered at Packard's "coming back several years later and applying political pressure without any basis for a full understanding of the situation. This blurs the line between political, administrative and business decisions." Proxmire also pointed out that by law any claim payment of over $20 million must be reviewed by Congress. "Claims should be made on merits, on the facts, after an audit, an assessment, not horse-traded at the taxpayers' expense in smoke-filled rooms behind closed doors and at high levels among military brass, high government and corporation officials," the Wisconsin senator stated.

Due to Proxmire's intense pressure, Schlesinger turned the matter over to a Navy panel for further investigation. The panel, in turn, sent the matter to the Justice Department for fraud investigation. The Justice Department action has held up the complete payment of the $62 million to Lockheed. According to a Lockheed spokesman, some $49 million, $13 million short of the total, had been paid.

LOCKHEED-PACKARD CONNECTION

Packard's role in the Lockheed dispute with the Navy raises questions of judgment, but his strong business ties to the aerospace contractor bring up even more damaging speculations.

A scant three months after leaving the Nixon administration, Packard was appointed to the board of directors of Trans World Airlines, a company deeply concerned about Lockheed's financial solvency. A leading customer for the L–1011 airliner—TWA is committed to buy $733 million worth of the planes—the airline, according to its own figures, faced a $101 million loss if Lockheed went under.

Like just about everyone else, TWA recognized the government's key position in keeping Lockheed afloat. In its May 1971 contract with Lockheed for the L–1011, TWA notes the need for a "consummation of settlement" of Lockheed's "outstanding government contract disputes"—including resolution of some of the very items on which Packard was working while in the Defense Department and as recently as last winter.

"CURIOUS LOBBYING"

This confluence of interests between Packard, TWA and Lockheed disturbs some of Washington's most experienced observers. One is Richard Kaufmann, chief counsel of the Joint Economic Committee. Kaufmann, who has been probing cost overruns during the last several sessions of Congress, believes

Packard's 1974 trip to Washington "went a little beyond his obligation as a former federal official." Speaking of Packard's TWA affiliations, Kaufmann told *City*, "It adds up to the uncomfortable feeling I have that he is engaged in some very curious lobbying and that it's unseemly."

Packard's interest in Lockheed is not limited to his seat on the TWA board of directors. There are numerous connections between Packard's own firm, Hewlett-Packard, and Lockheed.

Hewlett-Packard, a Penninsula electronics firm in which Packard owns thirty percent of the outstanding stock and is chairman of the board, manufactures many products used by the big government defense contractors—special clocks for naval vessels, testing equipment, radio communications devices. Over fifteen percent of the company's business in 1974 was with the federal government.

"... A VALUED CUSTOMER"

The exact-dollar amount of business between Lockheed and Hewlett-Packard is protected by corporate secrecy. However, according to Washington columnist Jack Anderson, it runs into the millions of dollars. A Hewlett-Packard spokesman, Dave Kirby, wouldn't give a direct estimate of the Penninsula firm's business with Lockheed but confided that "Lockheed is a valued customer."

David Packard, who besides his TWA and Hewlett-Packard connections, sits on the boards of two other major military contractors—Caterpillar Tractor and Standard Oil of California—sloughs off any suggestion that anything but ideology is leading contractors toward the Ford camp. It's simply a matter, the genial, sixty-two-year-old business executive told *City*, of finding the Ford military policies "appropriate and very important."

ITEM 22.—*Dec. 9, 1975—Letter from Senator Proxmire to Secretary of Defense Rumsfeld protesting the Armed Services Board of Contract Appeals decision in the case of Lockheed Shipbuilding. Senator Proxmire requests assurance that no claim payment is made to Lockheed in this matter pending completion of the fraud investigation currently underway in the Justice Department*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C. December 9, 1975.

Hon. DONALD RUMSFELD,
Secretary of Defense, The Pentagon,
Washington, D.C.

DEAR MR. SECRETARY: On May 29, 1975, I wrote to your predecessor, Dr. James R. Schlesinger, protesting an incredible decision by the Armed Services Board of Contract Appeals regarding a Lockheed Shipbuilding claim. The Board had overruled a $6.7 million Contracting Officer decision and ordered the Navy to pay Lockheed Shipbuilding and Construction Company $62 million, even though the Board made no attempt to assess the merits of the claims. Instead, the Board used a legal technicality, the theory of estoppel, to reach its conclusion that the government should not be allowed to deny that it owes $62 million.

The letter expressed my belief that the Board had acted improperly and illegally in this case. In particular, I believe:

a. The Armed Services Board of Contract Appeals has no authority to grant extracontractual relief such as payments authorized under Public Law 85–804. The Board's decision does not determine the facts arising under the contract but constitutes an overall settlement outside the shipbuilding contract.

b. The Department of Defense has no authority to make payment in accordance with the Board's decision without first complying with the requirements of P.L. 85–804, including the requirement for prior submittal to Congress of any proposed relief in excess of $25 million. Not even the Secretary of Defense can use Public Law 85–804 for a payment of $62 million without complying with the "anti-bail out" provisions of P.L. 85–804 which require reporting the proposed action to Congress for prior review and possible disapproval. Thus, the

Board has arrogated to itself authority which even the Secretary of Defense does not have.

c. The Department of Defense should not make payment while the claim is being investigated by the Department of Justice for possible fraud.

In my letter, I asked Dr. Schlesinger, as the official ultimately responsible for the Armed Services Board of Contract Appeals, to suspend implementation of that decision (ASBCA No. 18560 of 14 May 1975) and stop the payment to Lockheed.

In a letter dated June 18, 1975, the General Counsel of the Department of Defense responded for the Secretary. He promised me that no action would be taken pending the Board's decision on the Navy's motion for reconsideration and pending completion of an investigation by the Department of Justice into possible fraud by Lockheed on these same claims.

I have now been informed that in November the Armed Services Board of Contract Appeals reaffirmed its prior decision in a reconsideration requested by the Navy and has again directed payment to Lockheed. I might add that I am informed the same Board members who issued the original decision also conducted the reconsideration. I understood from your General Counsel's letter that the Board's Senior Deciding Group would be involved in the motion for reconsideration. Please explain the apparent discrepancy in the statement made by the General Counsel with regard to the reconsideration and what actually happened.

The Board concluded that the conduct of former Deputy Secretary of Defense Packard, who admitted he knew nothing of the value of the claim and made no explicit promises to the contractor, obligated the Government to pay Lockheed $62 million, without regard to the merits of the company's claim nor the Defense Department's own regulations.

Since the Armed Services Board of Contract Appeals derives its authority solely from the Secretary of Defense, and since I am unaware of any authority the Secretary of Defense has to authorize payments under these circumstances, it seems to me you cannot allow the Board's decision to stand. Otherwise, you would create a loophole in which a board of civil service lawyers within the Department of Defense can authorize payments that even the Secretary of Defense himself cannot legally authorize.

I am concerned that the Department of Defense might blindly comply with the Board's order and pay Lockheed $62 million without fully recognizing the consequences. In this regard I would like to know:

a. Have you taken steps to ensure that no claim payment is made to Lockheed on this matter pending completion of the fraud investigation currently underway in the Department of Justice? As explained earlier, your General Counsel previously assured me that the DOD would not make payment to Lockheed pending completion of that investigation.

b. What will you do to ensure that any payments to Lockheed in this matter are based either on the merits of the claim or on a formal Secretarial determination in complete accordance with the requirements of P.L. 85–804?

c. What do you intend doing to ensure that, in the Lockheed case and in all other cases, your Armed Services Board of Contract Appeals does not circumvent the requirements of P.L. 85–804 or other federal statutes by rendering decisions independent of the merits of the claim or contract dispute in question?

If it is your opinion that you, the Deputy Secretary, or any other Defense Department official or DOD board has the authority to give a contractor $62 million without basing the payment on the merits of the claim in relation to contract obligations and without notifying Congress as required by Public Law 85–804, please inform me of the legal basis for your opinion so that I may consider what action Congress should take in this specific case, and the corrective legislative action that is needed.

Finally, I would like you to provide me with the legal authority and justification for the ASBCA, its annual operating costs, a list showing the names of individual Board members, their salaries, previous experience and qualifications for membership on the Board, their tenure, and the method of appointment.

Sincerely,

WILLIAM PROXMIRE.

ITEM 23.—*Jan. 6, 1976—Letter from Deputy Secretary of Defense Clements to Senator Proxmire responding to the Senator's Dec. 9, 1975 letter on the Lockheed decision. Mr. Clements assures Senator Proxmire that in no event will the Department of Defense implement the Board's decision in the Lockheed case until the Justice Department indicates that it is proper to do so. This letter provides data about the Armed Services Board of Contract Appeals*

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C., January 6, 1976.

Hon. WILLIAM PROXMIRE,
U.S. Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: This is in answer to your letter of 9 December 1975 concerning the decision of the Armed Services Board of Contract Appeals in the matter of Lockheed Shipbuilding and Construction Company's $62 million claim settlement.

Lockheed's appeal was taken to the Board on 24 May 1973, based on the Government's failure to follow through with the $62 million tentative settlement which had been reached between Lockheed and the Naval Ships Systems Command on 29 January 1971, and on the contracting officer's failure to issue a final decision. On 14 June 1973, the contracting officer issued a final decision in the matter, and Lockheed took a second appeal to the Board.

You are quite correct that the ASBCA has no authority to act pursuant to Public Law 85–804. It neither did nor did it purport to do so in the Lockheed case. A contract claim which arises either explicitly or constructively under a provision of the contract is adjusted within the terms of the contract, either by the contracting officer or, failing that, by the Board of Contract Appeals. In such case, there is no need for adjustment of the matter under Public Law 85–804 which is addressed to matters not falling within the terms of the existing contract. The Lockheed claims, originally in the amount of approximately $160 million, were matters arising under the contract and were uniformly so handled by the Navy and then the ASBCA. Lockheed argued in its appeal to the Board that these matters arising under the contract had been settled by Secretary Packard in the exercise of his contractual authority and sought to be paid as a contractual right the amount of that settlement. It was these claimed contractual rights which the Board addressed in its decision and again in its response to the motion for reconsideration.

The doctrine of estoppel, on which the Board relied in reaching its decision, is a well-established principle, not merely a legal technicality. The courts have established many conditions that must be satisfied before an estoppel will be applied against the Government and these are discussed and applied in the Board's lengthy opinion.

You mention that you understood that the Government's motion for reconsideration of the original Lockheed decision would be referred to the Board's Senior Deciding Group. In his letter to you dated June 18, 1975, the General Counsel reported that the Navy had requested that its motion for reconsideration be referred to the Senior Deciding Group. Whether such a referral was to be made was, under the Board's charter, discretionary with the Chairman of the Board and the request was not granted. The basis for the Chairman's denial I understand was his feeling that under the circumstances it was inappropriate to use the Senior Deciding Group at this late stage when such a Group had not participated in the original decision.

With respect to the ongoing fraud investigation of Lockheed by the Department of Justice, I wish to assure you that the Department of Defense is coordinating closely with Justice and in no event will the Department of Defense implement the Board's decision until it is in receipt of advice from that Department indicating that it is proper to do so.

Finally, responding to the questions in the last paragraph of your letter, the ASBCA is established by a charter promulgated jointly by the Secretaries of Defense, Army, Navy and Air Force. It exists because of the requirement in the standard contract Disputes clause for a decision by the appropriate Secretary or his duly authorized representative upon appeal from a decision of a contracting officer and the contractor's right to a hearing. The Board's annual operating costs for FY 1975 were approximately $1,160,000. Board

members are appointed jointly by the Assistant Secretary of Defense (Installations and Logistics) and the corresponding Assistant Secretaries in the Military Departments. Tenure is indefinite. Brief biographical sketches on the members of the Board, indicating their experience and qualifications for membership, and date of appointment are contained in the attachment to this letter, as are copies of the Board's Charter, a separate listing of members as of 12 December 1975, and their annual salaries.

Sincerely,

W. P. CLEMENT JR.

ITEM 24.—*July 26, 1976—Business Week article entitled "The FBI Is Probing Litton and Lockheed"*

For more than a year the FBI has been looking into irregularities in connection with claims against the Navy by two of the armed service's shipbuilders—Litton Industries Inc. and Lockheed Aircraft Corp. A heavy blanket of security has hung over the investigations, and the companies will say only that they have been cooperating with the probe and that as far as they know it has turned up nothing.

In at least one of the cases—Litton's claim of money due on three submarines—the FBI is due to submit a final report to the Justice Dept. by the end of the month, however. And indications are that federal authorities will pursue some legal action against the Beverly Hills (Calif.) company.

"We've got some pretty hard stuff," says Richard D. Kibby, a Justice Dept. attorney assigned to the Litton case. "But it boils down to a question of do you want to go criminal on the matter or pursue it on the civil side."

Specifically, Kibby contends that FBI agents are questioning the validity of some documents that had been submitted in support of Litton's original claim of $32 million for late delivery of government-supplied materials on three submarines that the company had built in its Pascagoula (Miss.) shipyard between 1969 and 1974.

Last Apr. 16, the Armed Services Board of Contracts Appeals offered a compromise. It suggested that the Navy pay $17.3 million in compensation to Litton for late delivery of the materials. The compromise was agreeable to both sides.

"Thorough Job."—Because of the FBI investigations, however, the payment has been held up. And within the past month, the FBI has beefed up the number of agents it has working on the Litton case—from three to eight.

"We have found enough evidence of unexplained situations that we must make sure that we have done a thorough job of investigation," explains William B. Cummings, U.S. attorney for the Eastern District of Virginia, which has jurisdiction over the Litton case.

In the case of Lockheed, the claim against the Navy is older than the Litton claim. The Lockheed claim dates back to the early 1960s and $140 million for design changes as well as late material deliveries on five destroyer escort ships and seven support ships. After negotiation, Lockheed settled for $61.6 million and the Navy promptly paid $49 million.

Late in 1971, however, the service had a change of mind. It decided to reinvestigate Lockheed's claim and did so far a three-year period.

By May, 1973, Lockheed had had enough. It appealed to the board to force the Navy to hand over the additional $12.6 million. "We could see that the review process appeared to be endless and that it was designed to frustrate the settlement," says Robert C. Gusman, a Lockheed attorney.

On May 13, 1975, the board ruled in Lockheed's favor. But before then—in December, 1974—the Navy had called in the FBI, and the resulting investigation is still in motion. The FBI has up to eight investigators now working at Lockheed's Seattle shipyard.

Another possible probe.—Last week Lockheed made another move. It submitted a formal request to the Justice Dept. to release the $12.6 million it claims the Navy owes it plus $5 million in interest payments it says are now due. "We decided the investigation has run its course," says Gusman, explaining his company's request.

No reaction has been heard from the Justice Dept. yet. But meanwhile, says Cummings, FBI agents may also be ready to review the records of a third shipyard—the nation's largest shipbuilder, Newport News Shipbuilding & Dry Dock Co., owned by Tenneco Inc.

"We will decide within the next 10 days if we are going to investigate Newport News," says Cummings. He will not elaborate, but the company has close to $800 million in claims outstanding against the Navy.

"Let them come," says John P. Diesel, president of Newport News. Diesel is in a stronger position than the management of other shipbuilding companies because his yard is the only U.S. facility large enough to build nuclear aircraft carriers, two of which are now under construction.

Having FBI agents camped in any shipyard does not lead to an easy work relationship, however. And the FBI's stay can be a long one.

"The Justice Dept. told us last December that its investigation would be wrapped up this spring," says Litton President Fred W. O'Green. But FBI agents are still at the Pascagoula facility. And just last week O'Green threatened to stop work on yet another program at the big Mississippi yard—a Navy helicopter assault shipbuilding contract on which Litton claims the Navy owes it $504 million.

APPENDIX C

Documents relating to Ingalls Shipbuilding Division, Litton Industries, Inc.

CONTENTS

ITEM 1.—*June 1969—Government Executive Article—"New Shipyard and the LHA"*

The Navy has contracted with the Ingalls Shipbuilding Division of Litton Systems to build multipurpose amphibious assault ships (LHAs), designed to perform a mission that now requires four different types of amphibious warfare vessels, in a new shipyard at Pascagoula, Miss.

The multi-year, fixed-price incentive contract provided $112.5 million for the first of the revolutionary vessels and, subject to the continuing approval of Congress, Navy calls for construction of a total of nine. Total potential of the contract was placed at $1,012,500,000.

The 39,500-ton multipurpose ship is designed to transport and land approximately 2,000 Marines or other troops and supporting equipment by helicopter or landing craft.

Traditionally, the Navy had done almost all of its own design and detailed specification work, then let a contract. After deciding in 1966 to produce a multipurpose amphibious assault ship, the service took a different course. It gave industry only broad specifications—such as the requirement to operate in shallow coastal waters and to negotiate the Panama Canal—and, on the basis of initial responses, asked three companies to submit more detailed proposals.

After four or five months evaluation of these proposals by a team of nearly 300 operators, logisticians, cost experts and others, Navy concluded that the Litton proposal was the best of the three. Litton's selection to build the ship was announced by the Secretary of Defense on May 28, 1968, and contract negotiations followed.

Navy Secretary John H. Chafee, former Governor of Rhode Island who fought with the Marines in World War II and Korea, appeared with a panel of Navy and Marine officers at a Pentagon news conference to announce the contract.

The LHA is the fastest, most versatile amphibious warship yet designed, he said, and will perform a mission which now requires a troop carrier, a stores ship, a helicopter carrier and a ship that carries landing barges.

"The multi-year ship procurement concept is significant for an additional reason," Chafee added. "It provided the incentive for the design and construction of a totally new shipyard which Litton Systems is building. This new yard will incorporate the latest in shipbuilding technology. The modular construction techniques which this yard makes possible are expected to make a significant impact on shipbuilding technology in the United States, as well as substantial reductions in shipbuilding costs. This type of shipyard represents a significant addition to the Nation's capability to produce merchant ships as well as Navy ships, and should prove to be a valuable asset to our national security and economic posture."

Nine LHAs would enable the Navy to drop from its five-year building plan some 21 specialized amphibious warfare ships for which funds would have been requested, the announcement said, and three *Boxer*-class amphibious assault ships and some older amphibious vessels would be retired when replaced by the multi-purpose ships.

The LHA design is nearly as large as an *Essex*-class aircraft carrier. Beneath the rim of its broad helicopter flight deck are covered walkways for troops; the control "island" at one side of the flight deck will be packed with enough communications for a flagship directing an assault landing force; and landing craft will be carried in a "wet well" in the stern, where they could be loaded with troops and vehicles before sailing.

"Living conditions in the LHA for both the crew and embarked Marines will be substantially improved over existing amphibious ships," the announcement said. "The ship's crew and embarked Marines will ride and sleep in air-conditioned spaces. A fully equipped gymnasium will be available for use as a training and recreation area. Embarked troops may be conditioned to either tropic or arctic weather at the flick of a switch in the special acclimatized gym."

Navy describes the $130-million facility in which the ship will be built as the world's most modern shipyard, producing on an assembly line basis using modular construction techniques. Modular construction employs standardized units or dimensions for flexibility and variety in use.

Chafee said Congress approved construction of the first of this new class of ships in the Fiscal Year 1969 budget, that the Navy was requesting two more in the FY 1970 budget and, with the continued approval of the Congress, expected to build a total of nine.

Rear Adm. Edward J. Fahy, commander of the Naval Ship Systems Command, was asked what assurance there might be that costs of the new type ship would not run over present estimates as have cost of the C-5A, the Air Force's giant air transport.

There had been a lot of misnaming of cost overruns, said Fahy. "Some deficits have been caused by rising costs between the time when original estimates were made and the time when contracts could be placed. In this case," he said, "there was no such deficit—the Navy had the necessary funds. With some 18 months of additional design and engineering work yet to be done before construction, there should not be many change orders during the building process."

Further, the design would incorporate features which, found necessary in the Vietnam War, had required such orders during construction of other ships. The contract did provide for increased costs reflecting basic rises reported by the Bureau of Labor Statistics.

Beginning this Fall, seven commercial ships will be built in the new Ingalls yard. The LHA is scheduled to go directly into production, with no research and development prototype, about two years from now and be completed about 1973.

ITEM 2.—*Dec. 1, 1969—Forbes article—"Litton's Shattered Image"—Discusses financing of new shipyard*

HAVING SURVIVED THE SHOCK OF LAST YEAR'S DECLINE, LITTON INDUSTRIES' EARNINGS (AND ITS STOCK PRICE) HAVE RECOVERED. MUCH OF THE GLAMOUR, HOWEVER, IS GONE. AND FOR GOOD REASON.

Litton Industries Inc., the onetime high-glamour conglomerate from Beverly Hills, Calif., calls to mind, curiously, the admonition that John Patterson, founder of National Cash Register and father of modern marketing, used to give his salesmen: "Don't talk machines, talk the prospect's business." Well, Litton has taken the Patterson principle a step further, into the field of investor relations and corporate image. Litton doesn't like to talk products; it prefers to talk concepts and systems and the technologies of tomorrow. For years this impressed the security analysts, and the investors followed along. It helped win Litton a sky-high price/earnings ratio. This, in turn, helped Litton get acquisitions on favorable terms. But now the practice is backfiring. What is clearer almost daily is the considerable distance between concept and reality at Litton.

The reporting of Litton's earnings in the fiscal year ended July 31 is typical. This was the year for Litton's return to grace after the earnings decline of fiscal 1968. Return it did, *apparently*. Earnings were up 35% to $82.3 million as sales churned past the $2-billion mark.

But follow, if you will, this complicated bit of bookkeeping. There were (as there usually are in earnings statements) some interesting footnotes. One revealed that Litton had included in its operating earnings a $23.2-million capital gain on sale of McLean Industries stock to RJR Corp. (formerly R. J. Reynolds). A capital gain in operating earnings? Not really. For Litton added a paragraph to the footnote, which spoke most unspecifically of "amounts by which estimated contract costs are expected to exceed contract revenues." Litton's chief financial officer, Senior Vice President Joseph T. Casey, is more blunt about it: "We are actually taking a writeoff," he says.

Litton had initially, in its nine-month earnings report, precisely offset the $23.2 million capital gain by setting up a "reserve" for start-up costs on its new shipyard. Now talk of a reserve has disappeared, and so, in specific terms, has the $23.2-million. But there really is no reserve at all, there never was. Litton is taking a $23.2-million writeoff to cover losses anticipated on contracts to produce seven container ships for American President Lines-Farrell Lines and to overhaul nuclear submarines for the Navy. Litton, in short, has already lost the money for all practical purposes. The loss, however, will never reduce reported earnings—not this year, not when the ships are delivered. The loss already has been washed away by balancing it against last year's capital gain.

To be blunt, a nonrecurring capital gain was used to offset what is—or will be—an operating loss, and Litton will never have to reflect the shipyard losses in its operating statement.

Illegal? Not at all. Misleading? Perhaps. For such sophisticated bookkeeping, Litton is increasingly drawing doubts and questions where once it won only praise and faith from analysts and professional investors.

Not surprisingly, therefore, the stock market did not jump with enthusiasm when Litton came out with its impressive 35% earnings gain. Although Litton stock has rallied substantially from its 1969 low, it sold last month at less than one-half its all-time high, 120, set in 1967. It recently sold at about 23 times earnings for fiscal 1969; as recently as 1967, Litton sold at 46 times earnings.

LOST LEGEND

For a long time, Litton was a legend. A legend of 14 years of unbroken growth that carried the company from $3 million in sales in 1953 to $1.6 billion in 1967, with earnings growing apace. This legend, carefully cultivated by one of the smartest investor-relations campaigns ever seen, helped persuade investors to accord the company a total stock market value of $2.7 billion in 1967. Its market value was then in the same class as those of such far older and bigger companies as Chrysler, Westinghouse, Union Carbide and Goodyear Tire. Litton had woven a magic spell that convinced many people that its growth could go on almost forever, that every $1 of its earnings was worth more, much more, than that of more conventional companies.

Suddenly, the spell was broken, the legend shattered.

A poor quarterly report in the second quarter of fiscal 1968 ended 57 straight quarters of earnings gains. The decline in annual earnings came to just $11.6 million, but because of it Litton's aura was dispelled. Litton's stock fell in 1968, rallied but then declined precipitously once more. At the worst levels this year stockholders suffered a paper loss of nearly $2 billion.

Ignoring the fact that the company had greatly encouraged the growth mystique, Litton's bosses today tend to blame the fall from grace not on themselves, but on the financial community. "Analysts," says President Roy Ash, "had become believers more than analysts. Now they have become appraisers again. There is a lot more interest in the internal substance of Litton." As to what lit the flame of faith in the analysts, Ash sees only the fabled "57 quarters," when Litton went from peak to higher peak in earnings, and the analysts' own lack of industry. He minimizes the role of Litton's adroit use of public relations and a series of annual reports that were feasts for the eye, if a famine for the mind.

WHERE'S THE TECHNOLOGY?

But Ash is correct that there is a lot more interest in the substance of Litton. Analysts no longer freely swallow talk about the systems approach, or about synergy. Now they ask hard questions about the typewriters, conveyor belts, calculators and syringes that are Litton's reality. At least some analysts are realizing that Litton's Business Systems & Equipment division—scratching to earn 3% on sales of $608 million—is not really a first-rate contender in a business where the leader, IBM, earns 12.6% and the industry average is 7%; that Litton's Industrial Systems division—aside from the electronic components business that contributes some $150 million of the division's $657-million volume—is only a collection of good-to-poor capital goods companies; that its shipbuilding operations, though promising, are incurring heavy losses.

Not all about Litton is gloomy. A portion of its military business is growing rapidly. In its years of acquisitions, the company has picked up some real win-

ners and gone into some fancy businesses, like the currently voguish medical electronics field.

But beneath all the surface examination of Litton's lot lie more fundamental questions. They concern Litton's ability to produce regular earnings gains now that its size reduces its ability to have the mathematical joys of acquisitions. There is a nagging suspicion that Litton, by nature and disposition, is incapable of spending the research and product development dollars to become really first class in any field.

The Federal Trade Commission was blunt about this in a complaint issued last April against Litton's acquisition of German typewriter-maker Triumph-Adler. Litton has had Royal Typewriter for five years now. "Litton recognized in 1965 a requirement for basic improvement in the typewriter products of Royal," states the FTC. "Its response was to choose expedients that avoided commitment to original research and development. Acquisitions have been among the expedients chosen."

Litton's response did nothing to blunt this sharp criticism. In writing and in testimony before the FTC, its executives admitted that Royal Typewriter operations are sustaining heavy losses: $6.5 million in fiscal 1968 and at least $6 million in fiscal 1969. Also, it was admitted that Royal's sales organization had been declining.

This state of affairs Litton blamed almost totally on IBM's dominance of the $350-million office electric typewriter market. It laid the plight of Royal on IBM's research and development and its breadth of marketing. Litton asked that it be allowed to acquire Triumph-Adler on the grounds that the latter's electric office machine, although not comparable to newer IBM models, would at least give Litton a chance. But later in its statement Litton admitted that at least half of Royal's losses were due to a portable typewriter plant in Springfield, Mo., which is now closed. IBM does not even make portables.

To read Litton's statements to the FTC and then, as FORBES did, talk to Litton executives, gives a curious sense of unreality, of concepts related only slightly to facts. Senior Vice President Ralph O'Brien, a 40-year-old Bostonian and marketing man who heads up business equipment today, says that the losses at Royal have been reduced but not eliminated. Five days after that conversation, chief finance office Joe Casey says flatly: "Royal is not losing money."

Aside from such questions, O'Brien radiates only confidence. "We have completely reorganized the Royal company and they are confident now that, with Triumph-Adler, they will have the R&D capability, the manufacturing and worldwide marketing capability that will give us the ability to sell at a scale allowing us to produce at a reasonable cost." (Litton is proceeding on the basis that it has Triumph-Adler until forced to divest.)

Beyond the German company, though, readers of Litton annual reports might wonder what Litton was doing these five years with Royal while it was reporting, in 1965, "* * * an engineering design breakthrough in typewriter technology." Or, in 1966, how "* * * our advanced technology applied to design and production of the machines resulted in the sale of more Royal typewriters."

What Litton was doing, of course, was marketing old products because it had neither better products nor the knowhow to get them. The same is true of its Royfax copier introduced in 1966. The Royfox, which requires sensitized paper, is today doing a volume of around $20 million in a market of $1.4 billion, a minimal position.

The pattern of Litton's lack of product development carries over in the Monroe calculating machine operation. This is significant because Monroe was Litton's first (in 1958) nonelectronic company acquisition. The Litton plan, according to Chairman Charles B. "Tex" Thornton, was—and is—that new technology is going to transform industries and that Litton will be there to reap the markets, in this case with desktop electronic calculators.

But Monroe kept making electro-mechanical calculators (though it produced an electronic printing calculator some eight years after it joined Litton). By this time the whole market had changed. The Japanese were making electronic display calculators; the market was and is crowding up. Monroe has just introduced four new electronic calculators; Canon of Japan makes three. This is therefore Japanese, not Litton, technology. Did Litton have the knowhow in time itself? "No, not at the time," says Monroe head Donald McMahon.

McMahon is immediately corrected by John Rubel, senior vice president and head of planning for Litton. "The distinction must be made between technology

and technique," says Rubel. He goes on to explain, as many people at Litton do, that this company concentrates on applying techniques to the needs of the marketplace.

Maybe so, but the fact remains that Monroe is now positioned in a very crowded calculator market where the Japanese are making the greatest gains; where there is no technological edge and price- and profit-margin cutting is inevitable. The higher-technology market is in office systems where IBM is king, particularly with the introduction of its System 3 desk-top computer. In the scientific-engineering field for calculators, the market is held by Wang Electronics and Hewlett-Packard. "Monroe," says McMahon, "will introduce a machine in that market." A business equipment consultant who knows Monroe renders a terse judgment on that effort. "They haven't spent the R&D money."

ON KEEPING AHEAD

Waynesboro, Pa. is headquarters for Milburn Alfred (Metz) Hollengreen, 66, president and guiding force of Landis Tool Co. This company is a smallish but highly profitable member of the grinding machine industry and a gem of a company that joined Litton when Hollengreen decided to sell for personal reasons. Landis is the kind of company that averaged better than 13% net on sales for five years; that had $7-million earnings on $52-million sales the year before it joined Litton. Landis Tool prospered because it lavished money on research and on new equipment. Says Hollengreen: "We try to average double our depreciation in buying new machinery every year. Stay ahead and you're all set. You don't have to market if you've got a better machine. I've spent money when they called it 'Hollengreen's Folly.' The next year they called it foresight."

Certainly Landis is one of Litton's crown jewels. But certain questions arise. For example: Is Landis' style of future-looking spending compatible with Litton's heavily financial orientation, its commitment to the concept of Return On Gross Assets? Under the ROGA concept, divisional managers are rewarded in direct proportion to their ability to earn a high return on the assets entrusted to them. The trouble, of course, is that spending on research and on plant modernization can penalize ROGA in any given year, bringing rewards only in the future. ROGA can, moreover, be maximized by buying parts and products on the outside, thus reducing the need for plant investment.

FORBES asked Roy Ash about this. His reply: "What you are asking is: Is the manager's self-interest aligned with the company's self-interest by this measurement technique? First, we have two or three things in that measurement technique to align this self-interest, and the managers are pushed for growth. We have built this in on occasion in compensation systems." Ash details several measures—reckoning on the basis of undepreciated assets, on the increase in assets employed, and so on. But it all comes down to, he says, "legitimate behavior."

But the fact still remains that in a company where a few tens of millions in profits support billions in market value, the pressure for profits *now* can be overwhelming. From the beginnings of its business Litton has taken great pride in the fact that it could take the other fellow's technology and produce it at a profit. This technique reduces the need for capital and increases ROGA. So does another Litton technique: producing a commonplace product but producing it so efficiently that Litton can grab a slice of the market—and at a profit. "We started out cutting our slice out of the hide of Sylvania, Raytheon, RCA and others," says Ash, and jokes that once, years ago at a trade show, somebody put a banner above the Litton booth reading "World's Largest Manufacturer of Obsolete Products."

A veteran security analyst who followed Litton for many years recalls going to see the company's electron tube facilities in the Fifties. "Litton had taken somebody else's R&D in every tube and had done product engineering and brought out a cheaper product and got the business. They were making the profits. Sylvania and Raytheon were originating the tube technology. In most cases, management had been financial types. This can be an advantage and a disadvantage. It is okay to operate without product development when you're small, but when you become big you have to have a broad capability and preserve it."

DEFENSE AS LEVER

Interestingly enough, Litton *did*, in its early days, do considerable original product research and development. Litton got into business producing power tubes for the Government at low cost. Its costs were so low that it was booking high profits, but on government contracts where profits were limited. So Litton used the excess profits from the power-tube contracts to get into other businesses selling to the Government. The founders of Litton knew that the Defense Department's renegotiation board considers the totality of a company's business with the Government in calculating profit levels. Power-tube profits went into developing for Litton its successful data systems business for the military and its real breakthrough in inertial guidance systems for aircraft. This question remains: Since those early days, how many really new products has Litton brought out? The answer must be: not very many. And the man who did bring out the great inertial guidance system, Dr. Henry Singleton, has long since departed to found Teledyne.

Litton puts great hopes on its newest growth business, medical electronics. Litton has been in it actually since 1960, when it acquired Fritz Hellige & Co., a West German maker of electrocardiographs, electroencephalographs and other monitoring equipment.

Litton has paid more attention to the field since it acquired $3-million (wholesale sales) Profexray Inc. of Chicago in 1964. Charles Vatz heads the Medical Products groups and is a member of the family that once owned Profexray. He describes how he saw an opportunity to expand Profexray's volume dramatically if he could build a sales force and sell retail. Profexray could then supply equipment ancillary to the X-ray unit itself. As Vatz explained it to Litton, his $3 million at wholesale generated $30 million in business for dealers—sales of image intensifiers, films and chemicals, supplies and accessories. Litton bought Vatz' business, built a sales and service force, and Profexray's current volume is around $50 million. Today it supplies the accessories, the films and chemicals. But profits have grown less than half as fast as sales, reflecting, perhaps, lower-margined products in the mix but surely some price-cutting as well.

Price-cutting in a high-technology business such as X-ray? That is what happens if you don't have an edge in product innovation. Profexray does not have such an edge. So far, Litton has adapted Hellige's German monitoring equipment to sell in the U.S.—where Hewlett-Packard and Beckman Instruments lead the field. Litton acquired another German firm, a manufacturer of disposable syringes, and also took a chain of dentist's office equipment supply stores.

Needles? Dental chairs? The Litton litany in this area runs thus: "We found that our products form a nucleus of medical sysems. Litton would build from a high-technology company into a broad-range medical supply company." But meanwhile, back at the technology, medicine marches on. On the new frontiers of medicine, says Vatz, Litton is working under a licensing agreement with Toshiba of Japan. "We are using Toshiba's technology to spring us into new businesses," he explains. "In order to shorten the time span, we've chosen to buy the technology." Translated from Littonese that means simply this: In the new field of nuclear medicine, Litton must buy from a foreign firm to stay in the ball game. Competitor Picker X-ray, a subsidiary of CIT Financial and leader of the X-ray market, along with General Electric, is ahead in technology.

Litton people are eloquent in defense of such practices. Planning head John Rubel offers the truism: "Technology standing alone rarely is the key to a company's success." He adds, "More important than innovation is being the fellow who can respond to a felt need in the medical community."

One of Litton's competitors sees it differently: "If I had to make a statement on how you survive in this market, it is through product innovation rather than just competing on a high-volume, low-cost basis."

TUBES AND SYNERGISM

The list goes on. Microwave cooking—used as an auxiliary cooker; it is very fast—is a field about which Tex Thornton waxes enthusiastic. This is another field where Litton will "help to advance the frontiers of technology and be able to bring that technology to a useful product." Litton currently has about a $20

million-a-year business in the commercial market with its microwave oven. Frontiers? Litton's product capability here came to it under license from Raytheon for the essential microwave tube technology and through acquisition of Robert Bruder's oven company of Cleveland. (Bruder is now vice president in charge of Litton's Food Products group.)

The frontier, if there is one, is in the consumer market where 50,000 units have been sold. Raytheon, through its Amana subsidiary, is a participant in the market, as is General Electric. The market projection in 1970 is for 250,000 microwave cooking units. That's a market of $125 million. So new competitors are coming in, among them Sears, Admiral, some Japanese firms and Litton Industries, marketing through Tappan.

This hardly sounds like the kind of business that could be worth 50 times earnings, but Tex Thornton talks bravely of somehow combining microwave cooking with the Stouffer Foods Corp., makers of frozen prepared dinners and operators of Stouffer's Restaurants, which Litton acquired in 1967. He sees vast frontiers in an era when housewives shun the drudge part of preparing meals. But meanwhile, Litton uses another company's technology to market ovens through yet another company, while Stouffer goes on running restaurants.

Still, no one can doubt that Litton has some distinctly first-rate firms within it. Landis Tool is one of them, the highest profit performer—at over $7 million—in Litton's industrial systems and machine tool group, an agglomeration that contributes over $500 million sales and some $20 million profit to Litton. Because of Landis' profitability, the machine tool side—New Britain Machine and UTD Corp. are the other components—ranks with the best in its business in profitability, some $14 million earnings on $200 million sales. But machine tools are fairly new to Litton, barely two years within the company. The other side of the agglomeration, the industrial systems, does about $300 million sales but brings in only $7 million, roughly, of profit. This grouping of Hewitt-Robins, a materials handling company, Louis Allis Co. in electrical motors and Rust Engineering, among others, trails in profitability almost anybody one could name in its various business, from Rex Chainbelt and Link-Belt in materials handling, up through Reliance Electric and, of course, General Electric in motors and drives, to such outfits as Square D in industrial controls and automation.

The industrial systems companies came into Litton at different times over the past five years. The idea, in Littonesque terminology, was to give the company "a total systems approach to design solutions to industrial production problems." However that may be, while sales of the grouping have grown, profitability has not. The synergism seems to have come unstuck someplace.

THE BIG SHIPS

But what of shipbuilding? Surely in this newly promising industry, Litton has been the technological innovator. Hardly. Sun Shipbuilding has built gas turbine ships; other shipyards are building container ships all the time. New assembly techniques are being learned. Litton has talked a lot, but mostly about its shipyard. In plain truth, it hasn't built that many ships.

But shipbuilding as an industry does seem promising. The U.S. Navy wants to replace its fleet and has budgets calling for $3 billion a year for the next ten years to go into new ship construction. President Nixon has asked Congress for $3.8 billion over the next ten years to help build 30 merchant ships a year. The Great Lakes ore- and grain-boat fleet is old and in need of replacement.

Litton is now in deep in shipbuilding. In 1961 it acquired Ingalls Shipbuilding in Pascagoula, Miss. for $20 million. It also has a new shipyard at Erie, Pa., paid for by $9 million in Pennsylvania industrial bonds and $1.5 million by Litton. Much has been written on Litton's "shipyard of the future" in Pascagoula. Despite the Litton hyperbole, it is an adaptation of existing Swedish techniques for moving material in a ship-production process. The first ships to be built in the yard are the APL-Farrell container ships—being built at a loss.

But to really fill its big yard for years to come, Litton wants the Navy's contract for 30 new destroyers, a potential $2-billion-plus contract in total to be awarded in mid-January. Litton people already assume the contract will be worth far more than that estimate; also the contract would provide business to Litton's Military Data Systems division, which would do most of the electronics.

The competition is Maine's Bath Industries, a well-regarded builder of destroyers. Bath has told the Navy that if it wins it will build a $65-million expansion to its existing yard. The State of Maine is guaranteeing credit for Bath up to $32 million of that amount.

MONEY MEN

In that regard, Bath is far more courageous than Litton Industries about risking its own money. Litton's yard, of course, cost $130 million, all of it financed by a Mississippi bond issue. Litton does not begin to pay the $9-million-a-year lease on the yard until 1972. But it got $125 million ($5 million was underwriting costs) the day (Nov. 19, 1967) the bonds were sold at 4.99% and has since been investing the unused portion of the funds, building up a cushion against the lease payments in advance. For Litton is nothing if not adept at handling money and keeping itself well insulated from substantial risk.

Tex Thornton talks easily of having "put millions into that [yard], all the R&D, all the new concepts of ship designs. The kind of ships that we are in are those that require a lot of technology." But actually, Litton spent under $3 million of its own money designing the shipyard *and* competing for the Navy contract that made the shipyard possible—the still unfunded fast-deployment logistics ship. And Thornton well knows that those ships that require a lot of technology are Navy ships.

Now the Navy is good to do business with. In its contract for a new assault ship called the LHA, for example, Litton has a stipulation that the Navy reimburse it 100% for all expenses on the contract over the first 48 months of the work. And Litton bills the Navy weekly. Litton's cash investment is therefore limited to what is in the pipeline from week to week. Normally Litton can get 90% progress billings from the Navy anyway. Such terms are much harder to come by from commercial customers—but with the Navy and Mississippi so benevolent, does Litton really want such customers?

A DIFFERENT TUNE

Thus, looked at up close—rather than through a glamorous prism of Litton rhetoric—this huge company looks a good deal more like a collection of nuts and bolts, and less like a marvelous pattern of synergy.

None of this is to say that Litton is a bad company. Its top people are able, dedicated and shrewd. Litton's trouble is that it has oversold itself. It simply never was worth 46 times earnings. But it has compounded its problem by continuing to talk as if it were.

An ex-Litton man, highly successful on his own, who admits he owes much to what he learned at Litton, sums it all up very well: "The trouble with Litton today is that they are singing the same old song that once was very popular. But they forgot that the new sounds now aren't from the Beatles, but from Arlo Guthrie."

To put it a little differently: The age of the magic numbers, of blind faith in corporate rhetoric, is over, and the time has returned when investors are going to ask about typewriters and machine tools and frozen dinners instead of simply being mesmerized by earnings curves.

ITEM 3.—*Dec. 15, 1971—Forbes article—"Litton: Seasick?"—Discussion of major problems at new shipyard*

"They said it couldn't be done—we'll show them."—Sign at Litton Industries Pascagoula, Miss. shipyard.

"If the contractor would refrain from using superfluous slogans and get on with the job, it would be better off."—John A. MacInnes, Maritime Administration supervisor.

Litton Industries is the California conglomerate (total annual sales: $2.5 billion) that makes, among other things, typewriters, machine tools, "mini" business computers and dentists' chairs. Litton is also trying to build ships on a large scale.

It was music to Litton's ears when in the mid-Sixties the Navy suddenly decided it could save money and get better vessels by handing the work over to contractors on what was called a "company-designed, total procurement basis." Basically, the Navy would simply specify what it wanted the ships to do. The design would be up to the company, and if successful in construction bidding the firm would get the whole package, not just a piece of it. It was a winner-take-all concept, well worth the risks. Litton was already in shipbuilding since its 1961 acquisition of Ingalls. Here was a chance to show what Litton could really do in bringing an old industry into the age of automation and cybernation. Sensing a rare opportunity, Litton went all out.

To direct its design competitions, Litton had hired John Rubel, a former Assistant Secretary of Defense. Then Litton went out and built a production-line "new concept" shipyard at Pascagoula, Miss., a town of 28,000 on the Gulf of Mexico.

A-SAILING WE WILL GO—HERE'S THE SCOPE OF LITTON'S SHIPBUILDING VENTURES NOW ENCOUNTERING ROUGH WATER.

Ship	Quantity	Purchaser	Schedule	Contract amount	Contract status
Containerships	4	Farrell Lines	1 yr late	$84, 000, 000	No ship has been completed but Litton had already spent $84,000,000 this summer. Farrell is suing for delays.
Do	4	American President Lines	Late	90, 000, 000	Moved to older Ingalls yard.
Ore boat	1	Bethlehem Steel	do	18, 000, 000	Ship in water but Bethlehem has refused delivery. Overrun may total $6,500,000.
LHA amphibious assault ships	5	U.S. Navy:	1 yr late	666, 000, 000	Secretary of Navy John Chafee estimates ships could now cost $985,000,000.
Destroyers	[1] 16	do	Litton says construction will begin on time in 1973.	1, 014, 000, 000	Though construction has not yet begun, costs are now estimated to be $136,000,000 higher.

[1] Funded.

NEW IDEA

"By using modular techniques," Litton says, the new shipyard "incorporates he world's most advanced marine production technology." For such a large roject, the financing, too, was novel. The state of Mississippi issued $130 illion worth of tax-exempt revenue bonds to build the yard and then leased it o Litton. Since then Litton has spent $126 million of the funds on the yard. Construction began in 1968, but the first lease payment isn't due until next ear.

By the summer of 1970 Litton had won almost $3 billion in total package ontracts—potentially the biggest backlog of any U.S. shipyard.

Then things started to go wrong. Litton seems to be ending up with some errible problems.

The first ship being built at the new Pascagoula yard is a simple enough job. t is a containership, not very different from scores of others built elsewhere. itton is now a year late. The vessel, the 668-foot *Austral Envoy*, has encoun- ered so many production problems that there is a chance its customers, Farrell ines and the Maritime Administration, won't accept it. So says John A. lacInnes, MarAd's man at the yard. MacInnes also predicts the ship will cost wice the contract price of $21 million; an ex-Litton executive predicts that fter-tax losses on four containerships that were included in the contract will it $50 million. Litton counters that the flaws are being fixed and the ship will e accepted; but it does not deny that costs will run way above estimates. In tself, a loss of $20 million or so wouldn't break Litton, which has well over 1 billion in current assets and a cash flow well in excess of $100 million a year. ut the big question is: Do the foul-ups at Pascagoula go deeper than this ingle ship?

If the overruns continue at the present pace, the consequences could be much ore serious when it comes to building the five Navy amphibious assault ships nd 16 destroyers funded so far. Projecting current cost trends, these overruns ould run into the hundreds of millions of dollars.

What kind of problems then does Litton have in shipbuilding? Fred W. 'Green, Litton executive vice president, calls them start-up problems. He lames Litton's promising but radical new methods, Hurricane Camille and a ecent 37-day strike. He says the wrinkles are ironed out now, and the next ree containerships will go much more quickly than the first one.

BIG ORDER

MacInnes, however, takes a very different view. "Look," he says, "modular ip construction was never really a new concept in the first place. It was used y Kaiser back in World War II. Big assembly unit plans are traditional now all yards. Litton tried to carry the concept beyond that stage, but they were lso trying to build a new shipyard and handle contracts at the same time. It as too much to chew." A Maritime Administration report noted that in response such criticism, "We were given irrelevant dissertations on what is done in e rocket and aircraft industries around the country."

The recent problems, apparently, were very basic and went deeper than infla- on. Litton's O'Green concedes that computerized design work led to some goofs" in the shipyard when modules and plates couldn't be joined properly. here were other problems, O'Green admits. The *Austral Envoy's* deckhouse as placed on the hull structure, but the main deck sagged because beams nderneath had been left out. Litton jacked up the deckhouse, put in the beams, id set down the deckhouse again—still off kilter. "It's only nine-sixteenths of inch off," says O'Green. "It doesn't affect the ship's performance."

Design problems led to grumbling by the workers, who perhaps knew they ad the upper hand because the new shipyard has been short of skilled labor. espite heavy recruiting across the country, the yard still must hire 4,500 men get the 11,000 needed. For the destroyer contract, some 1,000 more workers ill be required. But once Litton has trained new men, they have often gone off work on housing for new workers at higher pay rates. It's still too early to ow what the effect will be of recent labor pacts that enable Litton to exchange orkers between the new yard and the older Ingalls facility.

Partly to keep the Navy LHA contract moving ahead, Litton has begun bcontracting part of the fabrication work out to other Gulf Coast shipbuilders.

The added cost makes sense, O'Green says, as Litton will benefit from the "learning" another shipyard already has. Marine experts say that it will slow the critical "learning curve" for the Litton shipyard—a key to cutting costs on repeat model—because Litton's men won't be doing the work.

The Navy's not saying much yet, but has sent an admiral to supervise shipbuilding there, something done in only two other yards in the country. (Often, the Navy's yard supervisor is a captain.) And it has ordered a production audit team of shipbuilding experts to Pascagoula. "The audit will be under way for several months," says Rear Admiral Nathan Sonnenshein, chief of the Naval Ships Systems Command. Admiral Sonnenshein admits there are problems at the shipyard, but he says, "You know, this was the first new shipyard built in this country since World War II."

Still, the Navy obviously doesn't like what rising costs at Pascagoula are doing to its program. To save money it has cut the Litton amphibious-assault-ship contract from nine vessels to five. Still at issue between Litton and the Navy is a $109.7 million cancellation payment. Secretary of the Navy John Chafee has already told Congress that the price per ship, if the full cancellation costs claimed by Litton are paid, will be up from $154 million to $197 million.

BACK TO THE WELL?

How much protection does Litton have against possible overruns on the Navy contracts? It's hard to say. The Navy's contract for 30 destroyers, for instance, carried a set "target price" of $1.8 billion. Above that, Litton has to pay 20 cents on the dollar up to a ceiling price of $2.14 billion; after that Litton would be stuck with all the overrun. O'Green says confidently that design changes ordered by the Navy, escalation clauses and "target reset provisions" will allow Litton to collect more than the ceiling price if necessary.

Meanwhile, another new Litton shipyard, this one at Erie, Pa., ran into difficulties with its first vessel, an ore boat for Bethlehem Steel. Litton is working out a deal to sell the yard to American Ship Building, its major Great Lakes competitor, but there is some dispute about the terms.

What it all boils down to is this: Litton has taken a major risk in the hope of a major reward. Litton's bosses, Chairman Charles B. Thornton and President Roy L. Ash, insist it was a sound risk. Echoing them, Executive Vice President O'Green says: "We've built ourselves a competitive edge that can't be matched today * * * As for costs, there will be no surprises. We're not walking up to a cliff and know we're going to fall off."

Litton's top men may be right, but they can't deny that there is a terribly steep precipice out there.

ITEM 4.—*June 6, 1972—Memo for File—Meeting among Roy Ash, President Litton Industries; Assistant Secretary of the Navy (I&L); Commander, Naval Material Command; and Contracting Officer, Naval Ship Systems Command—Discussion of Litton's alternative solutions to performance of LHA contract because of Litton's tenuous cash flow position*

Subject: 6 June 1972 Meeting among Mr. R. Ashe, President, Litton Industries Inc., ASN (I&L), MAT 00 and SHIPS 02.

1. At the request of Mr. R. Ashe subject meeting was held between 1030-1200 on 6 June to discuss Litton's analysis of alternative solution to performance of the LHA contract. Mr. Ashe indicated that based on consultation with his lawyers, the following alternatives appear to be available to the parties:

a. Navy continue cost reimbursement payment basis beyond the 40 month current contract limit.

b. Navy terminate the contract.

c. Navy order work stopped.

d. Litton stop work.

e. Parties agree to reformation of the contract.

f. Parties agree to reduce contract quantity from 5 to 3 LHAs.

g. Litton could sell the West Bank facility to the Navy.

h. Litton could sell or spin-off the West Bank facility to absolve Litton Industries of the guarantee responsibility.

2. A general discussion among the participants ensued to achieve a better understanding of the Litton alternatives. In this discussion Mr. Ashe indicated the extreme seriousness of this LHA matter to Litton, particularly if Litton were required to convert to a physical progress payment basis in September 1972. Should that occur, Litton would be unable to perform due to the impact on an already tenuous cash flow position Litton had presented on 2 June 1972. Mr. Ashe also explained that reformation meant a cost type contract for at least the lead ship.

3. Mr. Ashe also recommended that the Navy consider presenting this type contract problem along with other similar shipyard problems to Congress. This presentation would be in the form of a procurement policy change and would perhaps require $1 to 2 Billion. Mr. Ashe indicated that he had discussed such an approach with Mr. Connally. Mr. Connally was quoted as saying such a program should be positively presented, on a grand program scale—make it bigger than the Congress.

4. Admiral Kidd then indicated his general reaction to the alternative presented:

a. Continue cost funding—Navy not likely to agree since it would be an acknowledgement of Navy responsibility for delay.

b. Termination—the Navy is considering its termination rights but this would not get the Navy the 5 LHAs it needs.

c. Stop work—would undoubtedly cost both parties money but would not yield any ships.

d. Litton stop work—if so, the Navy would resort to litigation to protect its interests.

e. Reformation—the retroactive application of 5000.1 to the LHA contract does not appear feasible or reasonable.

f. Reduction from 5 to 3—while accomodating Litton, the Navy would not get the 5 LHAs needed.

g. Sale to Navy—No comment is considered appropriate except to consider it impracticable for a myriad of reasons.

h. Spin off—no reason to believe that the Navy would give up it guarantee rights against the parent Litton Corp.

5. Mr. Ashe again explained that the Litton in its financial planning assumes that the Navy will continue payments on a cost basis (as opposed to physical progress). Mr. Ashe also indicated that he considered payments should continue until the Request for Equitable Adjustment is resolved.

6. Adm. Kidd queried Mr. Ashe as to whether Litton had considered requesting relief under PL 85–804. Mr. Ashe said he was not fully aware of the implications, but doubted that Litton would do so.

7. Mr. Ashe indicated that Litton would not request an advance payment loan (this possibility was discussed in 2 June meeting).

8. Admiral Kidd indicated in summary that the Navy will have to require Litton to abide with the contract and it appears to be within the law to oblige performance under the contract. Mr. Ashe indicated in LITTON's view, the Navy had failed to perform under the contract.

9. RADM. Woodfin indicated that in any event Navy owed Litton answers to 2 letters—one requested extension of reset from 34 to 54 months, the second requested extension of cost type progress payments from 40 to 60 months. RADM Woodfin indicated that the extension of either would require Litton to provide factual substantiation of the time related portion of Litton's request for Equitable Adjustment—as yet Litton has not provided any such basis. RADM Woodfin indicated that since Litton had indicated the availability of such information in July, the Navy would give this information every consideration at that time.

10. Mr. Ashe indicated that it appears that some in the Navy have a built-in sense of self-righteousness concerning Litton's performance, and that the Navy would have to relax this view if Litton is expected to proceed with the contract. Mr. Ashe indicated that he intended to meet with Secretaries Sanders and Warner and then on to the White House to explain the problem.

11. The meeting was closed by the Navy indicating it would respond to Litton's letter requests in the future.

ITEM 5.—*June 19, 1972—Letter to William Casey, Commissioner, SEC from Senator Proxmire questioning the propriety of Litton reporting earnings based on expected claims recovery*

JUNE 19, 1972.

Hon. WILLIAM J. CASEY,
Commissioner, Securities and Exchange Commission,
Washington, D.C.

DEAR MR. COMMISSIONER: As you know the Joint Economic Committee has held several hearings on weapons acquisition programs of the Department of Defense. One aspect of these hearings involves large claims by Navy shipbuilders. Currently these claims total about $1 billion and involve some of the Nation's largest companies.

Litton Industries has the largest dollar amount of claims against the Navy; these total about $450 million. Some Litton claims are several years old. Navy witnesses have testified that Litton's claims appear exaggerated and Litton's actual entitlement is substantially less than the amounts of its claims. Reports by the General Accounting Office indicate that some of the claims have been overstated.

Recently Litton announced it was taking a $25 million write-off against its FY 1972 operations for expected losses on the LHA Navy shipbuilding contract. According to the press, Litton stated that the company doesn't expect a further write-off this year, but indicates that the negotiations with the Navy are continuing. But looking at Litton's published financial statements in the light of its recent release, it appears that for several years the company has been reporting profits based on the anticipation of obtaining substantial sums from its claims against the Navy. If these claims are in fact overstated, Litton's profits for the past several years may also have been overstated. At least it appears that Litton's profit or losses are subject to considerable uncertainty until these claims are settled, and have been for some time. Yet there are no footnotes or other explanations in Litton's published reports—specifically in its FY 1971 annual report and interim reports of October 31, 1971, and January 31, 1972—to indicate that this is the case. In fact, the Litton FY 1971 annual report states:

* * * The outlook for Defense and Marine Systems is good. Our present backlog spans several years of activity providing a basis for continuing growth of sales and profits independent of the general economy.

The Accountants Report for the year—by Touche, Ross and Company—also fails to note that Litton had several large claims against the Navy in process or under negotiations, the outcome of which could substantially alter Litton's financial results. These reports, therefore, appear very misleading.

I would like to know: Has Litton in fact reported earnings based on its expected recovery of large claims against the Government? If so, can you tell me to what extent Litton's earnings have been overstated for the past several years—say 1968–1971—if such claims are not honored by the Navy? It appears to me that if substantial portions of the alleged claims are not paid by the Navy, Litton may not have the financial capability to carry out its contractual commitments.

What are the Securities and Exchange Commission rules concerning the company's obligations for public disclosure of information in a situation such as this? If, in fact, Litton was including anticipated claims settlements as valid receivables from the Government, would it be violating any SEC rules? Has Litton violated any Securities and Exchange Commission rules by its failure to reflect uncertainty in its published reports as to the ultimate settlement of its claims against the Government?

Do other publicly owned defense contractors follow similar practices? If so it seems to me that defense contractors can manipulate earnings to show whatever they want to show just by the size of their claims against the Government.

At what point does the Securities and Exchange Commission require disclosure of expected large over-runs or under-runs of defense contracts by defense contractors?

I would appreciate obtaining answers to my questions by June 30, 1972.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommitttee on Priorities
and Economy in Government.

ITEM 6.—*June 22, 1972—Letter to John Warner, Secretary of the Navy from Senator Proxmire expressing concern over Litton Shipbuilding claims and financial problems and requesting the Navy position on these matters*

JUNE 22, 1972.

HON. JOHN W. WARNER,
Secretary, Department of the Navy,
Washington, D.C.

DEAR MR. SECRETARY: I have become increasingly concerned over the Navy's problems with the Ingalls Shipbuilding Division of Litton Industries. As you know, Litton is responsible for the largest single amount of outstanding shipbuilding claims now pending against the Navy, totaling about $450 million. In addition to the huge cost over-runs represented by these claims, Litton has fallen far behind the performance schedule on the LHA and is experiencing serious technical difficulties on this and other government programs.

I now have reason to believe that because of cash shortages, Litton is confronted with a financial crisis of major proportions. I am informed that in in order to extricate itself from its financial problems, the company is attempting to persuade the Navy to pay millions of dollars of worthless and inflated claims. Or, alternatively, to restructure the LHA contract or take other steps to solve Litton's shipbuilding problems, including a Navy takeover of the Litton shipyards at Pascagoula.

According to my information, Litton has told the Navy that it wants at least $40 million for two of its larger claims to be paid no later than July 31, 1972. This date coincides with the end of the company's fiscal year when it will be required to demonstrate its financial solvency to its auditors and creditors. You may already be aware of Litton's precarious financial condition. After the first nine months of its current fiscal year, Litton showed a loss of $11.1 million. In addition, a preliminary review of Litton's financial statements for the past several years, suggests that the company has been reporting earnings based on anticipated settlements of claims pending against the Navy. If this is correct, and Litton's claims are in fact exaggerated, the company will soon have a lot of explaining to do. Such a method of reporting profits would be highly irregular if not improper because of the uncertainty surrounding claims against the Government, especially Litton's claims. I have already written to the Securities and Exchange Commission requesting an investigation of this matter. A copy of my letter of June 19, 1972, to Commissioner William J. Casey is attached for your information.

One can easily understand why Litton so desperately needs large amounts of cash and why it is making such a great effort to extract favorable settlements of its shipbuilding claims. There is considerable evidence, however, that at least part of Litton's claims are inflated and insupportable. The two claims I mentioned above, for example, total $82 million. These claims involve work at Litton's East Bank Shipyard on nuclear submarines and ammunition ships. The Navy apparently considers both claims grossly overstated as it offered to pay Litton approximately $12 million for both claims as recently as a month ago. I am informed that a review and investigation of these claims by the appropriate authorities in the Navy shows that these claims cannot be substantiated for more than the amount the Navy offered to pay.

As you know, there are about $180 million worth of claims arising out of the East Bank Shipyard, including the above two. The largest claim in the East Bank Shipyard is for $95 million for the alleged "ripple effect" on Litton's business produced by change orders to a number of submarines built at this yard several years ago. NAVSHIPS, according to my information, considers this claim totally unjustified.

The largest Litton claim, valued at $270 million based on the LHA contract, arises out of the West Bank Shipyard. This is a relatively new claim and has not yet been fully evaluated. There are other problems with the LHA contract. As you know, the original amount of this contract was about $1 billion for nine LHA ships. The current estimate to complete the work on the five ships comprising the present program is $1,441,000. The unit cost of this contract has risen from about $113 million to $288 million per ship. In addition to this huge over-run, the program is now estimated to be about two years behind schedule. In my judgment, the schedule delay constitutes grounds for declaring the contractor in default of his contract, and I am at a loss to understand why the Navy has not issued a 10-day cure notice. The continued failure on the part of

the Navy to take action could be construed as a constructive change and could result in the loss of millions of dollars for the Government.

The delays in the LHA program have already impacted on the DD–963 destroyer program which Litton is also supposed to be performing in the West Bank Shipyard. Although it is true that a keel-laying ceremony was conducted recently for the first DD–963. I am informed that the delays and technical problems in the West Bank Shipyard are so serious that Litton has proposed to the Navy that it be permitted to construct several of the DD–963's in its older East Bank Shipyard, where nuclear submarine construction is now in progress. As you know, one of the major reasons for awarding the DD–963 contract to Litton was in anticipation of the efficiency of operations in the new and modernized West Bank Shipyard. So far as I can tell, none of the benefits expected from the West Bank Shipyard have yet been realized. Moving the destroyer program into the East Bank would not only cast doubt on the decision to award this contract to Litton, it could have a detrimental impact on the nuclear submarine construction in the East Bank Shipyard.

It occurs to me that the only way the Navy may be able to obtain the DD–963 destroyers would be to further reduce or terminate the LHA program so that work on the DD–963 can go forward. I plan to communicate with you further on this matter.

It is not surprising that officials of Litton, including the President, the Executive Vice President, a Senior Vice President, and a Vice President, have made recent visits to high officials in the Department of the Navy circumventing the officials charged with the responsibility for negotiating claims settlements in attempts to resolve its difficulties.

In view of the disturbing facts, I would like the Navy to respond to the following questions:

1. Does the Navy plan to pay unsupported and unsubstantiated shipbuilding claims to Litton or to take other steps calculated to bail out the company from its financial difficulties?

2. What is the Navy's assessment of Litton's financial capabilty to complete performance on its Navy contracts? Has the Navy done a cash flow study of Litton?

3. Why hasn't the Navy declared the Litton LHA contract in default?

I urge you, Mr. Secretary, not to allow Litton to become the Navy's Lockheed. A decision to allow this company to ignore its contractual obligations to the Navy will have serious consequences and will become a most unfortunate precedent. If my information and interpretation of Litton's financial situation is correct, even a $40 million settlement of Litton's inflated East Bank claims might only be the down payment on future similar unwarranted demands. The only way to assure that the public interest will be served in the settlement of claims is for the proper officials to negotiate them strictly on their merits. If an agreement cannot be reached on a claim, it should be referred to the Armed Services Board of Contract Appeals. For high officials of the Navy to be "horsetrading" claims with corporate presidents and vice presidents is both demeaning to the Navy and improper, in my judgment.

I have asked the General Accounting Office to conduct an independent investigation of Litton's financial capability to perform its contracts, and I hope you will fully cooperate with it.

Your early reply to this letter will be appreciated.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 7.—*June 22, 1972—Letter to Elmer Staats, Comptroller General from Senator Proxmire requesting GAO investigation of Litton's financial capability to carry out Government contracts*

JUNE 22, 1972.

HON. ELMER STAATS,
Comptroller General of the United States,
General Accounting Office,
Washington, D.C.

DEAR ELMER: Recently I have written to the Chairman of the Securities and Exchange Commission and the Secretary of the Navy requesting answers to questions concerning Litton Industries.

There is a growing amount of evidence raising questions about Litton's corporate finances. If my information is correct, Litton in addition to suffering a loss on the first nine months' business of the current fiscal year, has been reporting as earnings the full amount of pending claims on Navy shipbuilding contracts.

As you know, shipbuilding claims in the past, including claims of Litton Industries, have often been grossly overstated. If Litton's shipbuilding claims are in fact exaggerated, the company's true financial condition may be at sharp variance from the picture protrayed by its public reports.

This letter is to formally request that the General Accounting Office conduct an independent investigation of Litton's financial capability to carry out its government contracts. Because of requests now pending before Congress affecting some of these contracts, I would hope that your investigation can be begun immediately and completed by July 31, 1972. I am sure you are aware of the seriousness of the questions I have raised and the need to answer them at the earliest possible time.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 8.—*June 26, 1972—Excerpt from Congressional Record: Senator Proxmire announces requests to SEC, GAO and Navy for investigations of Litton*

INVESTIGATION OF LITTON INDUSTRIES

Mr. PROXMIRE. Mr. President, I have asked the Securities and Exchange Commission, the General Accounting Office, and the Navy to investigate the financial capability of Litton Industries to complete performance of its Government contracts. I have also asked Navy Secretary John W. Warner, in a letter I am releasing today, to reject proposals made by Litton that the Navy pay inflated and unsubstantiated claims and take other actions in order to help the company solve its financial difficulties.

It is becoming increasingly clear that Litton is unable to perform any of its major shipbuilding contracts without running up huge cost overruns. Litton's $450 million worth of shipbuilding claims against the Navy must be seen as an attempt to shift the costs of its own inadequacies to the American taxpayer.

Litton executives, from the president on down, have been meeting almost daily with Navy officials in an effort to obtain a bailout from its financial plight.

In my letter to Secretary Warner, I said:

"I urge you, Mr. Secretary, not to allow Litton to become the Navy's Lockheed. A decision to allow this company to ignore its contractual obligations to the Navy will have serious consequences and will become a most unfortunate precedent. If my information and interpretation of Litton's financial situation is correct, even a $40 million settlement of Litton's inflated East Bank claims might only be the down payment on future similar unwarranted demands. The only way to assure that the public interest will be served in the settlement of claims is for the proper officials to negotiate them strictly on their merits. If an agreement cannot be reached on a claim, it should be referred to the Armed Services Board of Contract Appeals. For high officials of the Navy to be "horse-trading" claims with corporate presidents and vice presidents is both demeaning to the Navy and improper, in my judgment."

Because of Litton's cash shortages, the huge cost overruns, schedule delays, and technical difficulties encountered on its shipbuilding programs, a shadow has been cast over two of the largest ship contracts awarded in recent years.

Litton is now 2 years behind schedule on the LHA contract and there is a serious question as to whether Litton is capable of building even the first LHA ship.

LHA contract has already been delayed with adverse effects to the DD–963 destroyer program and Litton may also be unable to deliver on that contract.

Litton has given the Navy grounds for declaring the LHA contract in default and continued failure to take corrective action on the Navy's part could increase the cost to the taxpayer by hundreds of millions dollars.

If the Navy does not pay the unsubstantiated portion of Litton's claims, the company could face a financial crisis of major proportions in the near future.

For these reasons, I have asked the Securities and Exchange Commission t tell me whether Litton's annual reports correctly state the company's earnings If the shipbuilding claims have been reported as earnings but are rejected b the Navy, Litton may not have the financial capability to carry out its con tractual commitments.

I have also asked the Commission to state whether Litton's reporting method comply with SEC rules and regulations, and whether the SEC requires publi disclosure of expected large overruns or underruns of defense contracts b defense contractors.

I have asked the General Accounting Office to conduct an independent inves tigation of Litton's financial capability to carry out its Government contracts.

I ask unanimous consent, to insert in the RECORD copies of my letters to th Securities and Exchange Commission, the General Accounting Office, and th Department of the Navy.

There being no objection, the material was ordered to be printed in th RECORD, as follows:

JUNE 19, 1972.

Hon. WILLIAM J. CASEY,
Commissioner, Securities and Exchange Commission,
Washington, D.C.

DEAR MR. COMMISSIONER: As you know the Joint Economic Committee has held several hearings on weapons acquisition programs of the Department of Defense. One aspect of these hearings involves large claims by Navy shipbuilders. Currently these claims total about $1 billion and involve some of the Nation's largest companies.

Litton Industries has the largest dollar amount of claims against the Navy; these total about $450 million. Some Litton claims are several years old. Navy witnesses have testified that Litton's claims appear exaggerated and Litton's actual entitlement is substantially less than the amounts of its claims. Reports by the General Accounting Office indicate that some of the claims have been overstated.

Recently Litton announced it was taking a $25 million write-off against FY 1972 operations for expected losses on the LHA Navy shipbuilding contract. According to the press, Litton stated that the company doesn't expect a further write-off this year, but indicates that the negotiations with the Navy are continuing. But looking at Litton's published financial statements in the light of its recent release, it appears that for several years the company has been reporting profits based on the anticipation of obtaining substantial sums from its claims against the Navy. If these claims are in fact overstated, Litton's profits for the past several years may also have been overstated. At least it appears that Litton's profits or losses are subject to considerable uncertainty until these claims are settled, and have been for some time. Yet there are no footnotes or other explanations in Litton's published reports—specifically in its FY 1971 annual report and interim reports of October 31, 1971, and January 31, 1972—to indicate that this is the case. In fact, the Litton FY 1971 annual report states:

"The outlook for Defense and Marine Systems is good. Our present backlog spans several years of activity providing a basis for continuing growth of sales and profits independent of the general economy."

The Accountants Report for that year—by Touche, Ross and Company—also fails to note that Litton had several large claims against the Navy in process or under negotiations, the outcome of which could substantially alter Litton's financial results. These reports, therefore, appear very misleading.

I would like to know:

Has Litton in fact reported earnings based on its expected recovery of large claims against the Government? If so, can you tell me to what extent Litton's earnings have been overstated for the past several years—say 1968–1971—if such claims are not honored by the Navy? It appears to me that if substantial portions of the alleged claims are not paid by the Navy, Litton may not have the financial capability to carry out its contractual commitments.

What are the Securities and Exchange Commission rules concerning the company's obligations for public disclosure of information in a situation such as this? If, in fact, Litton was including anticipated claims settlements as valid receivables from the Government, would it be violating any SEC rules? Has Litton violated any Securities and Exchange Commission rules by its failure to

reflect uncertainty in its published reports as to the ultimate settlement of its claims against the Government.

Do other publicly owned defense contractors follow similar practices? If so it seems to me that defense contractors can manipulate earnings to show whatever they want to show just by the size of their claims against the Government.

At what point does the Securities and Exchange Commission require disclosure of expected large over-runs or under-runs of defense contracts by defense contractors.

I would appreciate obtaining answers to my questions by June 30, 1972.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

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JUNE 22, 1972.

Hon. JOHN W. WARNER,
Secretary, Department of the Navy,
Washington, D.C.

DEAR MR. SECRETARY: I have become increasingly concerned over the Navy's problems with the Ingalls Shipbuilding Division of Litton Industries. As you know, Litton is responsible for the largest single amount of outstanding shipbuilding claims now pending against the Navy, totaling about $450 million. In addition to the huge cost overruns represented by these claims, Litton has fallen far behind the performance schedule on the LHA and is experiencing serious technical difficulties on this and other government programs.

I now have reason to believe that because of cash shortages, Litton is confronted with a financial crisis of major proportions. I am informed that in order to extricate itself from its financial problems, the company is attempting to persuade the Navy to pay millions of dollars of worthless and inflated claims. Or, alternatively, to restructure the LHA contract or take other steps to solve Litton's shipbuilding problems, including a Navy takeover of the Litton shipyards at Pascagoula.

According to my information, Litton has told the Navy that it wants at least $40 million for two of its larger claims to be paid no later than July 31, 1972. This date coincides with the end of the company's fiscal year when it will be required to demonstrate its financial solvency to its auditors and creditors. You may already be aware of Litton's precarious financial condition. After the first nine months of its current fiscal year, Litton showed a loss of $11.1 million. In addition, a preliminary review of Litton's financial statements for the past several years, suggests that the company has been reporting earnings based on anticipated settlements of claims pending against the Navy. If this is correct, and Litton's claims are in fact exaggerated, the company will soon have a lot of explaining to do. Such a method of reporting profits would be highly irregular if not improper because of the uncertainty surrounding claims against the Government, especially Litton's claims. I have already written to the Securities and Exchange Commission requesting an investigation of this matter. A copy of my letter of June 19, 1972, to Commissioner William J. Casey is attached for your information.

One can easily understand why Litton so desperately needs large amounts of cash and why it is making such a great effort to extract favorable settlements of its shipbuilding claims. There is considerable evidence, however, that at least part of Litton's claims are inflated and insupportable. The two claims I mentioned above, for example, total $82 million. These claims involve work at Litton's East Bank Shipyard on nuclear submarines and ammunition ships. The Navy apparently considers both claims grossly overstated as it offered to pay Litton approximately $12 million for both claims as recently as a month ago. I am informed that a review and investigation of these claims by the appropriate authorities in the Navy shows that these claims cannot be substantiated for more than the amount the Navy offered to pay.

As you know, there are about $180 million worth of claims arising out of the East Bank Shipyard, including the above two. The largest claim in the East Bank Shipyard is for $95 million for the alleged "ripple effect" on Litton's business produced by change orders to a number of submarines built at this yard several years ago. NAVSHIPS, according to my information, considers this claim totally unjustified.

The largest Litton claim, valued at $270 million based on the LHA contract, arises out of the West Bank Shipyard. This is a relatively new claim and has not yet been fully evaluated. There are other problems with the LHA contract. As you know, the original amount of this contract was about $1 billion for nine LHA ships. The current estimate to complete the work on the five ships comprising the present program is $1,441,000. The unit cost of this contract has risen from about $113 million to $288 million per ship. In addition to this huge over-run, the program is now estimated to be about two years behind schedule. In my judgment, the schedule delay constitutes grounds for declaring the contractor in default of his contract, and I am at a loss to understand why the Navy has not issued a 10-day cure notice. The continued failure on the part of the Navy to take action could be construed as a constructive change and could result in the loss of millions of dollars for the Government.

The delays in the LHA program have already impacted on the DD–963 destroyer program which Litton is also supposed to be performing in the West Bank Shipyard. Although it is true that a keel-laying ceremony was conducted recently for the first DD–963, I am informed that the delays and technical problems in the West Bank Shipyard are so serious that Litton has proposed to the Navy that it be permitted to construct several of the DD–963's in its older East Bank Shipyard, where nuclear submarine construction is now in progress. As you know, one of the major reasons for awarding the DD–963 contract to Litton was in anticipation of the efficiency of operations in the new and modernized West Bank Shipyard. So far as I can tell, none of the benefits expected from the West Bank Shipyard have yet been realized. Moving the destroyer program into the East Bank would not only cast doubt on the decision to award this contract to Litton, it could have a detrimental impact on the nuclear submarine construction in the East Bank Shipyard.

It occurs to me that the only way the Navy may be able to obtain the DD–963 destroyers would be to further reduce or terminate the LHA program so that work on the DD–963 can go forward. I plan to communicate with you further on this matter.

It is not surprising that officials of Litton, including the President, the Executive Vice President, a Senior Vice President, and a Vice President, have made recent vists to high officials in the Department of the Navy circumventing the officials charged with the responsibility for negotiating claims settlements in attempts to resolve its difficulties.

In view of the distributing facts, I would like the Navy to respond to the following questions:

1. Does the Navy plan to pay unsupported and unsubstantiated shipbuilding claims to Litton or to take other steps calculated to bail out the company from its financial difficulties?

2. What is the Navy's assessment of Litton's financial capability to complete performance on its Navy contracts? Has the Navy done a cash flow study of Litton?

3. Why hasn't the Navy declared the Litton LHA contract in default?

I urge you, Mr. Secretary, not to allow Litton to become the Navy's Lockheed. A decision to allow this company to ignore its contractual obligations to the Navy will have serious consequences and will become a most unfortunate precedent. If my information and interpretation of Litton's financial situation is correct, even a $40 million settlement of Litton's inflated East Bank claims might only be the down payment on future similar unwarranted demands. The only way to assure that the public interest will be served in the settlement of claims is for the proper officials to negotiate them strictly on their merits. If an agreement cannot be reached on a claim, it should be referred to the Armed Services Board of Contract Appeals. For high officials of the Navy to be "horse-trading" claims with corporate presidents and vice presidents is both demeaning to the Navy and improper, in my judgment.

I have asked the General Accounting Office to conduct an independent investigation of Litton's financial capability to perform its contracts, and I hope you will fully cooperate with it.

Your early reply to this letter will be appreciated.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 9.—*June 26, 1972—Washington Star article—"Litton in Bad Shape, Proxmire Says"*

(By Stephen M. Aug)

Sen. William B. Proxmire, D-Wis., contended today that Litton Industries Inc. is in "precarious financial condition," and that it has been hiding the truth from its shareholders by issuing misleading earnings reports.

Proxmire made his claims in letters to Chairman William Casey of the Securities and Exchange Commission, Navy Secretary John W. Warner and Comptroller General Elmer Staats.

Proxmire, the chairman of the Joint Economic Committee, asked Casey to examine Litton's financial statements to determine whether the company had included in its earnings report $450 million worth of claims against the Navy.

He pointed out that some of the Litton claims are several years old and Navy officials have testified that the claims "appear exaggerated and Litton's actual entitlement is substantially less than the amounts of its claims."

NO EXPLANATIONS

Proxmire contended that if the claims actually are overstated," Litton's profits for the past several years may also have been overstated."

He said there appears to be considerable uncertainty until the claims are settled. "Yet there are no footnotes or other explanations in Litton's published reports," and the company's outside accounting firm—Touche, Ross & Co.—failed to note Litton had a number of large claims against the Navy under negotiation, "the outcome of which could substantially alter Litton's financial results. These reports, therefore, appear very misleading."

Proxmire's letter to Casey was dated last Monday, three days before the SEC made public a staff investigative report on defense contracting. The commission—although deciding that its rules are adequate to protect the public—did warn defense contractors that they should make public promptly adverse financial information resulting from defense contracts.

CRISIS IS SEEN

Proxmire asked Staats to have the General Accounting Office investigate Litton's financial capability to carry out its government contracts.

The senator told Warner that he believes "because of cash shortages, Litton is confronted with a financial crisis of major proportions," and urged the secretary "not to allow Litton to become the Navy's Lockheed."

Proxmire said also that Litton officials appear to be trying to circumvent normal procedures for adjusting claims against the Navy. He said that rather than discuss matters with officials responsible for negotiating claims settlements, Litton officials—including President Roy L. Ash—"have made recent visits to high officials in the Department of the Navy."

He asked Warner whether the Navy plans to "pay unsupported and unsubstantiated shipbuilding claims" or take other steps to bail the company out from its financial difficulties. He suggested a number of alternatives to the Navy, one of which is to restructure some of the contracts in question or have the Navy take over Litton's shipyards at Pascagoula, Miss.

Litton issued a statement saying Ash had indeed met with Navy officials in an effort to obtain payments which the Navy owes on contracts and to discuss negotiations with respect to a repricing proposal Litton recently submitted on its LHA contract (landing helicopter assault vessels).

CLAIMS OUTLINED

The company said claims from East Bank shipyards amount to about $65 million and relate to contract modifications on summaries over a 4-year period, and to 31 change orders on four ammunition supply vessels.

The company said it had "carried out the requirements of standard accounting and reporting practices and full disclosure in accordance with SEC regulations."

Orion L. Hoch, Litton senior vice president, said in a telephone interview from Beverly Hills that he believes Proxmire has combined claims with the repricing proposal which was required by the contract. He said $270 million of Proxmire's over-all claims figure is due to the repricing of the LHA contract.

Hoch said Litton was not in precarious financial condition and "we expect to deliver the ships."

Proxmire contended Litton is two years behind schedule on the LHA contract and these delays have had an adverse impact on a major destroyer program. "It is increasingly clear that Litton is unable to perform any of its major shipbuilding contracts without running up huge cost over-runs. Litton's $450 million worth of shipbuilding claims against the Navy must be seen as an attempt to shift the costs of its own inadequacies to the American taxpayer," Proxmire said.

ITEM 10.—*June 27, 1972—N.Y. Times article—"Proxmire Asserts Litton Is in Crisis"*

URGES NAVY TO REJECT CLAIMS—ASKS S.E.C. INVESTIGATION

(By Richard Witkin)

Senator William Proxmire said yesterday that huge cost overruns on Navy shipbuilding contracts had seriously drained the cash balance of Litton Industries and the company faced "a financial crisis of major proportions."

In a Senate speech, the Wisconsin Democrat urged the Navy to reject proposals that it pay "millions of dollars of worthless and inflated claims" to help Litton solve its troubles.

Mr. Proxmire disclosed that he had asked the Securities and Exchange Commission and the General Accounting Office to investigate Litton's financial ability to finish work on Navy ships it is building or will build at its trouble-ridden new yard at Pascagoula, Miss.

These include five LHA amphibious-assault ships, which are two years behind schedule, and 30 DD-963-class destroyers. Metal-cutting for the first of the destroyers has begun ahead of schedule.

But officials are afraid the destroyers could run into serious delays and cost increases unless technical and labor problems at the highly-automated new yard show faster improvement.

REPLY FROM LITTON

In a reply to Mr. Proxmire, the West Coast conglomerate said:

"Litton's financial health has never been the issue. What is the issue are the claims Litton has before the Navy for work performed at our East Bank shipyard and negotiation for the pricing proposal for the LHA's."

The new yard is on the west bank of the Pascagoula River. The East Bank yard just opposite it is a well-established facility that has been turning out nuclear submarines and ammunition ships, among other things.

Mr. Proxmire pursuing what has emerged as a prime issue in the Congressional debate over alleged Pentagon waste, said:

"It is becoming increasingly clear that Litton is unable to perform any of its major shipbuilding contracts without running up huge cost overruns. Litton's $450-million worth of shipbuilding claims against the Navy must be seen as an attempt to shift the costs of its own inadequacies to the American taxpayer."

Noting that Litton was two years behind on the LHA, the Senator said there was a "serious question as to whether Litton is capable of building even the first LHA ship."

"Litton has given the Navy grounds," he said a moment later, "for declaring the LHA contract in default, and continued failure to take corrective action on the Navy's part could increase the cost to the taxpayer by hundreds of millions of dollars.

"If the Navy does not pay the unsubstantiated portion of Litton's claims, the company could face a financial crisis of major proportions in the near future," he said.

ITEM 11.—*June 27, 1972—Wall Street Journal article—"Proxmire Asks Inquiry Into Financial Health of Litton Industries"*

HE CHARGES IT'S IN WORSE SHAPE THAN CONCEDED ON NAVY JOBS, CALLS FOR SEC, GAO REVIEW

WASHINGTON.—Sen. William Proxmire, calling for government investigations into Litton Industries Inc.'s financial health, charged that the company is in worse shape that it has conceded on big Navy shipbuilding programs.

The Wisconsin Democrat, a frequent critic of Pentagon procurement policies, has asked both the Securities and Exchange Commission and the General Accounting Office, Congress' fiscal watchdog, to determine whether the company is financially capable of finishing work on its military contracts.

Among Litton's military programs are contracts to build five giant LHA assault ships and 30 DD963 class destroyers. The LHA program is several years behind schedule and has been plagued by rising costs. Moreover, it appears increasingly likely that the delays on the LHA at Litton's modern, automated shipyard in Pascagoula, Miss., will cause trouble on the destroyer project.

At the same time, the Senator urged the Navy to reject any "inflated" financial claims by Litton against the government on shipbuilding work. Mr. Proxmire said that Litton's unsettled shipbuilding claims—for work on the LHA, nuclear submarines and ammunition ships—total $450 million.

"If the Navy doesn't pay the unsubstantiated portion of Litton's claims, the company could face a financial crisis of major proportions in the near future," the Senator asserted.

In California, a Litton spokesman said that the company is "capable of supporting all cash requirements." In a statement issued earlier, Litton had said that its claims were justified.

Among the other charges made by Sen. Proxmire—in correspondence with the SEC, the GAO and the Navy—and the Litton spokesman's responses—were as follows:

"A preliminary review of Litton's financial statements for the past several years suggests that the company has been reporting earnings based on anticipated settlements of claims against the Navy," the Senator said. The company spokesman said: "We don't book claims until they're settled. We don't book profits on claims until they're settled."

The company has suggested to the Navy that one way to solve Litton's shipbuilding problems would be for the Navy to "take over" the company's yards in Pascagoula, Mr. Proxmire said. The Litton spokesman responded that the company "isn't asking Navy to take over" the yards.

Litton has proposed to the Navy that it be permitted to construct several destroyers in the older East Bank yard in Pascagoula, rather than in the new automated West Bank yard, the Senator stated. The Litton spokesman denied it has asked the Navy to make such a switch.

ITEM 12.—*July 3, 1972—Time article—"Conglomerates: Litton's Sad Litany"*

Only half a year ago, Roy Ash, president of California's Litton Industries, sounded like a man who had seen light at the end of a tunnel. Profits of the troubled conglomerate in 1972, he confidently predicted, would increase substantially over their lackluster showing of $50 million in 1971, and one reason for the gain would be Litton's $130 million shipyard in Pascagoula, Miss. Ash calls the ultramodern facility, opened about two years ago, "a national asset that will make U.S. shipbuilding competitive in world markets."

In the months since then, Litton's light has dimmed considerably. The company lost money during two quarters of its 1972 fiscal year, and will close the books later this month with what Ash now calls only a "small profit." The trouble stems in large part from the Pascagoula yard, which has produced a small armada of labor problems, construction delays, cost overruns—but so far very few ships.

Litton's biggest headache is a $752 million order, for U.S. Navy general-purpose amphibious assault vessels called LHAS (for Landing Helicopter Assault ships). After the company fell 18 months behind in construction, the Navy slashed the order from nine ships to five. Navy brass caused some of the delay and increased costs by ordering changes in the design. As a result, under the terms of its agreement, the Navy may owe more for the five LHAS it will get than it had planned to spend for all nine. The two parties are currently renegotiating the contract.

Cost estimates are also spiraling upward on a $2.1 billion Navy order for 30 Spruance-class DD-963 destroyers, a new model to be used primarily for anti-submarine duty. Although the contract is designed to hold Litton to fixed prices, it allows for inflation and some other variables that may permit the company to collect additional sums. Some estimates put the eventual cost of each new destroyer at $100 million, *v.* the $90 million that the Navy deems appropriate; the question is how much of the extra cost will be paid by Litton and how much by the Navy.

Reports of Litton's troubles touched off a furor in Congress, which is growing increasingly impatient with overrun-prone defense contractors. The House Armed Services Committee recently cut next year's budget authorization for the destroyer from $610 million, as requested by the Pentagon, to $247 million. The committee expressed "concern" over costs and delays in both shipbuilding programs, with an eye toward finding remedies.

Game Plan. The Pascagoula plant is also far behind on construction of eight container ships for the Farrell and American President lines. Now scheduled for completion next fall, the first such vessel will be 21 months behind schedule and will cost about double its contract price of $21 million, making it the most expensive general cargo ship ever built. Litton will doubtless pay heavily for the overrun.

What went wrong in Pascagoula? For one thing, the plant's advanced "modular" technology, in which sections of a ship are built separately and then welded together, produced some monumental bloopers. Some of the sections simply did not fit together, forcing engineers to order expensive recuttings. In addition, Litton staffed the yard largely with top managers drawn from other businesses, who knew little about shipbuilding, and engineers transferred from West Coast aerospace operations, who did not adapt easily to a Southern environment; the general air of discontent spread to the blue-collar force. In Pascagoula's first year, labor turnover ran as high as 60%, double the normal rate.

Ash claims that Litton has finally worked out its management and labor problems in Pascagoula. He professes no concern about the reduced Navy orders and congressional funding cutback. "The Navy will commission other ships and we, as the most competitive shipbuilder in the country, will get other Navy business," he says. Ash further points out that about two-thirds of the conglomerate's businesses (1971 total sales: $2.5 billion) are turning in healthy profits. They include Monroe calculators, Sweda sales-recording systems, medical products and new inertial navigation systems. "We are still on the game plan we're been on for the last 15 years," says Ash.

It is doubtful that Litton's game plan included some $70 million in losses—$25 million of them in high start-up costs at Pascagoula—that the company is writing off this year. Yet Ash still exudes confidence in his theory of "free form" management. Stockholders, whose shares have plunged in price from a high of 120⅜ in 1967 to 15⅞ last week, will be waiting for proof.

ITEM 13.—*July 12, 1972—Letter to Senator Proxmire from the Acting Secretary of the Navy setting forth the Navy position regarding Litton's problems*

DEPARTMENT OF THE NAVY,
Office of the Secretary,
Washington, D.C.

Hon. WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government, Joint Economic Committee, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I have received your letter of June 22nd expressing your concern over the Navy's problems with the shipbuilding divisions of Litton Industries. You mentioned the claims against the Navy made by Litton and its

technical difficulties with the LHA and other Government programs and indicated your belief that the company is confronted with a financial crisis of major proportions.

You asked three questions concerning the foregoing, the first of which involved whether the Navy plans "to pay unsupported and unsubstantiated shipbuilding claims to Litton or to take other steps calculated to bail out the company from its financial difficulties." Only those amounts which are factually supported and to which Litton is clearly entitled after detailed review will be paid on submitted claims. Since the review and negotiation of these claims have not been completed, any comment on their validity or possible settlements would be premature. The Navy has no intention of restructuring the LHA contract, but will take the necessary action to enforce its rights thereunder and assure delivery of its ships under construction at Pascagoula.

Your second question concerned the Navy's assessment of Litton's financial capability to complete performance on its Navy contracts and whether the Navy had done a cash flow study of the company. We have continually reviewed its financial position with the company and will continue to monitor closely. Since the data is company-confidential, I consider it inappropriate for the Navy to comment on Litton's financial condition; this is a matter for the company officials to address.

You also asked why the Navy has not "declared the Litton LHA contract in default." The Navy is in the process of analyzing, evaluating, and auditing the target price re-set proposal required by the contract and submitted by Litton on March 31st. While we have expressed to Litton our dissatisfaction with certain aspects of this re-set proposal, because of the complexity of the contract and the proposal, we do not expect to have a final position before August.

Your letter further addressed the possible effect on the DD-963 destroyer program that delays in the LHA program might have. It is too early to state categorically that the admitted LHA delays have impacted the destroyer program. The possibility is real, and the Navy is reviewing all alternatives for obtaining economical delivery under the contract. Although the keel-laying you mentioned has not occurred as yet, Litton did begin construction of the DD-963 several weeks ago (earlier than scheduled) as a means of "proofing" the construction plans.

In summary, the Navy will proceed in the Litton situation in accordance with the terms of its contracts with the company and established Navy claim settlement procedures. No "horsetrading" of claims with corporate officials is taking place; and to the extent that Litton disagrees with any proposed settlement, the corporation may appeal to the Armed Services Board of Contract Appeals. The Navy will cooperate fully with the General Accounting Office in any investigation that it conducts in response to your request.

I hope that the foregoing responds satisfactorily to your letter.

Sincerely yours,

FRANK SANDERS,
Acting Secretary of the Navy.

ITEM 14.—*July 13, 1972—Memorandum for the Assistant Secretary of the Navy (I&L) from Gordon Rule commenting about the mistakes made by Navy Secretaries and Admirals in meeting with top corporate officials. Mr. Rule encloses a Navy letter of June 23, 1972 taking a firm position with Litton on the LHA contract and a speech by Mr. T. Lynch, Gould, Inc.*

DEPARTMENT OF THE NAVY,
Headquarters Naval Material Command,
Washington, D.C., July 13, 1972.

MEMORANDUM FOR THE ASSISTANT SECRETARY OF THE NAVY

(INSTALLATIONS AND LOGISTICS)

Subject: Meeting in Your Office 14 June 1972.
Enclosure: (1) Letter dated 23 June 1972 from NSSC to Litton Industries, Inc.
(2) Talk by Tom Lynch of Gould, Inc.

1. At subject meeting you asked the substance of my comments to Secretary Warner the previous day re: Litton Industries, Inc. You were trying to get

away that evening on some leave and I asked if filling you in could be deferred until your return. You agreed.

2. Knowing how Secretary Warner appreciates complete candor, my statements to him, based upon my experience in Navy procurement/contracting, were substantially as follows:

(i) we have made a big mistake with Litton—and indeed other contractors—by Navy Secretaries and Admirals, unfamiliar with specific contractual terms and conditions etc. and with no discernible record of negotiating ability, holding 'summit' meetings with top corporate officials on their contractual problems;

(ii) It is most unwise for these same Secretaries and Admirals to maintain the existing open door policy to these same top corporate officials, who by design, practice and technique, *always* attempt to deal and negotiate with Navy topside, rather than deal with the cognizant contracting officer and the contract people in a SysCom.;

(iii) that I do not blame industry officials for attempting this "start at the top" technique but I very definitely fault Secretaries and Admirals who permit this continued practice without telling those corporate officials in no uncertain terms to get down to business with the SysCom 02, who knows what to do on behalf of the Navy regarding contract problems because that is his particular profession.

3. Had I more time with Secretary Warner on that occasion I would have added that if Secretaries and/or Admirals feel the necessity to meet with top corporate officials to discuss contractual problems, they should never do so without the SysCom 02 and his lawyer in attendance. It is absolutely amazing for example to read the LHA contractual matters discussed in the 'executive session' held at the conclusion of the third 'summit' meeting at Litton on 18 November 1971 with Mr. Ash et al of Litton. The minutes of that session read in part as follows:

"There was a rather complex discussion concerning the interpretation of the contract terms as they relate to target and ceiling price. It appears the whole contract may need to be readjusted and in the minds of some there is much concern over the meaning of the details of the contract.

Mr. Krause (Litton) said the contract terms are somewhat nebulous about escalation. "There are big dollar numbers involved here."

It appears we don't have a ceiling price as of now, on the proposed contract for five ships. Ill says so. Ash and O'Green say so."

It is difficult to comprehend what possible benefit to the Navy could inure from any such a discussion in the absence of NavShips 02 and his lawyer. Indeed, the reverse may well be true. For a Secretary to make that comment about no ceiling when NavShips 02 believes there is a ceiling illustrates the danger of such meetings. These 'summit' meetings with their inherent possibility of unwise comments and/or commitments, are anathema to knowledgeable contract professionals who are not permitted to be in attendance.

4. In my opinion, the enclosure (1) letter to Litton on the LHA contract, is one of the finest contract related letters the Navy ever sent to a contractor. It is so appropriate and so clearly states the position of the Navy that one wonders why it took so long to get released and why this same type of positive Navy action has not been taken with the Ogden Corp. on the Avondale claim.

5. Those responsible for the contents of enclosure (1) should be commended for having restored a little Navy respect and image, so far as contractual matters are concerned. This is the sort of action the professional SysCom 02's would take, if left alone and permitted to perform their function. Obviously, the Secretaries and CNM may be called upon at some later time to get into the act but they should rely upon their professionally capable SysCom 02's to staff problems up to them, if and when necessary, rather than dictate action on contractual problems from the top down to them.

6. I respectfully suggest that your procurement/contracting philosophy may be enhanced by taking the time to read enclosure (2).

GORDON W. RULE,
Head, Procurement Control & Clearance Division.

DEPARTMENT OF THE NAVY,
Naval Ship Systems Command,
Washington, D.C., June 23, 1972.

LITTON INDUSTRIES, INC.,
Beverly Hills, Calif.
Attention: Mr. F. O'Green.

GENTLEMEN: Your "LHA Program Reproposal" of 31 March 1972 submitted under Contract N00024-69-C-0283 pursuant to our 23 April 1971 Memorandum of Agreement has been reviewed by the Navy. Its covering letter dated 30 March 1972 advises that it embraces the reduction from nine to five vessels; the establishment of a firm target cost, target price and ceiling price for LHA-1 through LHA-5; revised labor and material escalation provisions; revised contract provisions; request for equitable adjustment; and a proposed new delivery schedule.

In our opinion this "Program Reproposal" as submitted is almost completely unresponsive to the obligations undertaken by Litton in the 23 April 1971 Memorandum of Agreement with the Navy and thus has breached the terms of that instrument. Its escalation coverage, for example, is based upon an inflated and unsupported target cost, introduces an entirely new split between labor and material factors, and an undocumented stretch-out of proposal coverage from 24 to 35 quarters. Further, and even more critically, the proposed revision to the LHA delivery schedule, would result in approximately 19½ months slippage in LHA–1 and as much as 26 months slippage in LHA–5. This slippage could have a direct and potentially disastrous effect upon your ability to deliver the DD 963 Class destroyers under Contract N00024-70-C-0275, and thus directly contravenes the requirement of paragraph 3(g) of the 23 April agreement that any proposed delivery schedule not impact deliveries under that contract. The Navy's concern in this regard was the subject of COMNAVSHIPS' letter. Ser 797-022G to you of 26 May 1972. Additionally, the "Reproposal" presents its requests for equitable adjustments in price and delivery in only the most cursory fashion, devoid of detailed factual documentation, and with the statement that further details may be made available in approximately one year. In these and other respects the "Reproposal" fails materially to comply with the terms of the 23 April agreement.

As provided in contract ARTICLE VII (a), cancellation of LHA-6 through LHA-9 occurred when the Navy did not fund the construction of those vessels by 15 November 1971. Pursuant to ARTICLE VIII CANCELLATION OF ITEMS you are entitled to submit your claim for applicable cancellation charges, which claim may not exceed the $109.7 million cancellation ceiling established in subparagraph (c) of that article, and must be fully supported by verifiable records. The summary 3-page treatment of cancellation contained in your "Reproposal" is completely unsupported and is hereby rejected.

On a separate but related point, your letter of 9 May 1972 requested reconsideration of the Navy's earlier denial of your request to extend for an additional 20 months the operation of the special "costs incurred" basis for progress payments provided in contract ARTICLE IV. This would extend the application of that special procedure from 40 to 60 months to compensate, in your view, for Government-caused delays of that extent. Your request was denied by letter of 7 April 1972 for its failure to present detailed documentary proof of such alleged Government-caused delays, and our review of all related information received from you to date affords the Navy no basis to disturb its position. Contrary to your suggestion, furthermore, the now-expired 23 April "Memorandum of Agreement" did not even embrace this point, but only contemplated such revisions to ARTICLE IV as would result from establishing a new firm target cost, target price, and ceiling for LHA-1 through LHA-5.

In view of the expiration of the 23 April "Memorandum of Agreement" by its own terms on 31 March 1972, the performance and delivery obligations under Contract N00024-69-C-0283 are hereafter governed, as you were advised by letter of 3 April 1972, by the original contract terms and conditions. Our overall assessment of your "LHA Program Reproposal," combined with the Navy's own evaluation and surveillance of progress being made under Contract N00024-69-

C-0283, have significantly increased our long-standing concern with Litton's ability to perform this contract even under your proposed extended delivery schedule. Our analysis of those delays in performance which may be excusable under various contract provisions cannot be reconciled with the revised delivery dates you have proposed. Your summary description of asserted excusable causes of delay is grossly unsupported by factual documentation. The "Reproposal" also takes little or no account of such factors as the internal difficulties you have encountered in organizing and operating the West Bank yard and in recruiting and retaining the necessary personnel for its successful operation which are contributing so predominantly to your production and delivery problems.

Turning to the matters covered by your 12 May 1972 letter, the Navy is willing to negotiate a new delivery schedule on the following conditions:

1. The new dates will be the "Guaranteed Delivery Dates" contemplated by ARTICLEIII(b) of the contract.

2. Litton will agree to a contract modification incorporating facilities improvement requirements and milestones as discussed in RADM Sonenshein's letter of 26 May 1972.

3. Based on any additional documentation Litton submits in July 1972, as stated in your 9 May letter, the Navy will make a determination of the amount of excusable delay, if any, to which Litton may be entitled and, as contemplated by ARTICLE X(a), liquidated damages of $10,000 per ship per day, up to a maximum of $600,000 per ship or $3,000,000 for all ships will be assessed for unexcused, Litton-responsible delay.

4. Based on the cost and pricing data in your 31 March "Reproposal", we shall negotiate to establish a firm target cost, price and ceiling and escalation coverage for the five ship program. In the event of a failure to agree, it is the Navy's intention to make a unilateral determination as contemplated by ARTICLE XXVIII(i).

5. Litton will furnish adequate backup data to support its claim for cancellation costs under ARTICLE VIII and the Navy will consider making provisional payments based on the cancellation claim.

6. Litton will expeditiously complete its justification of its request for equitable adjustment and will provide supporting documentation at the earliest practicable date.

Of course, any of the foregoing unilateral determinations by the Navy would be subject to appeal under the "Disputes" clause of the contract. If you do not agree with the course of action proposed herein, the Navy may have no alternative but to pursue its remedies under the "Default" clause.

Sincerely yours,

R. C. GOODING,
Acting Commander,
Naval Ship Systems Command,

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DEPARTMENT OF THE NAVY,
Office of Naval Material,
Washington, D.C., October 28, 1971.

DEAR MR. RULE: I was recently invited to offer a luncheon talk at the 10th Annual National Conference on Government Contracts at the University of Minnesota.

The theme is one which I think supports your views, and although the talk is light and easy, it may nonetheless be of interest to you.

—

SPEECH BY T. LYNCH, OCEAN SYSTEMS DIVISION, GOULD, INC., AT A LUNCHEON AT THE UNIVERSITY OF MINNESOTA ON OCTOBER 21, 1971

Mr. Marquardt, ladies and gentlemen, I have read the prospectus for this conference, and conclude there is very little I can offer in a technical sense to the discussion. However, I have served the Department of Defense as a contractor for more than three decades, and I do have a conclusion or two I think it might be proper to share with you.

The first conclusion is that the Department of Defense is a good customer if you know what you are doing and do not enter the game with the idea that Uncle Sam is a patsy.

In order for you to understand the meaning of this sentence, I offer the fact that in these three decades of service to the Department of Defense, we have never suffered loss in any major program, and for the last decade or so, our rate of return from Government business has been better on average than that from non-Government.

How is this possible?

First, we do not accept contract obligations we cannot discharge. Sounds simple, doesn't it. It is simple. It is so damn simple that many contractors don't believe it, and the landscape is littered with their remains, and the courts are noisy with their screams of anguish.

I understand fully the temptation to accept untenable contract language, with the hope that luck or the turn-of-events will rescue the situation. I have faced this situation many times, and the record reveals we have in some instances lost some big contracts because of our reluctance to contract beyond our beliefs. It is interesting to examine these contracts we have lost to others who signed without understanding. Almost without exception they have been bad contracts with bad results for both contractor and Government, and in some instances the strength of our conviction has been rewarded by our being contracted for rescue operations. In these instances, one's position in negotiation is obviously strengthened, and one can and does obtain better contracts and higher fees.

I cannot help but remind you that the MK 48 torpedo contract we have just signed is a case-in-point. We lost the MK 48 program in 1963, when we refused to agree to what we regarded as an unworkable solution to a technical problem. It is now clear that our course was right. The corporation that agreed to the bad contract allegedly lost tens of millions of dollars, the Government lost at least two years of time in an important program and many millions of dollars for a rescue program, and we who lost from conviction have now won a major assignment, on very attractive terms.

Don't conclude this is the only case. It isn't. It is, perhaps, as much the case as the exception, at least for us.

This brings me to one of my favorite soapbox topics:

I call this the Uncle Sam-is-a-Sucker syndrome. What it means is that no matter how stupidly or cleverly we contract, Uncle is expected to pick up the check, and bail us out. For example, in a recent competition, which we won, it is our understanding that the unsuccessful finalist in that program will bring suit against the Government on grounds his losses in the program were caused by misrepresentation of the state-of-the-art by the Government. Well, we were there, and we recognized the deficiencies, and spoke out against them. The fact that the other company did not can be traced, perhaps, to one of two causes. First, it may have been believed the important matter was to get the contract. The second is that perhaps there was insufficient technical know-how brought to bear upon the situation.

I do not allege that either of these *were* the case in this instance; I say that typically these *are* the reasons why people sign bad contracts. Whatever the reason, to expect Uncle to bail out the situation is unbelievably bad, not only for Uncle, and all his taxpayers, but also for other contractors.

I want to dwell upon this conclusion for a bit. Everytime Uncle bails out a bad contract, all contractors hear the message. Which is, simply, get the contract and let the lawyers bail you out. A kind of Gresham's law comes into play, and contracts get worse and worse, discouraging competent firms, leaving the business to the incompetent, and a rapidly diminishing group of specialized companies which are really captive to the military. The message is clear to me, and I hope to you. Let us, through our trade and technical associations attempt to break this vicious practice. Let us press for quality contracts, with teeth. Let us get off this terrible view that Uncle-is-a-Sucker. If he is, we all are in our role of taxpayers and citizens, and it is my conviction that if this Uncle-is-a-Sucker concept continues to spread, we shall have, in our small way, struck a mortal blow against the Free Enterprize System, at least in so far as it relates to Military/Industrial business practices.

I hope you do not conclude I am an alarmist. I quote from an interview with Professor Galbraith; the noted Harvard Economist and advisor to Presidents, as reported in the 16 October Business Week. He is responding to a series of

questions about the evolution and control of business in the United States and he says, and I quote "and take the extreme case of the munitions firm. You can talk now of their being socialized without anybody having a hemorrhage. Actually, in four or five years the question of bringing the large specialized firms into public ownership will be a very live political issue." Anyone who does not see sentiment building to this proposition in Washington is simply not looking. Indeed, all the shouting is not confined to the fiery-eyed radicals. It has been said by thoughtful people that when the two largest defense contractors in the country have exhausted means of raising needed capital, it is clear that a free military supply system is in jeopardy.

In other words, to put a cap on the argument, I think the Lockheed decision was a bad one, bad for everyone, but particularly bad for those of us who serve the Department of Defense.

Perhaps you will think I am done with that topic. I'm not, quite. What I now shall say will shock some of you. You are aware of Congress' concern with this bad contracting problem, and some of you will know that the General Accounting Office is investigating several aspects, including a study of the feasibility of a Uniform Accounting Practice for those engaged in Government contracting.

I have listened to many of my colleagues who argue against this concept, and I want to say to you that I believe we are fighting a lost cause. Uniform Accounting of Government contracts is going to come, and it will either develop with our help or without it. I urge you to buy the concept and to work with your Corporations on the one hand and with your associations on the other hand to help to develop a system useful and illuminating on both sides of the table. If we do not cooperate with this idea, whose time has come, we shall see rules and procedures we do not like.

I have never had any negotiating secrets, and I do not want any. How easy it is to adjust differences and how easy it is to negotiate good contracts where there are no hidden cards. Uniform Accounting of Government contracts will give us a common language, will help to take that hidden card from both sides of the table, and will be good for both of us.

What I have tried to say to you this morning is that bad contracts are the key root to the bad reputation defense contracting is getting, and it is up to us to spring to the rescue. Our natural reaction to fight any infringement on custom, even when the end results are good, will simply mean the ball will be taken away from us, and I hope I have given some arguments in support to the thesis that control of the situation is not entirely out of our hands.

In reporting my proposed remarks to your Program Director, Mr. Amundson, I said I'd like to offer an example or two of widely different ways to price a bid, and I allowed that each is profitable and legal but widely different in bid price. If it sounds like *funny* bidding or cards in the hip pocket, it isn't, and, perhaps a story will not only be useful to reveal a bidding technique but also interesting to illustrate what I mean by open negotiation.

For obvious reasons, I shall discuss a theoretical case, but I assure you it derives from an actual case, and the ratios are preserved in the example.

The Government had contracted with a company to develop a widget, and to prepare to manufacture the widget in quantity. To obtain that capability, the Government supplied the company with tooling money, and engineering support in the amount of about two million dollars. In due course, the item went out to bid, and we decided to bid it, although we didn't really have a ghost of a chance unless the Government allowed us a bogey equal to the two million dollar head start. The rules are clear: in such a case, the Government must charge the built-in contractor rent on the cost of the Government tooling, and this becomes a credit to the antagonist. So, this closed the gap by $480,000 leaving us $1,520,000 as a bogey. The normal way to handle this bogey was to write it off over the number of widgets in the contract. That didn't do it. The price of the package was too high. So we took a deep breath and argued with ourselves as follows: if we invest so we win this first order for widgets, the chances are good that we'll be very attractive for one-going orders for widgets, and each order in turn will be easier for us and more difficult for competition because each order reduces the total against which any competition could amortize *their* entering costs. So we amortized our starting costs against the total number of widgets we expect will be procured—ever. And now we had a good price. Well, some of you will say "you bought in—and that's a 'no no' ". I agree we bought in, and I don't think it's a 'no no'.

The reason I don't think it is a 'no no' is that the plot is spread on top of the table, open for Government and all to see. And that is the difference. We have no devious plan to lose money on the first contract and make it up in subsequent negotiated contracts. We are announcing at the beginning our write-off against each widget, and that's the figure we'll use in all this widget's history. As we operate our accounting against this program, therefore, we shall include in the pricing the normal costs plus the amortized start-up costs, and the program will show a normal profit. If we are unsuccessful in getting the follow-on widget orders, of course, we'll have to write off the unamortized costs. This is the risk, but we believe it is a rational approach to the start-up problem, and because the plot is announced in negotiation, it becomes an agreement, and no element of fancy footwork is left.

The arithmetic is interesting, and must take account of interest costs and the small negotiating point customarily accorded the contractor who does not require Government facilities, but any accountant can fill in the vital statistics, from the ground rules already expressed.

One could go on for a very long time in this talk about contracts. There is much to be said, but I'd like to repeat my opening remark, "The Department of Defense is a good customer if you know what you are doing and do not enter the game with the idea Uncle Sam is a patsy."

I'd now like to conclude these few remarks with the observation that the contract game is a two-way street.

We never go into negotiation with any other view than to see movement on both sides to a middle position fair and possible for both parties. I offer the observation that this also goes for setting the rules of the game. The ASPRA committee continuously seeks counsel from the Industrial community in setting rules. The best way to make one's views known is through one's technical societies. I am in the management structure of both AOA and NSIA, and we observe with alarm the drop-off of Corporate members. These societies provide forums to help make the rules, and I hope you will join with me in support to your particular Military/Industrial Society, not only by membership, but by active participation in the committees.

If the rules of the game go sour, and it becomes possible to conclude, as some have, that the Defense business is a lousy business, we shall have only ourselves to blame.

Thank you for permitting me to join you. I have enjoyed it.

ITEM 15.—*July 14, 1972—Letter from William J. Casey, Chairman, Securities and Exchange Commission to Senator Proxmire responding to the Senator's June 29, 1972 letter. The letter states, "whether the inclusion of anticipated claim settlements as accounts receivable from the Government would violate any SEC rules, this would depend on numerous factors . . ."*

SECURITIES AND EXCHANGE COMMISSION,
Washington, D.C., July 14, 1972.

HON. WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government,
Joint Economic Committee, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to the matters raised in your letter of June 19, 1972 regarding Litton Industries' defense contracting problems and the manner in which they are reported, and the reporting requirements applicable to defense contractors generally. I regret not being able to respond to your letter by June 30 as I had intended. However the staff was unable to gather necessary information as quickly as it had hoped.

You indicate that Litton Industries has about $450 million of claims against the Navy and that Touche Ross & Co. in its report on Litton's financial statements for the fiscal year ended July 31, 1971 fails to mention that it had several large claims against the Navy in process or under negotiation, the outcome of which could substantially alter Litton's financial results. Your letter does not identify or specify the nature of the claims to which you refer. In response to inquiry Litton's management has identified the contracts which it believes you refer to, and a financial officer of the company has stated that its financial statements at April 30, 1972 reflect only a relatively small amount (when compared to total current assets) on account of claims against the Navy involving those contracts.

We are further informed that the company is negotiating with the Navy on the largest of these contracts with respect to work which is yet to be performed. However, we are told that revenues with respect to the matters under negotiation, where the work has not been performed, have not been booked and accordingly are not reflected in the company's financials.

In your letter you pose a number of questions concerning Litton's reported earnings, i.e., whether Litton has reported earnings based on expected recovery of large claims against the Government, if so, whether Litton's earnings have been overstated as a result and the extent of the overstatement, if any. You also ask whether the inclusion of anticipated claim settlements as accounts receivable would violate SEC rules.

First, perhaps I should note that by merely examining the disclosures in its financial statements we would be unable to determine whether Litton in fact reported earnings based on its expected recovery of "large claims against the Government." Such a determination could be made with any degree of certainty only by means of an extensive examination. While the staff has not performed such an examination, it has made preliminary inquiries into the area in question. From our inquiry to date and particularly from discussions with company officials in which they indicated the relatively small amount of claims presently reflected in Litton's financials, we have no reason to believe the company's most recent financial statements reflect profits to any material degree based on claims against the Government. We are cognizant of Litton's recent pre-tax write-off of which we are informed some $14 million related to the LHA contract. However, we have no information at this time as to whether this write-off involved the previous recognition of profits based on anticipated settlement of "claims" against the Navy. I might note that the company has stated that profits on Navy contracts represent a very small percentage of Litton's total pre-tax earnings during the past four years and nine months.

The accounting methods used by a company are also relevant to a discussion of its financial statements. In the most recent annual report on Form 10–K filed with the Commission Litton has disclosed in a footnote to the financial statements a description of the method of accounting followed by the company in the recording of income on long-term construction contracts. The note states: "It is the policy of the company to recognize income on long-term contracts as the work is performed. Any costs incurred under contracts which are not recoverable are charged to current operations." This policy represents an acceptable accounting practice. This note, incidentally, does not appear in the company's annual report to shareholders for the fiscal year ended July 31, 1971.

As to whether the inclusion of anticipated claim settlements as accounts receivable from the Government would violate any SEC rules, this would depend on numerous factors, the principal ones being the validity of the claim, the amount involved and the extent to which the company has a reasonable basis for believing it will be settled in a manner favorable to it. As you can recognize, this is basically an area involving the judgment of the company's management and its independent auditors.

Your letter poses the question "What are the Securities and Exchange Commission rules concerning the company's obligations for public disclosure of information in a situation such as this?"

Securities Act of 1933 Release No. 5263, previously sent you, outlines in general terms what disclosure the Commission feels should be afforded investors. In that release the Commission emphasized the need for prompt and accurate disclosure of material information by defense contractors. In citing areas where disclosure is important the Commission pointed out that at any time in the performance of a long-term defense contract an estimate of its profitability is often subject not only to additional costs to be incurred but also to the outcome of future negotiations or possible claims relating to costs already incurred. The Commission also pointed out the need for appropriate disclosure concerning the fact that extensive periods of time may be required to settle claims which fact could have an effect on the company's working capital. In addition to the release, certain of the Commission's forms require disclosure which would be applicable to major defense contracts. For example, Instruction 4 to paragraph (a) of Item 9 of Form S–1 requires disclosure with respect to any material portion of a company's business which may be subject to renegotiation of profits or termination of contracts or subcontracts at the election of the Government. A similar requirement is found in the instructions to Item 1 of Form 10.

You ask, "Do other publicly owned defense contractors follow similar practices?" (report earnings based on expected recovery of large claims against the Government). I am informed by the staff that in accounting for income earned on long-term defense contracts the practice generally followed is the percentage of completion method which involves accruing of income as work is completed. This may in numerous instances result in accruing of income in situations where claims against the Government may arise. The propriety of this practice as I noted above depends on such things as the validity and collectibility of the claims.

You ask, "At what point does the Securities and Exchange Commission require disclosure of expected large over-runs and under-runs of defense contracts by defense contractors?" It is the Commission's position that issuers are required accurately to reflect progress on material contracts including the effect of material cost overruns in their financial statements and where necessary to make appropriate textual disclosure. The Commission has also taken the position that material corporate developments should be announced promptly as they occur. This would of course include information concerning any material effect on a company's operations resulting from cost overruns on major contracts.

I hope the above information proves helpful to you. There are some additional steps which the staff intends to take in this matter, and I will provide you with any resulting information which tends to modify or amplify my present responses to your questions.

Sincerely,

WILLIAM J. CASEY, *Chairman.*

Item 16.—July 19, 1972—Letter from Senator Proxmire to Securities and Exchange Commission Chairman Casey criticizing Mr. Casey's July 19, 1972 letter as not being straightforward, and again asking, "Has Litton in fact reported earnings based on its expected recovery of large claims against the Government?"

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., July 19, 1972.

Hon. WILLIAM J. CASEY,
Commissioner, Securities and Exchange Commission, Washington, D.C.

DEAR CHAIRMAN CASEY: Thank you for your reply to my inquiry regarding Litton Industries' defense contracting and financial problems. A close reading of your letter, which I must say is rather hard to understand, leads me to conclude that (1) Litton has indeed reported earnings based on its expected recovery of large claims against the Government, and (2) the Securities and Exchange Commission has no way of telling whether Litton's published reports are in violation of SEC rules. Based on these conclusions, I believe it is imperative that the SEC immediately begin a full-scale investigation of Litton's failure to fully disclose its financial condition to the public and I urge you to authorize such an investigation. I also urge the Commission to adopt specific guidelines for public disclosure by defense contractors of claims against the Government, cost over-runs, and other risks that could profoundly affect the firm's financial condition.

I would like to comment on your letter of July 14 and show how it supports my conclusions and where, in certain respects, it fails to come to grips with the issues I raised.

In the second paragraph of the first page of your letter you state, "We are told that revenues with respect to the matters under negotiation, *where the work has not been performed,* have not been booked and accordingly are not reflected in the company's financials." (Emphasis added.) This statement appears to deny the assertion that Litton has booked revenues with respect to matters under negotiation, such as claims against the Navy, and included anticipated recoveries in their financial reports. However, it only denies that this has been done with respect to matters under negotiation "where the work has not been performed." This phrase is a major qualification of the denial and strongly implies that where the work has been performed, revenues with respect to matters under negotiation have been booked and accordingly are reflected in the company's financials. Because a major portion of Litton's claims against the Navy relate to shipbuilding programs where the work has been performed, I interpret your statement as an admission that Litton is including anticipated recoveries from

claims in its financial reports. As an illustration, the company has filed $180 million worth of claims against the Navy based on contracts performed in the East Bank shipyard. Most of the work on which these claims are based has been performed. Further, a substantial amount of work has been performed in the West Bank shipyard on the LHA contract against which Litton has filed a claim against the Navy valued at $270 million.

Your statement in the same paragraph that Litton's reports "reflect only a relatively small amount (*when compared to total current assets*) on account of claims against the Navy involving those contracts," (emphasis added) tends to reinforce my conclusion. The fact that the anticipated revenues from claims against the Navy are small compared to Litton's total current assets is not relevant. They may be small as a portion of total current assets and still be quite large in absolute amount. As you must know, in its current annual report, Litton shows total current assets of $1.2 billion. A company with total current assets of that amount could completely mislead the public by incorporating in its annual reports anticipated recoveries from claims which would comprise only a small portion of total current assets, but equal or exceed net earnings for the year. For example, if Litton included in its current annual report $60 million from anticipated recoveries on claims against the Navy, that sum would represent less than 5 percent of its total current assets and more than 100 percent of its net earnings. This alone demonstrates why companies should fully disclose in their reports facts such as pending claims against the Government.

In light of this analysis, the public can take small comfort from the statements of Litton's officials, reported on page 2 of your letter, "in which they indicated the relatively small amount of claims presently reflected in Litton's financials," or in your statement that you "have no reason to believe the company's most recent financial statements reflect profits to any material degree based on claims against the Government." Here Litton seems to be admitting that some claims are presently reflected in its reports, although it considers them relatively small. As I have already shown, the claims can be relatively small compared to something like total current assets and still be quite large. Your own understanding that Litton's reports do not reflect profits to any material degree based on claims against the Government is beside the point. Its most recent financial statement reflects losses and not profits. Your later statement that Litton's profits on Navy contracts represent a very small percentage of Litton's total pre-tax earnings in recent years is also beside the point. The issue here is to what extent have Litton's reported earnings been distorted or misrepresented in its annual reports. If the company has been taking into account anticipated recoveries on pending claims against the Government, then distortions and misrepresentations have occurred, regardless of reported profits or losses.

As you point out, the accounting methods used by a company should be considered in any discussion of its financial statements. You quote the footnote in Litton's Form 10-K which reads "It is the policy of the company to recognize income on long-term contracts as the work is performed. Any costs incurred under contracts which are not recoverable are charged to current operations." The question, however, is who determines which costs are recoverable or not recoverable? The company officials could very well make an internal determination that all or most of its claims pending against the Navy represent costs incurred under its Navy contracts which are "recoverable" and therefore simply not charge them to current operations. If part of those costs were really not recoverable, in the sense that they formed the basis for unsupported and exaggerated claims, the report would be highly misleading.

I am utterly flabbergasted by your admission that the Securities and Exchange Commission cannot by itself determine whether its own rules have been violated by Litton's accounting and reporting practices. You say at the bottom of page 2 of your letter that whether the inclusion of anticipated claims settlements as accounts receivable would violate SEC rules would depend on such factors as "the validity of the claim, the amount involved, and the extent to which the company has a reasonable basis for believing it will be settled in a manner favorable to it." You go on to say that "this is basically an area involving the judgment of the company's management and its independent auditors." In other words, whether violations have occurred deepnds on certain factors, but those factors involve the judgment of the company's management and its independent auditors.

Under this interpretation, the company might include anticipated claims settlements valued at $100 million as accounts receivable, and so long as the company's management and independent auditors judge that there is a reasonable basis for believing they will be settled in a manner favorable to the company, no violation of SEC rules is involved. This, despite the fact that an objective and impartial evaluation of the anticipated claims settlement might disclose that there is no reasonable basis for believing it will be settled in a manner favorable to the company. It would seem to me that the SEC ought to have a way of making its own findings of SEC violations and ought not to have to rely upon the judgment of company officials and auditors.

The report of your staff entitled "In the Matter of Disclosures by Registrants Engaged in Defense Contracting" shows that the vast majority of large aerospace firms fail to make prompt and accurate disclosure of material information in their annual reports. You acknowledge in your letter that the accounting and reporting practices of defense contractors "may in numerous instances result in accruing of income in situations where claims against the Government may arise." You conclude, however, that the propriety of this practice depends on such things as the validity and collectability of claims. Again, you seem to be saying that although Litton and other major defense contractors may be reporting earnings based on expected recoveries of large claims against the Government, the propriety of this practice depends on factors which can only be judged by the officers and auditors of the contractors.

I find it impossible to reconcile your admission of the SEC's inability to make its own determinations as to whether its rules are being violated with your assertion that "it is the Comission's position that issuers are required accurately to reflect progress on material contracts, including the effect of material cost over-runs in their financial statements and where necessary to make appropriate textual disclosure." As your own staff study which I referred to above shows conclusively, most defense contractors do not now accurately reflect progress on material contracts, do not show the amount of claims pending against the Government or the magnitude of cost over-runs in their financial statements. The Commission therefore has taken a position which it so far has refused to enforce.

In light of the evidence of massive failures to disclose material information on the part of the large defense contractors, I find the Comission's rather relaxed attitude most unfortunate. The notice you issued on June 22 urging defense contractors "to review their policies with respect to corporate disclosure" amounts to a mere slap on the wrist. Why doesn't the Commission act to protect the public from misleading financial statements by large defense contractors?

So long as the SEC maintains its present dependence upon company officials and auditors for judgments about the propriety of the company's practice, the SEC is falling down in its responsibility to protect the public from misleading and inaccurate financial statements. Your response to my inquiry is not satisfactory because it does not show that your staff has done any investigation of its own or that you are prepared to deal with the difficult questions I raised. Throughout your letter you indicate that your information is based on statements made by Litton officials in response to your inquiry. Your assertions are prefaced by statements such as "We are further informed," "We are told," "From discussions with company officials," and so forth. These qualifications show that your staff did not make the kind of on-site inspection of books and records and other independent evaluation which I had hoped would be performed. Litton's method of accounting and reporting cries out for a thorough and full-scale SEC investigation, as the results of your own cursory review show. The replies given to you by Litton officials begged the questions and seem to be intended to confuse rather than clarify matters. As a result you are unable to provide me with unequivocal straightforward answers to my questions.

Has Litton in fact reported earnings based on its expected recovery of large claims against the Government? If so, can you tell me to what extent Litton's earnings have been overstated for the past several years—say 1968–1971—if such claims are not honored by the Navy? Has Litton violated any Securities and Exchange Commission rules by its failure to reflect uncertainty in its published reports as to the ultimate settlement of its claims against the Government? These are some of the same questions I asked in my earlier letter. I would like answers accompanied by appropriate facts and figures. In addition, I believe the Commis-

sion should re-evaluate its decision to not issue specific guidelines for public disclosure by defense contractors of matters that could severely influence the firm's financial condition such as pending claims against the Government and cost over-runs.

I assume that the fact that Litton's chief executive office is a close advisor and financial contributor to the President will not deter you from fully investigating this case.

Your early response will be deeply appreciated.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 17.—*July 21, 1972—Litton Press Release acknowledging that portions of claims are carried on books as assets*

LITTON INDUSTRIES NEWS,
July 21, 1972.

STATEMENT

Yesterday afternoon Senator Proxmire again attacked Litton Industries in a statement he handed out to reporters for release Saturday night. We believe this information should be made public immediately. The Senator's press release, which is attached, implies that Litton has improperly reported earnings based on its expected recovery of large claims against the U.S. Navy. This is not so.

The facts are:

Litton has change orders and claims filed with the Navy for work done and to be done under Navy contracts as follows:

	In Millions
4 AE Ammunition supply ships, all but one delivered (including 31 change orders)	$38
Submarines, to be delivered in 1973–74 (contract originally modified by Navy in 1968)	36
Disruption costs from Navy imposed emergency schedule on all nuclear submarines after *Thresher* accident (*Thresher* built by U.S. Navy)	94
Total	168

Litton considers these amounts justified and has submitted substantiating data in their support.

The $94 million claim for the submarine disruption costs, which was submitted to the Navy over a year ago, is now before the Board of Contract Appeals. It is expected that the AE and submarine changes and claims, which the Navy has been considering for some time, will be submitted to the Board soon.

Of the more than 1.2 billion dollars of current assets reflected on Litton's April 30 balance sheet, only $22 million of the AE and submarine changes and claims are carried on its books as assets. This amount represents costs for work in process on these contracts and is covered by unpriced change orders and modifications issued under the contracts. As additional costs are incurred on these contracts, they will be carried as assets as long as the amounts recoverable on these claims and changes are expected to exceed the carrying values.

Litton's normal course of business with all elements of the Defense Department includes continual program changes and claims and their settlements. An amount of $10 million is carried as the value of all these items including the $94 million disruption claim. The remainder of the costs incurred in connection with these claims have been expensed in earlier years.

On the Navy program for LHA (Landing Helicopter Assault) ships, Litton submitted to the U.S. Navy on March 31 its repricing proposal according to the terms of the contract. That proposal included $270 million, representing the expected effect of changes on the program which will run to 1976. Litton will be entering into negotiations with the Navy to determine a final contract price. Until negotiations are completed we are not booking any profits on this contract.

These facts substantiate that Litton's handling of claims against the Navy in its financial reporting is correct.

ITEM 18.—*July 23, 1972—Washington Star and News article entitled "Proxmire Asks Litton Probe, Suggests Faulty Reporting"*

(By Phillip M. Kadis)

Sen. William Proxmire, D–Wis., repeating earlier charges that Litton Industries Inc. may have misled shareholders in its earnings reports, has called on the Securities and Exchange Commission to lauch an investigation of the diversified electronics corporation's financial reporting.

Litton flatly denied Proxmire's accusation.

Proxmire, chairman of the Joint Economic Committee, also urged the SEC "to adopt specific guidelines for public disclosure by defense contractors of claims against the government, cost over-runs, and other risks that could profoundly affect the firm's financial condition."

Proxmire's requests were contained in a second letter to SEC Chairman William J. Casey July 19.

SECOND LETTER

The first letter, sent a month earlier, claimed that Litton was in "precarious financial condition" and had misled shareholders about its true earnings by including claims against the goverment which may be only partially recoverable and by failing to note this in its earnings reports.

In a reply on July 14, Casey noted that amounts involved in the claim ($450 million against the Navy) reflect a relatively small amount compared to total current assets of Litton.

Whether the inclusion of anticipated settlements as accounts receivable would violate SEC rules, Casey wrote, depend on such factors as the validity of the claim, the amount involved and "the extent to which the company has a reasonable basis for believing it will be settled in a manner favorable to it."

Casey said this was "basically an area involving the judgment of the company's management and its independent auditors."

SEC ACTION URGED

Proxmire, in return, said "It would seem to me that the SEC ought to have a way of making its own findings of SEC violations and ought not to have to rely upon the judgment of company officials and auditors."

He said that the "SEC's slow motion action up to now suggests to cover-up of what could be a major scandal."

In his request to the commission to set up specific guidelines for defense contract financial reporting, Proxmire noted that "most defense contractors do not accurately reflect progress on material contratcs, do not show the amount of claims pendin gagainst the government of the magnitude of cost over-runs in their financial statements."

Litton, in a statement from its Beverly Hills headquarters, noted that Proxmire had implied the company "has improperly reported earnings based on its expected recovery of large claims against the U.S. Navy.

SUGGESTION DENIED

"This is not so."

Litton listed change orders and claims filed with the Navy for work done and to be done under Navy contracts as $38 million for 4 AE ammunition supply ships (of which all but one have been delivered), $36 million for submarines to be delivered in the 1973–74 year, and $94 million for disruption costs resulting from a crash schedule imposed by the Navy on all nuclear submarines after the loss of the nuclear submarine Thresher. These claims total $168 million.

In addition, Litton said, continual program changes in the normal course of business have involved additional claims of $10 million. The balance of the $450 million figure results from a repricing proposal Litton submitted to the Navy on March 31 on the LHA (Landing Helicopter Assault) ship program.

It added that Litton was not booking any profits on the contract until negotiations with the Navy (which are to begin soon) are completed.

ITEM 19.—*July 24, 1972—Wall Street Journal article—"Litton Gives Details of Its Navy Contracts in Response to Attack"*

SEN. PROXMIRE AGAIN CRITICIZES FIRM'S ACCOUNTING ON DEFENSE WORK, ASKS FOR AN SEC INQUIRY

BEVERLY HILLS, CALIF.—Responding to another round of charges by Senator William Proxmire regarding its financial statements and accounting, Litton Industries Inc. issued statements detailing the nature of its Navy contracts and how those contracts are reflected in Litton earnings.

The Wisconsin Democrat charged Saturday that the Securities and Exchange Commission is "covering up what could be a major scandal" involving Litton, and requested a formal investigation of the matter. Last month, the Senator asked the SEC to look into the possibility that Litton has been misrepresenting its financial conditions by failing to disclose in its annual reports large shipbuilding claims against the government and by including in its earnings expected recoveries from the claims.

The Senator's latest charges are in response to a letter from SEC Chairman William J. Casey which, Sen. Proxmire said, indicates the SEC "seems reluctant to probe into Litton's financial reports." The Senator said a "close reading" of Mr. Casey's letter discloses that "Litton has, indeed, reported earnings based on its expected recovery of large claims against the government."

A Litton spokesman, denying the charge, enumerated Litton's Navy work as follows:

He said Litton has $168 million in change orders and claims filed with the Navy for work done and to be done under Navy contracts. These include $38 million in claims and change orders for four ammunition-supply ships, all but one delivered, and involving 31 change orders; $36 million for submarines to be delivered in 1973-74 (the contract originally was modified by the Navy in 1968, Litton said); $94 million for disruption costs from Navy-imposed emergency schedules on all nuclear submarines after the accident of the Thresher, built by the Navy.

The spokesman said Litton considers these amounts justified and has submitted substantiating data in its report to the Navy on these contracts.

Litton said the $94 million claim for the submarine-disruption costs, submitted to the Navy more than a year ago, is before the Board of Contract Appeals. It is expected, the company said, that the ammunition ships and submarine changes and claims, which the Navy has been considering for some time, will be submitted to the board soon. Litton said the Navy is expected to make a provisional payment on these in the interim, probably this month.

Of the more than $1.2 billion of current assets reflected on Litton's April 30 balance sheet, only $22 million of the $168 million in ammunition ship and submarine changes and claims are carried on its books as assets, the spokesman said. He said this amount represents costs for work in progress on these contracts.

Litton's normal course of business with all elements of the Defense Department includes continual program changes and claims and their settlements, Litton said, adding that an amount of $10 million is carried as the value of all these items, including the $94 million claim. The remainder of the costs incurred in connection with these claims has been expensed in earlier years.

About $25 million of ammunition ship and submarine costs under these changes remains to be incurred. The amounts recoverable on these claims and changes are expected to exceed the carrying values and to result in additional income when finally settled, Litton added.

On the Navy program for the LHA, or landing helicopter assault ships, Litton submitted to the Navy on March 31 its repricing proposal according to the contract terms. That proposal included $270 million representing the expected effect of changes on the program that will run to 1976. Litton will be entering negotiations with the Navy to determine a final contract price. A Litton spokesman said "until negotiations are completed, we aren't booking any profits on this contract."

ITEM 20.—*July 27, 1792—N.Y. Times article—"Navy Expresses Deep Concern to Litton on Its Proposed Cost Rises and Delays 30-Ship, $2-Billion Contract"*

The Navy has written to Litton Industries expressing "significantly increased" concern over the company's ability to carry out its $1-billion contract to build five LHA amphibious-assault ships.

The letter also warned that delays proposed by Litton in completing the ships could have a "disastrous effect" on the delivery schedule for the new class of destroyers the company has contracted to build. The contract for the 30-ship program comes to close to $2-billion.

The Navy letter, sent June 23, was subsequently obtained by Senator William Proxmire, and the Wisconsin Democrat made it public yesterday.

The two ship projects, being carried out at Litton's highly automated new shipyard at Pascagoula, Miss., have for months been a source of worry to top Navy admirals. But never before has their concern been disclosed to be so intense, possibly because the letter, with its uninhibited language, was not intended for public consumption.

Mr. Proxmire also disclosed that the Navy had assured him there would be no "bail-out" of Litton and "that any claims of the company would be decided strictly on their merits." The Senator drew this conclusion from a letter sent to him by the Acting Secretary of the Navy, Frank Sanders.

While the new Proxmire release, the latest of several on Litton's troubles, was made public long before the stock market closed, it did not appear to have had an appreciable effect there. Litton closed at 13, down ⅛ and only ¼ above the low for the year. The volume was a moderate 35,000 shares.

The Navy letter to Litton took sharp aim at a March 31 Litton proposal. In it, Litton requested a $270-million increase in the price for the five amphibious ships, known as LHA's, as well as $109.7-million, the maximum provided in the contract, for cancellation of four of the originally projected nine ships.

The letter contended that Litton's new cost figures were "unsupported" and "undocumented."

"And even more critically," it said, "the proposed revision to the LHA delivery schedule would result in approximately 19½ months slippage in LHA no. 1 and as much as 26 months slippage in LHA no. 5. This slippage could have a direct and potentially disastrous effect upon our ability to deliver the DD963-class destroyers * * * and thus directly contravenes the requirement * * * that any proposed delivery schedule not impact deliveries under that contract."

The Navy said its over-all assessment of Litton's repricing proposal, combined with its own firsthand evaluation of work in progress, "have significantly increased our longstanding concern with Litton's ability to perform this contract, even under your proposed extended delivery schedule."

Challenging Litton's rationale for program delays, the letter said:

"Your summary description of asserted excusable causes of delays is grossly unsupported by factual documentation. The [repricing proposal] also takes little or no account of such factors as the internal difficulties you have encountered in organizing and operating the [new Pascagoula] yard and in recruiting and retaining the necessary personnel, which are contributing so predominantly to your production and delivery problems."

The Navy letter concluded by expressing willingness to negotiate a new LHA delivery schedule under several conditions, including agreement by Litton to improve the yard's capacity.

"If you do not agree with the course of action proposed herein," the letter concluded, "the Navy will have no alternative but to pursue its remedies under the 'default' clause."

That would mean the company would face cancellation of some or all of the five currently programed LHA's, and would not stand to recover its investment.

The letter was signed by Rear Adm. Robert C. Gooding, acting commander of the Naval Ship Systems Command. He takes over as commander on Monday.

ITEM 21.—*Aug. 18, 1972—Letter from Securities and Exchange Commission Chairman Casey to Senator Proxmire stating that Litton had recorded amounts in its financial statements based on estimated future profitability of disrupted Navy contracts*

SECURITIES AND EXCHANGE COMMISSION,
Washington, D.C., August 18, 1972.

HON. WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government, Joint Economic Committee, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: Thank you for your letter of August 1, 1972, providing us promptly with sources of your information about Litton's shipbuilding work for the Navy. This is to provide you with further information resulting from our staff inquiry concerning Litton's financial reports through April 30, 1972. We will follow subsequent developments closely.

We have reviewed (1) the manuscripts from the hearings you mentioned, (2) reports sent to us by the General Accounting Office, (3) information provided by the Secretary of the Navy, and (4) Admiral Gooding's letter of June 23, 1972, to Litton as well as Litton's reply. We have studied the original contract for the LHA, signed May 1, 1969, and the related agreement between Litton and the Navy, dated April 23, 1971. In addition, we have had discussions with Litton's executives, two partners of Touche Ross & Co. (the company's independent auditors), and Rear Admiral Kenneth L. Woodfin. We understand that the GAO is reviewing the status of Litton's claims, as in Touche Ross.

The Navy has reported that, as of July 31, 1972, Litton's total claims against the Navy were $440.4 million. Different dates apparently account for the difference between this amount and the $450 million you mentioned and the amounts listed on page 10686 of the hearings held from January 25 through April 24, 1972 on "Military Posture" before the House Armed Service Committee, 92d Congress, Second Session (Part 2). While the term "claims" has a specific meaning in military contracting. I will use the term generically to cover three different types of situations: a request for payment of $73.8 million in connection with unpriced change orders and modifications issued under contracts to build four AE ammunition ships ($36.8 million) and three 680 model submarines ($37.0 million); a $94.4 million claim for recovery of extra costs incurred when work on a number of contracts was disrupted as a result of Navy imposed emergency schedules on nuclear submarine construction after the Thresher incident; and a reqeust for equitable adjustment of the LHA contract, in the amount of $270.7 mililon. In addition, Litton has small claims totalling $1.5 million on other programs. I will discuss the status of these contracts and Litton's treatment of them in its financial reports before responding further to the questions raised in your previous letters.

Litton reported total earnings of about $7.0 million after tax under the LHA contract in fiscal 1970, 1971 and the first half of 1972, reflecting what the company believed to be a conservative estimate of the final profitability of the contract and the progress toward completion of the work. Under a provision of the original contract, modified by an agreement dated April 23, 1972, with the Navy, Litton undertook a thorough review of the program and submitted a request dated March 31, 1972, for equitable adjustment of the contract price (a "program reproposal"). In view of the nature and breadth of the questions raised by the review and reproposal, Litton decided to refer any profit accrual until they were resolved. Therefore, the earnings of $7.0 million after tax accrued on this program were written off in the third quarter of 1972. In addition, $5.4 million of overhead allocated to Navy programs were written off at April 30, 1972, although Litton still believes these costs are reimbursable. I believe this overhead allocation dispute is the one that GAO reported to you.

Under the terms of the LHA contract, the Navy reimburses Litton with progress payments for all of its expenses. Therefore, whether Litton's expenses have been inventoried or charged to cost of sales (and carried in accounts receivable) to a large extent they have been offset by progress payments. As of April 30, 1972, approximately $6.1 million of the expenses on the LHA were carried on Litton's balance sheet in current assets.

Litton has recorded revenues and earnings on the ammunition ship and 680 submarine contracts on a percentage of completion basis. Approximately $1.9 million in revenues (recorded without profit and carried in accounts receivable)

and $20.2 million of costs carried in inventory represent work covered by unpriced change orders and modifications under the contracts. Accordingly, $22.1 million of the $73.8 million in dispute on these two contracts appeared in current assets on Litton's balance sheet at April 30, 1972. The remainder of the work relating to this disputed amount had not been performed as of April 30, 1972 and has not appeared in any form in Litton's financial reports.

Litton had reported a total of less than $3.0 million of earnings after tax on these two contracts in fiscal 1970, fiscal 1971 and the first nine months of fiscal 1972 (through April 30). These earnings include no profit on work performed which is under dispute, but they do assume that Litton will receive under its $73.8 million claim at least the $22.1 million spent to date on unpriced change orders and modifications. Should the settlement of the $73.8 million claim be less than $22.1 million, the amount of the difference (a maximum of about $11 million after tax) would have to be written off at the time of settlement.

The $94.4 million "Thesher" claim is to cover expenses resulting from work disruptions on several contracts during the 1960's, which expenses were written off when the contracts were completed. Litton carries $10 million in accounts receivable offsetting the prior expenses, which represents the minimum recovery the company expects from the Thresher claim and several smaller claims. Should nothing be recovered, a maximum $5 million after tax write-off would be required.

Based on the above information assembled by the staff, the following is an attempt to answer directly the questions you posed earlier.

Has Litton reported earnings based on recovery of claims against the Navy? The company reported earnings on the LHA contract based on an estimate of future profitability, not on an expectation of recovery from claims, and reversed these earnings when the repricing proposal was submitted and it became apparent that a reasonable estimate of profitability could not be made until the contract was renegotiated. Net earnings of less than $3.0 million have been reported for the ammunition ship and submarine work; however, none of these earnings is connected with disputed changes or modifications. No earnings have been reported on the extra work resulting from the Thresher disruptions.

To what extent have earnings been overstated if Litton's claims are not honored by the Navy? Litton carries in receivables and inventory $22.1 million in disputed costs on the ammunition ship and submarine contracts and $10 million from the Thresher disrupted work—a total of $32.1 million (pre-tax) compared with total related claims of $168.2 million ($73.8 million for the ammunition ship and submarine contracts and $94.4 million for the Thresher). If the recovery is less than $32.1 million, earnings must be adjusted by the amount of the shortfall, a maximum of $16 million net after taxes; conversely, recovery in excess of $32.1 million would also result in an adjustment. Litton reversed the earnings recorded earlier on the LHA because of this situation and will review its LHA accounting periodically to reflect negotiations with the Navy and further analysis of the estimated costs to complete the contract.

Litton's net earnings after taxes, for the period when the above costs were incurred were: 1970, $68.8 million; 1971, $50.0 million; and the first nine months of 1972, a loss of $11.1 million (after the total write-offs of about $35 million after-tax for consolidation and relocation of commercial operations, for costs associated with commercial shipbuilding and for reversal of the LHA profits reported earlier). Total net profits for 1970 through the third quarter of 1972 were $107.7 million. Litton's current assets at April 30, 1972 were $1.2 billion, total assets were $2.0 billion and retained earnings were $799 million. These numbers compare with the disputed costs accrued of $32.1 million ($16 million net after taxes) and the $6.1 million of inventoried LHA costs.

To what extent have Litton's reported earnings been distorted? Financial reporting of government contracts, as well as other long term contracts, requires estimates of the costs required for completion of the contracts to attempt to avoid distortions in reported income. These estimates must be revised as circumstances change and the appropriateness of the estimates must be judged on the facts available when they were made and not with the benefit of hindsight.

As we have pointed out before, in fulfilling our statutory responsibilities we rely on the review of the management estimates by the company's independent auditors in the absence of bad faith or inadequate consideration. Touche Ross & Co. partners have discussed the status of Litton's claims with the Navy, and will continue to do so. Based on our staff's inquiry and the information ascertained by it to date, our staff has concluded at this time that Litton's earnings have not been distorted.

The staff will be reviewing subsequent developments to be certain they are properly reflected in future reports. For example, we are aware that Litton received last week the formal notice of the contracting officer's decision to offer settlement of the ammunition ships and submarine claims in an amount less than the $22.1 million on Litton's books. The Navy explained that this decision is based solely on an interpretation of the contracts and that if Litton believes there is a question of equity, the decision can be appealed to the Armed Services Board of Contract Appeal. Litton intends to make this appeal, as it has with the Thresher claim. Touche Ross is reviewing these developments in connection with its audit of Litton's fiscal year ended July 31, 1972, and will discuss them with the Navy along with the progress in the LHA negotiations.

In addition to questioning Litton's financial reporting methods, you also raised the concern in your letter of June 19, 1972, that "if substantial portions of the alleged claims are not paid by the Navy, Litton may not have the financial capability to carry out its contractual commitments." All the expenses which gave rise to the $94.4 million Thresher claim have been incurred, so settlement of this claim can only have a positive effect on Litton's cash position. While substantial work remains for completion of the ammunition ship and 680 submarine contracts, receipt of Navy funded amounts will cover all but about $10 million of the estimated future costs. This is largely because the Navy's progress payments have been less than the costs expended on undisputed portions of the contract. Litton's cash exposure, therefore, if nothing is received in settlement of these claims, appears at this time well within its resources. All Litton's LHA work to date has been funded by the Navy, under the terms of the original contract. Future funding of this program will be arranged as part of the negotiations of Litton's repricing proposal.

I recognize the problems inherent in estimating the results of long-term contracts, both military and commercial. I am particularly concerned about the large write-offs many companies have reported in the past two years due to, among other things, poor estimates of future costs. As a result, we are strengthening the Chief Accountant's staff and adding a special analytical unit in the Division of Corporation Finance to examine methods of identifying the potential for large write-offs and the judgmental bases on which major expenditures are deferred or charged off.

Sincerely,

WILLIAM J. CASEY, *Chairman.*

ITEM 22.—*September 23, 1972—Business Week article—"Behind the Write-offs at Litton Industries"*

Charles B. "Tex" Thornton and Roy L. Ash have passed many notable milestones since they bought a small electron tube company from a man named Litton 19 years ago. In little more than a decade, they expanded it into the nation's fastest-growing billion-dollar company, became celebrated as the most successful practitioners of the conglomerate style, and gained renown as managerial wizards whose tactics were emulated by scores of companies.

This month, Chairman Thornton, 59, and President Ash, 53, achieved another kind of landmark: Their company, Litton Industries, Inc., reported its first annual deficit. In a preliminary statement for the year ended July 31, Litton showed a loss of $2.3-million, before a special credit, on sales of $2.5-billion. The company netted $50-million on virtually the same sales volume in the previous year.

As recently as last December, when the company was already in its second quarter, Ash was predicting that earnings for the year would surpass those of fiscal 1971. Then, Litton abruptly plunged into the red at the end of its second quarter. Ash has given no explanation of why his prediction was so far off the mark. It appears, however, that some complex and continuing problems—all adding up to a severe case of indigestion—became just too big for the company to live with.

Housecleaning: To help solve these problems, Litton's top management is doing as other conglomerates have done and is now concentrating much more on operations than making acquisitions. The change is a difficult one. Litton has turned to write-offs after a "stringent management review of all operating and marketing units in all business areas."

The costs of the cleanup indicate the breadth of Litton's troubles. In the second and third quarters, there were a $17.2-million charge to relocate a Royal typewriter plant, $5.7-million for losses on contracts with relocation of the Rust Engineering division (later sold), $5.9-million to consolidate electric motor production in Milwaukee, and $25.4-million for problems at its new shipyard in Mississippi. There were also at least 20 other items covering plant closings, and the dropping of product lines. Altogether, the write-offs totaled $70-million before taxes.

In its housecleaning, Litton is turning to a ploy that has become typical of the troubled conglomerates. It has started to divest itself of pieces. Litton has been trying, for example, to sell the Wilson Marine Transit Co. fleet of Great Lakes ore boats that it acquired in 1966 and the $20-million shipyard that it built in Erie, Pa. It had hoped to revolutionize ore-hauling on the lakes, but Wilson lost its biggest customer, Republic Steel Corp., and the Erie yard has stirred up little business. The prospective buyer for these operations is their major competitor, American Ship Building Co. Last month, American Ship said it would buy nine boats from Wilson, but the Justice Dept. immediately filed suit to block the deal on antitrust grounds. A federal court has since approved the transfer of three ships.

Last May, Litton sold Rust Engineering to Wheelabrator-Frye for $18-million cash. This month, Litton announced plans to spin off its profitable Stouffer operations, acquired in 1967. Critics say that Litton has only now realized that there is no logical connection between Stouffer's food-processing, restaurant, and motel businesses and the rest of Litton.

LITTON: A DECADE OF UP AND DOWN

Fiscal year ending July 31	Sales	Net income	Earnings per share millions of dollars	Common stock price	
				High	Low
962	$393.8	$16.3	$0.66	$30	$15
963	553.1	23.3	.92	36	23
964	686.1	29.8	1.14	33	24
965	915.6	39.8	1.45	65	31
966	1,172.2	55.6	1.94	75	50
967	1,561.5	70.1	2.30	109	70
968	1,855.0	58.5	1.66	95	65
969	2,176.6	82.3	2.26	69	33
970	2,404.3	68.8	1.81	37	15
971	2,466.1	50.0	1.27	34	18
972	2,476.6	(2.3)	(.14)	26	10

Data: Investors Management Sciences, Inc.

Bitter pill: The earnings collapse and the divestments add up to a big and bitter pill for Litton, a pioneer among conglomerates. In touting its own achievements, Litton introduced two concepts into the lexicon of American management. One is synergism, which holds that the combined efforts of several merged companies can produce better results than the sum of the efforts of the same companies operating independently. The other is "free-form management," a creative, flexible system that scorns the idea of the corporate manager as a specialist working in a tightly structured setup. Litton, however, has been skidding ever since its highly publicized record of 57 consecutive increases in quarterly earnings was broken in 1968. Since then, both concepts have lost much of their glamour.

For a while, Litton's mystique enchanted Wall Street. The company's stock soared as high as 73 times earnings. With such valuable currency in its coffers, Litton was able to make acquisitions. "The business of Litton Industries," Ash once said, explaining the company's diversification strategy, "is the fusion of the technological revolution of this era with society's increasingly demanding needs." Ash expected new products to "cascade out" from such a fusion.

But, says a former Litton executive vice-president: "The company was not a high-technology pool where, for example, you could throw in a typewriter and come out with a new 1980 writing instrument." Moreover, says a New York security analyst who has followed the company for years: "Litton was weak in

long-term planning. They really believed the economy would never go down. Why else buy uncompetitive business equipment companies and machine tool companies at the top of the cycle?" Litton, for example, bought UTD Corp., a maker of cutting tools, in 1968 at 28 times earnings just before UTD's profits fell off.

Diverse groups: Along the way, Litton failed to achieve its lofty objective of becoming a high-technology company and instead emerged as essentially a mundane manufacturer of capital goods. It is composed of four major groups: business systems and equipment (about 30% of sales), defense and marine systems (28%), industrial systems and equipment (25%), and professional services and equipment (17%). These groups produce thousands of products ranging from oceangoing ships, Landis machine tools, and school books, to Monroe calculators, inertial guidance systems, and conveyors.

In assembling these diverse lines, Litton steered clear of buying market leaders, presumably because less powerful companies were cheaper and usually involved no antitrust problems. Ash has boasted that Litton could take, say, the fourth- or fifth-ranked company in an industry and make it a stronger competitor. Litton figured that synergism, coupled with Litton's own aggressive managerial style, would jazz up the performance of even a doggy acquisition.

Litton's style allowed considerable operating autonomy for profit-center managers. They, in turn, were motivated to be entrepreneurs with hefty rewards of stock options for performance. "A group of thoroughbreds, with only a light rein," as Ash once described the process.

Short view: Litton's profit managers, however, tended to concentrate on near-term performance to meet the hard-nosed profit targets of the Beverly Hills (Calif.) headquarters staff. "The compensation scheme was built on that," recalls a former Litton executive. "You had to hold the job to cash in the options, so if you have to increase profits every quarter, where do you reach to find the money? You throw out your advertising budget and R&D. What do you care about the product five years out if you're not going to be around?"

One example of a Litton acquisition gone wrong is the former Royal McBee Corp., a typewriter maker that Litton bought for less than book value in 1965. Royal's big problem was that it had been slow to get into the electric typewriter business. With Royal's R&D pared way down, Litton tried to buy technology on the outside—first from the British and then through acquisition of Germany's Triumph Adler. But Royal stayed bogged down because of high labor costs and fierce competition with IBM.

Litton has recently brought out some new typewriter lines and is putting on a big push to boost international sales. Last year's write-off suggests that Royal's problems linger on. However, the business systems group, of which Royal is a part, has been the best profit-maker at Litton in recent years.

Litton's vulnerability to cyclical swings in the economy shows up most strongly in its industrial systems group, a mix of machine tool, material handling, and electric motor operations. Ash is said to be running this group personally since Harry J. Gray, a former senior executive vice-president, left Litton to become president of United Aircraft.

The group's sales have steadily declined, and operating profits nosedived from $65-million in 1969 to $24-million in 1971. Rust Engineering, which was sold, was in that group.

Sinking ships: Litton's biggest problem—and, ironically, perhaps its biggest opportunity—is its defense and marine group. To its aerospace operations, Litton in 1961 added Ingalls Shipbuilding, which had a record of good performance for the Navy. Then in 1965, Litton saw a need for special-purpose ships for both military and commercial markets, and a need for additional U.S. shipyard capacity as well.

So, across the river from Ingalls' conventional yard in Pascagoula, Miss., Litton built a $130-million facility under a long-term lease arrangement with the state. The yard copies the Japanese and Swedish technique of highly automated, modular-assembly ship construction. Problems appeared almost as soon as the new yard started up in 1970. It required workers with new crafts and skills. But such labor was scarce, and the men that were hired were harder to train than Litton had expected. The labor turnover rate ran high. In the end, components for container ships built under the new system did not fit together properly.

Plagued by such problems, the yard fell some two years behind schedule on eight container ships it was building for Farrell Lines and American President Lines. Last June, Litton paid the two shipping companies a total of $5.5-million to compensate for the delays. Moreover, the delays held up construction of $1-billion worth of Navy landing helicopter assault ships.

The Navy originally ordered nine of these LHAS, then cut back to five. So Litton and the Navy are renegotiating the contract's terms. Litton is asking for $110-million as compensation for the drop in the number of ships and $270-million as compensation for other changes that, it claims, are the result of Navy actions.

The Navy this month called Litton's requests "unsubstantiated" in their present form but, while negotiations continue, agreed to keep paying Litton for costs incurred on the LHA program until February.

Washington hassle: Because of the shipbuilding problems, questions have arisen in Washington about Litton's ability to fulfill its $2.1-billion contract to build 30 destroyers. Senator William Proxmire (D-Wis.) has charged that Litton may require a bailout of as much as $450-million from the government to complete its ship contracts. Litton maintains that it is in a sound financial position, with current assets more than twice current liabilities; a net worth of more than $800-million, a cash balance in excess of $92-million, and unused credit of $130-million.

Proxmire asked for a Securities & Exchange Commission investigation to determine whether Litton has based profit estimates partly on what it expects to receive in claims from the Navy rather than on what it has actually received. Besides the $380-million LHA claims, Litton is asking for an additional $168-million covering ammunition-ship and submarine work. Litton carries $38-million of the latter claims on its books as current assets.

Litton has shaken up its shipbuilding management, putting it under Fred W. O'Green, a nine-year Litton veteran and former Lockheed executive. The managers Litton had been using were not tough enough, says a former Litton executive, adding: "You need iron men, and that's what O'Green is."

Litton laid the keel of the first destroyer last June and expects to deliver it on schedule in 1974. But critics remain skeptical that the new yard will run smoothly.

Over-all, Litton operated in the black in its fourth-quarter, netting $12.2-million for the period vs. $13.8-million in the year-ago period. Getting out of the red is a positive turn. Thornton and Ash long ago demonstrated that they are enterprising empire-builders. Now they must prove that they can cope with the operating problems that come with running empires.

ITEM 23.—*Dec. 4, 1972—Newsweek article—"Today's Troubles at Tomorrow's Shipyard"*

It was billed as the "shipyard of the future"—which was only fitting, since the company that conceived it, Beverly Hills's Litton Industries, had long been acclaimed as one of the archetypes of conglomerate management. At a spanking new yard in Pascagoula, Miss., Litton proposed to build ships as they are built in up-to-date Japanese and Swedish yards, piece by piece in assembly-line fashion. To assure that traditionalists wouldn't slip back into ancient methods, Litton installed at Pascagoula executives who had extensive expertise in aerospace and very little in shipbuilding. Two commercial shipping companies and the biggest customer of all, the U.S. Navy, signed contracts for ships before the yard even existed. Then the state of Mississippi footed the bill by floating $130 million in industrial revenue bonds, and Litton's dream came to life.

From the first, however, the grand plans went awry. Litton's West Yard's maiden ship was a 688-foot containership for Farrell Lines. When the vessel's 560-ton deckhouse was lifted aboard, it developed a sag of about nine-sixteenths of an inch; inexplicably, six key members of the support structure had been left out. Similar blunders followed apace, and some insiders assert that by the time the containership was launched, it had cost Litton twice what it had bargained

for. And from then on, Pascagoula's troubles accelerated in almost comic-opera fashion. Litton has had to pay a total of $5.5 million to Farrell and American President Lines for late deliveries of containerships. Now delays and cost overruns on a huge Navy contract are giving Congress the queasy feeling that behind the roseate claims for Pascagoula lies a procurement mess on a scale matching the C–5A and the F–111 fiascos—and a looming battle over another huge corporate bailout.

Both of Pascagoula's Navy contracts—one of $1.2 billion awarded in 1968 for nine amphibious assault boats (LHA's), the other of $2.1 billion awarded in 1970 for 30 high-speed destroyers—were made under ex-Secretary of Defense Robert McNamara's "total procurement" concept, where contractors set a firm price far in advance on complex jobs and then supposedly had to live with it. Tantalized by the thought that a new-style company could better cope with new procurement concepts, the Navy in both cases rejected lower bids submitted by traditional shipbuilders and gave the business to Litton's untried yard.

The LHA contract now is more than two years behind schedule, and an unhappy Navy has cut the contract to five boats, leaving a question of $109.7 million in possible cancellation costs to be worked out. But even though it now will be producing fewer boats, Litton has asked for a $270 million price increase for the total contract, alleging that Navy-ordered changes are to blame. Congressional critics fear that the LHA delays portend a similar fate for the destroyer project, though Litton says it is six months ahead of schedule on that job.

Crisis? So far, the Navy has firmly opposed Litton's request for a $270 million price increase and it is fighting a $164 million claim for overruns on other contracts. But if the Navy squeezes too hard, the company may never be able to fulfill its obligations. Litton's earnings fell precipitously in the year ended last July 31, and the total funds currently in dispute amount to two-thirds of the company's entire net worth of $809 million. "If the Navy does not pay the unsubstantiated portion of Litton's claims," says Pentagon spending arch-critic Sen. William Proxmire, "the company could face a financial crisis of major proportions in the near future."

The Navy won't lack for help in deciding how to handle the Litton affair. The General Accounting Office is combing the company's records at the request of the Joint Economic Committee, which is doing some independent digging and promises hearings on the whole issue before Christmas. The Securities and Exchange Commission is investigating whether Litton's reported earnings were distorted by including part of its disputed claims in reported revenues, and is further disturbed by what some staff members feel is Litton's failure to disclose completely the seriousness of its financial plight to its own stockholders.

But Litton has already won one sizable concession from the tough-talking Navy. When the service turned down the $270 million price-increase request "in its present incomplete form," it agreed to continue to pay Litton for all its LHA costs through next February. According to the original contract, Litton's payments after last Sept. 1 should have been related to work completed; if sufficient progress hadn't been made, the company was to have paid back some of the $350 million already funded—which, by one estimate, would have been about $150 million. Litton actually had asked for an extension of twenty months or more, but took the six-month grace period with a sigh of relief. Some insiders at Pascagoula say that if the Navy were to stop paying the out-of-pocket expenses on the LHA, Litton's entire corporate cash flow would disappear in a month. Says a JEC investigator: "There has already been a Litton bailout to the extent that the day of reckoning has been postponed."

Irony: The biggest irony of the Litton case is that the company actually has basic shipbuilding expertise. The Ingalls division, acquired in 1961, had successfully built everything from nuclear subs to containerships, including assault ships and destroyers. But these were all turned out at other plants, including an old yard across the river from the new one at Pascagoula. "They came into the new yard with a program-management concept that is used extensively in the aircraft industry," one of the shipyard's many former executives told Newsweek's Hugh Aynesworth. "They thought they could 'manufacture' a ship, but shipbuilding is not an exact science." Despite the mutterings of Ingalls old-timers that it couldn't be done, Litton clung to the modular concept—so much so that when one disgusted shipyard official tried to get a containership project

moving by building the hull all in one piece, top management forced him to cut it in two.

Another key to the yard's trouble was that the pieces of the ships it was building were "net cut"—that is, no extra steel had been left for welding them together. "Everything was manufactured to exact dimensions," says the ex-yard executive. "That has never been successful in a shipyard." Inevitably, the assemblies were also inaccurate, causing dimensional discrepancies throughout the ships.

Unable to deny the problems at Pascagoula any longer, Litton executives have begun to eat humble pie. Much of the work, for example, has been floated across the river to be finished at the older yard. "We should never have called it the 'shipyard of the future'," admits executive vice president Fred O'Green, the no-nonsense boss put in charge of the yard a year ago. "All of us—[Litton president] Roy Ash, all of us—feel we have overstated our ability to put an organization, a facility as big as that, on line. It just takes longer than we thought." But with the apologies made, O'Green quickly proclaims that the corner has been turned. "I sleep at night now," he told Newsweek's Jim Bishop. "We've got our hands around the problem. The destroyer program stands as proof that the learning process has now set in."

Fate: Litton's ultimate fate, however, rests with the Navy and Congress, and the political pressures involved are formidable. Roy Ash is an old friend of President Nixon's, and is now being consulted on the President's executive shakeup. The flow of Litton executives to the Pentagon and Capitol Hill to plead the company's case became so embarrassingly large in recent months that the Navy had to demand that it cease. And Litton has friends in Congress as well as in the executive branch. The Pascagoula yard is in the home state of John Stennis and James Eastland, two unusually powerful senators who want to keep Pascagoula and its payroll of 18,300 humming.

Working against Litton is the current economy wave in Congress, the basic issue of corporate bailouts and the threat of continuing revelations. Wisconsin Rep. Les Aspin says he has already found a cost overrun of $100 million in the electronics package for the destroyer contract. But whatever the record, the Navy retains at least some faith in Litton: it has just awarded the company a $2.7 million preliminary design contract for an advanced 100-knot, air-cushion warship.

ITEM 24.—*February 1973—Wall Street Journal article—"Navy Puts $946 Million Lid on Shipbuying"*

WASHINGTON.—The Navy's decision setting a new $946 million price on Litton Industries Inc.'s assault-ship program leaves the project in continuing dispute and guarantees hugely bloated bills for the Pentagon.

The Navy said yesterday that it had acted "unilaterally" to establish a new price and delivery schedule for the controversial five-ship program after having been "unable to reach a negotiated agreement" with the company.

The Navy's move brought threats by Litton of legal action aimed at producing a higher price. In a separate statement issued before the Navy announcement, the company put the new price at "approximately $948 million" and contended this was $108 million less than it should get.

Calling the Navy price "unrealistically low," the company statement asserted: "It is Litton's belief that the difference between the company's final offer of $1,056,000,000 to complete the program and the Navy's unilateral price of $948 million is the minimum government obligation which Litton will recover."

For its part, the Navy termed its unilateral move a "fair and just application of the contract." Still, the decision left the service with the unpleasant prospects of a continuing contract wrangle and inflated bills for the five Landing Helicopter Assault ships, or LHAs.

At the same time it set a new maximum price, the Navy informed the company that it was changing the basis on which it will make payments. Starting today, Navy payments to Litton will be based on physical progress on the ships, rather than on contractor costs incurred.

This switch, the Navy said, means the company "will owe the Navy approximately $55 million" for payments for which the company hasn't yet shown construction progress because of schedule slippages. The contract provides that

Litton "must repay the full money owed within three months and that further payments will be suspended until the repayment has been made," the Navy declared.

The company took another view. "Litton believes such a repayment isn't due and will oppose the Navy's claim," it said.

Though the Navy "memorandum for correspondents" didn't provide details, yesterday's action means that the government will end up paying Litton almost as much for five ships as it orginally planned to pay for nine.

In May 1969, when Litton won the LHA award, the Navy said the nine-ship contract had a "potential value of $1.01 billion." Now, the Navy stands to get five ships for $946 million. Government-furnished equipment and other non-Litton costs will add $185.2 million to the final bill.

DELIVERIES ARE DELAYED

Under the modified contract the first LHA, originally due to be delivered at the end of this month, will be 23½ months late. And the fifth LHA, originally scheduled for April 1975 delivery to the Navy, will be 32½ months late.

The LHA's cost and scheduling problems stem, in part, from Litton's unexpected difficulties in ironing out the bugs from its new, highly automated shipyard at Pascagoula, Miss. The yard, designed to build ships in giant assembly-line modules, has had labor troubles and skilled-manpower shortages, and allegedly produced sloppy work on early commercial vessels.

Navy officials offered these details on how they arrived at a maximum payment figure of $946 million: The original target cost of five ships was $562.5 million. To this is added $109.7 million to cover Navy-initiated cancellation of four ships, $103.7 million in increasing the price from "target" to "ceiling," $150.8 million to cover "escalation" and $19.3 million for change orders.

The $108 million difference between the Navy and Litton positions in the negotiations, Litton said, "represents the costs of work and schedule delays caused by actions of the Navy and not included in the scope of the contract."

Fred W. O'Green, Litton's president, who has played a major role in trying to work the kinks out of the Pascagoula shipyard, said: "The Navy's unilateral price is unreasonable and unrealistic; and the company intends to aggressively seek an equitable settlement of this continuing dispute through any and all remedies, if necessary."

PROXMIRE BACKS NAVY

The Navy's action brought praise from an unusual source—Sen. William Proxmire, the Wisconsin Democrat who is the leading congressional critic of Pentagon procurement policies. Sen. Proxmire commended the Navy move as "tough and right." While the Navy "made some concessions" that will lead to higher-than-estimated prices for the LHA, Sen. Proxmire said cost increases will be "held in check" and this could prove a "valuable precedent."

Litton insisted that the new LHA schedule won't slow progress on 30 DD-963 destroyers being built by Litton in Mississippi for $2.2 billion. The destroyer project is "currently ahead of schedule and within contract cost projections," Litton said. Pentagon officials have been worried that the destroyer project would be disrupted by the LHA delays.

Pentagon spokesman Jerry Friedheim, responding to a newsman's question, said that Roy Ash, former Litton president, who is director of the Office of Management and Budget, didn't have anything to do with the Navy decision on the LHA. Because of his recent connections with Litton, Mr. Ash has come under attack from Congressmen worried that he would help "bail out" Litton.

ITEM 25.—*May 1973—Harpers Magazine article—"Getting and Spending—Litton Industries and the Seven Rules of Big Time Defense Contracting"*

In Washington every spring the Congress celebrates the new season with an uproar of hearings, investigations, requests, appeals, and theatrical demands. The ceremony in both Houses takes the form of a morality play in which the

actors cast themselves in the role of the returning hero. With rhetorical denunciation (of the President, the special interests, the Pentagon, etc.) they seek to renew the blossoming of conscience in the American wilderness.

The evil figure of the defense establishment has become a stock character in the play, and tradition requires that it be reviled with ritual abominations. Each year the Congress must bring forth an unwilling conspirator, most often a large corporation, on whom it can drape the vestments of infamy. The role in recent years has been played (not without talent) by General Dynamics, by ITT, and by the Lockheed Aircraft Corporation. This year it has been assigned to Litton Industries.

The shipyard division of this conglomerate, ranked thirty-fifth in the Fortune 500 on $2.5 billion in sales, has fallen behind schedule on its contracts with the U.S. Navy, and its delinquency promises to cost the taxpayers no less than $500 million in unforeseen overruns. The conglomerate also happens to have been put together by Roy Ash, the man Richard Nixon chose to appoint director of the Office of Management and Budget.

The irony is too obvious to ignore. Accordingly, throughout the winter and early spring, the Senate has been demanding the right to pass judgment on Ash's appointment; at the same time, as if to sustain its prerogative, it has been inquiring into the affairs of Litton Ship Systems. The preliminary evidence appears to encourage the expectations of inefficiency, incompetence, and possible fraud.

As the bad news gradually becomes public, the Congress gives voice to dramatic anger, and the newspaper editorialists write their customary sermons. The general outcry depends upon the assumption that large government contractors do business in the familiar ways of American free enterprise (i.e., he who fails the trial of the marketplace goes broke). That assumption is necessary to the morality play, but it has little to do with the prevailing economics.

The lessons of the past ten years suggest that the government intends to support the defense establishment at no matter what cost. The government conceives of that establishment as a precious mechanism (or, in the usual phrase, "a national asset"), and it will spend whatever money is required to maintain production, to keep the people employed, and to continue the orderly accumulation of credit. All other considerations give way to this national imperative. Anybody still possessed of illusions on the subject had only to listen to John Connally testifying before Congress on the occasion of the Lockheed bankruptcy. At the time Connally was the Secretary of the Treasury, and he spoke with extraordinary candor: ". . . What do we care whether they perform? We are guaranteeing them basically a $250 million loan.

Why for? Basically, so they can hopefully minimize their losses, so they can provide employment for 31,000 people throughout the country at a time when we desperately need that kind of employment. That is basically the rationale and justification.

The large defense contractor thus operates within a system that absolves him of frisk. When the money and politics reach sufficient magnitudes, the supposedly iron laws of free enterprise melt like so much wax. The government guarantees, however, do not extend to profits. The corporations remain in existence, but the stockholders almost invariably lose money.

Consider one other quotation, again from a man who should know whereof he speaks. Also in 1971, also testifying on the matter of the Lockheed loan, Admiral Hyman Rickover offered the following opinion: " . . . Large defense contractors can let costs come out where they will, and count on getting relief from the Department of Defense through changes and claims, relaxation of procurement regulations and laws, government loans, follow-on source contracts, or other escape mechanisms. Wasteful subcontracting practices, inadequate cost controls, shop loafing, and production errors means little to these contractors, since they will make their money whether their product is good or bad; whether delivery is on time or late."

If Rickover and Connally can be accepted as honest witnesses, then at the upper limits of the political and financial spectrum, the conventional forms of business are transformed into an elaborate charade. The government and its contractors perform the ritual arguments about prices, claims, and competitive bids, but their arguments have no more substance than speculations in a gossip column. The ritual supports a system of waste and incompetence, but it also

supports a great many voters, who, in turn, support the politicians who complete the ritual by pretending to condemn it. Without somebody masquerading as villain, who can play the part of hero?

Not all members of Congress agree to the hypocracy of the charade, and a few of them do what they can to dismantle it. But for the most part Congress approves a system of defense spending that makes nonsense of the virtues supposedly inherent in the character of American enterprise. The theoretical or schoolbook virtues become liabilities in a system governed by ritual rather than by the exigency of the marketplace.

The two Litton contracts presently in question provide an exemplary demonstration of the new capitalism. The first of the contracts is for amphibious assault ships (the LHA) and the second is for large destroyers (the DD–963). The Government has appropriated $3 billion for the two series of ships, all of which are to be built in the Litton yard in Mississippi on the Pascagoula River. The first of the ships, i.e., the first LHA, is already two years behind schedule.

Both contracts have come under extensive scrutiny during the past year (in the House Armed Services Committee and in the Joint Economic Committee in the Senate), and the following principles have been derived from a study of the relevant testimony.

I. The Contractor Need Not Deliver What He Has Contracted For

The original contract the Navy signed in May 1969 was for nine LHAs at a total cost of $1.4 billion, but in February 1971 the Navy informed Litton that the program would be reduced to five ships. The official reason was overall fleet reductions, but others suspect that the Navy realized the LHAs would be late and might consequently delay the DD–963s that were to be built in the same shipyard. Under the terms of the 1969 contract, the four-ship cutback in the LHA program put Litton in line to receive cancellation costs of $110 million. The Navy publicly estimates the five LHAs will cost $970 million, but the Senate's foremost opponent of military waste, William Proxmire of Wisconsin, claims the Navy's unpublished figures show "it will cost $1.4 billion to complete" the five LHAs. In other words, the Navy would be getting five ships for the price of nine—a cost overrun of some $400–$500 million.

At the end of March last year, Litton submitted a fifteen-volume, 6,000-page "reset proposal" for the LHA program that included a $270 million claim against the Navy. (Having initially tapped the treasury by winning the contract, the successful "competitor" then begins to seek ways to make up for his low bid. Although the particular maneuver chosen—in this case a "reset proposal"—may be Byzantine in its complexity, the purpose is simple, to raise the price of ships.) The details of the reset proposal were not made public because the Navy considers the information to be "corporation confidential." Asked the basis for Litton's claim of $270 million, the Navy wrote: "The contractor's alleged basis of the claim is Navy interference in Design Development and over management, late GRE and GFI (government furnished equipment and information)." (A "claim" is another of those rituals for increasing the price of your product: blame the Navy for your own mismanagement, threaten the government with a large claim, and settle out of court for all you can get.)

Two months later the Navy gave its official response to the Litton reset proposal or, as it unaccountably came to be called, "reproposal." In a letter dated June 23, 1972, Admiral R. C. Gooding, the Acting Commander of the Naval Ship Systems Command, opened fire on the Litton proposal with blunt language: "In our opinion this 'Program Reproposal' as submitted is almost completely unresponsive to the obligations undertaken by Litton in the 23 April 1971 Memorandum of Agreement with the Navy and thus has breached the terms of that instrument * * *."

Admiral Gooding then listed the conditions under which the Navy would be willing to "negotiate a new delivery schedule" for the LHAs. He ended the letter with this warning: "If you do not agree with the course of action proposed herein, the Navy may have no alternative but to pursue its remedies under the 'Default' clause."

Recognizing the ritualistic character of the warning, Litton remained unimpressed, and it responded with its own press release after the Navy's letter was made public by Senator Proxmire. One sentence in that one-page release stands out: "Litton does not expect to subsidize the construction of LHAs nor be required to finance the Navy during the construction period." It was, in effect,

an ultimatum, and on August 31, the date on which Litton was to begin receiving payments only on the basis of physical progress on the LHAs, the Navy gave Litton a six-month extension and continued reimbursing the company for its incurred costs.[1]

II. The weapon need not be needed

The LHA was designed to transport and land a battalion of marines (1,900 troops), twenty-five to thirty helicopters, and four large landing craft. About the size of an aircraft carrier of the *Essex* class, the LHA is supposed to do the work now done by four separate amphibious ships: it would no doubt have been ideal for Gen. Douglas MacArthur's Inchon landing in Korea. The DD–963s have been designed as antisubmarine warfare (ASW) vessels with the principal mission of supporting the force of aircraft carriers. Not all naval analysts think they will be very good ones.

Navy Captain Robert H. Smith, an ASW expert, won the U.S. Naval Institute's 1971 prize for his essay, "A United States Navy for the Future." In his essay Smith called the carriers "too many eggs in too few baskets. They present the Soviet strategist, keenly conscious of the Navy we have built around them, with a small number of enormously high-value targets upon which to focus extraordinary and intense aim with every kind of force that can be brought to bear." Destroyers designed primarily to serve carriers, he reasoned, do not have "the versatility to acquit themselves formidably in many kinds of tactical scenarios." Of the DD–963, Smith said, "It makes no sense to plan to build a ship that even now, on paper (and the first of which is not to be delivered for years), is inferior to competitive Soviet ships which are already at sea."

Arnold M. Kuzmack, a naval affairs expert at the Brookings Institution, has reservations about the Navy's preoccupation with aircraft carriers and its rationale for building more escort ships. "Applying the lower planning factors used in the late 1960s," Kuzmack writes, "would mean that the United States already had enough modern escort ships to meet requirements for a twelve-carrier force in the 1980s." (The United States now has sixteen carriers; the Russians have none but are said to be building one.) So, Kuzmack concludes, "it would be possible to cancel the DD–963 program beginning with the [fiscal year] 1973 budget request."

There is no unanimity, then, in knowledgeable circles that the Navy needs a new destroyer or, if it does, that the DD–963 would be the right one. Nonetheless, Litton has a thirty-ship contract for the DD–963. The Navy had originally wanted fifty.

III. The contractor can afford to be wrong

After two rounds of bidding, the competition for the destroyer contract narrowed to Litton Industries and Bath Iron Works of Maine. On February 2, 1970, the third round of secret bids was submitted, and the two shipbuilders were close: Litton's ceiling price was $80.8 million per ship and Bath's was $81.1 million. According to a GAO analysis of the bidding released in August 1970:

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[1] The extension expired in February 1973, and the occasion demanded another ritualistic exchange of press releases. On March 1 the Navy announced it had been "unable to reach a negotiated agreement" with Litton on its LHA reset proposals. So, the service unilaterally set the new "firm target price, ship delivery schedule, progress payment system and escalation provisions." Payments on the LHA contract will now be made "on the basis of physical progress, rather than the cost incurred." Because progress payments would would have been instituted six months before but for negotiations on the reset proposal, the Navy calculated that Litton owed the government $55 million "for payments in excess of physical progress earned."

The Navy's unilateral decision received prominent newspaper coverage on March 2, but nine days earlier another Litton story was buried deep on the back pages. The lead of the Associated Press story sums it up: "The Navy released $182 million in advance procurement funds to Litton Industries yesterday as the next step in its $2.5 billion destroyer-construction program." A week earlier the Navy confirmed that an additional $192 million for the LHA had been hidden in the 1974 budget. Instead of appearing in the line item "amphibious ships" where all earlier LHA funds had been listed, it was included in the request for "auxiliaries and craft," two lines below.

Although Litton has performed poorly as a builder of Navy ships, the month of February found the company getting $182 million to begin work on seven more DD-963s and a $192 million price increase on the LHAs (add $374 million). Although Litton has been asked to return a sizable sum (subtract $55 million), that money eventually will be returned to Litton when, far from public scrutiny, the Navy decides that progress on the LHAs has improved sufficiently. By the one measure that matters to the defense contractor, *cash,* Litton has come out ahead (net an additional $319 million).

"The [Navy's] Source Selection Advisory Council ultimately concluded that the proposal of either contractor would provide destroyers suitable for the future needs of the Navy." So, on March 20, 1970, the Navy asked Litton and Bath for their "best and final offers," but unlike the earlier rounds for which the contractors were given about a month to prepare their bids, the Navy gave them just six days.

No technical changes were made in the ship's design by either contractor, but both dropped their prices. Bath dropped its ceiling price per ship a modest $1.4 million to $79.7 million. Litton's drop was more dramatic: a $9.5 million decrease to a ceiling price per ship of $71.3 million. Litton underbid Bath by almost a quarter of a billion dollars even though it had not changed its design.

The key to Litton's drastic cut in price centered on the company's estimate of what effect inflation would have on the prices it had to pay for labor and material. Litton was optimistic and estimated it would recover $144 million *more* from the Navy than it would actually pay out because of inflation. Bath's estimate was pessimistic: it expected to recover $146 million *less* from the Navy than it would actually pay out because of inflation. In short, because Litton's crystal ball predicted a rosy future whereas Bath's figures took inflation into account, Litton got the contract. This $290 million disparity apparently did not trouble the Navy even though it was, in the words of the GAO report, "the largest single point of difference between them in the final bid."

The Navy now puts the price (to Litton plus government equipment) of one DD–963 at $90.5 million, but if one includes an electronic warfare system cost overrun discovered by Rep. Les Aspin of Wisconsin, the cost is closer to $95 million. How much higher might it go? At the moment no one is saying, but there are signs that the DD–963 could match the LHA's lamentable performance.

IV. The contractor must promise miracles

Litton won the contract to build the LHAs in competition with General Dynamics and Newport News Shipbuilding and Dry Dock. Departing from precedent, the Navy issued performance (rather than design) specifications for the LHA and invited shipbuilders to submit their own designs, the winner of the competition to build the entire class of ships. The Navy's choice of Litton, a relatively inexperienced shipbuilder, was controversial because (among other reasons) Litton had yet to build the automated shipyard on the west bank of the Pascagoula River in Mississippi, where the ships were to be built on an assembly line.

When the LHA contract went to Litton, some thought it signaled a great leap forward for the American shipbuilding industry. Long envious of the innovations of Japanese, European, and Russian shipbuilders, the Navy was excited by Litton's aerospace concepts of modular construction applied to shipbuilding. Admiral Isaac C. Kidd, the present Chief of the Naval Material Command, which is responsible for ship construction, now believes that the Litton shipbuilders "promised more than they have been able to produce. We've got to remember," he told the House Armed Services Committee, "that we made a decision on the basis of a shipyard that was nonexistent at the time, and a technique for production that was still sort of a gleam in somebody's eye."

The DD–963 contract was distinguished by two "firsts." It was the first time the Navy had turned over the responsibility for designing a major combat vessel to a shipbuilder, and it was the first time since World War II that so many Navy ships had been awarded to a single contractor. These two breaks with established practice were controversial, and now, three years later, they appear to have been serious mistakes.

To understand these decisions, one must go back seven years to the McNamara Pentagon and the innovative procurement practices that were then introduced. The key individual in these changes was Alain C. Enthoven, the Deputy Assistant Secretary of Defense for Systems Analysis. (Enthoven is now a Litton vice-president responsible for the medical products division. He did not choose defense contractors while at the Pentagon, and his work at Litton, he says, has never involved defense contracts.) Thought by many to have been the brightest of the McNamara "Whiz Kids," Enthoven attracted some of the best men from the officer corps and the universities. Among them was Lieutenant Commander Charles J. DiBona, a 1956 Naval Academy graduate and a Rhodes scholar. In January 1966 an article by DiBona appeared in the U.S. Naval

Institute's influential magazine, *Proceedings*. "Can We Modernize U.S. Shipbuilding?" was its title, and it became the genesis of the DD–963 contract.

DiBona briefly traced the development of the aircraft and shipbuilding industries since World War II and found that while the American aircraft industry had become "the leading supplier of the world's commercial aircraft," American shipbuilders were "limited to producing naval ships and commercial ships for which the government subsidizes half the cost." By adapting the practices of the aircraft industry to shipbulding, DiBona saw an opportunity to make U.S. shipbuilders more efficient. By standardizing the design of naval ships, building them in large blocks of twenty-five to seventy-five, and having just one contractor design and build them, the cost of building some classes of ships could be cut in half. By modernizing facilities—using such methods as a "flow-line shipyard with automated machinery"—the productivity of the shipbuilding industry would be increased, and the multiyear contracts to build these large blocks of ships would assure the shipbuilder the necessary cash flow needed to modernize. Hence, by changing the way the Navy bought ships, one could create a process that benefited everyone. The shipbuilders would become more efficient, the Navy would get better ships more cheaply, and the American taxpayer would eventually be able to stop paying subsidies to a revitalized industry that could compete in the international marketplace against foreign shipbuilders. On paper it was a brilliant scheme.

There were, however, two assumptions inherent in the concept and the eventual contract that would later prove to be flaws of monumental proportion. One was the assumption of a "learning curve" that would result in successively lower costs to produce each destroyer as the shipbuilder learned how to build the ship more efficiently. (That there is *some* learning curve is nondebatable, but how accurately it can be predicted in the absence of experience is another matter.) The second assumption was that the cost-estimating process could produce *hard* contract prices for a radically different destroyer to be built in a shipyard that had never built a ship.

V. The contractor can make absurd mistakes

Litton prides itself on decentralized management, and the company's Beverly Hills headquarters claims to give its managers in the field a free hand as long as their performance reports are within acceptable limits. At Litton, however, "decentralization" can mean that headquarters simply does not know what its various divisions are doing. A labor union official from Pascagoula, Dean L. Girardot, told Proxmire's Joint Economic Committee in December about what happened to the second commercial container ship being built at the west bank yard. A Litton official at Pascagoula decided to build the ship in one piece rather than in modules and was well along in his work when headquarters found out about it. Beverly Hills ordered Pascagoula to "cut the ship in two," said Girardot.

"Then they had to put it back together again?" asked an incredulous Proxmire.

"Yes," said Girardot, "but it was module construction at that point."

(In June of last year, Litton agreed to pay $5.5 million to the two companies whose container ships will not be delivered on schedule. Litton had first filed suit against them, claiming that the companies had requested changes that would cost Litton $8.4 million. Unlike the Navy, the two companies were not intimidated; Litton dropped its suit and agreed to settle out of court.)

In its successful bid for the LHA contract, Litton estimated that 36.8 million labor-hours would be required to develop and build nine LHAs: about 4.1 million hours per ship. In its reset proposal, Litton raised its estimate to 55.8 million labor-hours for five LHAs: about 11.2 million hours per ship. In other words, Litton's labor estimate for each ship nearly tripled. Of the 55.8 million hours, 42 million were for actual production of the ships. When the hearings were held a year ago, less than 2 percent of the 42 million production-line labor-hours had been expended. By year's end, however, the company had collected about $400 million of the $970 million contract.

Admiral Gooding told the House Armed Services Committee in April 1972 that Litton's west bank shipyard was "several hundred men short" and that the prospects for improvement were bleak. "The projection is [that] even with their current hiring rate, they will be 2,000 men short by the end of the calendar

year," he said. Asked about Litton's labor turnover rate, Gooding said it was inordinately high, "about 50 percent."

"In other words," Chairman F. Edward Hebert asked, "if the program is continued and the contract [i.e., the reset proposal] is awarded, they don't have the manpower to carry it out if they don't show an improvement?"

"That is correct, sir," Gooding replied.

VI. The contractor must understand the art of bookkeeping

Litton is fighting the Navy not only on the LHA and DD-963 but for "claims" it says the Navy should pay for work performed on other Navy ships in the east bank shipyard at Pascagoula. Litton, indeed, has already begun counting a portion of these claims as money in the bank. Although the company's sales for both 1971 and 1972 were $2.5 billion, after tax profits dropped from $50 million in 1971 to just $1 million last year. Litton would have been in red ink but for the legerdemain of its accountants, who counted $41 million in *claims* against the Navy, which Litton may never be paid, as *assets*. It was all perfectly legal and in accordance with the magical mathematics in the handbook of "generally accepted accounting principles." Had these claims not been included as assets, the company would have shown a net *loss* of some $23 million (by my rough calculations).

Litton's imaginative bookkeeping was exposed by Senator Proxmire in August 1972 when he found that $32 million in claims were being carried by Litton as assets and that this had not been reported to Litton's stockholders. After Proxmire made Litton's "profit formula" public, the company owned up to it in its 1972 annual report and revealed that its "assets" had increased from $32 million to $41 million by another stroke of the pen in the last quarter. Litton's stock now sells for about a tenth of its 1967 high of 120.

VII. A contractor is in the business of politics

Although Litton's profits and the price of its stock have been on the downside in recent years, Litton has been cornering an increasing share of the Pentagon's business. Ranked fourteenth in 1968, in the space of two years Litton moved up to ninth largest defense contractor (based on the dollar amount of defense contracts held). That this rise occurred after the election of Richard Nixon to the Presidency may have been a coincidence.

The authoritative *Congressional Quarterly* reported that "officials of companies ranking among the top 25 defense, space and nuclear contractors in fiscal 1968 contributed at least $1,235,402 to political campaigns during the 1968 Presidential election year." Of what was reported, the largest amount given to either political party came from the officers and board members of Litton Industries: $151,000, all of it to the Republican party.

Campaign contributions are one way to influence elected officials, but a more effective way is to have one of your own in the inner councils of state. Roy L. Ash was a cofounder of Litton in 1953 and its president from 1961 until he resigned in December 1972 to become President Nixon's director of the Office of Management and Budget. Ash, who admits giving "five figures" to each of Mr. Nixon's successful Presidential campaigns, did not meet the President until after the 1968 election. Apparently impressed, Mr. Nixon appointed Ash in April 1969 to head the President's Advisory Council on Executive Organization: one of the council's recommendations led to the creation of OMB.

In the past, OMB and its predecessor, the Bureau of the Budget, have been two of the more effective internal checks on the power of the Pentagon. As a matter of course, OMB reviews the performance of defense contractors, and of necessity it will have to evaluate Litton's performance on the $3 billion in Navy shipbuilding contracts it holds and the validity of the half-billion dollars in claims against the service. When Ash was designated for the OMB post, he said he would divest himself of his 233,000 shares of Litton stock, and when asked if he would be in line to receive any "deferred compensation" from the company, he said he had "no pension plan or anything else." With his financial connections to Litton thus severed, Ash averred there would be no "potential conflict of interest" if he were called upon to pass judgment on the company he founded.

Will Ash hold defense contractors to their contractual obligations or will he advocate a continuance of the present corporate welfare system to maintain their prosperity?

A Navy memorandum raises doubt that Ash will be able to see matters from other than the defense contractor's point of view. The memo recorded a meeting on June 6, 1972, which was one of a series between Ash and Admiral Kidd. The meeting, convened at Ash's request, was to discuss the LHA contract. The memo notes that the meeting opened with Ash indicating that "based on consultations with his lawyers" Litton and the Navy had to choose one of eight alternatives on the LHA. These ranged from outright termination of the contract to continuing "cost reimbursement payment basis beyond the 40-month current contract limit," which was when payments based only upon physical progress were to begin. Ash also indicated that "if Litton were required to convert to a physical progress payment basis in September 1972" the company "would be unable to perform due to the impact on an already tenuous cash flow position." (As earlier noted, the Navy continued reimbursing Litton for its incurred costs.)

The memo ends noting that Ash "indicated that it appears that some in the Navy have a built-in sense of self-righteousness concerning Litton's performance, and that the Navy would have to relax this view if Litton is expected to proceed with the [LHA] contract." Ash indicated he would go "to the White House to explain the problem" if the Navy's action did not satisfy him.

Ash is now one of the most powerful men *in* the Nixon White House. He presides over a $250 billion budget, and, equally important, he makes policy decisions and recommendations to the President concerning the management of the Executive Branch. How the Pentagon purchases weapons, its procurement regulations, and what legislation the Administration will promulgate are matters he can control directly or indirectly. If he reaches the conclusion—as others have —that the United States has too many defense contractors for its needs, perhaps he will recommend that this excess capacity be eliminated through free market mechanisms: a course that would probably result in the demise of one or more contractors. If, on the other hand, he continues to think like a Litton executive, we will probably see even greater subsidies for the already heavily subsidized shipbuilding and aerospace industries. The budget for fiscal year 1971 allocates $81 billion to the defense establishment, the largest such appropriation since World War II.

Litton's mismanagement of the LHA and DD–963 contracts may or may not prove to be the worst example of bungled Pentagon procurement, but it will certainly not be the last as long as defense contractors are allowed to inhabit a world where there is no penalty for failure. If the five LHAs are ever built, the cost overrun will be on the order of a half-billion dollars. If comparable errors were made in the labor and cost estimates for the DD–963, those thirty ships could cost $1 billion to $2 bilion more than anticipated. Although Congress has appropriated some $1.6 billion of the $2.7 billion required for the thirty-ship contract, it is still too early to know if there will be delays or cost overruns that would make the final price much higher. When will we know?

I asked that question of Congressman Aspin who, with Senator Proxmire, has been one of the individuals most responsible for exposing Litton's mismanagement of the LHA and DD–963. Aspin's answer was not comforting: "Everything indicates that Litton is going to overrun the DD–963 maybe even worse than it has the LHA, but we can't prove it. By the time we can, it will be too late."

ITEM 26.—*Dec. 1, 1973—Business Week article—"The Model Conglomerate Tries To Be an Operating Company"*

Litton Industries, the dethroned king of the conglomerates, has taught U.S. business at least two important lessons. The first was how to build a pyramid of acquisitions and boost corporate earnings through pooling-of-interest accounting, thus pushing up the stock price and making still other acquisitions cheaper. The second lesson, of longer-range value, was that clever builders do not necessarily succeed, as the conglomerate credo maintained, in running the businesses they acquire.

Now Litton is trying to write the text for solving the basic conglomerate dilemma: how to turn a vast, troubled corporate amalgam into a growing and profitable operating company. The goal, as Chairman Charles B. "Tex" Thornton

puts it, is to make Litton "creative, efficient, highly competitive—a leading edge." The means, it has now become apparent, is Fred W. O'Green, the 52-year-old son of a Mason City (Iowa) postman, whom Thornton moved up a year ago to succeed Roy L. Ash as president and chief operating officer. Ash, who is now the Nixon Administration's Director of Management & Budget, was a financial and acquisitions expert. O'Green is an electrical engineer and a nuts-and-bolts operating man.

Conglomerate managers around the country have a profound interest in seeing Thornton and O'Green make it. Though younger than Textron, Inc., and smaller than International Telephone & Telegraph Corp., Litton is the archetype of the modern conglomerate. Its more than 100 operating units produce goods ranging from McGuffey's Reader to Navy destroyers. If Litton can prove that it can run as "the General Motors of advanced technology," as Thornton ambitiously puts it, its success could reflect on the others, particularly on their stocks, now selling at fractions of their historic highs. It was Litton's initial stumble in 1968, when a highly touted record of 57 consecutive quarterly earnings increases was broken, that started the conglomerates' downfall in the market.

Thornton personifies the effort to remake Litton. A stocky, friendly, dignified Texan with a lust for the outdoors, he pretty much withdrew from active management in the late 1960s, turning it over to Ash, with whom he had started building the company 20 years ago. Thornton, who now is 60, signed on with scores of Presidential commissions, boards of major companies, professional groups, and charitable organizations. He also operated Royal Oaks Farm, his ranch in the hills northwest of Los Angeles where he breeds thoroughbred horses commercially.

In mid-1972, however, Litton reported a perilously thin fiscal-year net of only $1.1-million on revenues of $2.6-billion and, toward the end of that year, President Nixon brought Ash to Washington. Thornton decided to return to active management at Litton's Beverly Hills headquarters. He quit the commissions and resigned directorships at such companies as General Mills, Union Oil, and Times-Mirror. His return pleases many Litton-watchers. "Tex is one of the greatest industrial managers of the postwar era," declares Fred R. Sullivan, chairman and president of Walter Kidde & Co., Inc., another conglomerate. "He is a great motivator," adds Sullivan, a former top Litton executive.

But the Litton man to watch now is Fred O'Green. An 11-year Litton veteran, O'Green, who is of Scandinavian origin, is tough, direct, and demanding. He seems a little out of place in Litton's antique-crammed, colonial-style headquarters. He has a rich humor, and—uncharacteristically of the banker look among Litton's top management—his lush growth of graying hair drifts almost to the bottoms of his ear lobes. (He has it cut that way partly to hide a hearing aid.)

A SUCCESSFUL TROUBLESHOOTER

O'Green was uninvolved in the Litton acquisition game. He came to Litton from the Lockheed Missiles & Space Div., the one big unit of Lockheed Aircraft Corp. that has been perennially profitable. Litton had recruited him to direct production of what was then a little-known technology: aircraft inertial guidance systems. "The industry said, 'Inertial guidance is a great idea,'" O'Green recalls, "'but you'll never manufacture it—the tolerances are too small.'" But inertial guidance turned out to be one of Litton's most successful new ventures.

Two years ago, O'Green got a much tougher assignment: to turn around the new, disaster-prone "modular" shipbuilding operation that Litton had built opposite its Ingalls shipyard in Pascagoula, Miss. (box, page 68). Plagued by massive production snags, labor turmoil, and frequent management changes, it once seemed destined for shutdown. Through belt-tightening, improved construction techniques, and recruiting of seasoned shipbuilders, O'Green managed to get the yard on the right track, although its problems are still far from solved.

Litton's recovery effort has already produced encouraging returns. For the year ended July 31, 1973, the company reported earnings of $43-million on sales of $2.6-billion—still far short of the 1969 earnings peak of $82.3-million. This week, Litton reported fiscal 1974 first-quarter earnings of $10.9-million, up from $9.4-million last year. Sales rose $96-million from $582-million.

Management refuses to predict results for the current year, having burned and been burned by Wall Street in the late 1960s after a series of over-optimistic

forecasts. But barring heavy and unexpected write-offs on shipbuilding or serious reversals because of the energy shortage, management expects earnings to rise again this year. "Fiscal 1973 was not an isolated event," Thornton says.

HOW SYNERGISM BACKFIRED

It was Litton's go-go acquisition policy of the late 1950s and early 1960s that fired Wall Street's erstwhile love affair with conglomerates and sparked dozens of imitators. Thornton and Ash became the high priests of "synergism"—the idea that disparate enterprises can cross-fertilize each other and grow faster under intelligent common overseers than they could separately. But synergism never really worked.

Reduced to managing what they have, few conglomerates have been up to the task, especially those that acquired inherently weak companies simply to report earnings growth. Los Angeles-based Whittaker Corp., for example, "bought everything in sight, and price was no object," recalls a source close to the company. Problems of managing its array of enterprises brought Whittaker to the brink of collapse, forestalled only by a rash of divestments and write-offs.

Among the major conglomerates, only a few companies, notably ITT, have been able to grow steadily into the 1970s. Behind them is a string of companies that have been rebuilding, with varying degrees of success, after their earnings fell for two or three years. Textron leads the group, having easily surpassed its peak earnings years of the 1960s. At the lower end of the group is Litton, whose recovery has been slower to come. Beyond that group, of course, are the companies that have utterly disappeared as conglomerates, and those, such as LTV Corp., that are struggling to survive overwhelming setbacks in the past few years.

The trend among the conglomerates now, says Joseph F. Alibrandi, who came in as president of Whittaker after the peak of the acquisition era, "is to get to where you can dominate a business rather than having a little piece of the action in 40 or 50 areas." Still another trend: to avoid the huge acquisitions that some of the companies made—such as Litton's venture into shipbuilding—where a single setback can cripple the parent, and to concentrate on a better balance of equally strong businesses.

SOBERED AND CHASTENED

Litton's turnaround will not be easy. In recent years, Litton has been anything but the "leading edge" that Thornton talks of. The company was rocked by production problems and management errors that have shaken the confidence of company executives as well as outsiders and has pushed profits to their nadir in fiscal 1972.

Litton has been losing money on Pascagoula, minicomputers, the Hewitt-Robins conveyor system, and several other operations. The company's Royal typewriter operation has been unable to produce a quality electric model, for all the parent company's vaunted technical skills.

Like other conglomerates, Litton has largely been paying the piper for its overeager past growth. Former executives say that management bought Royal McBee and the Ingalls shipyard in Pascagoula partly because it could get them for less than book value and then report the difference as corporate profit over a five-year period—an accounting ploy no longer permitted. Litton felt that it could turn Royal around, one former Litton man says, but "management skill just wasn't enough to help a tired old company like Royal McBee." Litton finally moved the division's operations to England at a cost of $17-million.

But Litton seems to have profited from its past mistakes. Sobered and chastened, and with a new operations-minded president, the company seems on its way to resolving most of its troubles and building a new image based on internal performance. Further, Thornton insists that the company's new orientation has not required a top-to-bottom relearning process. During its first 15 years, he claims, Litton's growth was 60% internal. But he has banned acquisitions of any consequence until the company finishes sorting out its present businesses and deciding where to put its priorities.

The single major problem hanging over Litton is shipbuilding. Complains Thornton: "All people want to talk about is the shipyard. You'd think we

never did anything else. It's only 12% of our sales." But the loss potential is sizable. A two-year delay in building five aircraft-carrier-sized LHA (landing helicopter assault) ships for the Navy has pushed costs far above the Navy's ceiling. Litton accuses the Navy of making too many design changes, but it will likely have to swallow some of the excess costs itself. However, ship write-offs, if they come, "are not going to bankrupt Litton—far from it," says one of the company's bankers. And competing shipbuilders believe the yard has a promising future.

As the architect of Litton's recovery effort, O'Green is a radically different creature from his predecessor. Ash's financial wizardry helped during the acquision phase, but Ash was weak on operations, and insiders believe he would have been eased out of the company if the Nixon appointment had not come through.

Colleagues remember Ash as a humorless "numbers man," prodigious in "seeing the leaks in the financial dike of a balance sheet," as one Litton executive puts it, but unable to grasp Litton's day-to-day operating problems. "He never managed anything in his life," says a former co-worker. A staunch believer in the autonomy of operating units, Ash rarely left the Beverly Hills headquarters to visit subsidiaries. And when he did, he talked to plant comptrollers rather than to engineers or manufacturing personnel.

By contrast, O'Green gets personally involved in solving the manufacturing problems that have been at the core of Litton's recent woes.

"Ash tells you to solve a problem, but O'Green helps you solve it," says James R. Meller, senior vice-president in charge of Litton's Defense & Marine Systems Group. "He goes around organizational lines and gets close to the operating guys."

O'Green spends at least one-third of his time touring Litton's far-flung divisions, talking with engineers and plant managers about their problems. "You can't manage this company from Beverly Hills," O'Green says. Although he denies it, O'Green seems gradually to be pulling in the reins on Litton's previously autonomous units, partly centralizing the decision-making process.

Other Litton officers say O'Green emphasizes sticking to businesses that Litton knows. He probably would not have made the 1961 purchase of the Ingalls shipyard, they speculate, although he probably would have gone along with building the second yard once Litton was in the business.

O'Green believes that Litton strayed from healthy growth because of bad acquisitions and a failure to "move to correct things as quickly as we should have." That failure, he says, stemmed from a lack of management expertise in certain areas, notably in shipbuilding. "But we now have the skills to manage all our businesses," O'Green maintains.

O'Green's formula for turning Litton around is three-pronged: develop tighter controls so top management stays abreast of problems, get rid of operations that do not fit into Litton's basically technological calling, and use the company's human resources to the hilt across divisional lines.

LITTON'S OVERAMBITIOUS SHIPYARD

Cars in Pascagoula, Miss., are sporting bumper stickers that proclaim: "LHA-1 floats 12-73." The message means that this weekend, Litton Industries' local Ingalls shipyard is scheduled to launch the first of five giant LHAs (for "landing helicopter assault" ships) that Litton is building for the Navy at a total cost of more than $1-billion. The ships will carry both helicopters and landing craft. Originally there were to have been eight, but the Navy cut the order when Litton fell two years behind schedule and piled up some $300-million in extras on the fixed-price contract.

Blame for the cost overruns is being fought out between Litton and the Navy, but the company will probably have to write off a portion of the total. Meanwhile, the yard seems likely to fall behind on an even bigger Navy program: a $2-billion order for 30 destroyers. The first destroyer was launched a few weeks ago, and Litton originally believed it could churn out one a month. Now, with delayed LHAs clogging the destroyers' work areas, the company is projecting on the basis of one destroyer every five weeks.

Modular Shipbuilding.

Litton's troubles stem from monumental problems with a new modular construction concept for which it built a new $500-million yard, $130-million of which the state of Mississippi financed with a bond issue. The new yard stands on the west bank of the Pascagoula River, across from the old Ingalls yard. Instead of building an entire hull and then filling it with engines, pipes, wiring, and equipment, Litton decided to use an assembly-line approach.

The idea was to build ships in segments, equipping them inside before welding them together to make a completed hull. This would save labor by enabling workers to stay in one place and do repetitive jobs. But practice has fallen far short of theory.

As some shipbuilding experts see it, the yard made a basic error in trying to refine design details too far on paper rather than perfecting them on the first ship in the traditional way. Design engineers, many of them recruited from California aerospace plants, produced LHA drawings based on tolerances as fine as 1/16th in.—even though the sun's heat may expand big steel plates as much as 2 in. in one day. In modular construction of eight cargo ships for the American President and Farrell lines, the ducting in adjacent modules failed to match by as much as 2 ft. Piles of parts and precut steel plate, placed to supply the LHA module-building teams, turned out to have been stacked in the wrong sequence, causing delays.

Most important, the yard's labor force was ill-trained, and ill-motivated to switch to the new system from the traditional methods of the yard across the river. Inevitably, morale plunged and turnover multiplied. "I had 16 different bosses in three years," says Dan Appleton, a former data-systems manager on the LHA.

A turnaround.

Shipbuilding people still have a wait-and-see attitude, but most of them seem to think that Litton has now made the right moves to turn the yard around and that prospects should be fairly bright, once the LHA and destroyer contracts are out of the way. "If they ever lick their problems, they'll be the yard to beat in this country," says Richard Schaeffner, an Ingalls alumnus who now is manager of engineering for the Los Angeles Div. of Todd Shipyards.

Much of what has been accomplished in solving Pascagoula's problems can be credited to Fred W. O'Green. And that is largely what won him Litton's presidency last year.

Tough action.

In September, 1971, O'Green as executive vice-president took over Litton's Defense & Marine Systems Group, which runs the Ingalls yards. One of his first acts was to call the modular yard's 10,000 employees together and give them a pep talk from atop a crane. "You could see he was tough and meant business," a former employee recalls. He also lopped off 1,000 California-based design engineers—who were "doing nothing," shipyard sources say. He fired many of the former aerospace executives and replaced them with shipbuilders hired away from competitors. Operations chief John Serie, for example, was recruited from General Dynamics Corp.'s Electric Boat Div.

To cut managerial overhead, O'Green merged the previously independent older Ingalls yard with the new modular yard. As head of the combined operation he named Ned J. Marandino, a strong-willed, tenacious manager who had worked for O'Green at Lockheed's Missiles & Space Div. and had been running the old east bank yard. Marandino had to learn shipbuilding from scratch at Ingalls, but observers say he mastered it quickly. Declares a Navy admiral: "The only reason I have any confidence in Litton is Ned Marandino."

Finally, last year, O'Green and Marandino decided to back away a bit from the modular approach. The new yard is now building 100-ton LHA "mini-modules" that are easier to assemble and handle than the 6,000-ton modules originally planned. But O'Green says that the move was temporary, making full modularity a more gradual development.

Still in the woods.

The yard's troubles are by no means solved. An executive of a competing yard sees signs of serious labor problems. Litton, he says, "has been frantically trying

to subcontract steel fabrication, aluminum fabrication, ductwork—things our yards routinely do themselves."

Senator William Proxmire (D-Wis.), frequently a Litton critic, insists that there is no evidence of any improvement in the yard. He says that the Navy should cut its LHA order once more, from five ships to three. Other sources predict that the Navy will have to cut its destroyer contract; 30 ships are scheduled, but funds have been made available so far for only 16. Litton and the Navy are now negotiating to reset destroyer schedules.

Litton is also negotiating on some $20-million in LHA progress payments that the Navy says it paid too soon and wants back. Also, Litton asked last year for $350-million above the program's $775-million ceiling to cover extra costs allegedly caused by Navy specification changes. Litton will probably lower the claim when it is formally submitted next August. The company currently estimates the ships will cost $1.080-billion to build, which includes cancellation charges on the three scuttled ships but no profit. The Navy pegs costs at $1.018-billion and has offered to settle for $953-million. Litton says it will accept a $1.056-billion settlement, equal to a $24-million loss on the contract if the company's figures are right.

Litton already has $168-million of claims against the Navy outstanding for work on submarines and ammunition ships at Ingalls' East Bank yard from past years. Litton carries $61-million of these claims as receivables but has written off the rest whose recovery is considered less likely.

Says Marandino of the claims: "We won't make a big profit on the LHA, but we won't take a big loss, either." He vows to accept no more fixed-price contracts. Litton is not setting up any loss reserves on the Navy claims because, says Joseph T. Casey, senior vice-president for financial affairs, "it would make our negotiations more difficult."

Beyond the troublesome Navy contracts, the yard stands a good chance of doing a profitable business. Backlogs of U.S. shipyards are expanding and, says Litton's Chairman Charles B. "Tex" Thornton, "we'd be in clover if the yard were free to build commercial ships." He says that a year from now is the earliest that the yard could take on new business.

Litton's management insists it can make the yard respectably profitable." "There is no question in my mind," says O'Green, "that the yard will be profitable with new work after the LHA and destroyer contracts. But if it isn't, we just won't stay with it. That's all there is to it."

TRIMMING OFF THE FAT

Starting even before O'Green's arrival, Litton has lopped off a number of troubled operations. Among them: a paper mill builder, power transmission equipment maker, a medical instruments distributor, and a fleet of 10 Great Lakes cargo ships. The Justice Dept. is scrutinizing the sale of the last venture.

Last March, Litton even sold a solidly profitable subsidiary—Stouffer Foods, which is in the hotel, restaurant, and frozen food business. Litton bought Stouffer in 1967 for the "synergistic" relationship it thought it could develop with its budding microwave-oven business. "We thought there might be a razor-and-blade relationship between microwave ovens and frozen food," says Thornton "It was wishful thinking." Litton bankers believe that Litton also had another reason for selling Stouffer: the investment that would have been necessary to make a go of Stouffer's hotels. With shipyard losses threatening, Litton balked at taking on that additional burden.

Litton has realized $125-million from the sale of subsidiaries over the past two years. The divestitures and shutdowns have slashed some $350-million from Litton's annual sales volume. O'Green says that several more subsidiaries could be dumped.

Though synergism is a discredited word among conglomerates, O'Green now seems, ironically, to be putting the concept into practice. He has launched a program, for example, of cross-fertilizing Litton divisions by transferring experts among them on temporary assignment to help solve sticky problems. That program has been effective in Litton's effort to enter the hotly competitive retail "point-of-sale" equipment business through its Sweda cash register unit. When Sweda engineers ran into reliability and cost reduction problems, O'Green dispatched a team of specialists from the electronics side of Litton, where such problems are faced routinely.

In other case, a unit of the Industrial Systems & Equipment Group was having difficulty designing an inexpensive gyroscope for light planes. O'Green sent in military gyroscope experts from another division of the group. Says Arnold R. Kaufman, senior group vice-president: "We used to spend thousands of dollars going outside for help. These guys solved our design problems in seconds."

O'Green's own engineering background makes him an effective trouble-shooter. When visiting Litton's Western Geophysical Div. in Houston recently, he showed engineers there how advanced circuit boards and wire-harnessing techniques developed by a Litton military equipment unit could improve a new digital data recording device for oil exploration. "In five minutes, Fred understands a product," says Kaufman.

Another way O'Green keeps tabs on problems is through a monthly meeting with the heads of seven operating groups and subgroups. Astonishingly in a company ostensibly built on synergism, Ash met with operating heads only individually and on an infrequent, ad hoc basis. "We met about twice a year, and it was never in great depth because he couldn't talk about R&D and technical things," says Mellor of Defense & Marine Systems.

Thornton and O'Green have divided duties to let O'Green concentrate on operations. Thornton now directs all staff functions—finance, legal affairs, and public relations. Previously, staff as well as operating executives reported to Ash.

FOUR CRUCIAL NEW PRODUCTS

In his one year as president, O'Green has devoted most of his time to trouble spots and new product lines. Aside from the shipyard, he has been working closely with the Business Systems & Equipment Group, the company's biggest and traditionally most profitable.

Four of Business Systems' product lines represent big gambles for Litton: electric typewriters, minicomputers, the new point-of-sale machines, and a new line of office copiers.

The move to a more efficient plant in England has apparently helped the Royal typewriter operation. Now called the Royal-Imperial Div., it is making money. "But we still have to improve profitability," says Ralph H. O'Brien, executive vice-president in charge of the group.

To do that, Litton will try to increase its market share through a frontal attack on IBM's near-90% hold on the office electric typewriter market. Some Litton executives attribute Royal's weakness to an inferior product, but Litton has some new machines up its sleeve. Next March, the company is expected to launch a new single-element typewriter, with a rotating, inter-changeable type ball, similar to IBM's Selectric but purportedly faster and with better print quality. In addition, Litton is test-marketing an automatic, computer-driven typewriter to compete with an IBM machine.

Litton faces a possible divestiture order on another typewriter subsidiary, Germany's Triumph-Adler, acquired in 1969. After ordering a divestiture last March, the Federal Trade Commission agreed to reconsider its decision. However, Litton does not expect a ruling before next summer. If Litton should lose the decision, it could sell the prosperous Triumph-Adler operation at a healthy profit, industry observers believe. In that event, Litton would also try to sell Royal, which depends on Triumph-Adler for R&D and part of its product line.

Point-of-sale equipment also has been an expensive venture for Litton, and it will continue to soak up cash for development, manufacturing startup, and sales training during the current fiscal year, says O'Brien. Management is convinced that its Sweda unit should be in the business and can prosper in it. "There are going to be five or six major manufacturers," O'Brien says. "Nobody will dominate as National Cash Register did in conventional cash registers."

The office copier business is another big risk, given Xerox's dominant position and the recent entry of IBM. But O'Green says the copiers are already producing profits. O'Green and O'Brien are mapping new strategy in this sector and promise some important new products before long. "We are going to be successful," O'Green vows.

Minicomputers, which had been losing money, are now profitable "and will continue to grow in profitability," O'Green predicts. And Litton's Monroe calculator operation, though late in marketing an electronic machine, has expanded production rapidly and is now one of the world's largest manufacturers of the new machines.

But of all Litton products, the one closest to management's heart these days is the microwave oven. An outgrowth of Litton's original microwave-tube business, the fast-cooking ovens have conquered much of the commercial food-preparation market and now seem poised for takeoff in the consumer field. Litton claims to be the market leader, with 30% of sales. The company forecasts a total U.S. oven market next year of 500,000 units, up from 30,000 in 1972. In anticipation, Litton is considering building a new plant in Minnesota to make all the critical parts for home ranges, putting the company squarely in the consumer appliance business. At present, Litton assembles ovens from parts produced outside.

O'Green, characteristically, has been personally poring over designs for the proposed oven plant with Executive Vice-President Joseph S. Imirie, who oversees the oven operation. Recounts Imirie: "O'Green asked me who looked at the plans. I told him we hired outside consultants. He said, 'That's fine, but I won't approve them until you also go over them with plant layout specialists from our unit handling systems division.' " The decision is now awaiting the verdict of the Litton experts.

PROSPECTS FOR PROFITS

O'Green's and Thornton's primary goal these days is building profits. The biggest threat to their success would be big write-offs on the naval LHA ship contracts and unfavorable decisions on the other claims. But while Litton's earnings might suffer under those circumstances, the company's bankers say Litton would pull through without great strain. "There is no chance whatever that Litton would need a government-guaranteed loan like the one Lockheed got," says a leading Litton banker. He notes that the company has reduced its long-term debt, it generates "tremendous depreciation," and it has unused revolving bank credits of $95-million, plus sizable overseas credit lines.

But big write-offs would make unattractive reading, of course, and this is a big reason why Wall Street continues to hold Litton at arm's length. The company's stock is currently locked in the $6 to $8 range, with a price/earnings ratio of seven. In 1967, Litton stock sold as high as $109.

Restraints on energy usage, too, could hurt the company. Its office furniture plant in York, Pa., and its machine tool factories in New England would be hurt if the looming Northeastern fuel tightness turns severe. A luxury item, the microwave ovens would suffer in any recession that the shortage might cause. On the other hand, increased oil exploration should help Litton's Western Geophysical Div. "We think we're no more vulnerable than other companies," says Glen McDaniel, chairman of the Litton's executive committee. A recession would help shipbuilding, he says, by freeing qualified labor from construction projects to build ships.

But there remains considerable skepticism about Litton's future as a growth leader, a cross that all conglomerates bear today. Says a former Litton executive who now heads another conglomerate: "Litton can go on to be a good industrial company, but its days of leadership in anything are over."

Thornton and O'Green say they are going to prove such skeptics wrong. Though they concede that as a large company, Litton cannot grow as it did in its heady early days, they believe they can make Litton a profit leader once again. "If anybody can do it," says William E. McKenna, a former Litton officer who is now chairman of Technicolor, Inc., "Fred O'Green can." Adds Fred O'Green: "I foresee Litton being an exciting place."

ITEM 27.—*Dec.* 21, 1973—*Letter from Senator Proxmire to Touche Ross & Co. questioning reliability of Litton's financial statement as audited and qualified by Touche Ross & Co.*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., December 21, 1973.

TOUCHE ROSS & CO.,
Los Angeles, Calif.

DEAR SIRS: In the course of my work on the Joint Economic Committee and the Senate Appropriations Committee, I have become increasingly aware of the tremendous impact annual financial reports to corporate stockholders play

throughout our economy. In addition to the obvious impact these reports have on stock prices, the results are used in determining the financial capability of firms to accept government or commercial contracts. Government agencies use financial reports to assist them in deciding on the profitability of companies or industries for purposes of evaluating the need for subsidies, changing profit policies, and many other aspects of government and public business operations.

Great reliance must be placed on the fact that these figures have been audited and certified by independent certified public accounting firms such as your own because the public is generally unable to confirm the figures contained in these reports.

I would like to understand better what independent checks are made an figures reported by corporate management and whether the public is justified in relying on CPA certifications to confirm the accuracy of information contained in annual reports to stockholders. In this regard, I have compiled a list of specific questions that come to mind in reviewing the 1973 financial report published by Litton Industries. I am somewhat familiar with the shipbuilding activities of this firm, as a result of my continuing investigations into major defense procurement programs. I want to reconcile some of the information contained in the Litton report with some of the problems I know the company is encountering in its defense business.

Your certification of Litton's financial statement was qualified because of "unsettled matters related to the LHA Program and recovery of recorded contract claims described in Financial Comments—Marine Contracts." As I understand the situation, these unsettled issues could be the key to determining the profitability of the Litton Corporotion and its financial position. Therefore, it is important to understand precisely what you did and did not cheik in this area and other matters relating to the conduct of this audit. Specifically:

(*a*) Why were you unable to reach an unqualified opinion as to whether or not Litton's estimates of total contract revenues on Navy contracts were fairly presented?

(*b*) If you were conducting an audit of Litton's Pascagoula Shipyard as an independent entity, would you still have been willing to issue a qualified opinion rather than a disclaimer o fopinion in view of the impact the "unsettled matters" would have on the financial position of the shipyard?

(*c*) Did you attempt to make any independent evaluation of the claims or the likelihood that they would be honored by the Navy?

(d) Did you contact the Navy or outside independent technical or legal experts to evaluate the likelihood of recovery of the claims?

(*e*) If the figures reported by Litton in this regard were accepted by you at face value, without independent check, why was this not identified more clearly in your certification? Does your certification carry an obligation to the public either to independently confirm the reasonableness of these estimates of claims or to indicate how the reported profit figures could fluctuate in the event these claims are not honored?

(*f*) The Financial Notes to the Litton report state "Revenues and profits on long term contracts are recognized under the percentage of competition method of accounting . . . an estimate of profitability depends not only upon the forecast of additional costs to be incurred but also upon an estimate of total revenues which will result from future negotiations and possible claims." How did you independently confirm the validity of Litton's estimates of physical completion? Were outside experts consulted? I know that Litton is required to submit estimates of physical completion on Navy shipbuilding contracts to substantiate progress payments. Did you attempt to reconcile the estimates of completion used for progress payment purposes with those used in preparing their financial reports? What auditing test did you perform to determine that Litton's estimates of total contract costs and total contract revenues on Navy shipbuilding contracts were valid?

(*g*) The Financial Comments—Marine Contract to the Annual Report state that approximately $128 million of nonrecurring manufacturing process development costs have been incurred, but that only $31 million have been charged to cost of sales, with the remaining $97 million included in inventory. I am not familiar with the term "nonrecurring manufacturing process development costs." Isn't it correct that by deferring a large part of the $128 million allegedly incurred for this purpose Litton is able to report profits $97 million higher than if these costs were fully recognized in 1973? A concern, of course, is that Litton

might be trying to amortize, under a more palatable title, losses incurred on prior contracts. From the professional accounting standpoint, what specific criteria must be met for a cost to qualify as "nonrecurring manufacturing process development costs"? What criteria establishes the time period over which these costs can be amortized? Were these costs accounted for separately so that you could confirm that $128 million was actually spent specifically for this purpose and not just a management estimate or "plug" figure to increase the reported profit figures?

The Financial Comments to the Annual Report state that Litton has filed 3 claims with the ASBCA which total approximately $170 million. Yet the comments go on to state that only $56 million of costs related to these matters have been recorded in receivables and inventories as of July 31, 1973, with an additional $5 million to be incurred to complete these contracts. From the accounting standpoint does this mean that Litton has filed claims for $170 million while expecting to recover $61 million from these claims? You are aware, I am sure that the Navy has evaluated these claims and concluded they are worth less than $10 million. On what did you base your judgment that the company can reasonably expect to recover $56 million on the claims?

(*h*) Note 11 to the Litton Consolidated Financial Statements states that process billings on current contracts exceeds recorded sales by $288 million. Since Litton records sales and the Navy pays progress payments based on percentage of completion, how can there be a disparity between these two figures? Considering retainage on incompleted contracts and the fact that progress payments generally are not made on claims, I would expect progress payments to be less than sales. Does the Litton report mean then that the Navy or other customers are agreeing to higher estimates of physical completion for progress payment purposes than the Company uses for financial reporting? How were you able to reconcile these disparities?

(*i*) Note H to the Financial Statement states that included in Government accounts receivable are amounts presently not billable of approximately $81 million. Does this $81 million figure include the $56 million in claims recorded in receivables? If so, did you attempt to verify the validity of these claims and the remainder of the $81 million? If not, why not? If so, what specific checks were made?

I am not asking you to breach any professional code of ethics about public accounting firms releasing corporate business data to third parties. Therefore, in responding to these questions, it is satisfactory if you identify what you have checked, how you have gone about to confirm certain figures, and what is the rationale for certain accounting treatments without disclosing your client's confidential business information. However, I need *specific* answers to each of the above questions; general language about "appropriate checks" and "generally accepted accounting principles" will not be responsive. My purpose in asking these questions is to find out specifically how you actually go about auditing this large firm, to what extent you verify figures that profoundly influence the financial results reported, and what reliance can be placed on information contained in corporate financial reports that have been audited and certified by public accounting firms. As you know, I have raised questions with the Securities and Exchange Commission about the adequacy of certifications to annual financial reports made by independent CPAs, particularly with regard to firms with large long-term government contracts. Please feel free to add any amplifying comments in this regard.

I would appreciate an early response to this letter. However, to insure you have time to make a complete reply it will be satisfactory if I receive your response by 30 January 1974.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 28.—*January 10, 1974—Senator Proxmire letter to Secretary of the Navy Warner expressing concern that the Navy has spent about a year investigating charges of possible fraud in connection with the Litton Shipbuilding claim and that the results of the investigation "have been lying on your desk since September." The Senator asks for a decision on referral of the matter to the Justice Department for further investigation*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., January 10, 1974.

Hon. JOHN W. WARNER,
Secretary of the Navy,
Washington, D.C.

DEAR MR. SECRETARY: In November I was assured by spokesmen for the Navy that action would be taken by your office within two weeks on alleged fraud in the submission of a shipbuilding claim by Litton Industries. The Navy has had more than enough time to make up its mind about what to do with this case and I cannot understand why action has still not been taken.

Because of the seriousness of the charges that have been made against Litton, and the facts that have been brought to my attention, I can only conclude that the Navy is dragging its feet on this matter perhaps in the hope that the difficult decision that is called for will not have to be made. I want to remind you that the Navy's Office of General Counsel undertook a study of the alleged fraud more than a year and a half ago and that the study was concluded and a report forwarded to your office in September 1973.

Equally disturbing is the fact that Navy spokesmen stated in a public hearing before a congressional committee on November 16, 1973 that action would soon be taken on this case. On that day, Assistant Secretary Jack L. Bowers, Admiral R. L. Baughan, Jr., Admiral K. L. Woodfin, Rear Admiral S. J. Evans, Captain W. J. Ryan, and the Navy's General Counsel, Mr. E. G. Lewis, testified before the Subcommitttee on Priorities and Economy in Government. When I inquired into the results of the Navy's investigation of the alleged fraud, Mr. Lewis stated that the findings were being discussed with the Secretary of the Navy who would have to make the final policy decision. I asked when the Navy would take action on the matter. Mr. Lewis replied, "I would say within the next couple of weeks." This answer was allowed to stand in the corrected transcript.

My staff has made repeated inquiries to find out what the Navy has done. On December 11, 1973 we were told that a decision by the Secretary of the Navy was "imminent." I have not yet been able to learn when the Navy can reasonably be expected to act.

This long delay and foot dragging is inexcusable. In addition, I think the good faith of the Navy is called into question when promises are made to a committee of Congress in a public hearing and subsequently broken.

It is not asking too much for the Navy to move off dead center in this case. The charges that were made were serious. The Navy spent about a year investigating the charges and the results of that investigation have been lying on your desk since September. All the fact finding that the Navy can do has been done. What is awaited is your decision to refer or to not refer the matter to the Justice Department for further investigation.

Additional delays can only lead to suspicions about the motivations for sitting on the case. Once again, I urge you to act.

Sincerely yours,

WILLIAM PROXMIRE,
Vice Chairman.

ITEM 29.—*Jan. 11, 1974—Memorandum for the Deputy Secretary of Defense from the Acting General Counsel—Subj: Possible Violation of Federal Criminal Statutes Arising Out of a Claim Asserted Against the Department of the Navy by Litton Industries. Recommends Deputy Secretary of Defense sign reply to SECNAV approving referral of Litton claim to the Justice Department. Attached are: 1. Secretary of the Navy letter to the Secretary of Defense dated Jan. 10, 1974 with attached Navy General Counsel letter to the Justice Department dated Jan. 9, 1972. 2. Reply to the Secretary of the Navy dated Jan. 14, 1974. 3. Summary report of inquiry*

[Memorandum for the Deputy Secretary of Defense]

GENERAL COUNSEL OF THE DEPARTMENT OF DEFENSE,
Washington, D.C., January 11, 1974.

Subject: Possible Violation of Federal Criminal Statutes Arising Out of a claim Asserted Against the Department of the Navy by Litton Industries—Action Memorandum.

The Secretary of the Navy by memorandum to the Secretary of Defense (Tab A) dated 10 January 1974 referred to the Navy's investigation of the facts and circumstances arising out of the submission of a claim by the Ingalls Nuclear Shipbuilding Division, Litton Systems, Inc., for additional compensation for constructing three nuclear-powered submarines. The Secretary in his memorandum states to the Secretary of Defense that in his opinion the result of the investigation establishes a requirement for the Navy to submit its findings, together with evidence, to the Department of Justice for further investigation to establish the presence or absence of fraud.

With his memorandum the Secretary of the Navy enclosed "the document for the transmission of this case to the Department of Justice." We understand the document has not been transmitted as yet. Apparently the Navy is awaiting some word from OSD.

Attached as Tab B for your signature is a proposed reply to the Secretary of the Navy which requests that he transmit the submission to the Department of Justice forthwith. Alternatively, the message to the Navy could be communicated orally. A need for quick action is indicated by the attached news article (Tab C).

While time has not permitted this office to study the 251-page report and the carton of exhibits referred to the proposed submission to the Department of Justice as attached to the Secretary of Navy's memorandum (already signed by the Navy General Counsel and dated January 9, 1974), the report in its summary of conclusions and recommendations (Tab D) states in part on page 9:

"On the basis of the information obtained from all sources, and as more particularly amplified below, there are reasonable grounds for believing that the claim represents a willful attempt by Ingalls to take unfair advantage of the Government, including the making of false statements, submission of false claims, deceit by suppression of the truth by the withholding of information and by misrepresentation of material fact.

"The history of the procurement and the record of dealings between Ingalls and the Government raise very serious questions concerning the bona fides of the Contractor's representations and allegations as set forth in the claim, and the manner of the assembly, presentation, and proof of the claim."

Later commencing on the bottom of page 10 the report states:

"With regard to the matter of progress payments, the facts are incontestable that Ingalls submitted to the Government false information concerning the status of completion of the vessel, both in the material and labor categories, and that Ingalls certified to false information on invoices submitted to the Government for payment. The record establishes (i) that the information submitted was known by Ingalls to be false at the time of submission, (ii) that the submission of false information was made with the intention of inducing the Government to make payments of money to Ingalls in amounts greater than the amounts that properly would have been payable to Ingalls in accordance with the correct information, and (iii) that such greater amounts in fact were paid by the Government to Ingalls, in reliance upon the false information submitted."

I recommend your signature.

L. NIEDERLEHNER,
Acting General Counsel.

Attachments.

THE SECRETARY OF THE NAVY,
Washington, D.C., January 10, 1974.

[Memorandum for the Secretary of Defense]

Subject: Possible violation of Federal criminal statutes arising out of claim asserted against the Department of the Navy by Litton Industries.

The Nuclear Power Directorate of the Naval Ship Systems Command (headed by Admiral Rickover) forwarded through the chain of the Naval Material Command a request that the Department of Justice review the facts and circumstances arising out of an assertion of a claim by the Ingalls Nuclear Shipbuilding Division, Litton Systems, Inc. for added compensation for constructing three nuclear-powered submarines.

Under my direction, the General Counsel of the Department of the Navy and the Chief of Naval Material made a review of the files of the Department of the Navy and, to the extent of our investigatory ability, such outside documentation as was obtainable. This Navy preliminary review has established a requirement, in my judgment, for the Department of the Navy to refer our findings, together with the evidence in our possession, to the Department of Justice, the appropriate agency, to make such further investigation as deemed necessary to establish the presence or absence of allegations of fraud.

The General Counsel of the Department of the Navy has consulted with the General Counsel of the Department of Defense and I am enclosing the document for the transmission of this case to the Department of Justice.

JOHN W. WARNER.

DEPARTMENT OF THE NAVY,
OFFICE OF THE GENERAL COUNSEL,
Washington, D.C., January 9, 1974.

Re: Litton Systems, Inc., claims against the Navy under Contract N00024-68-C-0342.

Hon. HENRY E. PETERSEN,
Assistant Attorney General, Criminal Division,
Department of Justice. Attention: Chief, Fraud Section,
Washington, D.C.

DEAR MR. PETERSEN: Forwarded herewith is a copy of a Memorandum for the Chief of Naval Material dated 28 September 1973, signed by Rear Admiral Gooding, Commander, Naval Ship Systems Command, together with a 251-page report (in loose leaf binder), and a carton of exhibits contained in 15 individual folders. Introductory pages 1-9 explain the nature of the report and afford a summary of conclusions and recommendations, thereafter proceeding to the substance of the matter. An index of these exhibits appears at page 242-251.

Last summer, a contracting officer's decision was issued on the claim as then asserted, and provided for an increase in compensation approximating four million dollars ($4,000,000). The Ingalls Nuclear Shipbuilding Division of Litton has appealed that decision to the Armed Services Board of Contract Appeals (ASBCA No. 17717), and the appeal is now being heard.

Under the direction of the Secretary of the Navy, I and the Chief of Naval Material made a review of the files of the Department of the Navy and to the extent of our investigatory ability, such outside documentation as was obtainable. This Navy preliminary review has established a requirement, in our judgment, for the Department of the Navy to refer our findings, together with the evidence in our possession, to the Department of Justice, to make such further investigation as deemed necessary to establish the presence or absence of allegations of fraud.

Sincerely,

E. GREY LEWIS,
General Counsel.

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C. January 14, 1974.

[Memorandum for the Secretary of the Navy]

Subject: Possible Violation of Federal Criminal Statutes Arising Out of Claim Asserted Against the Department of the Navy by Litton Industries.

Reference is made to your memorandum of 10 January 1974 on the above subject. You should proceed with the submission of the matter to the Department of Justice immediately.

W. P. CLEMENTS JR.

SUMMARY OF REPORT OF INQUIRY

A. INTRODUCTION

I. STATEMENT OF REPORT

This is the report of the inquiry conducted pursuant to the request of the Chief of Naval Material as specified in Action Sheet No. 201–72, dated August 4, 1972, as modified August 28, 1972 and October 30, 1972.

II. ASSIGNMENT AND AUTHORITIES

The Chief of Naval Material (CNM), by Action Sheet 201–72 dated August 4, 1972 (Ex. 1), requested the Commander, Naval Ship Systems Command (COMNAVSHIPS) to convene a formal board to investigate the claim against the Navy by Ingalls Nuclear Shipbuilding Division, Litton Systems, Incorporated (hereinafter sometimes referred to as the "Contractor", "Ingalls" or "Litton") under Contract N00024–68–C–0342 for construction of SSNs 680, 682, and 683, and to determine whether Litton's actions in connection with that claim constitute a violation of the False Claims Act or of other federal statutes. The major part of the claim had been denied by the Government, and an appeal therefrom was docketed with the Armed Services Board of Contract Appeals (ASBCA). The requested investigation had been recommended by VADM Rickover in a memorandum to the CNM dated 19 July 1972 (Ex. 2). The claim of approximately $37 million was characterized in the memorandum as "grossly inflated" and that "many elements * * * appear contrived and are irreconcilable with facts contained in the company's own files".

Subsequently, the CNM concurred in a recommendation of the General Counsel of the Navy, in a memorandum dated August 28, 1972 (Ex. 3), that in lieu of an investigation by a formal board, NAVSHIPS submit a report to the CNM within the framework of the reporting procedures set forth in SECNAVINST 4385.1A, documenting NAVSHIPS basis for believing a fraud had occurred in connection with the submission of the Ingalls claim. Pursuant to that recommendation, COMNAVSHIPS, by memorandum dated 8 September 1972 (Ex. 4), designated the undersigned (Harold Kaufman, Office of Counsel, NAVSHIPS) to conduct an inquiry into the subject claim and to prepare a documented report on the question whether a fraud may have occurred in connection therewith. Captain Robert R. Fargo, (then SHIPS 05B, now Commander, Philadelphia Naval Shipyard) and subsequently Mr. Richard Everett, (a NAVSHIPS Contracting Officer and presently Claims Manager at Pascagoula, Mississippi), were designated to assist and consult with the undersigned in the inquiry. On October 24, 1972, the assignment was expanded to include review of progress payment submissions by Ingalls under the contract which resulted in over payments by the Government, to determine whether apparent false certifications of progress by Ingalls violated federal statutes (Ex. 5 & 6).

SECNAVINST 4385.1B, dated 20 April 1973, "Subject: Reports and Coordination of action involving allegations of fraud in the procurement and disposal of Government property; responsibility for" superseded SECNAVINST 4385.1A dated 27 June 1962. The Instruction establishes policy guidance, assigns responsibilities and specifies procedures for handling of complaints concerning, among others, allegations of fraud in connection with the procurement and acquisition of property.

The Instruction requires any naval person (including civilian employees of the Department of the Navy) having reason to suspect fraud in connection with procurement of Government property to report the matter immediately to an appropriate Navy Department Superior. The Instruction also provides that the General Counsel of the Navy is to advise the Chief of Naval Material with respect to the legal facets of fraud matters when associated with procurement cases, and refer appropriate matters for prosecution to the Department of Justice.

"Acquisition" encompasses procurement and is defined in the Instruction as including "the awarding and administration of Government contracts". "Fraud" is defined as:

"Any willful means of taking or attempting to take unfair advantage of the Government including, but not limited to, * * * making of false statements, submission of false claims, * * * deceit either by suppression of the truth or misrepresentation of a material fact; * * * falsification of records and books of account * * * and conspiracy to use any of these devices."

Article 1140, U.S. Navy Regulations, 1973 requires any person in the Department of the Navy who has knowledge of any fraud, collusion, or improper conduct on the part of a contractor in matters connected with the Department of the Navy to report the same immediately in writing to the proper authority, specifying the particular act or acts of misconduct, fraud, neglect or collusion and describing any evidence which may assist in proving the same.

In accordance with the SECNAV Instruction, the documented report to be submitted principally was to determine and establish the facts, and to indicate whether or not those facts reasonably reflected Ingalls "willful means of taking or attempting to take unfair advantage of the Government". The report was not intended to be or to include a legal analysis of the applicability of specific federal statutes regarding frauds or attempted frauds on the Government.

III. SUMMARY OF STATUS OF CLAIMS

The claim in question is a request by Ingalls that Contract N0024–68–C–0342 be equitably adjusted by extending ship delivery dates 17½ months, and by increasing the compensation $37 million (approximately) because of alleged Government-responsible delay in delivery of Government-furnished hull steel. After almost 18 months of analysis, evaluation, and negotiation of the claim, a Contracting Officer's final decision was issued on July 31, 1972, which determined that on the basis of the supporting evidence provided by the Contractor the equitable adjustment to which the Contractor was entitled was an extension of ship delivery dates by 11½ months, and an increase in contract compensation of approximately $4 million. The decision also determined that Ingalls was responsible for the additional 6 months delay claimed by the company and, subject to the application of contract incentive arrangements, would have to bear the responsibility for any increased costs of performance. On August 16, 1972, NAVSHIPS was notified that Ingalls had appealed to the Armed Services Board of Contract Appeals (ASBCA) from the decision of the Contracting Officer. The appeal was docketed with the ASBCA on 24 August 1972 and was assigned No. 17717. The matter presently is scheduled for hearing by the ASBCA on October 16, 1973.

IV. SCOPE AND CONDUCT OF THE INQUIRY

Pursuant to the cited authorities, a request for information and reports was addressed to all the Government personnel who had participated in the evaluation of the claim leading to the Contracting Officer's decision of July 31, 1972, and to persons who had been identified as possibly having knowledge of the events relating to the contract. By memorandum dated September 25, 1972 (Ex. 7), 24 named individuals were requested to provide written statements whether or not they had reason to believe that any specific statement or representation, made in the claim at any stage of its development, (i) represented an attempt to take unfair advantage of the Government, (ii) was factually incorrect, (iii) was deceitful either by reason of the suppression of the truth or by misrepresentation of material fact, or (iv) was based upon falsification of records. Each affirmative statement or representation was to be

supported by documentary proof of its alleged character. Replies were requested not later than October 25, 1972. There were 22 responses to this solicitation and two additional reports were voluntarily submitted by non-solicited individuals. With 4 exceptions, all replies were received substantially later than requested, the last reply being received in March, 1973. (Exhibit 8 lists the addressess of the memorandum (Ex. 7) and identifies the respective responses by Exhibit number. Exhibits 9 to 26 inclusive are the responses.)

At an early stage it had been determined that the scope of the inquiry would include an independent review of the entire claim, not only evaluation of the validity of previously identified instances of alleged gross misrepresentation. In furtherance of that objective, the individual members of the inquiry group have separately reviewed the pre-contract-award events and relationship of the parties, as well as specific events occurring during the time span covered by the claim and the particular representations and allegations of the claim. Contract negotiation and administrative files available at NAVSHIPS Headquarters and at SUPSHIP, Pascagoula were reviewed, as well as the Contractor's claim and its supporting documentation, and the Contracting Officer's decision on the claim and its supporting documentation. Supplementing the documentary review, personal interviews were conducted in Washington, D.C. and in Pascagoula, Mississippi with 22 present and former Government personnel who had been connected in some way with the contract and its performance, some of whom had not been previously contacted. One additional written report was received.

Contractor records, except those submitted to the Government in support of the claim and in response to interrogatories, were not available to and were not actively sought by the inquiry group, and Contractor personnel were not contacted or interviewed. The sole exception to the foregoing is the series of discussions with Mr. Lloyd Bergeson, formerly Executive Vice President of Ingalls Shipbuilding Company. Mr. Bergeson was the executive responsible for Shipyard operations and for the preparation of the Ingalls original proposal in March 1968 in response to the RFP. He also was responsible for the initial Ingalls proposal for an equitable adjustment in August 1968 and for Ingalls performance during the first year of the contract. On March 15, 1973, Mr. Bergeson voluntarily met in Washington with 2 members of the inquiry group (Mr. Kaufman and Capt. Fargo) and discussed with them his best recollection of events. This personal interview subsequently was supplemented by 3 telephone interviews with Mr. Bergeson at his home in Massachusetts (Ex. 29–31). The inquiry also has included review of the documents submitted by Ingalls in response to Government interrogatories in connection with the pending litigation of the claim before the Armed Services Board of Contract Appeals, some of which were not available until the end of June, 1973. In addition, each of the three members of the inquiry group having had individual exposure to and experience with some aspect of contract performance, including evaluation of claim, drew upon this knowledge in compiling this report.

B. Summary of Conclusions and Recommendations

On the basis of the information obtained from all sources, and as more particularly amplified below, there are reasonable grounds for believing that the claim represents a willful attempt by Ingalls to take unfair advantage of the Government, including the making of false statements, submission of false claims, deceit by suppression of the truth by the withholding of information and by misrepresentation of material fact.

The history of the procurement and the record of dealings between Ingalls and the Government raise very serious questions concerning the bona fides of the Contractor's representations and allegations as set forth in the claim, and the manner of the assembly, presentation, and proof of the claim.

The claim itself is masterfully contrived; it is a superb example of craftsmanship in drafting, regrettably in the service of an unworthy cause. There is scarcely a single sentence, standing alone, which can be characterized as literally false; withal, there is hardly a single page, paragraph, or sequence of sentences that reflects a full, complete and accurate account of the actions, events or planning involved. The pervading characteristics of the claim presentation are obscurantism and misleading implication, achieved through nondisclosure of significant information, absence of precise dating and time-phasing,

and out of sequence references. These failings have special impact in the unique situation presented in this claim. The Government always has acknowledged its obligation equitably to adjust the contract for an 11½ month delay in delivery. Where, as it appears here, the Government's obligation further to adjust the contract may depend in large part on the reasonableness and justifiability of Contractor's alleged planning and on the sequence of events and their relationships, the failure to provide full and accurate information creates a condition of non-credibility. Compounding the incredibility is the fact that during the claim evaluation period, Ingalls repeatedly disclaimed or implied lack of knowledge of information which, in fact, is reflected in overflowing measure in Ingalls in-house documents first made available only during the past 4 months, and only responding to ASBCA interrogatory requests. The Company records made available to the Government in response to interrogatories in the ASBCA proceeding also identify more than 20 different Ingalls' employees as having participated in Company planning and thus having some specific knowledge of particular events in the period May, 1968 (before contract award) to September, 1968 (after submission of the first request for an equitable adjustment). None of these individuals participated in the face-to-face discussions with Government personnel during the claim evaluation period. Their personal knowledge of events was not made available to clarify the issues.

With regard to the matter of progress payments, the facts are incontestable that Ingalls submitted to the Government false information concerning the status of completion of the vessel, both in the material and labor categories, and that Ingalls certified to false information on invoices submitted to the Government for payment. The record establishes (i) that the information submitted was known by Ingalls to be false at the time of submission, (ii) that the submission of false information was made with the intention of inducing the Government to make payments of money to Ingalls in amounts greater than the amounts that properly would have been payable to Ingalls in accordance with the correct information, and (iii) that such greater amounts in fact were paid by the Government to Ingalls, in reliance upon the false information submitted.

In recognition of the limitation of the inquiry with regard to access to Ingalls' personnel and records, and in some instances the inaccessibility of Navy records and of some current and former members of the Naval Establishment, it is recommended that the matter be more thoroughly further investigated by an authority competent (i) to obtain full and free access to all Ingalls' records, and (ii) to require the statements of both contractor and Government personnel who participated in or are knowledgeable concerning events prior to and contemporaneous with execution of the subject contract, and concerning contract performance and administration from the date of contract execution to the present.

ITEM 30.—*Jan. 15, 1974—Washington Post article—"Litton Case Referred to Justice by Navy"*

The Navy yesterday referred to the Justice Department a review of a controversial claim by Litton Industries for $37 million in cost overruns on three nuclear submarines.

The review—made by the Navy's general counsel at the direction of Navy Secretary John W. Warner—"established a requirement" for further investigation of "allegations of fraud."

Adm. Hyman G. Rickover, in a 1972 memo disclosed by The Washington Post a year ago, said that Litton's Ingalls Shipbuilding Division had engaged in "misrepresentation, if not fraud," in seeking the $37 million. He said the government owed no more than $4 million to $7 million.

But Litton has carried its claim to the Armed Services Board of Contract Appeals. The company has blamed the Navy for the cost overrun, saying the Navy delivered defective material and delivered it late. Litton also has accused the Navy of withholding the information underlying Rickover's accusations.

The case has been regarded as sensitive because Roy L. Ash, director of the Office of Management and Budget, was president of Litton when the cost overrun claim was made. Ash has said he would not remove himself from dealing at OMB with matters affecting the Navy.

Item 31.—Mar. 1, 1974—Letter to Senator Proxmire From Touche, Ross & Company Responding to the Senator's December 21, 1973 Letter

Senator WILLIAM PROXMIRE,
U.S. Senate,
Washington, D.C.

DEAR SIR: Our delay in answering your letter of December 21, 1973 is due to the unprecedented nature of your inquiry. We will attempt to respond insofar as it is within our ability to do so and to the extent we are permitted by the constraints of our professional responsibilities to our client.

It is true, as you say, that annual financial reports to corporate stockholders have a tremendous impact throughout our economy, are important to both investors and government, and that great reliance is placed on the fact that these figures have been audited and certified by independent public accounting firms. Thus, we appreciate your wish to understand better "what independent checks are made" and "whether the public is justified in relying."

It would appear that the event which suggested your letter was our issuance of a qualified opinion, and we wish to comment on that point.

The objective of the usual examination of financial statements by the independent auditors is the expression of an opinion of the fairness with which the company presents financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles. The auditor's report (opinion) is the medium through which he expresses his opinion, or, if circumstances require, disclaims an opinion.

As stated in the Statement on Auditing Standards adopted by the American Institute of Certified Public Accountants in 1972, the auditor's report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefor should be stated. The objective of this reporting standard is to prevent misinterpretation of the degree of responsibility the independent auditor is assuming whenever his name is associated with financial statements. Further, the statement on auditing standards indicates that in cases where the probable effects of a matter being reported upon are not reasonably determinable at the time of the opinion, such as in the case of certain law suits and other contingencies which may have a material effect upon the financial statements, and the final outcome is dependent upon the decision of parties other than management, the independent auditor should qualify his opinion and may use the phrase "subject to" as a means of expressing that qualification.

The Company's 1973 annual report says with respect to marine contracts, "Major contracts for complex marine weapons systems are performed over extended periods of time and are subject to changes in specifications and changes in delivery schedules. Pricing negotiations on changes and settlement of claims often extend over prolonged periods of time. As a result, at any given time in performance of such a contract an estimate of its profitability depends not only upon the forecast of additional costs to be incurred but also upon an estimate of total revenues which will result from future negotiations and possible claims. The accompanying financial statements have been prepared on the basis of management's current estimates of final contract revenues and costs."

The note later states, "on February 28, 1973, the Navy made a unilateral decision to pay a total of approximately $946 million for the construction of five LHA ships which is substantially less than the amount required to cover contract costs. It is the Company's position that reimbursement for work and schedule delays which were caused by Navy actions . . . will more than compensate for this difference . . . The ultimate profitability of this program is dependent upon performing to current cost estimates and an equitable resolution by negotiation or litigation." Litton and the Navy are presently in negotiation with respect to this matter and are also in litigation.

As to the Navy claims, the note says, "The Company has a number of other shipbuilding related claims against the U.S. Navy filed with the Armed Services Board of Contract Appeals . . . At July 31, 1973 $56 million of costs relating to such matters has been recorded in receivables and inventories. An additional $5 million is to be incurred to complete these contracts and will be included in work-in-process as costs are incurred."

As you stated in your letter, the Navy's offer in settling these marine claims was less than $10 million. As you are aware, these claims are in negotiation and are also presently being litigated with the Armed Services Board of Contract Appeals, and that body will make a determination of an amount to be awarded Litton and, of course, still further litigation may then ensue.

This situation as respects claims is not unique to Litton in that we note that testimony before the House Armed Services Committee indicated that a number of shipbuilders had claims which could not be resolved with the Navy aggregating in excess of $1 billion, excluding the LHA claim.

Inasmuch as the amount of claims as recognized in the Company's financial statements and the amount of LHA revenues and additional costs to be incurred are the subject of litigation and negotiation, the final outcome of which is partially dependent on the decision of parties other than management, we concluded that reporting standards required comment thereon in our opinion, but were not sufficiently material to cause us to deny our opinion.

You raise the question as to the nature of our opinion had Litton's Pascagoula yard been an independent entity. This question, of course, is hypothetical and cannot be answered under present circumstances without a considerable number of assumptions that would not appear appropriate for us to speculate on. The shipyard, as it exists, is not a facility which must look only to its own operations, its own credit, or its own management. It does, in fact, call upon the total resources and credit of Litton Industries.

In our examination of the marine claims and contracts in process of the Ingalls Shipbuilding Division, our audit tests of recent years are numerous, and we did not accept the marine amounts at face value or rely solely on management.

Broadly speaking, our tests included: tested costs incurred for various programs; reviewed documentation relating to the contracts and change orders; read transcripts of the House Armed Services Committee hearings and other published data relative to Litton ship operations and claims; tested the recording of revenues and profits on long-term contracts; reviewed comparisons of incurred costs and hours (which had been subjected to tests to determine that documentation supported such data) and discussed these with manufacturing management personnel for the purpose of evaluating the overall reasonableness of the Company's performance in relation to current plan and total costs; reviewed opinions of Litton's outside counsel with respect to these contracts and claims; and held discussion with senior Navy Department personnel at the Pascagoula yard. (In the previous year we held similar discussions with Navy Department personnel in Washington, D.C.)

During our conversations with a senior naval officer involved in the programs, he observed that there were probably no experts available who could on a timely basis independently review and evaluate these programs. As you are aware, a significant number of technical and legal personnel of both the Navy and Litton are occupied full time on these programs.

Progress payments are based on a measurement system as defined by the contract which is weighted for all elements of cost, including material on which no labor has been expended. The Company uses a conservative basis for recording revenues and profits on long-term contracts by computing revenues on the basis of direct labor expended to date compared to total estimated direct labor at completion. This is a long, established and widely used method of percentage of completion accounting.

DCAA and Navy personnel are engaged in regular observations and tests of costs incurred, progress achieved, and progress billings submitted by Litton as well as being responsible for quality of the shipyard work and the accuracy of billing amounts. Our inquiries have repeatedly disclosed no instances in which the Company's billing procedures are not acceptable to the Navy. All progress billings are audited and approved by the Navy prior to submission to the disbursing office.

Litton designed and developed an integrated shipbuilding facility capable of providing for the use of modern marine design and engineering techniques, in series production techniques for surface vessels. These new techniques required a unique facility and the retraining of personnel in the new shipbuilding methods. Any new manufacturing facility, especially one calling for significantly different production techniques requires a learning period in which production techniques

are tested, tried, and altered as necessary to provide an efficient operation. Many of these tests are made during the actual production process. These nonrecurring manufacturing development costs are the costs necessary to place the new marine facility in an efficient operating condition. These costs were deferred and are being charged proportionately with all other costs as work is performed on presently existing shipbuilding contracts in the new yard.

It is a generally accepted accounting principle that start-up and learning costs are appropriately deferred and charged against the future business which will benefit therefrom. Obviously, had Litton elected to charge these nonrecurring manufacturing development costs to operations as incurred, their reporting profits to date would be different. However, an important and highly critical accounting objective is the appropriate matching of costs with expected benefits and the Company therefore deferred and is amortizing these costs over the new yard contracts which directly benefit from these efforts. These costs are directly identifiable costs incurred in the new yard.

Requests for information pertaining to contract details, current status of negotiations with the Navy, background of the Company reporting policies, and any explanation of its footnote disclosures should be directed to the Company.

Yours truly,

TOUCHE ROSS & CO.,
Certified Public Accountants.

ITEM 32.—*Sept. 18, 1974—Mobile Register article—"Navy-Litton Pact Blasted by Solon"*

(By Philip W. Smith)

WASHINGTON.—Sen. William Proxmire, D-Wis., charges in a speech prepared for delivery in the Senate Wednesday that the Navy "may be engaging in another corporate bailout" through an $18 million settlement with Litton Industries for shipbuilding claims from Litton's shipyard in Pascagoula, Miss.

"I have not yet concluded that the settlement is a bailout or that anything improper was done, but I am concerned," the vice-chairman of the Joint Economics Committee said.

Proxmire has asked the General Accounting Office for an investigation of the settlement.

In the Senate speech, he charges that the Navy "short circuited its own claims review procedures and may be engaging in another corporate bailout by agreeing to pay Litton Industries $18 million for a shipbuilding claim which the Navy formally judged to be worth less than a million dollars in 1972."

Spokesmen for both Litton and the Navy had no immediate comment on the charges Tuesday afternoon.

Litton filed a claim three years ago with the Navy for $37 million in additional payments the company said it was due for work on ship construction at its Pascagoula yard.

The Navy initially agreed to pay only $962,057 of the claim and the company appealed the decision to the Armed Services Board of Contract Appeals, but later reduced its demand to $28.5 million.

The dispute involves a contract for construction of four ammunition ships awarded to Ingalls Nuclear Shipbuilding in 1968 for $113 million. Ingalls is now part of the Litton operation in Pascagoula.

Hearings before the appeals board had begun when, two weeks ago, the Navy reversed its earlier decision and agreed to pay Litton $18 million of the amount the company is seeking, according to Proxmire.

"The reversal of the decision came at a meeting of top Navy and Litton officials in Pascagoula." Proxmire says in the prepared text of speech.

"The meeting was attended by Isaac C. Kidd, chief, Naval Material Command, and Charles B. Thornton, chairman of the Board of Litton," according to the prepared text of the speech.

"The background of this claim and its handling raise serious questions in my mind as to whether the Navy is paying the true value of the claim or simply trying to help its contractor out of financial difficulties," Proxmire continues.

"What I find objectionable is that the claim appears to have been settled on the basis of horsetrading negotiations rather than as a legal matter. According

to information I have received, a team of Navy employes has been instructed to prepare the paperwork justifying the agreement reached by Admiral Kidd and Mr. Thornton," the Senator added.

"The legal and technical justification for settlements of this type of claim should be prepared before a final agreement is reached, if proper procedures are followed," Proxmire said.

ITEM 33.—*Dec. 11, 1974—Letter from Assistant Attorney General Peterson to Senator Proxmire responding to the Senator's Nov. 22, 1974 letter concerning the validity of submarine construction claims filed by Litton. Mr. Peterson states that the matter has been a subject of inquiry by the Federal Bureau of Investigation and is being explored before a Federal Grand Jury. He further states "It is contemplated that our review will give due consideration to the possible implication of inflated claims on financial statements the corporation has issued to stockholders and the public." He states the Department of Justice had informed the Navy it would oppose any out of court settlement of the claims in question*

DECEMBER 11, 1974.

Hon. WILLIAM PROXMIRE,
United States Senate,
Washington, D.C.

DEAR SENATOR: The Attorney General has referred to me for reply your letter dated November 22, 1974, concerned with the validity of cost claim filed in relation to construction of submarines for the Department of the Navy by Ingalls Nuclear Shipbuilding Division, Litton Systems, Inc. located at Pascagoula, Mississippi.

For some time now the possibility of fraud resulting from this contract performance has been the subject of inquiry by the Federal Bureau of Investigation. More recently the inquiry has been broadened to include exploration before a Federal grand jury. In this connection, it is contemplated that our review will give due consideration to the possible implication of inflated claims on financial statements the corporation has issued to stockholders and the public.

At this time it is not possible to predict either the extent or results of that investigation. However, during its pendency we have corresponded with the Department of the Navy concerning resolution of the claim before the Armed Services Board of Contract Appeals. That Department has been advised it is the position of the Department of Justice that any out of court settlement of this claim could prejudice the criminal investigation and we would oppose such settlement.

I shall be pleased to keep you informed of significant developments.

Sincerely,

HENRY E. PETERSEN,
Assistant Attorney General.

ITEM 34.—*Dec. 4, 1975—Letter to William Middendorf, Secretary of the Navy, from Senator Proxmire questioning Navy/Litton financial arrangements on the LHA contract*

DECEMBER 4, 1975.

Hon. WILLIAM J. MIDDENDORF,
Secretary of the Navy,
The Pentagon,
Washington, D.C.

DEAR MR. SECRETARY: Two years ago, during hearings before the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee, Navy officials testified on a number of issues relating to Litton Systems, Inc. shipbuilding contracts with the Navy. It was well known at that time that Litton had experienced delays and overruns on all of its ongoing shipbuilding contracts, and had submitted claims against the Navy on these contracts. The largest claim involved the LHA contract. During the hearings, Assistant Secretary Bowers told the Subcommittee that the Navy and Litton were negotiating to establish a cap on all of Litton's LHA claims, to settle the issues involved with Litton's LHA appeal before the Armed Services Board of

Contract Appeals, and to obtain a complete release of all other claims Litton had with the Navy.

The recently issued Litton annual report for fiscal year 1975 indicates that Litton needs about $300 million beyond the amount contained in the Navy's February 1973 Contracting Officer decision in order to break even on the LHA contract.

The report further notes that preparations for a trial of this matter before the ASBCA are continuing and states: "In the interim, discussions have continued with the Navy for resolution by negotiation of some of the substantive issues involved in this appeal, as well as provisional or other interim payments to finance continuation of contract performance pending resolution of the issues involved in the appeal."

Due to the above statement, the magnitude of dollars involved and Litton's past history of shipbuilding claims and poor contract performance, I continue to be concerned about the Navy's position with respect to Litton's shipbuilding problems. I am therefore asking you the following questions:

1. Is the Navy continuing to negotiate with Litton on the LHA claim while preparing to litigate this claim before the ASBCA? If so, please provide the names of the Navy and Litton officials who have participated in the negotiations.
2. Does the Navy contemplate a negotiated settlement of the LHA claim in excess of the February 1973 Contracting Officer decision? If so, does this mean that the February 1973 Contracting Officer decision was defective?
3. How is Litton financing this $300 million overrun on the LHA contract?
4. Has Litton requested "provisional or other interim payments" from the Navy? If so, what has been the Navy's response?
5. What steps has the Navy taken to ensure that, were Litton to become insolvent, public funds would not be lost?
6. What steps has the Navy taken to ensure that the entire assets of the Litton Corporation are behind its Ingalls Shipbuilding Division so that the corporation cannot simply sever itself from its financial difficulties at Ingalls and leave the Navy holding the bag?
7. Are any financial arrangements, other than the progress and escalation payments provided under the current terms of the LHA contract, necessary to "finance continuation of contract performance pending resolution of the issues" involved in the appeal? If so, does the Navy envision it will be required to provide any such financial arrangements?

I am concerned that Litton apparently has not yet resolved its shipbuilding problems and that the taxpayers may somehow end up paying for the company's mistakes.

I would appreciate an early reply to my letter.

Sincerely,

WILLIAM PROXMIRE.

ITEM 35.—*Dec. 4, 1975—Letter to Edward Levi, Attorney General, from Senator Proxmire warning of possible pressures to terminate Litton fraud investigation*

DECEMBER 4, 1975.

HON. EDWARD H. LEVI,
Attorney General,
Department of Justice,
Washington, D.C.

DEAR MR. LEVI: I have just reviewed Litton's annual financial report for fiscal year 1975. Among the problem areas highlighted in that report is the resolution of outstanding claims on Navy shipbuilding contracts. The report makes specific reference to the Department of Justice investigation into charges of misrepresentation and possible fraud in connection with certain shipbuilding contracts performed by Litton for the Navy and cites a Grand Jury investigation underway in Alexandria, Virginia.

In an earlier letter, I pointed out to your predecessor, Mr. Saxbe, the importance of the Justice Department's investigation of the Litton shipbuilding claims. Litton and several other shipbuilders have been attempting to obtain relief from their financial difficulties by attributing responsibility for substantially all of their losses to the Navy under Navy shipbuilding contracts. In the process, some contractors have submitted grossly exaggerated claims.

The Litton case is a test which will demonstrate whether this Administration intends to enforce existing statutes against the submission of false claims. It is also a test which will demonstrate whether the same standards will be applied to large defense contractors as are applied to individual taxpayers who are exposed to criminal penalties for knowingly making false claims in their dealing with the Government.

I recognize that the Litton shipbuilding claims investigation may require considerable time to complete and that upon completion of the investigation it might appear that the amount of money to be recovered through prosecution may not be large. However, a firm stand by the Government in prosecuting any claim that appears to be false or fraudulent will serve as a powerful deterrent against such claims in the future, and could save millions of dollars in the long run.

I have held hearings in recent years on the subject of shipbuilding claims and have found the Navy is not as diligent as it should be in protecting the taxpayer. My experience has been that the Navy is generally reluctant to consider prosecution of its large contractors. I am sure you recognize the substantial influence that some large defense contractors wield within the Defense Department. During the course of the investigation you may even find Navy officials attempting to intervene in the contractor's behalf—under the guise of national defense. Please bear in mind that Navy officials themselves may not be entirely blameless in the case of inflated or fraudulent shipbuilder claims. Before the investigation is completed, you may be pressured by the company and perhaps by Government officials to terminate the investigation. Please assure me you will employ whatever personnel and resources are necessary to investigate this matter thoroughly and that it will not be terminated prematurely.

I would appreciate receiving the following information at your earliest convenience:

1. Have any Navy or DOD officials contacted your Department regarding the status of the Litton case or any of the information uncovered to date? If so, please list the officials, who in Justice they contacted, the date of all such contacts. Also, please provide a copy of their questions and your Department's response.

2. Have the Navy, the FBI, and other affected agencies fully cooperated with your Department in providing information, witnesses, and other support as needed to investigate this matter?

In view of the importance of this matter, I trust that you will give it your personal attention.

Sincerely,

WILLIAM PROXMIRE.

ITEM 36.—*Dec. 23, 1975—Plan of Action signed by Navy and Litton Industries. This document lays out a plan to insure cash will be made available to Ingalls so as not to require additional cash from Litton. The plan contemplates periodic "provisional" payments by the Navy for Litton's LHA claim. Under the plan Litton agreed to provide documentation in support of the claim.*

The purpose of this Plan of Action is to maximize the probability that the DD–963 and LHA shipbuilding contracts at the Ingalls Shipbuilding Division of Litton Systems, Inc., can be completed satisfactorily on a contractual schedule. Litton has stated and the Navy has verified by independent review that continuation of the LHA program without new sources of funds would result in a negative cash flow, which between August 1, 1975, and July 31, 1977, would exceed $200 million at Ingalls Shipbuilding Division. Examination of the Litton corporate financial structure shows that this would present a problem of serious proportions.

Through discussions, the Navy and Litton have identified sources of additional cash which can be made available under certain specified conditions as described in Appendix A incorporated by reference herein. In addition, it is recognized that timely, adequate supply of funds cannot be assured from the above sources and so it will be extremely important for Litton to control their operations so that any reasonable shortfall can be covered. Short term and long term cash sources are discussed below.

SHORT TERM (ONE YEAR)

1. Certain sources of cash as set forth in Appendix A will be made available to Ingalls in such amounts so as not to require additional cash from Litton so long as these funds shall last. It is anticipated that these funds will supply the total Ingalls Shipbuilding Division needs for some part of Ingalls Fiscal Year 1976.

LONGER TERM (TO JUNE 1977)

1. The primary source of funds is the Litton appeal (ASBCA 18214). In order for funds to be made available on a timely basis the parties conclude that they will embark on an aggressive program of bilateral negotiation in accordance with Appendix B incorporated by reference herein. It is agreed that, assuming Litton can provide adequate substantiating data within the time frame provided in Appendix B, a target date for conclusion should be June, 1977. It would be the parties' intent to organize the negotiation so that, assuming valid proven merit of its claims, the Navy would have adequate justification for provisional payments beginning in April, 1976 and continuing successively thereafter. While Navy cannot make any guarantees at this time regarding timely adequacy of these funds to fulfill LHA needs, the parties agree that the outlook is not unreasonable if backed up by a reasonable amount of other Litton funds. The parties will monitor the progress carefully with top management meetings held at bi-monthly intervals.

2. In order to embark on this negotiating program it will be necessary for Litton to suspend, without prejudice, its appeal, ASBCA 18214 except for the SACAM issue. In phasing down this effort, both parties agree to respond to outstanding interrogatories insofar as possible without interfering with the ongoing effort. The specific agreement in this regard is set forth in Appendix B.

3. Despite the desire and intent of both parties it is recognized that if either:

a. Sufficient cash does not become available from all sources on a timely basis to adequately fund the LHA program on a satisfactory production schedule, or

b. The provisional payments made by June, 1977, as a result of bilateral negotiation do not equal or exceed $150 million, as stipulated by Litton, then Litton reserves all rights existing at the date of this Plan of Action. Such reservation of rights is not intended to impair or prejudice the flow of consideration from one party to the other as a result of the matters addressed by this Plan of Action. If, in either of these events, Litton does not provide continued performance of the LHA or other programs, Navy will pursue all remedies provided by law and the contracts. Nevertheless, in the event that the contract is in an overpayment situation due to actions taken under this Plan, the Navy agrees that full consideration will be given to deferment agreements limited only to the facts at the time and the applicable law and regulations.

Litton Systems, Inc., Ingalls Shipbuilding Division, By _____.
United States of America, Department of the Navy, By _____.
Effective date January 7, 1978.

APPENDIX A

I. SOURCES OF CASH INCLUDE:

A. Settlement of the LHA SACAM issue.

B. Provisional payments on the LHA claim as negotiations proceed under Appendix B.

II. OTHER FUNDS

In the event funds become available by the Government as a result of decisions of the Navy Contract Adjustment Board with respect to the LHA cancellation ceiling issue or of the Armed Services Board of Contract Appeals with respect to the Ingalls SSN 680, "Project X," SACAM progress payments appeals, or otherwise, such funds are to be included in the foregoing enumeration of sources of cash and are to be accorded first priority of application of government funds for the purposes of this Plan of Action.

III. PRIORITY

It is intended that the order of priority of application of all sources of government funds is: first, the "other funds" described in II above, and second, LHA sources of funds.

APPENDIX B

1. The level of documentation will equal or exceed that of "Stern Closure" in the technical and quantum areas, and will exceed "Stern Closure" in the area of proof of liability. Ingalls will provide this documentation without any request by the Navy. The bulk of the data will consist of copies of all referenced documentation, marked up copies of all affected drawings, and current pricing data. It is agreed that the level of documentation furnished to the Navy for the Stern Closure Claim is considered essentially adequate for the purpose of negotiation and settlement. Between the time Litton completes its submission of substantiating data and the time of agreement on factual work scopes, the parties may find it necessary to exchange further information and documentation.

2. Ingalls and the Navy will both review lists of interrogatories to eliminate data not specifically required to support successful negotiations. Ingalls anticipates a major reduction in the documentation previously requested. In addition the remaining documentation will be identified to specific claims so that providing it will be spread over a longer period of time. In addition to the above, the Navy agrees to respond to additional reasonable requests from Ingalls for factual information and documentation relevant to the claim, ASBCA 18214. It is also understood that the actions taken under this negotiating procedure with respect to exchange of documentation shall in no way affect or impair the rights of either party to further discovery should any portion of ASBCA #18214 be reinstated and tried before the Board.

3. Navy Procurement Directives will be followed. It is the understanding, however, that certain actions normally performed serially, may have to be performed in parallel or expedited in order to ensure that the necessary commitment authority exists to support the schedule objectives of the "Plan of Action."

4. The attached matrix schedule has been developed for accurate and timely monitoring of progress by both Navy and Litton's management. The matrix schedule is structured to ensure that adequate documentation is in the hands of the parties to achieve the main objective of the "Plan of Action." Revisions to the matrix schedule may be made by mutual agreement.

5. The Navy will make a provisional payment against the claim in July 1976 if data available to the Navy at that time supports such payment. It is understood that the Navy will not make provisional payments on individual claims elements, but that provisionals, when warranted, will be made incrementally based on evaluation of all data made available to the Navy up to the time of the provisional. The parties will expedite the negotiation of the LHA 6 months' delay claim and the Navy will make a provisional payment in respect of this item in April, 1976, if data available to the Navy at that time supports such payment.

6. It is also understood that the Navy will not make a counteroffer at the completion of discussions on each claim element. The Navy will provide sufficient information through the foregoing discussions however, for Ingalls to be able to know, with a high degree of accuracy, what the Navy position then is on liability and quantum, but it is not intended that the Navy will divulge discrete dollar positions to Ingalls.

7. Any and all factual information and evidence in existence prior to or apart from the claim settlement negotiations to be undertaken pursuant to the Plan of Action may be introduced and proved by either party should any portion of ASBCA #18214 be reinstated and tried before the ASBCA, but no statement, admission, offer of settlement, conclusion or matter of fact or any other documents or information subject to exclusion by the rules of evidence or discovery prepared for or arising, presented or discussed in said claim settlement negotiations will be admissible at any subsequent trial, motion or other subsequent proceeding before the ASBCA or any other tribunal.

MILESTONE FOR SUBMISSION, EVALUATION & NEGOTIATION OF LHA CLAIM ELEMENTS

Claim item	(a) Litton complete initial submission of substantiating information and documentation [1]	(b) Navy and Litton respond to interrogatories [2]	(c) Navy and Litton complete assessment of individual positions [3]	(d) Navy establish pre-negotiation position	(e) Commenced negotiations
1 Six-month delay	Jan. 9, 1976	Mar. 1, 1976	Apr. 12, 1976	May 31, 1977	June 1, 1977
2 Stern closure	Mar. 1, 1976	Apr. 1, 1976	July 1, 1976	May 31, 1977	June 1, 1977
7 Ballast/deballast			Aug. 1, 1976		
9 Replenishment					
3 Living and commissary					
3 Bilge and tank					
31 R/M/A	Apr. 1, 1976	May 1, 1976	Aug. 1, 1976	May 31, 1977	June 1, 1977
11 Ship service elect					
24 Main boiler					
22 Main and auxiliary sea water					
CP Rerated electric motors	May 1, 1976	June 1, 1976	Sept. 1, 1976	May 31, 1977	June 1, 1977
CP JFS control air					
CP Boat davits					
CP CCTV					
2A Combustible gas					
4A Central time frequency	May 1, 1976	June 1, 1976	Sept. 1, 1976	May 31, 1977	June 1, 1977
49 TACAN					
41 ECM					
27 MO gas					
1B AN/UQN-4	June 1, 1976	July 1, 1976	Oct. 15, 1976	May 31, 1977	June 1, 1977
64 Ship arrangements					
3A Personnel manning					
42 Radar and IFF					
Delay and disruption, initial submission	July 1, 1976	Aug. 1, 1976	[5]	May 31, 1977	June 1, 1977
01 landing craft handling	July 1, 1976	Aug. 1, 1976	Nov. 15, 1976	May 31, 1977	June 1, 1977
71 Guns and missiles					
71A Chaffroc decoy					
71B MK 86 GFCS					
03 Helicopter handling					
82 Safety					
23 Primary fuel coange	Aug. 1, 1976	Sept. 1, 1976	Dec. 15, 1976	May 31, 1977	June 1, 1977
84 Standardization					
46 Computer software					
52 Ship's protection					
61 Medical spaces					
21 Ship's propulsion power	Sept. 1, 1976	Oct. 1, 1976	Jan. 15, 1977	May 31, 1977	June 1, 1977
04 Cargo handling					
66 Habitability					
Island development					
MEAS					
Hi-Shock test	Oct. 1, 1976	Nov. 1, 1976	Feb. 1, 1977	May 31, 1977	June 1, 1977
Computer hardware					
Contract modifications					
Radio communication	Nov. 1, 1976	Dec. 1, 1976	Feb. 15, 1977	May 31, 1977	June 1, 1977
IVCS					
CDRL	Dec. 1, 1976	Jan. 2, 1977	Mar. 1, 1977	May 31, 1977	June 1, 1977
QPR					
GFE/GFI					
QA					
Plumbing					
DB/LHA cross impact					
Delay and disruption, final submittal	Dec. 1, 1976	[6]	Apr. 1, 1977	May 31, 1977	June 1, 1977

[1] Initial submission will be comprised of all currently available data including a cause and effect analysis and quantification equal to or exceeding data submitted under "Stern Closure".

[2] These interrogatories are the resultant of a refinement of the interrogatories which have been issued prior to the date of this agreement.

[3] Assessment will include fact finding, scoping, and entitlement discussion plus submission and discussion of related point papers with resolution of factual differences to the extent possible. Threshold legal issues will be documented and discussed when applicable as a part of each claim item as scheduled above.

[4] Initial Final (with DSD): Jan. 16, 1976.

[5] See delay and disruption, final submittal below.

[6] Not applicable.

ITEM 37.—*Jan. 9, 1976—Letter to Senator Proxmire from the Secretary of the Navy replying to questions concerning Litton finances*

DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., January 9, 1976.

Hon. WILLIAM PROXMIRE,
United States Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: This is in reply to your letter of December 4 requesting information about the LHA program and the Navy's current relationship with the contractor. In the interest of clarity and completeness, I am responding to each of your questions in turn on the following pages.

It is hoped that this information will be of assistance to you.

Sincerely,

J. WILLIAM MIDDENDORF II,
Secretary of the Navy.

Enclosure.

Question 1. Is the Navy continuing to negotiate with Litton on the LHA claim while preparing to litigate this claim before the ASBCA? If so, please provide the names of the Navy and Litton officials who have participated in the negotiations.

Answer. The Navy is not negotiating the claim at this time; however, discussions are being held with Litton relative to Litton's withdrawing or suspending their appeal before the ASBCA with the expectation that the parties could reach a negotiated settlement of the LHA claims.

Question 2. Does the Navy contemplate a negotiated settlement of the LHA claim in excess of the February 1973 Contracting Officer decision? If so, does this mean that the February 1973 Contracting Officer decision was defective?

Answer. Since the ceiling price of the Contracting Officer's decision of 28 February 1973 did not include nor recognize the LHA claims, any negotiated settlement of the LHA claim would exceed the ceiling price for the LHA contract established by the Contracting Officer's decision. That decision was not defective since the decision expressly eschewed making any determination on the claim, stating, "By Navy letter of 30 August 1972, Litton's 'REA' claim was rejected because it was based upon the unacceptable 'total cost' and 'total time' basis. The Navy offered to evaluate any claim properly resubmitted 'in a more suitable form, as contemplated by the changes clause, i.e., demonstrating cause and effect * * *.'"

Question 3. How is Litton financing this $300 million overrun on the LHA contract?

Answer. The 1973 Litton Annual Report advised that the dollar amount set forth in the February 1973 Navy unilateral decision on the LHA contract was approximately $300 million less than the current estimated total costs at completion for the LHA contract. The Navy projects that Litton has presently overrun the LHA contract about $53 million which is being financed by Litton Industries through their normal lines of credit.

Question 4. Has Litton requested "provisional or other interim payments" from the Navy? If so, what has been the Navy's response?

Answer. Litton officials, in recent discussions with Navy officials, have suggested the use of a provisional payment against the LHA claim as a means of partially alleviating the serious cash deficiency stemming from the LHA program. This suggestion is currently under consideration.

Question 5. What steps has the Navy taken to ensure that, were Litton to become insolvent, public funds would not be lost?

Answer. The terms of the existing contracts protect the Government funds by limiting the funds payable to the contractor based on the progress achieved on Navy programs and the total contractor expenditures to date. Further, the contracts provide for a percentage of earnings to be retained by the Government as a performance reserve. The contract also provides, under the Default clause, for the contractor to transfer title to all contract rights and materials to the Government. We believe these protect the Government's funds including their rights.

Question 6. What steps has the Navy taken to ensure that the entire assets of the Litton Corporation are behind its Ingalls Shipbuilding Division so that the corporation cannot simply sever itself from its financial difficulties at Ingalls and leave the Navy holding the bag?

Answer. On 26 September 1968, Litton Industries executed a Guaranty Agreement by which Litton Industries, Inc. guaranteed the full and faithful performance by the contractor of all the undertakings, covenants, terms, conditions and agreements of the LHA contract, including, but not limited to, providing financing, facilities and technical assistance. This guaranty was repeated on 28 June 1971 as an inducement by Litton Industries, Inc. to obtain the Navy's consent to a proposed Novation Agreement. The Navy has repeatedly advised Litton of its intention to require Litton to live up to its obligations as the financial guarantor of its wholly-owned subsidiary, Ingalls Shipbuilding Division, Litton Systems, Inc.

Question 7. Are any financial arrangements, other than the progress and escalation payments provided under the current terms of the LHA contract, necessary to "finance continuation of contract performace pending resolution of the issues" involved in the appeal? If so, does the Navy envision it will be required to provide any such financial arrangements?

Answer. The Navy is aware that Litton is experiencing increasing difficulties in financing performance of the LHA contract. Any Navy participation in additional financing would be derived from expeditious resolution of Litton claims resulting in appropriate contract amendments. During the claim resolution period provisional or other interim payments would be considered.

ITEM 38.—*Jan. 22, 1976—Letter to Senator Proxmire from Assistant Attorney General Richard L. Thornburgh concerning the investigation of the Litton claim*

DEPARTMENT OF JUSTICE,
Washington, D.C., January 22, 1976.

HON. WILLIAM PROXMIRE,
United States Senate,
Washington, D.C.

DEAR SENATOR: The Attorney General has asked me to reply to your most recent letter dated December 4, 1975, concerned with the validity of cost claims filed in relation to construction of ships for the Department of the Navy by Ingalls Shipbuilding Division, Litton Systems, Inc.

First, I want to reassure you that the possibility of fraud resulting from such contract performance remains a priority concern of the Department of Justice. It continues to be the subject of intensive inquiry by the Federal Bureau of Investigation as well as a Federal Grand Jury sitting in the Eastern District of Virginia. As I stated earlier, this review and evaluation will include the possible impact of inflated cost claims on financial statements the corporation has issued to stockholders and the public.

It is still not possible to predict either the extent or results of the investigation. Only last week representatives of this Division and the United States Attorney's office conferred on the scope and direction of future inquiry in this matter.

With respect to your inquiry regarding the identities, number and dates of contacts made by the Department of Defense, it is not possible to furnish the details you request. During the period of the ongoing inquiry there have been numerous contacts between our respective agencies regarding the accessibility of witnesses, availability of documents and the propriety of attempting to resolve any outstanding claims made by the contractor. None of these contacts are viewed as interference with the current inqury. The Navy has heretofore been cautioned that any out of court settlement of certain claims related to ship construction could jeopardize the criminal investigation and the Department opposes such settlement. This remains the view of the Department of Justice.

I trust that this report will serve as a meaningful response to your letter.

Sincerely,

RICHARD L. THORNBURGH,
Assistant Attorney General.

ITEM 39.—*Mar. 15, 1976—Ingalls letter to Commander, Naval Sea Systems Command, forwarding data in support of the LHA provisional payment*

INGALLS SHIPBUILDING DIVISION,
LITTON SYSTEMS, INC.,
Pascagoula, Miss., March 15, 1976.

Attention: Captain R. A. Jones (OOX).
Subject: Contract N00024-69-C-0283 LHA-1 Class; Submittal of Factual Data in Support of Provisional Payment.
Enclosures: (1) Government Responsible Delay Analysis dated March 15, 1976.
(2) Revised Table 1, Labor and Revised Table 2, Material.

COMMANDER,
Naval Sea Systems Command,
Department of the Navy,
Washington, D.C.

DEAR SIR: Ingalls is submitting herewith Enclosure (1) which is an analysis of extensive factual data, the purpose of which is to assist the Government in preparing its rationale in support of a provisional payment of $50,000,000 under the subject contract.

It was agreed at a meeting held in NAVMAT on March 3, 1976 that Ingalls and the Navy would reevaluate the data available in support of Ingalls' LHA Claim to determine if the basis for such a provisional payment does in fact exist. The principal attendees were, for the Navy, the Assistant Secretaries of the Navy for Installation and Logistics and Financial Management and the General Counsel of the Department of the Navy, and for Litton Industries, its President and Chairman of the Executive Committee. In subsequent meetings between the undersigned and Mr. Gerald McBride (SEA 02B), and other Navy representatives, it was agreed that Ingalls would submit a package of data which would support a substantial amount of Government responsible delay and thereby, provide the basis for a Contracting Officer's determination that a provisional payment in the amount of $50,000,000 could be made at this time.

Ingalls' analysis, Enclosure (1), of the impact of the Change Orders and Constructive Change Orders on Engineering Design and Development and the issue of System Design and Detail Design Drawings and the corresponding impact on the production process and ship delivery supports a Government Responsible Delay of at least 23 months. Since Enclosure (1) is a factual analysis of delay causes only, it does not, per se, contain the quantum analysis resulting from this Government Responsible Delay. Ingalls believes, however, that there are two vehicles existing within the Navy for determining that the value of this Government Responsible Delay would substantially exceed $50,000,000. The first is the delay rate in the Six Month Delay submittal which was issued to the Navy by Ingalls' letter C-76-62-023 of 16 January 1976. Since that Delay submittal is still under evaluation by the Navy and the determination of quantum associated with it is not due for at least another month, a second method of arriving at the quantum for the delay may be more acceptable. This method, acceptable to Ingalls of satisfying this request for provisional payment (although not the total cost of delay) would be to adjust the escalation Tables 1 and 2 as contained in the Contracting Officer's Decision of 28 February 1973 by adding four additional quarters. The resultant tables are consistent with the methodology used by the Government in providing the Contractor with 23, 24 and 26 quarter escalation tables during negotiations prior to the issuance of the Contracting Officer's Decision on February 28, 1973.

Enclosure (2) is the resultant table referred to in the preceding paragraph. It is calculated that Enclosure (2) would yield an additional $58,945,000 of escalation payments over the escalation tables which were contained in the Contracting Officer's Decision of February 28, 1973.

Ingalls believes that the Government has in its possession, as a result of receiving it from Ingalls, copies of all the documents and references which show on Attachment A to Enclosure (1). The Government has received these either through copying of data made available to the Navy, within the six Constructive Changes packages which have been submitted to date, or within the More Definite and Certain Statements that were submitted in April 1975.

Per our discussion of last Thursday, once you have had a chance to read the enclosed data, Ingalls wishes to meet with you and discuss in detail its analysis and attempt to answer any questions which you may have.

Yours very truly,

A. J. DUNN,
Vice President Administration.

ITEM 40.—*June 11, 1976—South Mississippi Sun article—"Ingalls to Analyze Cost Overrun Dispute Between Litton, Navy"—reporting that the President of Litton told a Congressman that LHA work would stop unless the claims are agreed to quickly*

(By Larry Arcell)

PASCAGOULA.—Ingalls Shipbuilding will "wait and analyze the situation" between the shipyard's parent company of Litton Industries and the Pentagon over disputed cost overrun figures for a shipyard contract, a spokesman said Thursday.

Litton and the Navy are battling over a $504 million cost overrun claim filed by the shipbuilders on the $930 million landing helicopter assault (LHA) carrier contract under construction at Ingalls.

Deputy Defense Secretary William Clements speculated Thursday the shipyards involved in the dispute would cease production if the claims were not allowed.

Jerry St. Pe, vice-president for industrial relations at the shipyard said there are "no plans at the moment to take that action."

Rep. C. V. (Sonny) Montgomery (D-Miss.), however, said Thursday the president of Litton Industries, Fred O. Green, called the congressman Wednesday and indicated work would stop on the LHAs unless a partial settlement on the claims were agreed to quickly.

"If the Navy continues to give money to Ingalls," Montgomery said Green told him, "They'll keep building. If not, they'll have to stop building the LHA."

"I related that to the committee this morning," Montgomery added. "The House Armed Services Committee, of which Montgomery is a member, was scheduled to hear testimony from Clements Thursday. Clements canceled his appearance, Montgomery explained, and the committee met at the personal request of the congressman.

The committee "is trying to get the matter off center" Montgomery said of the efforts to get the funds for Ingalls. "If they stop production it will have a great economic impact especially on the Coast."

St. Pe said, "We aren't certain at this time of our next approach" to get the cost overrun claims.

"At the present time," St. Pe added, "we don't feel it is appropriate to comment on Clement's statement" that the dispute will end up in a court battle.

Montgomery said the Government Accounting Office (GAO) has listed nine problem areas the Navy and Litton are claiming as reasons for the delays and overruns. Five of the problems causing the delays according to the report, Montgomery said, were the Navy's fault. These included delays in getting plans to Litton, he added.

Ingalls has been involved in a continuing dispute with the Navy on cost overruns on the five-ship, $930 million LHA project. Long delays have plagued the programs with the present actual delivery dates of the vessels almost five years behind the original delivery date.

The company claimed the increased costs were due in part to "higher inflation, higher labor rates and higher man-hour requirements due to lower productivity than previously expected."

Clements said the company and the Navy were close to $200 million apart on the cost overrun figures.

ITEM 41.—*June 25, 1976—N.Y. Times article—"Litton's Claims: High Stakes Poker" discussing anomalies between Litton's financial representations to the Pentagon and the public. The article quotes the President of Litton: "We have never said that we would be unable to fulfill the (assault ship) contract"*

(By Michael C. Jensen)

PASCAGOULA, MISS.—On the Gulf Coast, in this steamy, sun-drenched city, where Litton Industries has been building a fleet of modern assault ships and destroyers for five years, a contract dispute with the Navy festers like an open wound.

Leonard Erb, a 56-year-old former Navy captain who heads Litton's shipbuilding division, looked out the other day over the sprawling yard where 19 destroyers and three assault ships were taking shape.

"I just want to get all this hostility out of the way so I can spend my time building ships and not piles of paper," he told a visitor.

Adm. Hyman G. Rickover wants to get ships built too, but he has been sharply critical of Litton's recent efforts to bypass the Navy's normal claims procedure—an effort that won the support of the Ford Administration.

Although Litton's west bank shipyard here is the nation's most modern shipbuilding facility, it has been plagued with operating and manning problems since it opened in 1970. Cost overruns on two huge Navy contracts have run to hundreds of millions of dollars, partly because of errors in implementing a novel modular, or assembly line, technique in building ships.

However, Mr. Erb is taking unusual steps these days to take advantage of the modular system. For one thing, he is having more work done on the ships before they are floated.

He also is trying to improve productivity, and to that end has imposed penalties on workers for walking in the wrong part of the yard, so-called "walking violations," and for sitting arounl doing nothing—"sitting violations."

In addition, he has discharged 600 workers who were said to be chronic absentees, and has dismissed or demoted 550 supervisory and support employees who ranked at the bottom of their superiors' efficiency ratings.

Whether Mr. Erb's methods will work is an open question. He concedes that he is barely holding his own on productivity, and he has reduced absenteeism by only 2 percent.

Furthermore, his tough stance has drawn fire from the Pascagoula Metal Trades Council, A.F.L.–C.I.O., which represents 11 unions and more than 15,000 of the Litton's 24,400 shipbuilding employees.

Litton, once considered the king of the conglomerate companies, was founded 23 years ago by Charles B. (Tex) Thornton, who still serves as chairman. The company's appetite for acquisitions and its record of 57 consecutive quarterly earnings increases, which ended in 1968, made Litton a darling of Wall Street.

Manufacturing everything from Monroe calculators, Royal typewriters and microwave ovens to commercial tankers and Navy warships (at its Ingalls Shipbuilding division), Litton has performed erratically during the seventies, actually losing money in 1972 and 1974.

The company's current dispute revolves around two Navy contracts. The first, signed in 1969, calls for Litton to produce five assault ships for $967 million. The second, signed in 1970, is for 30 destroyers at a total price of $2.2 billion.

Both contracts are running well behind schedule and have incurred massive cost overruns. A few weeks ago, the Navy commissioned the Tarawa, the first of the assault ships, three years after the originally scheduled date. The Kinkaid, the third destroyer to be produced under the current contract, is scheduled to be commissioned July 10, about a year behind schedule.

With considerable controversy over who should pay for the delays, Litton in recent months has been playing high-stakes poker with the Federal Government over reimbursement.

LITTON INDUSTRIES—AT A GLANCE

	1976	1975
3 months ended April 30:		
Revenues	$925, 360, 000	$866, 271, 000
Net income	10, 107, 000	8, 946, 000
Earnings per share	25¢	22¢
9 months ended April 30:		
Revenues	2, 598, 025, 000	2, 551, 125, 000
Net income	28, 739, 000	26, 083, 000
Earnings per share	70¢	62¢
	1975	1974
Year ended July 31:		
Revenues	3, 432, 592, 000	3, 029, 873, 000
Net income	35, 260, 000	(39, 806, 000)
Earnings per share	87¢	----------

(Loss.)

Assets, July 31, 1975	$2, 185, 731, 000
Stock price, June 23, 1976, N.Y.S.E. consol. close	14
Stock price, 1976 range	17¾–6⅞
Employees, July 31, 1975	97, 000

William P. Clements, Deputy Secretary of Defense, citing a poisoned atmosphere between the Navy and the nation's major shipbuilders, has proposed settling $1.9 billion in shipbuilders' cost overrun claims for about $700 million.

Mr. Clements, a former oil entrepreneur from Texas, says that without some such action, the "viability" of Litton's shipbuilding complex might be "short-lived." Congressional watchdogs, however, attacked any such solution as a bailout and argued that the Navy's traditional claims procedures should be followed.

The Government's activity, first in fashioning a strategy to achieve a settlement and then in explaining it to Congress, has had the side effect of directing attention to Litton's financial condition.

Pentagon officials, citing Litton executives as their authority, have said the $3.4-billion conglomerate was in financial difficulty and was suffering from a serious cash flow problem as a result of its shipyard contracts.

That contention was used to help justify an unusual and controversial negotiation between the Pentagon and the shipyards under a "national emergency" law.

Litton itself is in a delicate position as far as commenting on such matters is concerned. On the one hand, it is to the company's advantage to convince the Pentagon that it is in a financial bind and therefore deserves a large outlay of Government cash.

On the other hand, in order to preserve public and investor confidence and to maintain the price of its stock at a healthy level, Litton cannot be too obvious about calling attention to financial deficiencies—if, indeed, they exist.

In testimony before Congress in 1974, Fred W. O'Green, Litton's president, hinted at the danger of Government intransigence. "In certain cases [it] has driven large prime contractors to the verge of bankruptcy," he said.

But recently, in an interview, he asserted that there was no danger that Litton would fail or that its shipyard would go out of business, no matter how the negotiations with the Government were resolved.

J. Pendexter Macdonald 2d, a research executive with the Wall Street firm of Salomon Brothers, says he isn't surprised by such anomalies. He sees Litton's public pronouncements largely as negotiating statements.

Until last week, Litton was negotiating for a settlement from the Pentagon for $504 million in cost overrun claims on the assault ship contract.

Three other shipbuilders also were involved in the talks—the Newport News Shipbuilding and Dry Dock Company, a unit of Tenneco, Inc.; the Electric Boat division of the General Dynamics Corporation and the National Steel and Shipbuilding Company, jointly owned by the Kaiser Industries Corporation and the Morrison-Knudsen Company.

The negotiations foundered when two of the four shipyards balked at the Navy's offer. Litton, which would have received about $260 million, said it was unwilling to cut back that much on present and future claims. Tenneco took a similar position.

So the poker game continues, with Litton constantly raising the stakes. Mr. O'Green said in an interview that the shipbuilding division now had pending or in preparation almost $900 million in cost overrun claims.

He said they included $504 million on the assault ship program, $20 million for back interest and another $20 million or so stemming from a contract cancellation—all old claims; plus $200 million on the destroyers and $133 million for "start-up" costs on the two contracts—both new claims.

Litton has already been awarded $17 million by the Navy as the result of one shipbuilding claim for about twice that amount, but payment has been held up because of a grand jury investigation into the contract involved.

Mr. O'Green said that Litton clearly did not expect to win all its claims.

One of Litton's problems at the moment is credibility. Several weeks ago Litton announced that its estimate on losses on the two big Navy contracts, previously set at $160 million, had leaped to $544 million. That included an estimated loss of $69 million on the destroyer project, which previously had been considered profitable.

Sources at the Pentagon said that the negotiating team was astounded at the revision and that it had been described as "laughable." Mr. Clements said that the increase was "remarkable" and, that he didn't "understand" it.

Mr. O'Green, in the interview, defended the revision and said it took into account new information, including the failure of the shipyard to achieve expected productivity increases as its shipbuilding program progressed.

With huge amounts of money at stake, the atmosphere in Washington has become highly charged, with the name Litton acting like a lightning rod.

Representative Les Aspin, Democrat of Wisconsin, asked about the sharp increase in Litton's estimate of anticipated losses on the two big contracts, said the figures "strained the imagination and appeared to be the boldest and craziest posturing."

Senator William Proxmire, also a Wisconsin Democrat, said even before the latest increase that he thought Litton's claims were based, at least in part, on "vague estimates, phony assertions and inflated figures."

Taking opposite sides in the controversy were Gordon W. Rule, the outspoken chief of procurement for the Navy, who defended a settlement with Litton under the "national emergency" law, and Admiral Rickover, who opposed it. Admiral Rickover asserted that although Litton first lodged its claim for $504 million on the assault ship contract in general terms four years ago, it did not agree until January 1976 to submit a documented claim.

Mr. O'Green says Litton has provided the Pentagon with accurate figures and bridles at any suggestion to the contrary.

Meanwhile, at the Pentagon, sources says prospects for settling with the shipyards under the "national emergency" law, technically known as Public Law 85–804, are virtually dead. As a result, the Navy has begun gearing up for "accelerated" handling of Litton's claims, as well as claims from other shipyards.

One aide on Capitol Hill warns, however, that shipyard lobbyists are pressing for a resolution of the matter by the House Armed Services Committee, rather than through the Navy's claims procedure, in hopes of obtaining a more favorable deal.

Analysts Consider Litton in No Danger of Failure

While Litton Indusries has had its ups and downs in recent years, the company is hardly in danger of failing, according to Wall Street analysts.

The picture of Litton is sketched by analysts and confirmed by interviews with the company's top executives differs sharply in some respects from the gloomy outlook presented as a bargaining point for additional Government funds on two disputed Navy contracts.

Considerable publicity has been given, for example, to Litton's cash flow problem. However, an examination of available financial information indicates that even at Litton's shipyard in Pascagoula, cash flow is under control—partly because millions of dollars already are being handed over by the Navy on the two contracts.

"We are healthy and strong, and are generating cash," Fred W. O'Green, Litton's president, said last week, as he summed up the company's condition at the conclusion of a 2½-hour interview at Litton's Washington offices.

"We have never said that we would be unable to fulfill the [assault ship] contract," Mr. O'Green said.

Far from being cash starved, Litton signed a "plan of action" with the Navy last January that has already resulted in two payments totaling $59 million in cash, according to Mr. O'Green, and considerably more Government money appears to be on the way before the year ends. Two more payments, totaling $40 million or more, are anticipated, one next month, and another in the Fall.

Furthermore, as Litton said in a document filed with the Securities and Exchange Commission a year ago, although the company is suffering from a negative cash flow on its assault ship contract, a large destroyer contract has offset that negative cash flow, "resulting in a positive net cash flow on the two contracts."

Mr. O'Green said in the interview that the cash flow on the two contracts was still positive, but noted that the Ingalls Shipbuilding division "as a whole" had been forced to draw $15 million from the parent company during the fiscal year that will end July 31.

Furthermore, a computer analysis of Litton's cash flow prepared for The New York Times by Thomas M. Roginski, formerly a portfolio analyst at Merrill Lynch, Pierce, Fenner & Smith, and now a partner in the firm of Moser, Roginski & Company, indicated that the company was not in any difficulty.

In recent months, Litton stock has leaped to $17 a share, although in the last few weeks, disclosure of foreign exchange losses have pushed it below $15. The stock sold earlier in the year for less than $7.

On earnings, Litton has had serious problems in recent years, but currently is enjoying something of a resurgence. Several weeks ago, the company announced that during the first nine months of the 1976 fiscal year, its earnings rose by 10.2 percent. In the most recent three-month period, earnings were up by 13 percent.

Furthermore, during the first half of the fiscal year, the Defense, Commercial and Marine Systems Group, which includes the shipyard, accounted for 34 percent of Litton's sales and 31 percent of its operating profits—or $25.3 million.

Although Navy calculations indicate that the Ingalls division has lost almost $40 million in aggregate over the last six years, Litton says its shipyard is earning a nominal profit.

ITEM 42.—*June 29, 1976—Ingalls News article reporting Litton notified Navy that unless LHA claim is settled by August 1, 1976 Ingalls will discontinue work on the LHA program. The article quotes President of Litton: "* * * it is our company's intention to discontinue performance of the contract"*

Litton Industries today announced that its Ingalls Shipbuilding division of Litton Systems, Inc., has informed the Department of the Navy that unless a settlement of long-standing financial claims can be reached by August 1, Ingalls will be forced to discontinue work on the LHA program.

"It is with sincere regret and a deep feeling of disappointment that we must inform you that as a result of the Navy's breach of the LHA contract and other actions or failures to act on the part of the Department of Defense and the Navy, it is our company's intention to discontinue performance of the contract," Litton President Fred W. O'Green said.

The Litton President added that the decision follows more than five years of sustained effort by the company to continue performance on the LHA program in spite of the failure of the Navy to meet its obligations in resolving contractual and financial issues.

He added that by August 1 the company will have financed performance on the contract by more than $100 million. "Continuation of performance on the present basis could ultimately require the company to finance this Navy shipbuilding work in an amount in excess of $400 million," he said.

"Unfortunately," Mr. O'Green said in his letter to the Navy, "we have now reached a point where continued performance is no longer legally required or permitted. We hope you will realize that we have left no stone unturned in avoiding this decision, and that we have reached it only after all reasonable alternatives have been exhausted."

In its letter the company indicated its willingness to continue or resume production of the ships under terms which would provide adequate funding.

Mr. O'Green also said that the company is willing to consider any reasonable arrangement which would ensure that continued production is currently funded, but that it is grossly unreasonable to expect a public company and 150,000 stockholders to finance a Government project.

In closing, the letter said "enormous human and material resources have been committed to the program, and that the company hopes a means can be found to avoid their loss."

A MESSAGE FROM LEN ERB

The most immediate effect on our shipyard, if an agreement cannot be reached with the Navy on our LHA claims by August 1, will be that our company will be forced to reduce our total workforce by substantial numbers.

There are approximately 5,900 Ingalls employees curretnly working on the LHA program, either in production or support capacities. Discontinuance of the LHA effort does not mean all 5,900 must be released. Full manning on other programs can absorb approximately one-third of that number. Additionally on June 4 when this situation appeared possible, the hiring of new employees was significantly reduced and therefore normal attrition would further reduce the excess by approximately 1,200.

However, this still means we may be faced with a significant reduction in force on a shipyard-wide basis. The reduction would be implemented in accordance with our present labor agreements and company policies. In plain English, the burden would not be borne by only those on the LHA program but will be addressed as a total shipyard problem. The reduction, if an agreement cannot be reached, would take place over a period of four to five weeks

commencing August 1. The first notices would be distributed beginning on July 23.

I deeply regret the necessity to inform you of these possible consequences, but I feel very strongly that you have the right to know. I can assure you that all the responsible officials of Litton Industries and those of us at Ingalls will continue to exert every possible effort to achieve a satisfactory solution before the deadline. We are building excellent ships for the Navy and must continue to do so.

We at Ingalls can best contribute to the solution of this problem by continuing what we have been doing for the past year—improving our performance in the delivery of quality ships so vitally needed by the Navy.

I ask your continued support through these difficult times. Please be assured that we are doing everything possible to resolve this situation and to continue to build these ships.

LEN ERB,
President.

ITEM 43.—*June 30, 1976—Wall Street Journal article—"Litton Notifies Navy Unit Will Halt Work on LHA Ships August 1"*

BEVERLY HILLS, CALIF.—Litton Industries Inc. formally notified the Navy that its Ingalls Shipbuilding division intends to stop production on the controversial LHA landing helicopter-assault ship program on Aug. 1 because of alleged breaches of contract.

Litton claimed it has already poured $100 million in financing into the project, and ultimately would have to increase that sum to $400 million to complete the contract.

In a letter from Litton's president, Fred W. O'Green, to Vice Admiral Robert C. Gooding, commander of the Naval Sea Systems Command, the company cited what it called numerous Navy breaches of contract on the program at Litton's Pascagoula, Miss., shipyard. They included failure to pay money due, "unilateral imposition of design changes," and delays and changes in performance conditions "so significant as to breach the contract."

The Navy acknowledged receiving Litton's notice but declined further comment.

Earlier this month, Litton was one of two companies that rejected the Defense Department's efforts to settle $1.9 billion in claims from shipbuilders. The other shipbuilder rejecting the proposed settlement, which could have cost about $700 million, was Newport News Shipbuilding & Dry Dock Co., a unit of Tenneco Inc. Two shipbuilders did accept the Pentagon proposals.

Litton further claimed that it is "no longer legally required or permitted" to finance work on the LHA program. Litton said the Navy must come up with future funding on the project. The company accused the Navy of violating the anti- Deficiency Act, which, it said, prohibits the Navy from ordering work unless sufficient funds have previously been appropriated. Litton said it's willing to continue, or to resume, work under terms that would provide adequate funding.

The company delivered one LHA to the Navy in May, and is in the process of outfitting a second for sea trials. Three more are in various stages of production. The original LHA contract was valued at $967 million Litton has claimed it's owed an additional $504.8 million.

Of the 24,000 people employed at the Pascagoula facility, about 5,900 work on the LHA program, a Litton spokesman said. If the halt is made, about 3,900 employes would be laid off and the remaining 2,000 would be switched to other projects, he said.

The spokesman said that Litton yesterday formally submitted a petition to the Navy to revise the contract. He said that if a work stoppage occurred, there would be "no impact" on Litton's balance sheet because the company expects "full recovery" of a claim filed with the Armed Services Board of Contract Appeals.

ITEM 44.—*July 22, 1976—L.A. Times article—"Navy Asks Court to Force Litton to Continue Work"*

WASHINGTON.—The government Wednesday asked federal courts to block a threat by Litton Industries Inc. to halt work on new types of helicopter-amphibious assault ships it is building under a $795 million Navy contract.

Litton, blaming the Navy for cost overruns and other problems, announced June 18 it will halt work on the ships at its Ingalls shipbuilding division yard at Pascagoula, Miss., at 12:01 a.m. on Aug. 1 unless the dispute is settled.

The Justice Department, which the Navy brought into the case, asked the U.S. District Court in Jackson, Miss., to block such a shutdown with a temporary restraining order. This is a step toward getting an injunction that would keep work continuing indefinitely.

The department at the same time asked the U.S. District Court in Los Angeles to throw out a suit filed by Beverly Hills-based Litton this month to void the Navy contract or else move that case to Mississippi.

The court in Mississippi was told the Navy needs the new type of ship, called the "largest, fastest and most versatile vessel in the history of American amphibious warfare," to bolster its lagging amphibious capability.

"The present capability of the U.S. active amphibious assault ships is inadequate for defense purposes and is at the lowest level since 1950," the court was told.

In addition, the court was told, Litton plans to start "massive layoffs" at the shipyard Friday. With a 24,000-man work force, the Ingalls yard is Mississippi's biggest industrial employer.

The ships, called LHAs, carry helicopter as well as amphibious landing craft. The Navy ordered nine in a $1.2 billion contract in 1969, but the number later was reduced to five. Only one has been completed.

Litton said it welcomed the Navy's action in filing the suit Wednesday.

"This will provide an opportunity to appear before an objective tribunal for a hearing on the merits and to obtain a resolution of an issue of great importance to both the shipbuilding industry and the Navy," said Glen McDaniel, chairman of the executive committee.

Litton expressed hope that the present legal proceedings would make it unnecessary to "disturb" the employment of some 5,900 Ingalls workers on the LHA program.

The Navy said no other shipyard can finish three of the incomplete ships because the Ingalls yard uses a novel assembly line method of fitting together huge self-contained "modules," that are moved about on rails. Each ship has four modules weighing 4,000 tons and a superstructure module weighing 400 tons.

The yard, which Litton leases from the state of Mississippi, is also being used for construction of 27 of 30 destroyers for the Navy.

Litton has piled up claims totaling $500 million in the course of building one ship and starting the other four.

ITEM 45.—*July 25, 1976—L.A. Times article—"Litton, Navy Play 'Chicken' with Ships"*

(By Robert A. Rosenblatt)

WASHINGTON.—The band won't be playing "Anchors Aweigh", next month at the Ingalls shipyard in Pascagoula, Miss.

Instead, the workers will lay down their tools on Aug. 1, stopping construction of four ships for the Navy.

More than 2,700 people will be laid off, casualties of an increasingly bitter confrontation between Litton Industries Inc. and the Department of Defense.

Attacking the Navy for breach of contract, interference and delays, Litton recently announced it will stop all work next month on the landing helicopter assault (LHA) ships being built as its Ingalls division shipyard. The parent corporation has already poured more than $100 million of its own cash into the program, and would have to spend another $300 million to complete the ships. This is money over and above the contract price, and would come out of Litton's corporate pockets.

The company decided to act now because it faced a cash drain of $200 million on the LHA project for the year starting Aug. 1.

Litton has filed suit against the government, asking the court to free the company from performing under the contract. The government responded last week with a suit asking for a court order compelling Litton to keep working.

Obviously, any future cash drains from the ships would present serious problems for Litton. The company already has filed cost overrun claims exceeding $500 million; the profit-and-loss impact of the LHA contract won't be known until the claims are finally resolved.

Litton officials hope the court, if it forces the company to continue LHA construction, will require the Navy to pay for completion of the ships.

Corporate executives won't speculate about the worst possible case for the company's financial statement—a court injunction compelling Litton to finish the ships using Litton cash.

The Defense Department, irritated because Litton rejected a compromise offer, insists that the ships will be built despite the company's defiant attitude.

"We have a contract, we fully intend to see that the contract is honored and the ships are built," William P. Clements Jr., deputy secretary of defense, said in an interview.

"I assume they're not bluffing," Clements said laconically when asked about Litton's intentions. Neither is Clements, apparently.

The Navy went to court once to force the Newport News (Va.) Shipbuilding Co. to continue working on a guided missile cruiser, and the clear implication is that the same tactic will be used against Litton.

Now, the government is close to reaching a settlement of the Newport News claims for reimbursement of cost overruns. Compromise with two other shipbuilders are also likely, leaving Litton isolated in its dispute with the Pentagon.

In the talks between the Navy and Newport News, Clements noted, "both parties have a common goal—they want to make progress." That's not true in the Litton situation, he charged.

Selecting his words carefully because the government will be in court against Litton, Clements said: "In 3½ years of discussion with Litton, I have not been impressed with their definition of the term compromise."

The heart of the dispute is this: the ships won't be finished on time, and will cost more than the $1 billion contract ceiling price. Litton says the delays and cost overruns resulted from Navy inefficiencies and errors. The Navy blames it on the Beverly Hills-based conglomerate.

Originally, the Navy contracted with Litton for nine ships at a total cost of $1 billion. This was reduced to five ships for $947 million, the final price figure issued in 1973 by a Navy contracting officer in response to cost overrun claims by the company.

Shipbuilding contracts allow the government to make changes in design and equipment during the actual construction process. A top official at the Ingalls yard drew this analogy:

"Suppose you're building a home and the contractor has the slab poured in place. You tell him that you want the bathroom in a different location. Then it's necessary to break up the concrete and change the plumbing around. The contractor says, "That will cost you $500 more and delay the delivery of the house by three days.' In shipbuilding, it's not $500 but hundreds of thousands of dollars. And it's not one change but hundreds of changes that have a domino effect."

A one-week delay of a single ship, with construction workers diverted to making changes, can ripple out to the schedules of other ships, the Ingalls official said.

The contract contained escalation provisions to cover rising expenses during the contract period. "Had they (Litton) been able to perform on time, the escalation clause would have protected them more than it turned out to do," Vice Adm. R.C. Gooding, the officer in charge of shipbuilding contracts, told a subcommittee of Congress' Joint Economic Committee.

But Litton fell far behind, three years and more on the delivery schedule. In this case, the company doesn't get more money—unless the delays were caused by the Navy. And that's the controversy—who's to blame for the delays?

Litton filed multiple claims with the Navy, blaming the rising expenses on changes required by the Navy. By March, 1972, Litton had filed claims of $370 million, the claims were increased to $504 million by April of last year.

Litton has delivered only one of the five ships, with the other four vessels in various stages of preparation.

Some of the claims can be blamed on inflation, the Ingalls yard official said, but most of the costs stem from Navy-sponsored changes and delays.

The Navy's shipbuilding program suffers from financial problems not restricted to Litton contracts. Claims totaled $3.2 billion, or 20% of all shipbuilding contracts—some $16.5 billion—during the past seven years.

The former deputy chief of contract procurement, retired Rear Adm. Kenneth L. Woodfin, was skeptical of the claims when he appeared before a Senate-House economic subcommittee recently:

"Shipbuilding claims figures can be misleading and should not be accepted at face value. Typically, shipbuilding claims are greatly exaggerated and viewed by many contractors simply as a starting point for negotiation."

Litton insists its claims are valid and supported by dozens of volumes of technical testimony. "The volume of documentation is just mind-boggling," according to an Ingalls executive.

The Navy disagrees.

Under questioning by Sen. William Proxmire (D-Wis.), chairman of the Joint Economic Committee, Gooding said Litton had only recently offered documentation for some of the $504 million in claims.

Litton wants the Navy to pay approximately $100 million to defray investment costs in the Ingalls shipyard, but has never filed a formal request supported by financial data, according to Deputy Defense Secretary Clements.

Using special legal authority, Clements offered the shipbuilders a compromise earlier this year, promising a settlement ranging between $500 million and $700 million in return for the companies dropping their $1.8 billion in claims.

Litton's final loss on the contract would have been $200 million if it accepted the compromise, according to Navy officials. This would have represented a significant loss when placed against Litton's retained earnings which at the end of its 1975 financial year amounted to $356.5 million.

But Litton and Newport News Shipbuilding Co. turned down the offer, although they would have received the money without any audits of their multimillion-dollar claims.

Some members of Congress thought this compromise offer was too generous. Proxmire said, "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 cents or 50 on the dollar."

The alternative is worse, countered Clements in his testimony. Handling the claims through the normal auditing system, he said, "will be a multi-year, drawn out process involving people, many, many lawyers and a very acrimonious atmosphere."

The ships would cost a lot more after a long audit than they could under his compromise, Clements said.

The proposal scorned as too generous by Proxmire was rejected as too niggardly by Litton. And the acrimonious atmosphere predicted by Clements has arrived.

Don't expect a last-minute compromise, Clements suggested during the interview. "We want our ships and intend to get them," he said.

Litton is equally adamant, insisting it cannot continue construction without a new financial arrangement. "Out of every dollar he spends now, we receive just 25 cents back from the Navy," said an Ingalls official.

Litton and the Navy keep steaming toward a collision in the courts. The company's claims, which exceed $500 million, won't be settled for years unless some unexpected compromise deal emerges before Aug. 1.

ITEM 46.—*July 29. 1976—Washington Star article—"Ingalls Is Told To Build Ships"*

JACKSON, MISS. (AP)—A federal judge ruled yesterday that Ingalls shipyards must continue building four U.S. Navy assault ships and that the Navy must pay construction costs.

The ruling came in a longstanding dispute over an estimated $504 million in cost overrun claims.

"It is extremely important to the public interest that construction continue and that the Navy have these ships as quickly as possible," the opinion by U.S. District Judge Harold Cox said.

The order takes efiect Sunday, the day Ingalls had said it would stop building the ships at its yards in Pascagoula, Miss.

ITEM 47.—*Apr. 7, 1977—Washington Post article—"Litton Is Indicted in $37 Million Overcharge Case"*

(By Jane Seaberry)

A federal grand jury in Alexandria yesterday indicted Litton Industries, a major national defense contractor, on a charge of fraudulently overcharging the Navy $37 million for building three nuclear submarines.

The indictment charges Litton with falsely submitting a claim to the government when one of its divisions, Ingalls Nuclear Shipbuilding of Pascagoula, Miss., gave the Navy a 42-page explanation of costs in building the submarines. Ingalls said delays by the Navy caused the company to subcontract part of the work and disrupt its schedule.

The government charged in the indictment that the cost data were "false, fictitious and fraudulent," and contained "misrepresentations and omissions of material facts."

Ingalls said yesterday in a prepared statement that "it is innocent" of the government's charges and that the incident "is another example of the Navy's mismanagement of its claims settlements in its shipbuilding programs * * * We are convinced there is no fraud in our claim."

The investigation into the charges was started in January, 1974, by the Justice Department after the Navy tried to determine how much of the cost over the original $100 million contract it was obligated to pay Ingalls, according to Special Assistant U.S. Attorney Richard D. Kibby.

The grand jury first heard testimony in November, 1974. The case was heard in Alexandria because the claim was sent to Navy offices in Arlington, Kibby said.

The Navy first entered the contract for the three SSN–680 submarines June 25, 1968, according to the indictment.

The first submarine was supposed to be delivered to the Navy in September, 1971, but the Navy postponed delivery a year because it was unable to ship steel to Ingalls on time, Kibby said.

Ingalls then said that to keep costs down due to the delay, it would stretch out the shipbuilding time rather than delay the start of construction, the indictment stated.

Ingalls claimed that the Navy was late in delivering steel, causing Ingalls to subcontract part of the work. Ingalls eventually said it had to subcontract part of the construction three times because the Navy's delays disrupted its schedules with other contractors.

On Nov. 30, 1970, Litton submitted to the Navy the $37 million claim and an explanation of the costs, the indictment said.

Litton, a Beverly Hills-based firm, receives about one-third of its $3 billion annual revenue from national defense contracts, according to a Litton spokesman. The company also manufactures typewriters and microwave ovens.

The Navy already has paid Litton about $3.5 million of the additional charges, according to Assistant U.S. Attorney Frank W. Dunham Jr. The submarines have been operating in the U.S. fleet for two to four years, the Litton spokesman said.

Neither Kibby nor Dunham would say how they knew the charges were deliberately false and not an oversight by Ingalls. The penalty for submittting a false claim to the government is $10,000, Kibby said. Recovery of any money paid because of fraudulent claims could be recovered by filing a civil suit.

Ingalls also said yesterday it is seeking from the Navy $13.6 million due on a $17.3 million judgment it said it was awarded by the Armed Services Board of Contract Appeals in April, 1976, in connection with the SSN–680 submarine contract. Ingalls said payment of the award was held up by the Justice Department investigation into the claims.

ITEM 48.—*April 21, 1977—South Mississippi Sun article—"Ingalls To Continue To Build Ships Under Extended Court Order"*

JACKSON.—Ingalls Shipbuilding, engaged in numerous legal battles over the construction of four landing helicopter assault (LHA) ships, will continue to build the ships under an extended federal court order.

U.S. District Judge Harold Cox renewed an order for six months Tuesday requiring that Ingalls build the controversial ships. Cox originally handed down the order in July, 1976 after Ingalls said it would halt construction of the ship in a dispute over its contract with the Navy.

Cox also extended the requirement that the Navy pay Ingalls aboue $3 million a week to cover its costs.

The $930 million contract for five LHAs has caused many law suits in different jurisdictions because of Ingalls' allegation that the contract does not allow the company a fair return on its investment.

Ingalls has filed a $700 million overrun claim on the contract for costs it says were incurred by the Navy but are not covered by the contract.

Ingalls officials have said the claim may rise to more than $1 billion before all five ships are completed. One LHA has already been delivered to the Navy while the second is scheduled for delivery late this summer.

Cox's original order was to extend until May. Under its terms, the Navy had to pay for such expenses as payroll workers, Social Security costs and unemployment payments for those employes working on the ships. It was not required to compensate the shipyard for security costs, vacation and sick leave pay, recruitment advertisement, management salaries or depreciation.

In a ruling handed down in November, Cox ordered the Navy to pay 91 per cent of the costs incurred by Ingalls since the August, 1976. This rate of payment will continue under the new order.

In the original suit filed by Ingalls, the shipyard asked to be relieved of contractual obligations for building the ships.

Ingalls is also engaged in claims litigation on other contracts completed at the yard, including one for three nuclear-powered submarines. The shipyard was recently indicted for falsifying parts a $37 million claim on the three subs. Ingalls pleaded innocent to the charge.

Ingalls has also filed suit on the same contract to recover more than $13 million it says the Navy owes the company on a claims settlement.

ITEM 49.—*April 25, 1977—Wall Street Journal article—Litton Industries Says SEC Will Investigate Accounting Methods"*

LITTON INDUSTRIES SAYS SEC WILL INVESTIGATE ACCOUNTING METHODS

BEVERLY HILLS, CALIF.—Litton Industries Inc. said the Securities and Exchange Commission will conduct a private investigation into accounting methods Litton used in reports related to its big shipbuilding contracts for the Navy and in claims disputes over those contracts.

Litton said the action "apparently continues a recent informal inquiry" by the SEC. The company, along with other shipbuilders, has been embroiled in a series of claims and counterclaims over ship contracts with the Navy.

In the latest of a series of disputes, Litton filed earlier this month a suit in the U.S. Court of Claims in Washington, asking release of funds due to its Ingalls shipbuilding unit but held by the Navy. The claims related to three nuclear submarines built for the Navy.

At the same time, a federal grand jury in Alexandria, Va., handed up a criminal indictment against Ingalls for allegedly filing a false claim with the Navy in 1972 in connection with the building of the vessels.

ITEM 50.—*May 26, 1977—Washington Post article entitled "Fraud Charge Against Litton Dismissed by Federal Judge"*

(By Jane Seaberry)

A federal judge in Alexandria yesterday dismissed an indictment charging fraud against Litton Industries, ruling that U.S. prosecutors abused the grand jury system in threatening Litton with the indictment if the company did not agree to government proposals.

The order of U.S. District Court Judge Albert V. Bryan Jr. also prohibits prosecutors from reindicting Litton on the charge because "prosecutorial discretion" [was] abused.

Litton, a major defense contractor, was indicted April 6 on a charge of fraudulently overcharging the Navy $37 million for building three nuclear attack submarines between 1968 and 1971.

This indictment came after an attempt to indict Litton in 1975 failed when the term of the special grand jury called in March of that year solely to investigate Litton expired.

But in April, 1976, the Armed Services Board of Contract Appeals awarded a $17.3 million judgment to Litton from the Navy in connection with the contract.

Bryan said in his opinion that after the 1975 attempt to indict Litton failed, prosecutors, in an attempt to get the award revised, continued to threaten to indict Litton if it did not agree to reopen the appeals board procedings.

"What is reprehensible here is the threat to use, as well as the actual use of, the grand jury as a bargaining tool in an effort to upset the final civil award to which Litton was entitled," Bryan said.

Prosecutors also had two FBI agents summarize evidence to the April 6 grand jury rather than formally present information and witnesses as in the previous grand jury, which did not indict Litton, Bryan said.

"This is further evidence of the cynical view that has been taken of the grand jury in this case, namely, as a mere echo of the office of the U.S. attorney," Bryan said.

"I think the court misread our action," said U.S. Attorney William B. Cummings, who, with the Justice Department, headed the two-year investigation of Litton.

Bryan "assumed that there were motivations, a desire on our part to get this thing back to the [appeals] board and use the grand jury to bludgeon them. Nothing could be further from the truth," Cummings said.

ITEM 51.—*May 26, 1977—Wall Street Journal article entitled "Suit Against Litton Industries Involving Navy Job Dismissed"*

ALEXANDRIA, Va.—A federal court judge dismissed a criminal indictment against Litton Industries Inc. for allegedly filing a false claim with the Navy in May 1972 for $37 million in connection with a contract to build three nuclear submarines.

The criminal indictment had been issued by a federal grand jury here. The three nuclear submarines have been operating with the U.S. fleet for two to four years.

The federal court judge said in his opinion: "It is entirely possible that upon trial Litton would be found guilty of presenting a false or fraudulent claim; however when prosecutorial discretion is abused, as here, dismissal of the indictment . . . is warranted."

Judge Albert V. Ryan Jr. added: "The determination and review of civil disputes . . . is governed by an established statutory and regulatory scheme. Allowing the government to circumvent . . . the administrative resolution of the contract disputes by threatening criminal prosecution in substance abrogates the private party's right to hold the government to its own rules."

ITEM 52.—*May 26, 1977—Washington Star article entitled "Judge Dismisses Litton Indictment in U.S. Sub Case"*

A federal judge has dismissed an indictment accusing Litton Industries of fraud and allegedly overcharging the Navy $37 million for building three nuclear submarines.

U.S. District Judge Albert C. Bryan Jr. of Alexandria issued the order yesterday along with a lengthy opinion explaining his reasons.

An attorney in the federal prosecutor's office there said the office was notified of Bryan's decision but that no decision has been reached about what course the government will take.

The attorney said Bryan, in the written opinion, discussed his earlier complaints that government investigators behaved improperly in the probe. At a hearing Friday, Bryan said "the government behaved badly here."

Litton sought the dismissal on grounds that federal prosecutors "improperly pressured" the company to reopen proceedings with the Armed Services Board of Contract Appeals in exchange for stopping the federal criminal investigation. Litton refused and the indictment was returned April 6.

The Armed Services Board of Contract Appeals in April 1976 awarded Litton $17.3 million from the Navy for the submarine contract. The award was made while the government was conducting its investigation of fraudulent overcharges.

ITEM 53.—*Jan. 18, 1978—Letter from Secretary of the Navy Clator to Senator Stennis announcing Navy's intent under Public Law 85–804 to modify its LHA contract with Litton's Ingalls Shipbuilding Division. (Printed in Congressional Record Feb. 14, 1978)*

CONTRACT MODIFICATION UNDER PUBLIC LAW 85–804, NOTIFICATION OF HEARING, STATEMENT OF HON. MELVIN PRICE, CHAIRMAN, COMMITTEE ON ARMED SERVICES

Mr. PRICE. Mr. Speaker, Public Law 85–804 (50 U.S.C. 1431) provides that the President may authorize a Government department to enter into contracts or enter into amendments or modifications of contracts and to make advance payments thereon, without regard to other provisions of law relating to the making, performance, amendments, or modifications of contracts when it is intended that such would facilitate the national defense. In Public Law 93–155, the Defense Department Appropriation Authorization Act for fiscal 1973, the law was amended to provide that the authority to modify contracts may not be used in any amount in excess of $25 million unless the Committee on Armed Services of the Senate and House of Representatives have been notified in writing and 60 days of continuous session of Congress has expired following such notification and neither House has adopted within that 60-day period a resolution of disapproval.

By this 1973 amendment, the Congress has thus placed upon its Armed Services Committees the responsibility for reviewing the use of the authority under Public Law 85–804 to be sure that such is in the best interest of the United States.

On January 18, 1978, the Honorable W. Graham Claytor, Jr., Secretary of the Navy, officially notified the Committee on Armed Services of his intention to use the provisions of Public Law 85–804 to modify the existing Navy contract with Litton Systems, Inc., for the construction of amphibious assault ships known as LHA's.

Mr. Speaker, as Members are aware, some of the contract claims involved with Navy shipbuilding are very complex and have been a problem to the Navy for several years. Secretary Claytor is attempting to resolve the problem of Navy claims in a way that is fair to the Government and will allow our important shipbuilding programs to go forward. Because of the complexity of the matter and because the Secretary's notification comes at a time when the Committee on Armed Services is heavily engaged in hearings on the Defense Department authorization legislation for fiscal 1979, I have asked the Comptroller General to examine the matter and to provide the committee a full report. I have asked the Comptroller General to have his representatives prepared to submit the results of their findings to the committee on March 7.

Any Members of Congress or other interested parties wishing to submit views on this matter will be heard on March 7, or may submit written views for the record.

Following a full hearing, the committee will determine whether it is necessary to recommend further action to the House. The 60-day period provided for in law for congressional review does not include any adjournment of more than 3 days to a day certain. Thus, there will be adequate time for further action following the March 7 hearing, if such were required.

For the information of my colleagues, I insert the notification of the Secretary of the Navy, dated January 18, 1978, into the RECORD at this point along with the documents which accompanied the notification:

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 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 U.S.C. 1431 (Supp. 1977). Information copies are being forwarded to the Chairman 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 CLAYTON, Jr.,
Secretary of the Navy.

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 percent of costs to 75 percent.

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 objectives 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 assemblyline production.[1] Even before

[1] On 23 June 1970 the Naval Sea Systems Command awarded Contract N00024–70–C–0275 to Ingalls for the construction of thirty destroyers of the DD–963 class, also to be performed at this new facility.

actual construction of the LHAs 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 prove dto 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 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 23, 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 percent 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 percent 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 proceding, 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 percent of its costs.

The Government has opposed the continuation of the 91 percent cost reimbursement provision but its efforts have met with failure. On October 26, 1977, the Court ordered the continuance of both the preliminary injunction and the condition that Litton receive 91 percent of cost incurred until July 31, 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 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 ban an immense cash drain on Litton. The position of the parties would revert to the present terms of the contract, resulting in an immediate indebtedness 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 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 power under Public Law 85–804, 50 U.S.C. SS1431 et seq., I find that the proposed modification to Contract N00024–69–C–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 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 accord ance 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.

ITEM 54.—*Mar. 7, 1978—Statement of Assistant Secretary of the Navy (M,RA&L) Hidalgo before the House Armed Services Committee concerning Litton's LHA contract dispute*

STATEMENT OF THE HONORABLE EDWARD HIDALGO, ASSISTANT SECRETARY OF THE NAVY (MANPOWER, RESERVE AFFAIRS AND LOGISTICS) BEFORE THE COMMITTEE ON ARMED SERVICES, HOUSE OF REPRESENTATIVES, MARCH 7, 1978

Mr. Chairman, Members of the Committee: I am pleased to appear before you today to discuss current Navy actions with respect to the contract with the Ingalls Shipbuilding Division of Litton Systems, Inc., for the construction of five LHA ships. The contract modification which we propose to execute and which is the subject of today's hearings is an integral part of a settlement effort initiated last fall concerning present litigation between the United States and Litton Systems, Inc. What we seek is a breakthrough, advantageous to the Navy, acceptable to Litton, in the massive legal and contractual problems associated with the LHA contract.

In order to understand the course we have set in pursuit of a possible resolution of these highly complex problems, permit me to review briefly the salient facts in the history of the LHA contract, claims and controversy.

Almost from its award in 1969, the LHA contract has been the cause of controversy between Litton and the Navy. Among charge and countercharge concerning program delays and escalating costs, the Navy and Litton were unable to agree on equitable adjustments to the contract as requested by the contractor or to the finalization of the contract price as called for in the contract terms. As a result, in March 1973, Litton appealed a unilateral Contracting Officer's decision to the Armed Services Board of Contract Appeals (ASBCA). It is that appeal, now almost five years old without substantial progress toward resolution, which is the nucleus of the present LHA claim.

In June of 1976, after several unsuccessful efforts to resolve difficulties, Litton announced that it was going to stop work on the LHA contract on 1 August 1976, asserting alleged breaches of the contract by the Navy. Underlying this threat was the fact that Litton, already experiencing heavy losses on the program, was then receiving progress payments equivalent to only 25% of LHA construction costs. The Department of Justice, at the behest of the Navy, instituted suit to compel performance on the contract in the Southern District of Mississippi in June of 1976 and sought a preliminary injunction. The District Court granted the injunctive relief. However, relief was conditioned on the Navy's reimbursing Litton 91% of the contractor's weekly invoiced costs. The court order originally ran to April 1977 but was subsequently extended to October of 1977 and again to 31 July 1978. The 91% reimbursement remained constant in the court order.

That suit is only one aspect of the LHA contract litigation which has become incredibly complex. The claims, presently quantified by Litton at $1.076 billion, are the subject of three separate actions. Affirmatively these claims form the basis for the ASBCA appeal; they were also raised, along with other issues, as breaches of contract justifying the work stoppage in the Mississippi action and urged as defenses to the issuance of a permanent injunction. In 1976, a third forum was added when Litton brought suit in the Court of Claims for damages allegedly suffered as a result of breaches of contract, substantially supported

by the same subject matter underpinning the claims. This latter action has been suspended virtually since its inception. Controversies concerning the contract have resulted in other litigation ancillary to the main issues. These presently include an action in the Court of Claims seeking an increase in the cancellation charge received by Litton due to the procurement reduction from nine to five ships and an ASBCA appeal concerning a prior disagreement on the computation of progress payments.

From the outset the results of all this litigation placed an imposing burden upon both Litton and the Navy. Relations between the parties had steadily deteriorated, to the point where even the simplest matters could not be resolved without extensive negotiation. The resources of both parties are straining under the massive load placed upon them by discovery and legal motions in the various cases. Given the constant need to consider the litigative consequences of each proposed contractual or technical action, there have been times when the construction of the ships has seemed almost incidental to the conduct of the parties' business relations and lawsuits.

The then existing court order, while insuring continued construction of the ships, left Litton with little incentive to resolve the controversy centering around the claims. This status was changed, however, when the Navy agreed with the Department of Justice that the appeal would be taken to the Fifth Circuit challenging the court order requiring the Navy to reimburse Litton 91% of the cost of performance. Such critical issues were involved in this appeal for both sides that the time was ripe for a negotiated settlement of the Mississippi action.

It is in this historical context that in the fall of 1977, Navy and Department of Justice negotiations with Litton resulted in an agreement memorialized in a document signed by Justice and Litton lawyers on 14 November 1977. In exchange for Litton's agreement to a joint motion reducing the reimbursement from 91 percent to 75 percent of costs until 1 April 1978 and staying all proceedings until that date, the Justice Department postponed the appeal until after 1 April 1978. A basic premise of the agreement with the Department of Justice was that the Navy and Litton would enter into a contract modification to make permanent the reduction in cost reimbursement from 91 percent to 75 percent. The other side of the coin, so vital to the Navy, is Litton's commitment to take necessary action, as long as payments were made under the modification, to continue the temporary injunction and the stay of the District Court proceedings.

Coincident with the negotiation of this reduction in payments on the LHA construction, and to ease the immediate cash flow consequences to the Ingalls yard of that reduction, the Navy acceded in part to a long standing request by Litton to accelerate the release of earned retentions on the DD–963 contract, also being performed in the Ingalls yard. This release will provide $12 million by August 1978 if the contract modification is executed; in the same period, the reduction from 91 percent to 75 percent will reduce the Navy cash input to the LHA contract by approximately $20 million. To the end of LHA construction the reduced rate of payment represents an increased Litton investment, and conversely a reduction in Government payments, of approximately $50 million.

It is important to understand that payments under the contract modification are subject to recoupment to the extent the ultimate claims resolution is in an amount less than the payments under the modification and prior court-ordered payments over the present contract ceiling. Payments pursuant to the 91 percent court order exceed to date by approximately $150 million the amount payable pursuant to the contract. As stated, execution of the 75 percent contract modification will reduce over ceiling payments to the termination of LHA construction by an estimated $50 million. The total amount over ceiling, pursuant to the Court Order and the contract modification, is expected to be approximately $250 million, or 23 percent of the face value of Litton's claim.

The benefit to the Navy of the contract modification is not merely the obvious one I have discussed but, more importantly, its essential contribution to the search by the parties since October of last year for a resolution of the overall problems. It is too early to speak of this in any detail and indeed we may never be able to do so, in which case the contract modification would nevertheless stand justified. But if we do move ahead in the search I speak of, the contract modification will have served an important intermediate role.

ITEM 55.— *Mar. 19, 1978—Washington Star article entitled, "A Fraud Probe on Ship Contracts"*

(by Gregory Gordon)

The Justice Department is investigating the possibility that three major shipbuilders committed criminal fraud in their filings of huge contract claims against the Navy, official sources report.

Justice Department officials are looking into number of fraud allegations among the $2.7 billion in claims lodged by Litton Industries, Newport News Shipbuilding and Drydock Co. and the Electric Boat Division of General Dynamics, the sources said.

Electric Boat, which has pending claims of $544 million, has threatened to halt construction of 16 submarines April 12 if it is not paid. The Navy offered the company a settlement, but it was rejected.

Adm. Hyman Rickover testified before Congress that he believes the claims are "grossly exaggerated" and has alleged fraud.

One high Justice Department official indicated the investigation by the department's fraud section may extend beyond the three companies, but said the number of firms involved in the review "does not exceed six."

Joseph Wornom, spokesman at Electric Boat in Groton, Conn., said, "We're not aware or have any knowledge at all of any such investigation."

The Navy's general counsel's office, which referred the cases to the Justice Department, and the FBI will assist in checking for possible fraudulent claims where a company:

Submitted bills for work never performed;

Falsely described the nature of the work and inflated the charges;

Or used cheaper parts than called for in the contract and charged for the prescribed parts.

An official explained the billing disputes between the government and defense contractors result mainly because most contracts are negotiated at a fixed price. He said the Navy often later alters its order when it learns of new technology, and there are disagreements over the cost of changing the specifications.

One source close to the investigation said there are "a whole host of suggestions or allegations" of fraudulent billing.

"But if they are true," he said, "how much money they amount to, I don't know."

ITEM 56.—*Apr. 4, 1978—Decision of United States Court of Appeals for the Fourth Circuit vacating the district court's dismissal of Litton's April 6, 1977 indictment by federal grand jury for filing a false claim. The appeals court remanded the case for further proceedings*

U.S. COURT OF APPEALS FOR THE FOURTH CIRCUIT

NO. 77-2191

UNITED STATES OF AMERICA, APPELLANT

v.

LITTON SYSTEMS, INC., D/B/A INGALLS, NUCLEAR SHIPBUILDING DIVISION, APPELLEE

Appeal from the United States District Court for the Eastern District of Virginia, at Alexandria. Albert V. Bryan, Jr., District Judge.

Argued February 7, 1978. Decided April 4, 1978

Before Winter, Butzner and Russell, Circuit Judges

Willam B. Cummings, United States Attorney (Frank W. Dunham, Jr., Assistant United States Attorney, Joseph A. Fisher, III, Assistant United States Attorney and Sara S. Beale and Elliott Schulder, Department of Justice on brief) for appellant; Bruce W. Kauffman (David H. Pittinsky, Stephen J. Mathes,

Lawrence D. Berger, Dilworth, Paxson, Kalish, Levy & Kauffman; W. W. Koontz, John S. Stump, Boothe, Prichard & Dudley on brief) for appellee.

Butzner, Circuit Judge:

The United States appeals from an order of the district court dismissing a one count indictment against Litton Systems, Inc., because of prosecutorial misconduct during pre-indictment negotiations between the parties. We vacate the order of dismissal and remand the case for further proceedings.

I

In 1972 the Ingalls Nuclear Shipbuilding Division of Litton Systems, Inc., filed a claim with the Navy for approximately $30 million in connection with a contract to construct nuclear submarines. The company appealed an adverse decision by the Navy contracting officer to the Armed Services Board of Contract Appeals, which in April, 1976, awarded Litton more than $16 million. Both parties agreed not to ask for reconsideration of the award.

In March, 1975, after the Board had concluded its hearings but before it announced its decision, the district court impaneled a federal grand jury to investigate Litton's claims against the Navy. At a conference with the assistant United States attorneys handling the investigation, Vincent J. Fuller, counsel for Litton, inquired whether there might be an alternative to the criminal investigation. One of the assisants responded that the government did not presently have enough evidence to make such a decision. Fuller also asked for advance notice if they decided to seek an indictment because he wanted a chance to attempt to dissuade the government from proceeding.

Toward the end of the grand jury's term, the government lawyers concluded that although the falsity of Litton's claims could be proved, the evidence of criminal intent was insufficient to establish guilt beyond a reasonable doubt. They therefore decided to let the term expire without seeking an indictment and to continue the investigation, exploring several promising leads that would enable them to prosecute the corporation rather than individual employees. About the same time, an attorney paid by Litton to represent employees before the grand jury suggested to Frank W. Dunham, Jr., the Assistant United States Attorney in charge of the investigation, that someone should talk to Fuller about alternatives to criminal prosecution. Dunham knew that this attorney communicated frequently with Litton's counsel and, recalling Fuller's earlier requests, he decided to confer with Fuller.

On September 9, 1976, Dunham explained to Fuller that the government had evidence that Litton's claim was false but that it had not yet found sufficient proof of willfulness and criminal intent. He told Fuller that no indictment would be returned but that the investigation would have to continue. Dunham said that he saw a possible way to resolve the controversy but was "reluctant to discuss it without assurances first being made that the discussions would not be taken as a threat or treated as other than a good faith attempt to resolve the intent question." Fuller agreed to this stipulation, encouraged Dunham to proceed, and said that he would terminate the talks any time he deemed them inappropriate or improper. Dunham then proposed that:

> A. Both Litton and the Navy would petition to reopen the [Armed Services Board of Contract Appeals] proceeding;
>
> B. Both Litton and the Navy would join in application to the Court for a [Federal Rule of Criminal Procedure] 6(e) Order to permit inspection by Litton and the Navy of grand jury materials for use by both parties in the reopened [Board] proceedings;
>
> C. The Government would not assert fraud as a defense in the Court of Claims to any final judgment for Litton in the [Board] nor would it initiate any civil fraud suits;
>
> D. The criminal investigation would be terminated.

Elaborating on this outline, Dunham emphasized that, upon hearing whatever additional evidence either side wanted to introduce, the Board could adjust its award up or down or let it stand.

Fuller found the proposal reasonable, describing it as a "breath of fresh air," and a few days later he advised Dunham that Litton was interested in discussing it. At a second meeting, Dunham disclosed the evidence of the falsity of Litton's claim, and the parties discussed the mechanics of reopening the proceeding before the Board and getting the corporate and governmental approvals necessary to

implement the plan. Two days later, however, Glen McDaniel, the chairman of Litton's executive board, who had not conferred with the government attorneys, met with Deputy Attorney General Harold R. Tyler, Jr., complaining that Litton was being threatened with indictment if it refused to reopen the Board proceedings. Fuller, upon learning of this complaint from Dunham, agreed that it violated their understanding concerning discussion of the proposal and offered to advise the Deputy Attorney General of this. After inquiring into the settlement negotiations, the Deputy Attorney General wrote Litton that he found nothing improper in them. He suggested that Litton's lawyers contact the government attorneys if further negotiations were desired.[1] At Litton's request, the parties again conferred, but on November 1, 1976, Litton rejected the proposal.

The government's investigation continued throughout the final months of 1976. On January 17, 1977, Assistant Attorney General Richard Thornburg requested the United States Attorney to present the matter to a new grand jury for the purpose of seeking an indictment. Attorney General Griffin Bell approved prosecution of the case on February 7, 1977.

Dunham honored Fuller's request and advised him of the decision to indict. In response, Litton expressed a desire to avoid prosecution and to return the matter to the Board along the lines of the government's proposal. Dunham indicated that the prosecutors were now opposed to such a disposition but that he would forward any proposal from Litton to the Department of Justice for review. At Litton's request, the Attorney General, his principal assistants for matters pertaining to criminal prosecutions and fraud, and the United States Attorney and his assistants met with Fuller, McDaniel, and two members of Litton's board of directors. At the conclusion of this conference the Attorney General found no justification for terminating the prosecution. The next day the grand jury returned the indictment. Litton, represented by new counsel, subsequently moved to dismiss it.

The district court granted Litton's motion. It found that the government's proposal constituted an implied threat of indictment designed to coerce Litton into giving up its award and that, when Litton refused, the government retaliated by obtaining the indictment. The district court acknowledged that the bargain could arguably have been justified if the government had made its proposal after indictment.

Nevertheless, it held that the government's use of the grand jury as a bargaining tool to upset the Board's award violated Litton's substantive due process right to have the finality of its civil claim attacked only within the statutory and regulatory schemes established for that purpose. Although Fuller did not testify, the court discounted his waiver of objections on the ground that the situation was so inherently coercive that no prudent attorney could have refused to entertain the proposal.

II

This case is governed by the principles expressed in 9 Bordenkircher v. Hayes, 98 S.Ct. 663 (1978). The district judge, it should be noted, did not have the benefit of that opinion, for it was published after he granted Litton's motion to dismiss the indictment. Hayes, a state prisoner, had been indicted for uttering a forged check. During plea negotiations, the prosecutor offered to recommend a five year sentence if Hayes would plead guilty; if Hayes would not plead guilty, the prosecutor threatened to indict him as a recidivist, for which the mandatory penalty was life imprisonment. Hayes refused the offer, and the prosecutor obtained the second indictment. On his plea of not guilty, Hayes was convicted of the charges in both indictments and sentenced to imprisonment for life.

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[1] The Deputy Attorney General's letter of October 7, 1976, to McDaniel stated:

This letter is in response to the concerns you raised at our meeting of September 15, 1976.

I have met with those in the Department of Justice who have been handling the investigation of Litton Industries. I see no compelling evidence that the settlement discussions entered into between Litton and the Government were anything other than good faith attempts, on both sides, to explore freely all possible avenues by which this investigation could be brought to a conclusion satisfactory to all concerned. The Department lawyers involved in these talks, I am told, made clear to Litton lawyer, Mr. Fuller, at the outset of the discussions that they do not possess authority to settle without approval from their superiors in the Department; this is in fact the case in all such settlement discussions.

I would suggest that your outside counsel, Mr. Fuller, contact our Department attorneys with a view to resuming these exploratory discussions, so that this matter may again proceed on course.

Hayes—like Litton—relied primarily on North Carolina v. Pearce, 395 U.S. 711 (1969), Blackledge v. Perry, 417 U.S. 21 (1974), and their progeny. These cases hold that after a defendant has succeeded in having his initial conviction vacated, the due process clause protects him from the vindictive imposition of an increased sentence on retrial and from the fear of retaliation by either a judge or prosecutor. The Supreme Court, however, refused to apply these cases to Hayes's situation. The Court recognized that the prosecutor's threat to procure another indictment was designed to deter Hayes from exercising his right to plead not guilty. It emphasized, however, "that the due process violation in cases such as *Pearce* and *Perry* lay not in the possibility that a defendant might be deterred from the exercise of a legal right, . . . but rather in the danger that the State might be retaliating against the accused for lawfully attacking his conviction." Bordenkircher v. Hayes, 98 S.Ct. at 667–68. It concluded that "in the 'give-and-take' of plea bargaining, there is no such element of punishment or retaliation so long as the accused is free to accept or reject the prosecutor's offer." 98 S.Ct. at 668. Applying these principles, the Court sustained Hayes's conviction.

Litton's situation is essentially like Hayes's. Although the prosecutor did not threaten to indict Litton if it rejected the proposal, he said that the fraud investigation would be continued to determine whether Litton should be indicted.

Litton's Board award was not final; even if Litton rejected the proposal, the government could attack the award for fraud in the Court of Claims. 28 U.S.C. § 2514; *See* S & E Contractors, Inc. v. United States, 406 U.S. 1, 15–17 (1972). Nevertheless, Litton was asked to forego a right as a price for the government's termination of the investigation. Specifically, Litton was asked to give up its righ to bar the Board's reconsideration of its claims.

The district court did not find that Deputy Attorney General Tylor, Assistant Attorney General Thornburg, or Attorney General Bell, who made the critical decisions in this case, were vindictive or retaliative. The absence of such a finding is proper because the evidence would not support a contrary ruling.[2] Instead, the district court concluded that it was unlawful for the prosecutor to use the implied threat of indictment to deter Litton from exercising a legal right. But this is precisely what *Hayes* allows a prosecutor to do when he is bargaining with the potential defendant of a threatened indictment.

Litton protests that *Hayes* is distinguishable because the government lacked proof that Litton had committed a crime when the prosecutor offered his proposal. We do not believe this distinction is significant. The court of appeals granted Hayes a writ of habeas corpus in part because the prosecutor had known about Hayes's recidivism when he obtained the initial indictment charging uttering a forged check. This prior knowledge, the court of appeals reasoned, justified a conclusion that vindictiveness alone motivated the prosecutor in obtaining the subsequent indictment. *See*, Hayes v. Cowan, 547 F. 2d 42, 44 (6th Cir. 1976). The Supreme Court's recognition of the prosecutor's prior knowledge clearly put to rest the court of appeals' notion that this factor supported granting the writ. Indeed, in Blackledge v. Perry, 417 U.S. 21, 29 n. 7 (1974), the Court explained that a prosecutor's inability to proceed on a more serious charge at the time of the initial indictment would indicate that a subsequent indictment was not motivated by vindictiveness. Accordingly, we cannot accept Litton's argument that *Hayes* is inapplicable. We do not believe that the Court intended to confine plea bargaining to those situations where the prosecutor possesses irrefutable proof of the most serious crime for which a defendant is ultimately prosecuted. A prosecutor's bargaining position should not be so circumscribed. This is not to say, however, that a prosecutor can employ deceptive tactics about the strength of his case to induce a bargain.

In this case the government did not engage in any deception. The attorney in charge of presenting the case to the grand jury candidly told Litton's attorneys that while the government had proof of false claims, it had not yet obtained sufficient evidence of willfulness and criminal intent to warrant prosecution. The government's lack of knowledge about criminal intent and the possibility of further investigation were factors that Litton could weigh in deciding whether

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[2] Litton insists that an Assistant United States Attorney's remark—"Litton bought this indictment"—conclusively demonstrates vindictiveness. There is no evidence, however, that the Assistant, who was not in charge of trying the government's case, reflected the views of the officials in the Department of Justice who were responsible for instituting the criminal prosecution.

to accept the government's proposal. The prosecutor's candor in revealing the weakness of the government's case dispels any notion of vindictiveness.

Litton also contends that the rejection of its belated acceptance of the government's proposal manifests vindictiveness and renders *Hayes* inapplicable. We find no merit in this argument. *Hayes* does not require a prosecutor to keep an offer of a bargain open indefinitely after it has been rejected. Again, we believe that a prosecutor's bargaining position should not be so closely circumscribed. There are many reasons why a prosecutor should be permitted to put a rejected offer aside and proceed with the development of the government's case. Certainly, after new evidence of the defendant's wrongdoing has been uncovered, prosecutors should not be bound by an offer rejected months before when the case presented quite a different profile.

Finally, *Hayes* cannot be distinguished because it dealt solely with criminal proceedings while this case presents a mixture of civil and criminal litigation. In *Hayes* the prosecutor's threat did not violate the due process clause even though life imprisonment was at stake if Hayes rejected the offer and subjected himself to indictment. We cannot say that the government violated the due process clause in this case where rejection of its offer would not subject anyone to imprisonment and the issues are primarily monetary. The prosecutor did not even ask Litton to forego its award but only proposed that the Board should be authorized to reconsider it in light of information not previously available. Moreover, the prosecutor did not advance the proposal as a means of leverage against an unrelated claim. The material elements of both the civil and criminal proceedings were closely interwoven, and the proposal was an effort to resolve all facets of an essentially single controversy.

Therefore, applying the principles expressed in *Hayes*, we conclude that the government did not abridge Litton's right to substantive due process.

III

Litton also urges us to apply the familiar rule that the judgment of a court can be defended on any ground consistent with the record. Massachusetts Mutual Life Ins. Co. v. Ludwig, 426 U.S. 479 (1976) ; *see* C. Wright, Federal Courts 523 (3d ed. 1976). It therefore seeks affirmance of the dismissal of the indictment on grounds rejected by the district court. We agree with the district court that neither of these grounds warrants dismissal.

In May, 1976, after the Board announced its decision, a government attorney who was looking for a document relating to the Litton claims contacted Administrative Law Judge Bird, who had presided over the Litton proceedings. Both the government and Litton had been unable to find the document, and since Judge Bird's opinion referred to it, a subpoena had been issued requesting his copy. Judge Bird did not have the document either. The attorney showed Judge Bird a later version of the document and asked whether he had considered it in reaching his decision.

In July, 1976, a federal agent interviewed Judge Bird and Judge Solibakke in an attempt to determine whether three documents submitted by Litton which the government's investigation suggested were inaccurate had been material to the decision of the board of contract appeals. Judge Bird respondent that, since two of the documents in question were cited in his opinion, they were material to it, while the third, which was not cited, probably was not material. The agent who conducted the interview stated in his affidavit that he did not reveal any of the proceedings of the grand jury to the judges and that he had acquired the basis for all of his comments independently of the grand jury proceedings.

In September, 1976, the grand jurors requested a final session in order to hear testimony from a group of government officials, including Judge Bird and Judge Solibakke. The prosecutor told the court that, while he wanted to accommodate the grand jury, he believed the testimony of these officials would not be relevant, and therefore he would not request issuance of the subpoenas. The Court directed that the subpoenas be issued, but the two judges never testified because the term expired before they could be heard.

We conclude that these contacts present no grounds for dismissing the indictment against Litton. Initially, we see no basis for finding governmental misbehavior in the May, 1976, communication during the search for the missing document or in the issuance of the subpoenas in August, 1976, by the district court. As for the allegations that grand jury materials were improperly revealed during the May and July contacts, we note that the district court made no finding

that materials were actually revealed. But even assuming that they were, the proper remedy would not be dismissal of the indictment. United States v. Hoffa, 349 F. 2d 20, 43 (6th Cir. 1965), *aff'd on other grounds*, 385 U.S. 293 (1966); United States v. United States District Court, 238 F. 2d 713, 721 (4th Cir. 1956).

Litton also complains of the government's use of federal agents to summarize for the second grand jury the evidence heard by the first. But, citing Costello v. United States, 350 U.S. 359 (1956), the district court declined to rule that the use of hearsay evidence required dismissal of the indictment, especially since the indicting grand jury heard other evidence. After examining the record, we agree that nothing in the form or content of the government's presentation requires dismissal of the indictment.

The judgment is vacated, and the case is remanded for further proceedings.

ITEM 57.—*Apr. 6, 1978—South Mississippi Sun article entitled "Litton Loses a Round in Cost Overruns Case"*

RICHMOND, Va. (AP)—The Government scored a victory Wednesday in its attempt to prosecute Litton Industries for allegedly filing false claims for cost overruns in the construction of nuclear submarines.

A three-judge panel of the 4th U.S. Circuit Court of Appeals ruled that a district court erred in dismissing an indictment against the Pascagoula-based Ingalls Nuclear Shipbuilding Division of Litton Industries Inc. The district court in Alexandria, Va. had ruled that the government improperly threatened Litton with indictment if it did not drop or alter its cost-overrun claim.

Wednesday's ruling enables the government to pursue the indictment unless Litton successfully appeals, said Frank W. Dunham Jr., one of the federal attorneys in the case. Litton has 21 days to appeal the ruling.

"We have a copy of the decision, which our attorneys are reviewing, but our position must be thought through thoroughly and has not been finalized," an Ingalls spokesman said Wednesday night. "I think our position would be we do not agree with the decision and, of course, we're disappointed in it."

The appeals court rejected Litton's contention that the government used deception or threats of retaliation to force it to settle its claim.

The case originated in 1972, when Ingalls filed a $30 million claim with the Navy in connection with a nuclear submarine project.

A government appeals board awarded Litton more than $16 million in April 1976.

But a year earlier, a federal grand jury had begun investigating Litton's claims against the Navy.

In September 1976 a government prosecutor told a Litton attorney the government had evidence that Litton had filed a false claim, but there was not yet sufficient proof of wilfulness or criminal intent to hand up an indictment.

The prosecutor suggested that if Litton would agree to reopening the claim, the government would not assert fraud and the criminal investigation would be ended.

Litton did not agree before a new grand jury was impaneled four months later. The grand jury subsequently handed up an indictment.

A U.S. District Court dismissed that indictment, saying that the offer of the prosecuting attorney constituted an implied threat of indictment intended to coerce Litton into giving up its original contract award.

The court said that when Litton refused the offer, the government retaliated by obtaining an indictment.

The appeals court disagreed Wednesday with the trial court, saying there was nothing wrong in the government's admitting it did not yet have sufficient evidence to prove a false claim, by Litton.

It said this was a factor which Litton was free to weigh in deciding whether to accept the prosecuting attorney's offer.

ITEM 58.—*Apr. 6, 1978—Mississippi Press article entitled, "Ingalls Loses First Round of Cost Overruns Claims"*

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ITEM 59.—*April 18, 1978—New London Day article entitled "At Ingalls Shipbuilding: SEC Investigates Financial Reports"*

(By Dan Stets)

WASHINGTON—The enforcement division of the Securities and Exchange Commission is investigating whether the manner in which Litton Industries Inc. reports shipbuilding claims to stockholders is misleading.

In its latest annual report to the SEC on July 31, 1977, Litton said it would recover at least $530 million of a $1.2-billion claim against the Navy for construction of amphibious assault ships and destroyers at its Ingalls Shipbuilding division in Pascagoula, Miss.

The key question is whether accounting techniques are being used to hide potential losses from stockholders, said a shipbuilding industry source familiar with the Litton investigation.

Litton uses a percentage-of-completion method of accounting similar to that used by General Dynamics for construction of 688-class and Trident submarines in Groton and Quonset Point, R.I.

Litton and General Dynamics are two of the three major shipbuilders which have a total of $2.7 billion in claims against the Navy for cost overruns.

The SEC declined to say whether any other shipbuilding was under investigation.

Den Knecht, a Litton spokesman in Pascagoula, said the corporation is cooperating with the SEC investigation, which formally began April 22, 1977.

The SEC is looking at company records going back to 1972, when it first reported claims on the amphibious assault vessels, known as LHAs.

"We are continuing to book neither a profit or losses on the programs," said Knecht.

General Dynamics, which has claims on two 688 contracts totaling $544 million, also is recording neither a profit nor a loss on that program.

In its last report to the SEC on December 31, General Dynamics included $267 million of the claims as expected revenue.

Gary Sundick, a branch chief with the enforcement division in Washington, confirmed the investigation was underway, but declined to elaborate.

He would say only that the division has the power to subpoena Litton's financial records during the private investigation.

A federal appeals court reinstated April 5 fraud charges against Litton in conjunction with the claims.

The appeals court ruled that a U.S. District Court judge in Virginia had erred when he freed Litton of charges that it attempted to defraud the Navy of $37 million.

The charges were the result of a grand jury investigation. The District Court judge had ruled that prosecutors had retaliated against Litton by seeking the indictment after negotiations over the shipbuilding claims collapsed.

The Navy has turned over to the Justice Department elements of the claims from General Dynamics and the other major shipbuilder in the country, Newport News Shipbuilding of Virginia, to investigate for possible fraud.

Last week, the Navy announced it will make up to $252.8 million in provisional payments to Litton while the two sides seek a final negotiated settlement of their dispute.

Under that agreement, the Navy will reduce payment to Litton from 91 and 75 percent of the weekly costs associated with construction of three ships.

Litton has been working on the ships under a court order issued after the company threatened to stop production if the Navy did not pay the claim.

The Navy was paying the company 91 percent of costs under that court ruling.

The original cost of the five helicopter-carrying ships was no more than $1.1 billion. The claims on the LHAs would double the cost of the program.

The Navy recently agreed to pay General Dynamics $66.5 million provisionally on the 688 claims. The provisional amount increases the $1.4-billion ceiling price of the two 688 contracts.

ITEM 60.—*June 23, 1978—Letter from Secretary of the Navy Claytor to the Chairman, Senate Appropriations Committee submitting the Navy's proposed Public Law 85-804 settlement of Litton's Ingalls Shipbuilding Division LHA and DD-963 Class claims and cost overruns*

DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., June 23, 1978.

Hon. WARREN G. MAGNUSON,
Chairman, Senate Appropriations Committee, U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: Attached is a copy of a letter with accompanying documentation which I have forwarded to the Chairmen of the House and Senate Armed Services Committee to inform them, in compliance with 50 U.S.C. 1431 (Supp. 1977), of the steps taken by the Navy to reform the LHA and DD-963 contracts with Litton Industries, Inc./Litton Systems, Inc. (Ingalls Shipbuilding Division). This is the outcome of a long series of arduous and complex negotiations and is considered by the Navy to be decidedly in the national interest.

My staff and I are prepared to brief you and your Committee members and staff as you may desire.

Sincerely,

W. GRAHAM CLAYTOR, Jr.
Secretary of the Navy.

Attachments.

MEMORANDUM OF DECISION

DEPARTMENT OF THE NAVY

LITTON INDUSTRIES, INC.

June 22, 1978

MEMORANDUM OF DECISION

LITTON INDUSTRIES, INC.

(LITTON SYSTEMS, INC./INGALLS SHIPBUILDING DIVISION)

This memorandum sets forth the results of more than nine months of intense and complex negotiations to resolve the contractual disputes arising from the design and construction of five ships of the LHA Class and thirty destroyers of the *Spruance* (DD–963) Class at the Ingalls Shipbuilding Division of Litton Systems, Inc. The dollars involved in this controversy have reached dramatic levels: the present combined estimated costs of these contracts are $4.726 billion; the present anticipated losses, in the absence of any claims adjustment, are $647 million; the major claim, presently quantified at $1.088 billion, is not hereby unparalleled in Navy procurement history but is the largest ever asserted on any Government contract. The thirty-five ships, of which nineteen have not yet been delivered, comprise an essential element of the Navy fleet of the future.

The Litton position is that the anticipated costs which will not be reimbursed under present contract terms and conditions place an unreasonable burden on the Company, that the cash requirements to meet these unreimbursed costs unduly strain other operating divisions and the corporate entity as a whole, and that the Navy is responsible for a sizeable part of these costs. Litton further asserts that the unprecedented and short-lived form of procurement represented by these contracts worked inequitable hardships that demand correction by a reformation of the contracts.

Financial verification by the Navy confirms the magnitude of the anticipated losses and review by an independent accounting firm confirms that anticipated cash requirements will impose serious financial strains upon Litton if these disputes are not resolved.

A detailed analysis of the history of the LHA and DD–963 contracts and the controversy it has engendered, together with the disruptive effects of further protracted, highly complex litigation, lead to the conclusion that it will "facilitate the National Defense" for the Navy to grant to Litton the measure of relief described in this Memorandum and in Attachments 1 and 2.

HISTORICAL BACKGROUND

The two contracts in question are the only remaining vestiges of a major systems acquisition policy introduced in the Department of Defense in the mid-1960's and commonly known as Total Package Procurement (TPP). This concept was a pendulum reaction to prior cost reimbursement policies in major weapon systems acquisition and effected a drastic reversal of normal design/development roles and responsibilities.

The LHA—an entirely new class of general purpose helicopter amphibious assault ships—and the DD–963—a new class of sophisticated destroyers—were contracted for in 1969 and 1970, respectively. Both contracts went to Litton after a competitive bid process; both were structured as multi-year, fixed price incentive, successive target contracts; both were to be performed in Litton's new west bank yard, designed (but at the time untested) to use high-technology modular techniques and material flow patterns to gain the advantages of assembly-line production.

History has shown that for totally divergent reasons neither the concept of Total Package Procurement nor the west bank yard, in the earlier stages, lived up to expectations. Given the complexities of shipbuilding, the Navy, contrary to an essential premise of TPP, because heavily involved in the design and construction process. Total Package Procurement was discarded as a defense procurement policy after the award of the DD–963 contract.

The new yard and new construction techniques did not achieve expected efficiencies in production. Sufficient levels of skilled manpower proved unavailable to Litton. Design problems emerged at the outset and persisted through significant stages of the programs.

As a result of these developments, severe slippages in contract schedules occurred, and, with delays, costs escalated. Today, it is anticipated that when both programs end in mid to late 1980 the last LHA will deliver six years late and the last DD-963 over two years late. Costs will exceed present possible recovery by $486 million and $161 million on the LHA and DD-963 contracts, respectively.

These delays and cost increases have engendered controversy, charge and countercharge, almost since the inception of the contracts. Five years of legal proceedings, both administrative and judicial, have conscripted enormous resources and produced immense waste, but little else. The multiplicity of legal actions arising out of these contracts has been dramatic:—Five Armed Services Board of Contract Appeals (ASBCA) proceedings; a Navy Contract Adjustment Board proceeding: two cases in the Court of Claims: four cases in Federal District Court; and two appeals to the Fifth Circuit. Absent a negotiated resolution of the disputes, seven to ten years of further litigative entanglement are a certainty.

Past controversies have vectored both shipbuilder and Navy away from coordinated technical efforts necessary to construct today's complex major warships. Instead, their efforts have been unduly distracted by nonproductive adversarial legal steps designed to provide the utmost in contractual insulation and avoidance of responsibility for growing costs; even so, the litigation has reached only the preliminary stages. The future effects, including the serious multiplication of these strained relationships, will seriously, if not fatally, jeopardize present and future programs.

In light of these factors, Navy and Litton representatives have sought since September of last year to reach a resolution of the claims and the underlying problems of the contracts. The first step was temporarily to place the most troublesome of the litigations arising out of the LHA claims in a dormant status so that settlement negotiations could proceed. In the summer of 1976, the Government was forced to seek injunctive relief in the Federal District Court in Mississippi to prevent Litton from stopping work on the LHA's. While achieving this primary goal, the temporary order conditioned relief on the payment of 91% of invoiced costs. Both parties embarked on a course of intense discovery and other litigative procedures. In November 1977 an agreement was reached by the Navy, the Department of Justice and Litton which assured construction of the LHA's while providing continued but reduced cost reimbursement (75% in lieu of court-ordered 91%) on a provisional basis to Litton. The proposed contractual modification to implement this agreement was submitted to appropriate Congressional committees under Public Law 85–804 on January 19, 1978 and, following expiration of the Congressional review period, was executed on April 13, 1978.

CRITICAL ISSUES

Negotiations to resolve the claims and, beyond that, the underlying problems arising from the LHA and DD–963 contracts, began in early December 1977 and concluded on June 20, 1978 with the Agreement described in this Memorandum and Attachments 1 and 2.

As a result of those negotiations and comprehensive Navy analysis, several key issues clearly emerged.

Total Package Procurement did not succeed. The only other major weapons systems in which these concepts were used encountered major difficulties and were cancelled or required contract reformation under Public Law 85–804. In addition, the unique complexity of shipbuilding made TPP particularly inappropriate for these programs.

The necessary design process could not be accomplished without Navy involvement in the design and construction process. Much of this interference overstepped the bounds of the relevant contractual provisions and constituted constructive changes to the contracts, resulting in delays and disruption, compensable to Litton under the contracts.

Hindsight analysis shows that in neither program could the ships have been constructed for the cost and within the schedules specified in the initial contracts. Overoptimism, based on the productivity expectations of a new yard and new

construction methods, compounded by numerous variables in the design process, resulted in an underbid of the work involved.

Once the inevitable delays occurred, the contract did not provide adequate protection against inflation, and even less so, the double-digit inflation of the mid-1970's.

It is presently estimated that for all the reasons previously indicated and many others of relatively less importance, the two contracts will result in costs of $4,726 million, or $547 million more than is recoverable under the contracts. This estimate is based upon a Defense Contract Audit Agency audit and is being reviewed by Deloitte, Haskins & Sells, an independent accounting firm under contract to the Navy.

BASIC ELEMENTS OF AGREEMENT

The prolonged negotiations ultimately produced the following basic elements of agreement:

1. Analysis of the $1,088 million claim by the NAVSEA Claims Team yielded a recommended figure of $312 million. After adjustments for $47 million in prior payments, the net amount of $265 million will be paid to Litton in accordance with the contract modifications to be executed.

2. Of the $382 million remaining loss, Litton will absorb $200 million on the LHA contract. Navy will pay the remaining $182 million under Public Law 85–804.

3. By operation of the adjustments to the ceiling prices of the LHA and DD–963 contracts, under the progress payment provisions Litton will receive $97 million on the effective date of the settlement agreement and the implementing contract modifications. Payments subsequent to the effective date will be made through the adoption of revised progress payment schedules including amorization of $182 million of the loss (it being estimated that after the $97 million payment there will remain $18 million in past unreimbursed expenditures by Litton).

4. Cost underruns will be shared between Litton and Navy on an 80%/20% basis, respectively, and cost growth will be shared on a 50%/50% basis up to an aggregate amount of $100 million, beyond which Litton will assume sole responsibility. The Navy assumes no obligation for escalation during the remaining terms of the contracts.

5. Appropriate modifications consistent with the elimination of unduly stringent Total Package Procurement concepts are to be implemented,

6. Litton will fully release, in form satisfactory to the Navy, all claims and actions on the LHA and DD–963 contracts based on events to date, as well as the impact of these contracts on each other or on any other contracts performed by Ingalls Shipbuilding. Two related actions by Litton against the Navy, in the aggregate face amount of $40.2 million, will be dismissed. Litton will not present on these contracts as invoiced costs any portion of the total $133 million it has identified as Manufacturing Process Development (MPD) costs and will release the Navy for these costs as allocated by Litton to the LHA and DD–963 contracts (stated by Litton to be $62 million).

7. The agreement is subject to appropriate Congressional review and the availability of appropriations.

An essential goal of the negotiations was to achieve a permanent solution of the claims on the LHA contract and, more importantly, of the serious problems under underlying that contract as well as the DD–963 contract, as described in this Memorandum and Attachment 1.

DECISION

The controversies described in this document and Attachment 1 have been festering for more than nine years. Litigation has growingly dominated the history of these programs for the last five years. The solution arrived at by the Navy and Litton, after strenuous and prolonged negotiations, recognizes the serious consequences of Total Package Procurement, the essential need for amphibious ships and destroyers that embody the ultimate in naval technology, and the importance to the national defense of the unique resources of the Ingalls shipyard.

Accordingly, in the exercise of my residual powers under Public Law 85–804, 50 U.S.C. § 1431, and in accordance with the Agreement (Attachment 2) reached

with Litton, an Agreement expressly made subject to the Congressional review provided in Public Law 85–804, it is my decision that it will "facilitate the National Defense" to reform the LHA and DD–963 contracts in accordance with the provisions of such Agreement. The contracting officer shall prepare and execute the required contractual terms and conditions in accordance with the stipulations of Attachment 2 which are an integral part of this decision.

W. GRAHAM CLAYTON, Jr.,
Secretary of the Navy.

ATTACHMENT 1

DETAILED ANALYSIS OF THE MEMORANDUM OF DECISION

At issue are two major ship construction programs involving thirty-five ships, nineteen of which are yet to be delivered. The LHA's are a unique component of the nation's amphibious lift capability and an essential ingredient of our ability to project forces ashore on a worldwide basis. The thirty DD–963 (SPRUANCE) class destroyers are urgently required to replace aging destroyer type ships in the Fleet. When the last of the DD–963's is delivered in 1980, this class will comprise almost 17% of all the Navy's major surface combatants.

Almost since the awards of the LHA and DD–963 contracts, in 1969 and 1970 respectively, Litton faced growing difficulties in its ship design and construction efforts. These efforts have been impacted by continuing disagreement between Litton and the Navy over the contractual division of responsibilities. Costs have escalated and Litton faces enormous losses on these programs. More than five years have been spent in litigation merely to resolve threshhold problems. The decision described herein ends this highly complex controversy in a manner consistent with the national interest.

Litton's financial position

Over the course of the negotiations, Litton has provided extensive data including corporate and divisional financial data. Comprehensive analysis of relevant data has been conducted by Deloitte, Haskins & Sells, an independent accounting firm engaged by the Navy, and by the Defense Contract Audit Agency. The Navy has requested that the General Accounting Office conduct its own analysis.

The analyses have established that the losses faced by Litton are $647 million on the two contracts. The accounting firm confirms that financial requirements to complete these ships will strain Litton's abilities to borrow or generate cash. It further confirms that a loss of this magnitude would place Litton in default of covenants in its loan agreements.[1]

Background of the LHA and DD–963 programs (1965–1970)

Two events in the mid-1960's form the setting against which the subsequent history of the LHA and DD–963 must be appraised. The first was the adoption of Total Package Procurement by the Department of Defense. This policy represented a reaction to prior cost reimbursement contracting policies in major weapons systems acquisition. Simply stated, the prime contractor was expected to design, develop and produce the product, on a fixed-price, or fixed-price-incentive, basis to meet performance requirements stated by the military service. The result was a drastic reversal of normal design/development roles and responsibilities.

The second event was the construction by Litton of a new shipyard in Pascagoula, Mississippi on the west bank of the Pascagoula River. The new yard, already portrayed before its construction as the "Shipyard of the Future," was designed to use relatively new high-technology modular techniques, establish logical material flow patterns and, in concept, gain the advantages of assembly-line production. Groundbreaking for this facility took place in early 1968.

In 1966, the Navy announced plans to develop a new amphibious assault ship under Total Package Procurement concepts. Litton and two other firms actively engaged in contract definition and bid procedures for the next two and a half years. On May 1, 1969, the Navy awarded Contract N00024–69–C–0283 to the Ingalls Shipbuilding Division of Litton Systems, Inc., for the construction of this

[1] In addition to performing other Navy programs at Ingalls, Litton is a major subcontractor on most fighter aircraft programs for both Navy and Air Force, is a subcontractor on the Cruise Missile programs and involved, as prime or subcontractor, on several Army contracts (e.g., TACFIRE).

radically new class of ships—the LHA's. It is a multi-year fixed-price-incentive, successive target contract, and initally called for the construction of nine ships. In January of 1971, however, pursuant of contractual provisions, the Navy cancelled four ships.

Reflecting the Total Package Procurement concepts, the LHA contract was fundamentally different in many respects from prior shipbuilding contracts. Most notably, the contractor assumed "Total Systems Responsibility." It agreed and represented to the Navy that it could build ships, as designed, and it assumed virtually full responsibility for delivering ships which met particular performance requirements/capabilities. Consistent with this increased shipbuilder responsibility was the explicit undertaking that Navy would minimize its interference or "engagement" in the design/construction process. The LHA contract was the first shipbuilding program to utilize the concepts contained in DOD Directive 3200.9, which formally embodied, in part, the Total Package Procurement concepts.

On June 23, 1970, the Navy awarded Contract N00024-70-C-0275 to Ingalls for the construction of thirty destroyers of the SPRUANCE (DD-963) Class. It is also a multi-year, fixed-price, successive target incentive contract, and again, the contract was awarded on the Total Package Procurement concept. It was the last DOD contract to use these concepts in major weapons systems acquisition.

Contract performance difficulties (1969–1978)

Litton planned to perform the contracts at its new shipyard, construction of which was underway during the LHA contract bid and award process. Even before actual fabrication of the DHA's began, however, Litton assumed significant financial commitments in regard to the west bank yard. Substantial costs in connection with construction at the new facility were incurred. Approximately $140,000,000 of these costs were subsequently identified as "Manufacturing Process Development" costs. These costs originated with expenditures during the construction of American President Lines and Farrell Lines commercial ships built immediately prior to the LHA's. The construction of these ships was intended to "debug" the facility and the planned new systems.

The LHA design effort did not proceed as originally conceived and failed, from the beginning of contract performance, to achieve design milestones. Partially at Litton's behest and partially because of Navy's own concern over emerging schedule and technical problems, the Navy became heavily involved in the design process contrary to the intent of the LHA contract and the Total Package Procurement concept.

Design problems persisted and fabrication began on LHA-1 eight months later than originally scheduled. Litton was severely handicapped by the unavailability of sufficient skilled manpower and the failure of initial construction to achieve the efficiencies (e.g., percentage of completion prior to launch) expected from the modular concepts introduced in the west bank yard. As the LHA design efforts proved to be far more difficult than anticipated, the time necessary to construct the ships also proved far greater than anticipated. This unexpected work and delay had spill-over effects on the DD-963 contract.

As a result of these developments, severe slippages in contract schedules occurred. Today, the last LHA is expected to deliver six years after the original contract delivery date. The last DD-963 destroyer will deliver about two years after the contract delivery schedule. The increased costs flowing from these factors are enormous: the LHA's are now expected to cost Litton $1500 million, without claims recovery, the DHA contract will result in $486 million in unreimbursed costs; the DD-963 construction is now expected to cost $3226 million, or $161 million in unreimbursed costs to Litton. The result is total losses between the two programs of $647 million.

Controversy, claims and litigation

During early 1971, in an attempt to bring some order to the contract administration, Litton and the Navy entered a Memorandum of Agreement concerning the LHA contract which included recognition of the cancellation of four ships. This temporary truce was short lived. In March of 1972, Litton presented its reset proposal on the DHA contract, pursuant to the successive target feature of that contract and the Memorandum of Agreement. Included with the reset proposal was a request for equitable adjustment (REA). The REA asserted that, as a

result of Government actions, there should be substantial price increases in the contract, including fully escalated adjustment to ceiling price of $475,500,000. The parties tried but failed to negotiate an agreement, and the contracting officer reset the contract by unilateral decision on 28 February 1973. He raised the contract price to ceiling, awarding only about $19,000,000 on account of changes, made no price adjustment for claims but allowed six months delay as excusable or Government caused. He also awarded the maximum adjustment to ceiling allowed in the contract for cancellation of the four ships—$109 million.[2] The contracting officer 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 under the strict 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 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. 8d 1301 (5th Cir. 1974). The Navy then withheld further progress payments until the overpayment had been recouped, with the inevitable cash flow impact on Litton that this entailed.

For nearly three years Litton pursued its claims before the ASBCA. Various informal avenues of settlement were sought at higher Navy levels but no resolution was reached. For example, in February 1975, Litton filed a "reset proposal," alleging improprieties in the formation of the contract and seeking what amounted to an entirely new set of contract terms under authority of Public Law 85–804. The Navy never took formal action on this proposal. Finally, in January 1976, Litton and Navy agreed on a Plan of Action pursuant to which the ASBCA case would be suspended and the parties would seek a negotiated settlement on the basis of Litton's claims, then priced at $505,000,000. The Plan of Action was unsuccessful. In May of 1976, then Deputy Secretary of Defense Clements proposed a resolution of all shipbuilder claims through the substitution of more liberal escalation clauses under Public Law 85–804. No agreement was reached on this plan between the Department of Defense and Litton and the Public Law 85–804 submission to the Congress was withdrawn in the summer of 1976.

In June of 1976, Litton, then receiving only 25% of its costs under progress payments on the LHA and growing dissatisfied with settlement progress, notified the Navy of its intention to stop work on the LHA's. In support of its action, Litton asserted that the alleged causes underlying the claims were, in effect, breaches of contract. The Navy and the Department of Justice succeeded in obtaining a preliminary injunction from the Federal District Court for the Southern District of Mississippi, forcing Litton to continue work but the order was conditioned on the Navy's paying actual costs of performance, subsequently defined as 91% of weekly invoiced costs.

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 (subsequent relatively minor repricing and adjustments have raised the amount to $1,088,000,000). The ASBCA case, suspended as part of a negotiation effort in January 1976, had not been reinstated. Despite Navy efforts to do so, the ASBCA had withheld reinstatement in deference to the Mississippi District Court. An action was also filed by Litton in the Court of Claims in October of 1976, which raises in affirmative fashion substantially the same issues in the District Court case and in the ASBCA proceeding, but this action has been in suspension from the outset.

Problem in retrospect

No single cause brought about the substantial cost overruns experienced on these programs. In most instances, responsibility cannot be allocated with precision between Navy and Litton. But hindsight analysis does underscore certain salient elements.

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[2] The contractor has asserted that the adjustment should have been approximately $20 million more than allowed and its assertions are presently the subject of an action in the Court of Claims which will be withdrawn under the June 20 settlement.

The failure of total package procurement

Total Package Procurement, as a procurement policy for major weapons systems acquisition, is a long discarded experiment. Other major programs substantially using these concepts were the Lockheed C–5A aircraft and Cheyenne helicopter programs, the Grumman F–14 contract, and the Boeing SRAM missile programs. The first three of these programs ultimately required the invocation of Public Law 85–804 to effect necessary reformations. The fourth, the SRAM Missile program, was cancelled (Lockheed was a subcontractor on the SRAM and its Public Law 85–804 relief took that program into account).

In the Memorandum of Decision in connection with the F–14 contract, dated 9 April 1973, Secretary of the Navy, John W. Warner, noted that Total Package Procurement had been made contrary to DOD policy for large and complex procurements and stated—

". . . the conclusion is inescapable, that the use of such a contract in this instance has significantly compounded what has become a major economic issue betwen the Navy and a long-standing aircraft producer. This complex development contract coupled with a series of firmly-priced production options extending over seven future years, has proved to be unworkable in that it offers no way within it terms to resolve the current problem."

The difficulties caused by Total Package Procurement in the Grumman and Lockheed cases are in many respects vastly multiplied in the instant case. Factors unique to shipbuilding—the very long-term nature of shipbuilding contracts, the dynamic nature of shipbuilding design, the timing and integration of Government-furnished equipment with a shipbuilder's design, the huge complexity of combatant ship construction, especially of radically new designs—all these elements combined, make it clear in retrospect that adoption of TPP for the LHA and DD–963 programs was a serious error in judgment.

It is now clear that the necessary design process simply could not be performed without Navy expertise and without close Navy involvement in the design and construction process. The necessary concurrency of design and construction, particularly on a totally new ship, dictated close "engagement" (and, as indicated below, the Navy did in fact become involved in the design process). When, in addition, as in the LHA contract, the design baseline existing at contract award was not sufficiently mature to allow the formulation of a realistic bid, the problem was compounded. The delays and additional costs caused by the design problems were in turn exacerbated in the construction phase by the use of a new facility, employing new modular concepts, with a vastly multiplied workforce lacking the necessary skills.

The claims analysis

Efforts to analyze the Litton claims, ongoing for several years, were intensified as part of the Plan of Action, referred to above. A multidisciplined Claims Team, headed by Captain Ronald A. Jones, SC, USN, was assembled in the Naval Sea Systems Command (NAVSEA), and assumed direction of the analysis of the Litton claims documentation on 1 January 1976. This analytical effort has occupied the full-time efforts of as many as 200 people since that time. Substantial documentation of the LHA claim was submitted by Litton as recently as September 1977. While this slowed down the claims analysis effort, it provided the analysts with vast material to reconstruct the events and causes of the large overrun.

In April of 1978, the claims analysis was substantially complete and the Claims Manager reported the results to the Assistant Secretary of the Navy (M,RA&L), who since September 1977 had been conducting negotiation with Litton. The analysis concluded that an adjustment to the contract price in the amount of $312 million was justified. Since the effects of the 1973 contracting officer's decision regarding delay and a $20 million provisional payment had to be netted out, the analysis concluded that $265 million in "entitlement" to Litton could properly be factored into the ongoing negotiations.

Significantly, the Navy Claims Team found that the contractual provisions unique to the TPP concept actually shifted more risk to Litton than the parties had probably contemplated at the time of award. As already noted, under these conpcepts, Litton was to be given considerably wider latitude in performing the design and production than under a conventional shipbuilding contract. Litton has persistently argued that it relied upon assurances that these contracts would involve limited Navy monitoring and contract administration. The claims anal-

ysis, however, revealed that this "hands off" posture by the Navy was not achieved and, in fact, the Navy actually practiced substantially the level of administrative engagement and monitoring customary in other shipbuilding contracts. This "excessive" monitoring and administration caused delays both in the approval of engineering changes and through the "excessive" requirements of quartely reviews. The resultant schedule problems resulted in delays to ship deliveries. In addition, the lack of "prompt" approval of design changes and engineering changes resulted in excessive work-around and rework in production which impacted the LHA contract and caused delays to the DD–963 program.

Litton's claims suffered from deficiencies and, in a number of instances, the Company was unable to carry its burden of proof that the Government was legally responsible under the terms of the contract for certain costs. In this regard, clauses unique to a Total Package Procurement acted as legal bars to recovery of such costs. In line with Navy procurement policy, no part of the "entitlement" analysis allowed adjustment to the contract for equitable reasons, that is, for reasons not grounded upon the existing terms of the contract.

LHA and DD–963 prices and schedules were unrealistic

In connection with its analysis of the claims, the NAVSEA Claims Team thoroughly reviewed the construction history of the LHA's and concluded that the five LHA's could not possibly have been constructed for the agreed upon pricing. Nor could the ships have been delivered on schedule. The analysis showed that the initial contract prices, even at ceiling, underestimated the work necessary to build the five LHA's by approximately $330 million. While a portion of this underbid was compensated by escalation coverage, approximately $200 million of the present overrun is attributable to this unrealistic pricing.

The reasons for the underbid are several: overoptimistic estimates of learning efficiencies in connection with the construction of new ships, at a new yard, with a new modular concept. In retrospect, the extent and complexities of the design effort were not understood. Estimating numerous unknown variables for this project demanded many subjective judgments which were not, by hindsight, made wisely. While such mistakes are, as a strict matter of legal entitlement, borne by the contractor, it should be noted that the Claims Team did not find that an intentional underbid occurred and, indeed, its review shows that at the time of contract award, Navy did not discourage Litton's overoptimism.

The effects of inflation

The LHA and DD–963 contracts contained the older escalation clauses which utilized pre-set expenditure curves. Once schedules began to slip, partly for the reasons expressed above, partly as a result of Litton's own misjudgments and inefficiencies, and partly as a result of Navy actions, the result was devastating cost growth. These escalation clauses did not provide compensation commenurate with the actual effects of the double digit inflation in 1974–5. After 1976 even the previously inadequate escalation coverage ceased in the LHA contract and Litton was required to absorb the compound effects of inflation since 1969, even on work payable under the contract, in base year 1969 dollars. In similar fashion, the DD–963 contract has not compensated Litton for the actual effects of inflation.

The Settlement of the Mississippi District Court litigation

The cash flow consequences of the large unreimbursed expenditures experienced from the overruns were onerous to Litton and jeopardized completion of the programs. This triggered Litton's anounced stop-work action on the LHA's in the summer of 1976 which gave rise to the institution of the Federal District Court action for injunctive relief described above. In the fall of 1977, after more than a year of litigative entanglement, Litton was still receiving 91% of costs on the LHA under court order .The order, however, was scheduled to expire on October 31, 1977 (subsequently extended to July 31, 1978) and was also the subject of an appeal to the Fifth Circuit in which the Government challenged the lower court's authority to impose any cost reimbursement requirements on the Navy as a condition of injunctive relief.

As more fully detailed in the Navy's 18 January 1978 Memorandum of Decision, the Navy, the Department of Justice and Litton reached an agreement in November of 1977, which led to a contract modification involving payments to Litton at a reduced rate of 75% of costs and in the entry of a permanent

injunction submitted to the Armed Services Committees in compliance with the notification requirements of 50 U.S.C. § 1431 (Supp. 1977) and hearings were subsequently held before the full House Armed Services Committee on 7 March 1978. The General Accounting Office was requested to report to Congress on the proposed arrangement and, after appropriate investigation, did so at these hearings. After the statutory sixty-day waiting period had expired, the implementing modification was executed on 13 April 1978.

The October–November 1977 negotiations between Navy and Litton officials fully recognized that a central purpose of this interim agreement was to place all litigation in a suspense status so that the parties could seek, as they subsequently did from early December 1977 to June 1978, a resolution not merely of the Litton claims but, more importantly, of the underlying problems.

Essentiality of a settlement

The Navy believes that resolution of the Litton claims at this time is essential and in the national interest for several reasons:

First, the ships being constructed by Litton are essential. The LHA's 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 expanded capability in conducting a total landing force operation, an LHA will carry a balanced force and perform functions now requiring four separate amphibious force ships. The LHA's 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 below the objective stated by the Joint Chiefs of Staff. Without the five LHA's, the Navy's amphibious lift capability, now at the lowest level since 1950, does not meet this established minimum and all five LHA's 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 thirty DD–963 Class Destroyers are and will be essential elements of the Fleet into the beginning of the next century. These ships provide necessary task force/amphibious force escort as protection against a surface/submarine threat, as well as shore bombardment mission capability. In addition, these ships possess numerous nonescort secondary mission capabilities. The full number of thirty DD–963 ships being built at Ingalls is urgently required to replace the aging destroyer type ships in the active fleet today as the latter reach the end of their service life. Without these thirty ships and their multi-purpose capability, the active fleet will fall short of the minimum number of combatants necessary to maintain control of the seas.

The final ships under the present contracts will be delivered in 1980. Even after final delivery of these ships, the Ingalls Yard will remain an essential asset, on both technical and economic grounds, to perform necessary work on these vessels, such as post-shakedown and restricted availabilities.

Second, the Ingalls shipyard is a valuable component of the industrial base for other present and planned shipbuilding and repair requirements. The yard is presently performing under contract to construct the Iranian DD–993 ship constuction contract and on nuclear submarine overhauls. It is one of two candidates for the DDG–47 AEGIS destroyer and is the sole source candidate for construction of the DD–997(H) (an air-capable destroyer), both planned for award this fiscal year. In addition, it is a potential candidate for participation in the LSD–41 procurements and DDG–2 converisons currently in the Five Year Shipbuilding Program.

Third, the Ingalls yard is a national asset. The west bank yard is the only new surface shipbuilding yard constructed in the United States since World War II, presently providing a unique capability for major warship construction on a serial basis. Construction of the DD–963 class ships is now proceeding efficiently and over a dozen of these ships will be delivered over the next two years. The yard also provides the single largest mobilization construction capability for surface ships in the United States. In addition, the Ingalls east bank yard provides an additional needed nuclear submarine overhaul facility, as well as a mobilization capability to construct nuclear submarines.

Elimination of the litigious and acrimonious environment existing between the Navy and one of the nation's largest shipbuilders is, in itself, in the national

interest. When a settlement acceptable to the shipbuilder, however reluctantly, upholds fundamental objectives of the Navy after complex and prolonged negotiations, the National Defense is clearly facilitated by the elimination of endlessly expensive trial preparation and by the restoration of a harmonious interface essential to the construction of Navy ships.

Public Law 85–804

It is precisely the strict limitations of Navy contract claims analysis and the narrow rules governing the settlement of claims by a contracting officer that require the use of Public Law 85–804 in the unique situation presented here. While the claims analysis explains where the contractor has shown his entitlement under legal principles applicable to a particular contract, such analysis does not answer the ultimate questions: How much of the overrun was caused by the contractor? How much by the Navy? How much by neither? How much by both? The answers to these questions can be radically different from the outcome of strict claims analysis as to how much entitlement the contractor has shown within the four corners of the contract and the constraints of the intricate evidentiary process.

Public Law 85–804 permits adjustments appropriately responsive to the problems experienced on these programs. This law, enacted in 1958, grants the President, and through delegation, the Secretary of the Navy, the power, among other things, to enter into amendments or modifications of contracts without regard to other provisions of the law "whenever he deems that such action would facilitate the national defense."

The elements of the agreement

On 20 June 1978 the Navy and Litton reached agreement on the basic principles of an acceptable resolution of their 9-year controversy. The principal points of the Agreement contained in Attachment 2 are:

1. Analysis of the $1,088 million claim by the NAVSEA Claims Team yielded a recommended figure of $312 million. After adjustment for $47 million in prior payments, the net amount of $265 million will be paid to Litton in accordance with the contract modifications to be executed.

2. Of the $382 million remaining loss, Litton will absorb $200 million on the LHA contract. Navy will pay the remaining $182 million under Public Law 85–804.

3. By operation of the adjustments to the ceiling prices of the LHA and DD–963 contracts, under the progress payment provisions Litton will receive $97 million on the effective date of the Agreement and the implementing contract modifications. Payments subsequent to the effective date shall be made through revised progress payment schedules. Since past expenditures unreimbursed to Litton are expected to be $115 million on the effective date, after payment of the $97 million, expenditures unreimbursed to Litton will be reduced to $18 million. The remaining $182 million loss ($202M less $182M) will be absorbed by Litton through proportionate progress payment deductions during the construction period.

4. Cost underruns will be shared between Litton and Navy on an 80%/20% basis, respectively, and cost growth will be shared on a 50%/50% basis in an aggregate amount of $100 million, beyond which Litton will assume sole responsibility. The adjustments are fully forward priced and the Navy assumes no obligation for inflation during the remaining construction period of the ships.

5. The Agreement also provides that provisions relating to liquidated damages will be deleted, as well as any future contractor responsibility for design, performance, maintainability and reliability under the 4-year guarantees on the DD–963 and warranties on the LHA. These adjustments are consistent with the elimination of unduly stringent Total Package Procurement concepts. The guarantee provisions for workmanship and defects in material, normal in shipbuilding contracts, remain in effect.

6. Litton will fully release, in form satisfactory to the Navy, all claims and actions on the LHA and DD–963 contracts based on events to date, as well as the impact of these contracts on each other or on any other contracts performed by Ingalls Shipbuilding. Two related actions by Litton against the Navy in the aggregate face amount of $40.2 million will be dismissed. Litton will not present as invoiced costs on the LHA and DD–963 contracts the Manufacturing Process Development (MPD) costs (stated by Litton to be in the aggregate amount of

$133 million) and will release the Navy from liability for that portion of those costs allocable to the LHA and DD–963 contracts (stated by Litton to be $62 million).

7. The agreement is subject to appropriate Congressional review and the availability of appropriations.

The division of the $647 million anticipated loss reflects the outcome of a tenacious effort throughout the negotiations to safeguard the Navy's interests. The settlement pays Litton for the claim as analyzed $265 million) and an additional amount $182 million) consistent with a conscientious analysis of the many considerations described in this Memorandum.

A key element, rigorously debated in the negotiations, is the fixed loss of $200 million assumed by Litton, independent of the release of MPD costs mentioned in paragraph 6, *supra*. Throughout the negotiations, the Navy stressed this essential element of the final settlement and Litton accepted this loss with extreme reluctance. Acceptance of the fixed loss was naturally linked with all the other terms of settlement, including the initial progress payment to Litton of $97 million (the result of the application of the ceiling price adjustments to the progress payment clauses). Under the agreement the entire loss of $200 million will be absorbed by Litton by the end of 1980.

Long term perspective

The measure of protection against unforeseen contingencies provided by the sharing of limited cost growth (50 percent/50 percent up to $100 million) and the abrogation of the unprecedented design liabilities, are justified. The risks of Total Package Procurement are properly compensated by such reformation. In addition, significant incentives are supplied by the underrun sharing (Litton 80 percent/Navy 20 percent). If cost growth occurs beyond the stated threshhold, it will be absorbed by Litton.

An essential goal of the negotiations was to achieve a permanent solution of the LHA claims and, more importantly, of the underlying problems on that contract as well as the DD–963 contract, as described in this Memorandum. A most important element is the return of a harmonious relationship between the parties which the settlement is certain to produce, impelling both in their real task of producing essential ships. In addition, the following points provide reasonable assurance of the permanent nature of the settlement:

—The $4726 million estimate to complete is realistic. The estimate is based on a Defense Contract Audit Agency (DCAA) audit and is being analyzed by an independent accounting firm (Deloitte, Haskins & Sells). With only two years construction remaining and stabilized design on both the LHA (two delivered) and on the DD–963 (fourteen delivered), these estimates can be made with confidence.

—The manpower buildup has ceased, indeed is abating, and coincident with the decline in numbers an improvement in skill mix of the remaining workforce is anticipated. The problems of new techniques in a new yard have substantially disappeared with eight years of experience and construction is now at an efficient level.

—The risks of inflation are within predictable limits given the relatively short length of the remaining construction period. This is particularly so since Litton's present major union agreement will be in force throughout this period and hence labor rates should not be subject to unexpected fluctuations. More than 90 percent of the material needed for ship construction (LHA and DD–963) has been acquired by Litton. These reasons explain the absence in the settlement agreement of any commitment by the Navy with respect to future escalation.

The solution meets the requirement of Public Law 85–804. Without this settlement agreement, protracted and wasteful litigation would seriously endanger these essential programs, uncertainties and cash flow demands would jeopardize the financial position of Litton, and ship construction would be severely destabilized.

A fixed loss of the magnitude taken by Litton ($200 million) [3] thoroughly safeguards the precedent established by this Agreement. As described in this Memorandum, unique circumstances surround this situation which will not find a future parallel even remotely resembling this 9-year history.

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[3] Independently of the MPD costs.

ATTACHMENT 2

AIDE MEMOIRE

Prolonged negotiations by the parties have produced the following basic elements of agreement concerning changes in the existing two contracts for the construction of LHA and DD–963 Class ships between the Navy and Litton Industries, Inc., Litton Systems, Inc./Ingalls Shipbuilding Division):

1. Analysis of the $1,088 million claim by the NAVSEA Claims Team yielded a recommended figure of $312 million. A prior provisional price increase as well as an adjustment for delay in an earlier contracting officer's decision resulted in contract adjustments of $47 million, included within the recommended figure. The net amount of $265 million shall be paid to Litton in accordance with the contract modifications to be executed pursuant to the understandings set forth herein.

2. Litton agrees to absorb on the LHA contract, without reimbursement, otherwise reimbursable costs in the amount of $200 million, as provided below.

3. It is presently anticipated by Litton that, based on 30 April 1978 estimates, the total allowable costs of the LHA contract will be $1,500 million and of the DD–963 contract will be $3,226 million or a total of $647 million in excess of amounts the Company would receive under the existing contracts in the absence of claims recovery. The Navy agrees to adjust the ceiling price of the LHA contract to $1,300 million, after deducting the amount specified in paragraph 2, and to adjust the ceiling price of the DD–963 contract to $3,226 million, subject in both cases to the provisions of paragraph 6. Payments subsequent to the effective date of the implementing contract modifications shall be made through the adoption of revised progress payment schedules for the remaining work to be performed to the final delivery of all ships, with the contract provisions for retentions, as applicable, not to exceed 5 percent of the total contract prices. By operation of the adjustments to the ceiling prices of the LHA and DD–963 contracts, under the progress payment provisions Litton will receive $97 million on the effective date of the contract modifications.

4. It is estimated that unreimbursed costs at the effective date of the contract modifications (estimated to be September 30, 1978) will be $115 million. The balance of the $200 million referred to in paragraph 2 after the payment by the Navy referred to in the last sentence of paragraph 3, or $182 million, will be absorbed by Litton through proportionate progress payment deductions during the remaining construction period.

5. Should the aggregate allowable costs at completion prove less than the aggregate anticipated costs set forth in paragraph 3, Litton and the Navy shall benefit from such reduction in a proportion of 80/20 percent, respectively.

6. Should the aggregate allowable costs at completion prove greater than the aggregate anticipated costs set forth in paragraph 3 ($4726 million), the Navy and Litton will share cost growth 50/50 percent up to an additional aggregate $100 million on the two contracts (up to $4826 million), but above the figure of $4826 million Litton will assume exclusive responsibility for cost growth arising from all events prior to the date of this document, subject to the provisions of paragraph 10.

7. The following modifications to the contracts will be made:

(*a*) provisions relating to liquidated damages will be deleted;

(*b*) contractor responsibility for warranties on the LHA or guarantees on the DD–963 contract for design, performance, maintainability and reliability will be deleted as to those defects not identified to Litton by Navy on or prior to 30 April 1978 (as evidenced by appropriate technical baseline agreements between Navy and Litton);

(*c*) new ship delivery dates, based upon present Ingalls' schedules, will be established;

(*d*) Cost Accounting Standards will be incorporated into the contracts, effective 1 August 1978, and will control, where applicable, as to the allowability of costs;

(*e*) cost for home office allowance expense (management fee) prior to 1 August 1978 will be allowed at the rate actually used by Litton;

(*f*) payments to Frigitemp Marine Division, a subcontractor on both contracts, pursuant to court order in *Litton* v. *Frigitemp*, an action in Federal District Court pending in Mississippi, or prior thereto, are to be allowable.

8. Litton agrees that no portion of the total $133 million it has booked and identified as Manufacturing Process Development (MPD) costs (no claim hav-

ing been submitted by Litton for such costs), will be invoiced against the LHA and DD–963 contracts. That portion of such costs related to the LHA and DD–963 contracts (stated by Litton to be $62 million) will be fully released by Litton.

9. Litton will fully release, in a form satisfactory to the Navy, all claims and actions based upon events occurring prior to the date of this document, except for formal changes since 1 May 1978, and arising under or in connection with the LHA and DD–963 contracts, including, but in no way limited to, all claims [4] and actions concerning the cancellation ceiling of the LHA contract, interest resulting from the method of material progressing of the LHA contract (the "SACAM" appeal), and the impact of either or both of those contracts on each other, or on any other contract involving Ingalls Shipbuilding Division. Litton further agrees that it will not contest in any forum the validity and enforceability of the two contracts based in whole or in part upon events prior to the date of this document.

10. To contribute to the orderly management of the contracts Litton and Navy will take all steps necessary promptly to process and negotiate on a fully priced basis contract change proposals since 1 May 1978, as well as subsequent to the date of this document. Only those change orders authorized by the Navy prior to 1 May 1978 are included in the total allowable costs set forth in paragraph 3.

11. The Government's obligations hereunder are subject to the availability of appropriations.

12. Litton and Navy will promptly execute contract modifications and such other documents as are necessary to implement this Aide Memoire and Navy shall submit these documents to Congress for the review required by Public Law 85–804. The effective date of the implementing documents shall be the date of the favorable conclusion of the Congressional review period. The implementing documents, when effective, shall annul and supersede the LHA contract modification executed by the Navy and Litton on 13 April 1978. In the event the implementing documents do not become effective or the appropriations do not become available, the Navy and Litton shall be released from the understandings set forth herein, and neither the Navy nor Litton shall be deemed to have waived or be in any manner prejudiced with respect to any rights existing prior to the negotiations conducted by the parties which led to the execution of this Aide Memoire.

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[4] Except for a subcontractor (RCA) claim in the face amount of $3.2 million.

APPENDIX D

Senator Proxmire's correspondence concerning Navy claim settlement practices

CONTENTS

ITEM 1.—*February 12, 1970—Letter from Senator Proxmire to Comptroller General Staats requesting a GAO review of Navy claims settlement efforts "with particular attention to the effects the settlements may have on future Government contracting"*

FEBRUARY 12, 1970.

Hon. ELMER STAATS,
Comptroller General of the United States,
General Accounting Office,
Washington, D.C.

DEAR ELMER: I am enclosing a copy of a letter I have sent to John H. Chafee, Secretary of the Navy, concerning the processing of more than $800 million in contractor claims under the Navy shipbuilding program.

My concern is that in order to expedite processing these claims, there might be a temptation for certain shortcuts to be taken.

Since the amounts involved are so large, I wonder whether the General Accounting Office could not actively review the disposition of the major shipbuilding claims, with particular attention to the effects the settlements may have on future government contracting.

Please let me hear from you on this matter.

Sincerely,

/s/

(S) William Proxmire
WILLIAM PROXMIRE,
Chairman, Subcommittee on Economy in Government.

ITEM 2.—*Feb. 13, 1970—Letter from Senator Proxmire to Secretary of the Navy Chaffee expressing concern over lump sum claim settlements. The Senator urges that each claim be carefully reviewed by legal and procurement experts to avoid horse trading. The letter expresses concern about the claims settlement made in the Todd DE1052 case*

FEBRUARY 13, 1970.

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

DEAR MR. SECRETARY: On December 30 and 31, 1969, the Subcommittee on Economy in Government of the Joint Economic Committee heard testimony from Navy witnesses concerning approximately $800 million in contractors' claims under Navy shipbuilding programs. We were told that the Navy has set up a special claims review group to examine and settle those claims.

In 1968 Admiral Rickover testified to this Subcommittee to the effect that because the Government often lacks the capabilities to adequately scrutinize unfounded contractor claims, it tends to negotiate a lump-sum settlement. That is, because it is unable to review them in detail, it simply bargains over the price it will pay.

Contractors know this. Consequently, they pad their claims so that they can accept something less than their face amount and still come out ahead.

I am of course delighted that the Navy has set up a special group to deal with the enormous pending claims. However, I am concerned over whether the Navy will follow through by taking steps to insure that any settlements are made within the terms of the written contracts involved, the facts and legal merits, rather than by the let's-cut-it-down-the-middle kind of horse-trading that goes on around the bargaining table. I urge you to have each claim carefully reviewed by your legal and procurement experts to avoid this possibility. Frankly, on the basis of the claims settlement made in the Todd DE–1052 case, I am somewhat skeptical about the Navy's willingness to insist on full performance under the contract.

In this regard, I am asking the Comptroller General to review the Navy's disposition of its major shipbuilding claims, giving particular attential to the method of settlement and the effects such methods might have on future government contracting.

I would appreciate hearing from you on this matter.

Sincerely,

(S) William Proxmire
WILLIAM PROXMIRE,
Chairman, Subcommittee on Economy in Government.

ITEM 3.—*Feb. 28, 1970—Letter from Frank Sanders, Assistant Secretary of the Navy (Installations and Logistics), to Senator Proxmire responding to the Senator's Feb. 13, 1970 letter. The letter states "You may be sure that our effort will be directed toward dealing with all claims in a manner entirely consistent with the terms of the written contracts involved, the facts and legal merits"*

FEBRUARY 28, 1970.

HON. WILLIAM PROXMIRE,
United States Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: Thank you for your letter of February 13, 1970, concerning the manner in which the Navy might approach the settlement of contractors' claims.

The Navy shares your interest in an effective method of dealing with claims. As you pointed out, special steps have been taken in this regard. You may be sure that our efforts will be directed toward dealing with all claims in a manner entirely consistent with the terms of the written contracts involved, the facts and legal merits, as mentioned in your letter.

The Navy will, of course, afford the Comptroller General all appropriate cooperation in any review which may be undertaken of the Navy's disposition of major shipbuilding claims.

Sincerely yours,

FRANK SANDERS,
Assistant Secretary of the Navy,
(Installations and Logistics).

ITEM 4.—*Mar. 11, 1970—Senator Proxmire letter to Assistant Comptroller General Robert F. Keller asking when will the GAO be able to provide the results of its review of Navy claim settlement*

MARCH 11, 1970.

HON. ROBERT F. KELLER,
Assistant Comptroller General of the United States, General Accounting Office,
Washington, D. C.

DEAR MR. KELLER: Thank you very much for your acknowledgement of my letter of February 12, 1970, concerning the Navy review of the pending shipbuilding claims.

I wonder if you can give me an indication of when you will be able to provide me with the results of your review of what the Navy is doing. I would hope it would take something less than a month for you to respond to this inquiry.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Economy in Government.

ITEM 5.—*Apr. 28, 1971—Letter from Comptroller General Staats to Senator Proxmire forwarding GAO Report B–171096 concerning Navy claims settlement procedures. This report is in response to the Senator's Feb. 12, 1970 request*

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., April 28, 1971.

B–171096

DEAR MR. CHAIRMAN: In view of your interest in the settlement by the Department of the Navy of claims made by ship construction contractors as expressed in your letter to me of February 12, 1970, I am enclosing a copy of our report to the Congress on evaluation of information from contractors in support of claims and other pricing changes on ship construction contracts.

Sincerely yours,

ELMER B. STAATS.

ITEM 6.—*May 12, 1971—Senator Proxmire letter to Secretary of the Navy Chaffee protesting further shipbuilder claim settlements arrived at on a lump sum basis without sufficient or factual grounds for the amount paid. The letter*

cites the GAO report of Apr. 28, 1971 which concluded that the Navy had paid $114 million in shipbuilding claims without adequate substantiation. The Senator requests information about outstanding claims and a description of all cases in the past two years where Navy officials have agreed to the amount of settlement without a complete legal analysis, technical analysis or audit substantiation

MAY 12, 1971.

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

DEAR MR. SECRETARY: The Subcommittee on Priorities and Economy in Government received testimony April 28 and 29, 1971, on the subject of shipbuilding claims against the Navy. You may recall the letter I wrote to you on February 13, 1970, about this matter. A copy of that letter is attached.

In my letter of last year, I expressed my concern over whether the Navy would take steps to insure that settlements of the claims would be made within the terms of the written contracts involved and based on the facts and the legal merits. I urged that claims not be settled through an informal bargaining process without regard to the merits and expressed my skeptism about the Navy's willingness to insist on full performance under the contracts.

The events of the past year reinforce that skeptism. In the recent hearings, it was ponted out by Admiral Rickover and the General Accounting Office that several shipbuilder claims had been settled by the Navy on a lump-sum basis without sufficient legal or factual grounds for the amounts paid.

The GAO Report of April 28, 1971, (B–171096) on shipbuilding claims fully corroborates my worst fears of over a year ago. In that Report, GAO concluded that the Navy had paid $114 million in shipbuilding claims without adequate substantiation.

In light of the recent testimony and other information I have received, it is apparent that this scandalous situation is continuing. I understand that several large claims have been negotiated and agreed upon between the Navy and the contractors in the past several months despite the fact that legal, technical, and auditing memoranda had not been prepared at the time of the agreement, and in some cases, are yet to be prepared. Such a procedure, in my judgment, violates all principles of administrative review of claims against the Government and creates an intolerable and completely unacceptable situation.

Because of the magnitude of the claims involved and their potential economic impact, the Subcommittee would like to keep abreast of these matters, and I would like you to provide me with the following information:

1. The total number and amount of shipbuilders' claims currently pending and an estimate of the amount of shipbuilding claims due to be filed in calendar year 1971;

2. A list of each individual claim in excess of $10 million;

3. The Navy's proposed schedule for settlement of these claims and a copy of the Navy's regulations or memoranda setting forth the procedures to be followed in settlement of shipbuilders' claims;

4. A description of all cases in the past two years where Navy officials have agreed to the amount of a settlement without a complete legal analysis, technical analysis, or audit substantiation for the amount, together with the Navy's rationale for entering such agreements;

5. A description of any existing agreement—formal or informal—between the Navy and a shipbuilder for the settlement of an outstanding claim, including the amount of the proposed settlement and the opinion of government counsel and the Defense Contract Audit Agency on the validity of the proposed settlement.

I would appreciate having the information requested in this letter no later than May 21, 1971.

Sincerely,

WILLIAM PROXMIRE,
Chairman.

ITEM 7.—*May 28, 1971—Secretary of the Navy Chaffee letter to Senator Proxmire responding to the Senator's May 12 1971 request for information. The letter outlines steps the Navy has taken to insure that settlements of ship-*

building claims will not be consummated without completed legal analysis, technical analysis and audit substantiation for the amount

DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., May 28, 1971.

Hon. WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government, Joint Economic Committee, Congress of the United States, Washington, D.C.

DEAR SENATOR PROXMIRE: Thank you for your letter of May 12, 1971, in which you asked for certain information on shipbuilding claims.

Subsequent to the Todd settlement which was the subject of GAO Report of April 28, 1971 (B–171096) referred to in your letter, the Navy took various additional steps to insure that settlements of the claims would be made within the terms of the written contracts involved and based on the facts and legal merits. These steps include the establishment of the requirement that all claim settlements in excess of $5,000,000 be approved by the Contract Claims Control and Surveillance Group of the Naval Material Command and the Assistant Secretary of the Navy (Installations and Logistics), and that no commitment shall be made to the contractor prior to such approvals. In connection with the request for such approvals, all pertinent technical, legal, and cost information is required to be presented.

Your understanding is correct that several large claims have been negotiated and tentative agreement reached between the Navy Ship Systems Command and the shipbuilding contractors in the past several months. However, none of the agreements with the shipbuilders has been consummated, nor can they be consummated, as explained above, prior to approval by the Contract Claims Control and Surveillance Group of the Navy Material Command and the Assistant Secretary of the Navy (Installations and Logistics). No such settlement will be consummated without exhaustive evaluation and documentation of facts and an in depth legal review. The following information is provided as requested in your letter.

1. The total number and amount are:

a. 11 claims aggregating $579,000,000.

b. An estimate of the amount of shipbuilding claims due to be filed in calendar year 1971 is $211,000,000.

2. A list of each individual pending claim in excess of $10,000,000 follows:

[In millions of dollars]

Contractor	Ships	Claim amount	Settlement schedule
Lockheed	DE 1052, LPD 9–15	$159.2	Settlement agreement reached subject to approval of ASN (I. & L.) and CNM.
Avondale	DE 1052, DE 1078	147.5	Do.
Newport News	CVA 67, SSN/SSBN	87.1	Do.
Do	LCC–20	11.0	Investigation completed. Expected resolution by December 31, 1971.
General Dynamics	AE 26, 27	22.7	Under investigation. No resolution expected in 1971.
Bethlehem Steel	AE 28, 29	48.3	Do.
Ingalls	Various	94.5	Received May 17, 1971. No resolution expected in 1971.

3. a. The Navy proposed schedule for settlement of these claims is set forth above.

b. A copy of the Navy's procedures followed in settlement of shipbuilder's claims is attached. These procedures required technical and factual analysis of the claim, an audit report, and a written legal memorandum analyzing the legal basis and factual merits of the claim. This documentation was required to be completed before a proposed settlement was forwarded for approval by higher authorities. A number of claims have been settled during the last two years in accordance with these procedures. These procedures are in process of revision.

It will be made clear that the technical analyses and legal opinions shall be in writing prior to establishing the pre-negotiation position.

4. As stated earlier, subsequent to the consumation of the Todd settlement in March 1969, the Navy took steps to insure that settlements of shipbuilding claims would not be consummated without complete legal analysis, technical analysis and audit substantiation for the amount. Accordingly, there have been no settlements consummated within the last two years without this required documentation. As previously noted however, there have been instances where tentative agreements on amounts of proposed settlements have been made in advance of completing the written documentation of legal analysis, technical analysis and audit. In such cases the formal documentation was, or will be, completed after the tentative agreements were made on the basis of information developed by the claims team. The rationale for this was the facilitation and expedition of the reaching of agreement and avoiding the expenditure of additional technical, audit and legal resources unless agreement could be reached. The following is the list of cases where written documentation of the technical, legal and audit positions were not completed prior to tentative agreement being reached:

Contractor:	*Ships*
Lockheed	LPD 9 15
Avondale	DE 1052 Cl
Avondale	DE 1078 Cl
National Steel	LST 1182–1198

However, as stated in the answer to question 3, above, the NavShips procedures for shipbuilding claims processing are being revised and, particularly, to provide that the technical analyses and legal opinions shall be in writing prior to establishing the pre-negotiation position.

5. Tentative agreements exist between th Naval Ship Systems Command and the following contractors in the following amounts, subject to approval by the Contract Claims Control and Surveillance Group of the Naval Material Command and the Assistant Secretary of the Navy (Installations and Logistics):

[In millions of dollars]

Contractor	Ships	Claim amount	Amount of tentative agreement
Lockheed	DE 1052 class (5 ships), LPD 9-15	$159.2	$62.0
Avondale	DE 1052 class (7 ships), DE 1078 class (20 ships).	147.5	73.5
Newport News	USS Kennedy (CVA 67) SSN/SSBN (11 ships).	87.1	42.0

As stated in the answer to question 4, above, there are some cases where the legal opinion was not completed prior to tentative agreement being reached. At that time, audit by the Defense Contract Audit Agency was completed in all the above cases, and legal memoranda were furnished by Government counsel in all the above cases except in the Lockheed LPD 9–15 and both Avondale claims. Inasmuch as final action is still pending in the above listed cases, public disclosure of the audit and legal documents would be prejudicial to the Government's interest and, hence, the Navy would prefer not to furnish them to your Committee at this time.

In closing, I wish to assure you that Navy's claim settlement procedures are in accordance with applicable laws and regulations.

Sincerely yours,

JOHN H. CHAFEE.

ITEM 8.—*June 13, 1971—Senator Proxmire press release praising Secretary Chaffee's action in reversing the previous policy which permitted unsubstantiated settlements*

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

Senator William Proxmire (D-Wis.), Chairman of the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee, announced Monday that the Navy has decided to revise its procedures for handling shipbuilding claims of defense contractors totaling $790 million.

"Under the revised Navy procedures," Proxmire said, "technical analyses and legal opinions will be required in writing before any shipbuilding claim is settled by the Navy, according to a letter I have received from Secretary of the Navy John H. Chafee.

"In hearings during April and May, we discovered that the Navy was following procedures that were nonsensical, wasteful, and of doubtful legality.

"In two cases involving claims filed by Lockheed and Avondale, the Navy brass had actually agreed to pay $135.5 million to the contractors before obtaining written legal opinions on the Government's liability.

"This, in my judgment, was a scandalous situation because it could lead to the payment of tens of millions of dollars on frivolous claims for which the Government is not responsible.

"Shipbuilding claims now pending against the Navy or due to be filed this year total $790 million. In addition, approximately $130 million worth of claims are pending against the Navy on weapon procurements other than shipbuilding.

"Fortunately the Navy's method of doing business was brought to light before final payments on the Lockheed or Avondale claims were actually made. Payments have been held up, and I am informed that there will be no further action until written, legal opinions have been made and the claims have been completely reviewed.

"It now remains to be seen whether the legal opinions forthcoming on the Lockheed and Avondale claims simply rubber stamp the settlements previously negotiated by the Navy brass.

"Secretary Chafee ought to be praised for the strong stand he has taken to reverse the previous policy, and I commend him for it. In my opinion, the Secretary's action should go a long way towards straightening out what can be described as a most peculiar situation."

ITEM 9.—*Feb. 14, 1972—Washington Daily News article, "Navy Probe Is Aweigh"*

(UPI)—Sen. William Proxmire, D-Wis., said today he plans a full investigation into why the Navy suddenly abolished a civilian group that guarded against excess payments to shipbuilders, and replaced it with an all-military board.

"If the Navy intended to replace an effective claims review group with a figurehead body intended to grease the skids for gigantic claims against the government, it could have chosen no better mechanism," Sen. Proxmire said, "I intend to look into this matter thoroughly?"

Sen. Proxmire did not say when the joint economic committee which he chairs might begin hearings.

CIVILIAN

Triggering Sen. Proxmire's anger was the recent removal of Gordon Rule, described as the Navy's top civilian procurement officer, as head of the group set up by the navy to accept or reject excess payment claims made against the government by shipbuilders whose costs were higher than original contract terms.

Sen. Proxmire's committee held hearings last fall on the review system, at which it was disclosed that more than $1 billion in such claims were pending against the government.

One claim the Rule group vetoed involved the Avondale Shipbuilding Co. of New Orleans, which had asked for an extra $158 million on several contracts. The Navy offered to settle for $73.5 million, but the Rule group refused.

"In our investigation * * * we found that only one man in the Navy was willing to challenge the Navy brass and question a major claim," Sen. Proxmire said. "That man was Gordon Rule.

"That he was doing a good job was underlined by the fact that when the Navy's claims policies were criticized, official Pentagon spokesmen pointed to Mr. Rule as proof that the government did not intend to pay any unsubstantiated claim," he said.

Further, Sen. Proxmire said, Mr. Rule last year was awarded the Distinguished Civilian Service award, the highest honor the Navy ever gives a civilian.

ITEM 10.—*Feb. 18, 1972—New York Times article entitled "Proxmire Scores Navy Claims Payment"*

(By Richard Witkin)

Senator William Proxmire said yesterday that he was asking the General Accounting Office to determine the legality of "provisional" payments on contractor cost claims such as the $48.5-million in payments the Navy has agreed to make to a Louisiana shipyard.

The Wisconsin Democrat contended that last week's Navy action in adding $25-million to an original $23.5-million payment, made over a year ago, "smells to high heaven."

Late in the day, the Navy confirmed that it had agreed with the builder, Avondale Shipyards, Inc., on this "provisional" $25-million increase in the contract price.

The Navy said that the money would be applied solely to construction of 14 destroyer escorts remaining to be built out of the 27 contracted for. It said this would "assure their timely delivery."

The implication was that delays in settling Avondale's claims threatened to hold up completion of the urgently desired craft.

An aide to Mr. Proxmire explained why the Senator thought the recent $25-million award was particularly "suspicious." He said it was because it closely followed the abolition of a civilian claims review board that had turned down a tentative Navy agreement to pay the shipyard $73.5-million in settlement of pending cost claims on the destroyer-escort construction program.

The claims were adjudged to have been unsubstantiated.

The board was headed by a strong critic of Pentagon contracting practices, Gordon W. Rule. Mr. Rule resigned when he heard the board was to be abolished but retained a companion Navy job and the same Navy salary of $36,000.

The board, a Navy spokesman said, has been replaced by a multitiered structure. This includes a civilian intermediate claims review board and a mostly military general board, which has the final Navy say. Appeals, as before, may be made to an independent Armed Services Board of Contract Appeals.

WIDE RAMIFICATIONS SEEN

"It appears," Mr. Proxmire said in his statement, "that Rule was shoved aside so that the major portion of an unsubstantiated claim could be paid. If this is true, there will be far-reaching ramifications throughout the Navy's procurement program."

The Senator said that the Congressional Joint Economic Committee, which he heads, would soon call upon Navy and shipyard officials to explain their side of the issue. His aide said that it was hoped the witnesses could be fitted into the schedule within six to eight weeks.

There was no estimate on how long the General Accounting Office, the auditing arm of Congress, might take to reach a conclusion on the legality of "provisional" claims payments.

Altogether, Avondale has put in claims of $140-million in extra costs on the destroyer-escort contracts. Among the alleged justifications have been: design changes, late or defective Government-furnished equipment and a stretchout in the construction schedule.

Theoretically, at least under the old system, provisional payments could not be made unless a Navy official certified that the final settlement would cover at least that amount. It is not yet known whether such certification was made in either of the two provisional awards made to Avondale.

Yesterday's Navy statement stressed that payments of the $25-million just added to the contract would be made on the basis of actual construction progress. It also left open the possibility that there could be a downward adjustment from the provisional payments in the final claim settlement.

ITEM 11.—*Feb. 18, 1972—Senator Proxmire and Congressman Les Aspin letter to Secretary of the Navy Chaffee expressing disappointment in the claims processing system*

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D.C., February 18, 1972.

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

DEAR MR. SECRETARY: We are disappointed to learn that the Navy has reorganized its machinery for dealing with large shipbuilding claims. The chairman of the old Contract Claims Control and Surveillance Group, Mr. Gordon Rule, resigned last November and the CCCSG was disestablished in January, and a new military board was empowered with the authority to approve claims in excess of $10 million.

The Navy's decision to reorganize the claims sytem excluding civilians and signalling to giant shipbuilders that a claims bonanza is about to begin is a serious mistake. We are requesting that you reestablish a civilian claims board with authority similar to the CCCSG and reinstate Mr. Rule as chairman of such a body.

It is our belief that Mr. Rule has been unfairly treated. The Pentagon should promote, not demote, men of Gordon Rule's integrity. In this case the facts are clear—men who are tough on claims lose their authority. This must be discouraging to all civilian personnel in our defense establishment who are faced with the responsibility of administering contracts.

Many military officers seem to be interested in promotion or good jobs in industry after retirement than in a fair claims system. It is high time that the Navy brass stop manipulating claims procedures in the interest of advancing their own careers.

It has become increasingly clear that the entire claims system is a colossal failure. It is common knowledge both inside and outside the Navy, that the contractors request inflated claims that are often granted. The removal of Mr. Rule and the civilian board will not stop the submission of inflated claims, it will only encourage contractors to seek more. The solution is the reestablishment of a civilian board with Gordon Rule as chairman. Then, hopefully, contractors will realize that the claims system will no longer provide them with unjustified extra payments.

Sincerely,

WILLIAM PROXMIRE,
United States Senator.
LES ASPIN,
Member of Congress.

ITEM 12.—*June 19, 1972—Letter to William Casey, Commissioner, SEC from Senator Proxmire questioning the propriety of Litton reporting earnings based on expected claims recovery*

JUNE 19, 1972.

Hon. WILLIAM J. CASEY,
Commissioner, Securities and Exchange Commission,
Washington, D.C.

DEAR MR. COMMISSIONER: As you know the Joint Economic Committee has held several hearings on weapons acquisition programs of the Department of Defense. One aspect of these hearings involves large claims by Navy shipbuilders. Currently these claims total about $1 billion and involve some of the Nation's largest companies.

Litton Industries has the largest dollar amount of claims against the Navy; these total about $450 million. Some Litton claims are several years old. Navy witnesses have testified that Litton's claims appear exaggerated and Litton's actual entitlement is substantially less than the amounts of its claims. Reports by the General Accounting Office indicate that some of the claims have been overstated.

Recently Litton announced it was taking a $25 million writeoff against its FY 1972 operations for expected losses on the LHA Navy shipbuilding con-

tract. According to the press, Litton stated that the company doesn't expect a further write-off this year, but indicates that the negotiations with the Navy are continuing. But looking at Litton's published financial statements in the light of its recent release, it appears that for several years the company has been reporting profits based on the anticipation of obtaining substantial sums from its claims against the Navy. If these claims are in fact overstated, Litton's profits for the past several years may also have been overstated. At least it appears that Litton's profits or losses are subject to considerable uncertainty until these claims are settled, and have been for some time. Yet there are no footnotes or other explanations in Litton's published reports—specifically in its FY 1971 annual report and interim reports of October 31, 1971, and January 31, 1972—to indicate that this is the case. In fact, the Litton FY 1971 annual report states:

* * * The outlook for Defense and Marine Systems is good. Our present backlog spans several years of activity providing a basis for continuing growth of sales and profits independent of the general economy.

The Accountants Report for that year—by Touche, Ross and Company—also fails to note that Litton had several large claims against the Navy in process or under negotiations, the outcome of which could substantially alter Litton's financial results. These reports, therefore, appear very misleading.

I would like to know: Has Litton in fact reported earnings based on its expected recovery of large claims against the Government? If so, can you tell me to what extent Litton's earnings have been overstated for the past several years—say 1968–1972—if such claims are honored by the Navy? It appears to me that if substantial portions of the alleged claims are not paid by the Navy, Litton may not have the financial capability to carry out its contractual commitments.

What are the Securities and Exchange Commission rules concerning the company's obligations for public disclosure of information in a situation such as this? If, in fact, Litton was including anticipated claims settlements as valid receivables from the Government, would it be a violating any SEC rules? Has Litton violated any Securities and Exchange Commission rules by its failure to reflect uncertainty in its published reports as to the ultimate settlement of its claims against the Government?

Do other publicly owned defense contractors follow similar practices? If so it seems to me that defense contractors can manipulate earnings to show whatever they want to show just by the size of their claims against the Government.

At what point does the Securities and Exchange Commission require disclosure of expected large over-runs or under-runs of defense contracts by defense contractors?

I would appreciate obtainting answers to my questions by June 30, 1972.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 13.—*June 22, 1972—Letter to John Warner, Secretary of the Navy from Senator Proxmire expressing concern over Litton Shipbuilding claims and financial problems requesting the Navy position on these matters*

JUNE 22, 1972.

Hon. JOHN W. WARNER,
Secretary, Department of the Navy,
Washington, D.C.

DEAR MR. SECRETARY: I have become increasingly concerned over the Navy's problems with the Ingalls Shipbuilding Division of Litton Industries. As you know, Litton is responsible for the largest single amount of outstanding shipbuilding claims now pending against the Navy, totaling about $450 million. In addition to the huge cost over-runs represented by these claims, Litton has fallen far behind the performance schedule on the LHA and is experiencing serious technical difficulties on this and other government programs.

I now have reason to believe that because of cash shortages, Litton is confronted with a financial crisis of major proportions. I am informed that in order to extricate itself from its financial problems, the company is attempting to persuade the Navy to pay millions of dollars of worthless and inflated

claims. Or, alternatively, to restructure the LHA contract or take other steps to solve Litton's shipbuilding problems, including a Navy takeover of the Litton shipyards at Pascagoula.

According to my information, Litton has told the Navy that it wants at least $40 million for two of its larger claims to be paid no later than July 31, 1972, This date coincides with the end of the company's fiscal year when it will be required to demonstrate its financial solvency to its auditors and creditors. You may already be aware of Litton's precarious financial condition. After the first nine months of its current fiscal year, Litton showed a loss of $11.1 million. In addition, a preliminary review of Litton's financial statements for the past several years, suggests that the company has been reporting earnings based on anticipated settlements of claims pending against the Navy. If this is correct, and Litton's claims are in fact exaggerated, the company will soon have a lot of explaining to do. Such a method of reporting profits would be highly irregular if not improper because of the uncertainty surrounding claims against the Government, especially Litton's claims. I have already written to the Securities and Exchange Commission requesting an investigation of this matter. A copy of my letter of June 19, 1972, to Commissioner William J. Casey is attached for your information.

One can easily understand why Litton so desperately needs large amounts of cash and why it is making such a great effort to extract favorable settlements of its shipbuilding claims. There is considerable evidence, however, that at least part of Litton's claims are inflated and insupportable. The two claims I mentioned above, for example, total $82 million. These claims involve work at Litton's East Bank Shipyard on nuclear submarines and ammunition ships. The Navy apparently considers both claims grossly overstated as it offered to pay Litton approximately $12 million for both claims as recently as a month ago. I am informed that a review and investigation of these claims by the appropriate authorities in the Navy shows that these claims cannot be substantiated for more than the amount the Navy offered to pay.

As you know, there are about $180 million worth of claims arising out of the East Bank Shipyard, including the above two. The largest claim in the East Bank Shipyard is for $95 million for the alleged "ripple effect" on Litton's business produced by change orders to a number of submarines built at this yard several years ago. NAVSHIPS, according to my information, considers this claim totally unjustified.

The largest Litton claim, at $270 million based on the LHA contract, arises out of the West Bank Shipyard. This is a relatively new claim and has not yet been fully evaluated. There are other problems with the LHA contract. As you know, the original amount of this contract was about $1 billion for nine LHA ships. The current estimate to complete the work on the five ships comprising the present program is $1,441,000,000. The unit cost of this contract has risen from about $113 million to $288 million per ship. In addition to this huge overrun, the program is now estimated to be about two years behind schedule. In my judgment, the schedule delay constitutes grounds for declaring the contractor in default of his contract, and I am at a loss to understand why the Navy has not issued a 10-day cure notice. The continued failure on the part of the Navy to take action could be construed as a constructive change and could result in the loss of millions of dollars for the Government.

The delays in the LHA program have already impacted on the DD–963 destroyer program which Litton is also supposed to be performing in the West Bank Shipyard. Although it is true that a kneel-laying—on 72 B,E ceremony was conducted recently for the first DD–963, I am informed that the delays and technical problems in the West Bank Shipyard are so serious that Litton has proposed to the Navy that it be permitted to construct several of the DD–963's in its older East Bank Shipyard, where nuclear submarine construction is now in progress. As you know, one of the major reasons for awarding the DD–963 contract to Litton was in anticipation of the efficiency of operations in the new and modernized West Bank Shipyard. So far as I can tell, none of the benefits expected from the West Bank Shipyard have yet been realized. Moving the destroyer program into the East Bank would not only cast doubt on the decision to award this contract to Litton, it could have a detrimental impact on the nuclear submarine construction in the East Bank Shipyard.

It occurs to me that the only way the Navy may be able to obtain the DD–963 destroyers would be to further reduce or terminate the LHA program so that work on the DD–963 can go forward. I plan to communicate with you further on this matter.

It is not surprising that officials of Litton, including the President, the Executive Vice President, a Senior Vice President, and a Vice President, have made recent visits to high officials in the Department of the Navy circumventing the officials charged with the responsibility for negotiating claims settlements in attempts to resolve its difficulties.

In view of the disturbing facts, I would like the Navy to respond to the following questions:

1. Does the Navy plan to pay unsupported and unsubstantiated shipbuilding claims to Litton or to take other steps calculated to bail out the company from its financial difficulties?

2. What is the Navy's assessment of Litton's financial capability to complete performance on its Navy contracts? Has the Navy done a cash flow study of Litton?

3. Why hasn't the Navy declared the Litton LHA contract in default?

I urge you, Mr. Secretary, not to allow Litton to become the Navy's Lockheed. A decision to allow this company to ignore its contractual obligations to the Navy will have serious consequences and will become a most unfortunate precedent. If my information and interpretation of Litton's financial situation is correct, even a $40 million settlement of Litton's inflated East Bank claims might only be the down payment of future similar unwarranted demands. The only way to assure that the public interest will be served in the settlement of claims is for the proper officials to negotiate them strictly on their merits. If an agreement cannot be reached on a claim, it should be referred to the Armed Services Board of Contract Appeals. For high officials of the Navy to be "horsetrading" claims with corporate presidents and vice presidents is both demeaning to the Navy and improper, in my judgment.

I have asked the General Accounting Office to conduct an independent investigation of Litton's financial capability to perform its contracts, and I hope you will fully cooperate with it.

Your early reply to this letter will be appreciated.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 14.—*June 22, 1972—Letter to Elmer Staats, Comptroller General from Senator Proxmire requesting GAO investigation of Litton's financial capability to carry out Government contracts*

JUNE 22, 1972.

HON. ELMER STAATS,
Comptroller General of the United States, General Accounting Office, Washington, D.C.

DEAR ELMER: Recently I have written to the Chairman of the Securities and Exchange Commission and the Secretary of the Navy requesting answers to questions concerning Litton Industries. Copies of these letetrs are enclosed for your information.

There is a growing amount of evidence raising questions about Litton's corporate finances. If my information is correct, Litton in addition to suffering a loss on the first nine months' business of the current fiscal year, has been reporting as earnings the full amount of pending claims on Navy shipbuilding contracts.

As you know, shipbuilding claims in the past, including claims of Litton Industries, have often been grossly overstated. If Litton's shipbuilding claims are in fact exaggerated, the company's true financial condition may be at sharp variance from the picture portrayed by its public reports.

This letter is to formally request that the General Accounting Office conduct an independent investigation of Litton's financial capability to carry out its government contracts. Because of requests now pending before Congress affecting some of these contracts. I would hope that your investigation can be begun immediately and completed by July 31, 1972. I am sure you are

aware of the seriousness of the questions I have raised and the need to answer them at the earliest possible time.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 15.—*June 26, 1972—Excerpt from Congressional Record: Senator Proxmire announces requests to SEC, GAO and Navy for investigations of Litton*

Mr. PROXMIRE. Mr. President, I have asked the Securities and Exchange Commission, the General Accounting Office, and the Navy to investigate the financial capability of Litton Industries to complete performance of its Government contracts. I have also asked Navy Secretary John W. Warner, in a letter I am releasing today, to reject proposals made by Litton that the Navy pay inflated and unsubstantiated claims and take other actions in order to help the company solve its financial difficulties.

It is becoming increasingly clear that Litton is unable to perform any of its major shipbuilding contracts without running up huge cost overruns. Litton's $450 million worth of shipbuilding claims against the Navy must be seen as an attempt to shift the costs of its own inadequacies to the American taxpayer.

Litton executives, from the president on down, have been meeting almost daily with Navy officials in an effort to obtain a bailout from its financial plight.

In my letter to Secretary Warner, I said:

"I urge you, Mr. Secretary, not to allow Litton to become the Navy's Lockheed. A decision to allow this company to ignore its contractual obligations to the Navy will have serious consequences and will become a most unfortunate precedent. If my information and interpretation of Litton's financial situation is correct, even a $40 million settlement of Litton's inflated East Bank claims might only be the down payment on future similiar unwarranted demands. The only way to assure that the public interest will be served in the settlement of claims is for the proper officials to negotiate them strictly on their merits. If an agreement cannot be reached on a claim, it should be referred to the Armed Services Board of Contract Appeals. For high officials of the Navy to be "horsetrading" claims with corporate presidents and vice presidents is both demeaning to the Navy and improper, in my judgment."

Because of Litton's cash shortages, the huge cost overruns, schedule delays, and technical difficulties encountered on its shipbuilding programs, a shadow has been cast over two of the largest ship contracts awarded in recent years.

Litton is now 2 years behind schedule on the LHA contract and there is a serious question as to whether Litton is capable of building even the first LHA ship.

LHA contract has already been delayed with adverse effects to the DD–963 destroyer program and Litton may also be unable to deliver on that contract.

Litton has given the Navy grounds for declaring the LHA contract in default and continued failure to take corrective action on the Navy's part could increase the cost to the taxpayer by hundreds of millions of dollars.

If the Navy does not pay the unsubstantiated portion of Litton's claims, the company could face a financial crisis of major proportions in the near future.

For these reasons, I have asked the Securities and Exchange Commission to tell me whether Litton's annual reports correctly state the company's earnings. If the shipbuilding claims have been reported as earnings but are rejected by the Navy, Litton may not have the financial capability to carry out its contractual commitments.

I have also asked the Commission to state whether Litton's reporting methods comply with SEC rules and regulations, and whether the SEC requires public disclosure of expected large overruns or underruns of defense contracts by defense contractors.

I have asked the General Accounting Office to conduct an independent investigation of Litton's financial capability to carry out its Government contracts.

I ask unanimous consent, to insert in the RECORD copies of my letters to the Securities and Exchange Commission, the General Accounting Office, and the Department of the Navy.

There being no objection, the material was ordered to be printed in the RECORD, as follows:

JUNE 19, 1972.

HON. WILLIAM J. CASEY,
Commissioner, Securities and Exchange Commission,
Washington, D.C.

DEAR MR. COMMISSIONER: As you know the Joint Economic Committee has held several hearings on weapons acquisition programs of the Department of Defense. One aspect of these hearings involves large claims by Navy shipbuilders. Currently these claims total about $1 billion and involve some of the Nation's largest companies.

Litton Industries has the largest dollar amount of claims against the Navy; these total about $450 million. Some Litton claims are several years old. Navy witnesses have testified that Litton's claims appear exaggerated and Litton's actual entitlement is substantially less than the amount of its claims. Reports by the General Accounting Office indicate that some of the claims have been overstated.

Recently Litton announced it was taking a $25 million write-off against FY 1972 operations for expected loses on the LHA Navy shipbuilding contract. According to the press, Litton stated that the company doesn't expect a further write-off this year, but indicates that the negotiations wih the Navy are continuing. But looking at Litton's published financial statements in the light of its recent release, it appears that for several years the company has been reporting profits based on the anticipation of obtaining substantial sums from its claims against the Navy. If these claims are in fact overstated, Litton's profits for the past several years may also have been overstated. At least it appears that Litton's profits or losses are subject to considerable uncertainty until these claims are settled, and have been for some time. Yet there are no footnotes or other explanations in Litton's published reports—specifically in its FY 1971 annual report and interim reports of October 31, 1971, and January 31, 1972—to indicate that this is the case. In fact, the Litton FY 1971 annual report states:

"The outlook for Defense and Marine Systems is good. Our present backlog spans several years of activity providing a basis for continuing growth of sales and profits independent of the general economy."

The Accountants Report for that year—by Touche, Ross and Company—also fails to note that Litton had several large claims against the Navy in process or under negotiations, the outcome of which could substantially alter Litton's finanacial results. These reports, therefore, appear very misleading.

I would like to know:

Has Litton in fact reported earnings based on its expected recovery of large claims against the Government? If so, can you tell me to what extent Litton's earnings have been overstated for the past several years—say 1967–1971—if such claims are not honored by the Navy? It appears to me that if substantial proportions of the alleged claims are not paid by the Navy, Litton may not have the financial capability to carry out its contractual commitments.

What are the Securities and Exchange Commission rules concerning the company's obligation for public disclosure of information in a situation such as this? If, in fact, Litton was including anticipated claims settlements as valid receivables from the Government, would it be violating any SEC rules? Has Litton violated any Securities and Exchange Commission rules by its failure to reflect uncertainty in its published reports as to the ultimate settlement of its claims against the Government.

Do other publicly owned defense contractors follow similar practices? If so it seems to me that defense contractors can manipulate earnings to show whatever they want to show just by the size of their claims against the Government.

At what point does the Securities and Exchange Commission require disclosure of expected large over-runs or under-runs of defense contracts by defense contractors.

I would appreciate obtaining answers to my questions by June 30, 1972.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities
and Economy in Government.

JUNE 22, 1972.

Hon. JOHN W. WARNER,
Secretary, Department of the Navy,
Washington, D.C.

DEAR MR. SECRETARY: I have become increasingly concerned over the Navy's problems with the Ingalls Shipbuilding Division of Litton Industries. As you know, Litton is responsible for the largest single amount of outstanding shipbuilding claims now pending against the Navy, totaling about $450 million. In addition to these huge cost over-runs represented by these claims, Litton has fallen far behind the performance schedule on the LHA and is experiencing serious technical difficulties on this and other government programs.

I now have reason to believe that because of cash shortages, Litton is confronted with a financial crisis of major proportions. I am informed that in order to extricate itself from its financial problems, the company is attempting to persuade the Navy to pay millions of dollars of worthless and inflated claims. Or, alternatively, to restructure the LHA contract or take other steps to solve Litton's shipbuilding problems, including a Navy takeover of the Litton shipyards at Pascagoula.

According to my information, Litton has told the Navy that it wants at least $40 million for two of its larger claims to be paid not later than July 31, 1972. This date coincides with the end of the company's fiscal year when it will be required to demonstrate its financial solvency to its auditors and creditors. You may already be aware of Litton's precarious financial condition. After the first nine months of its current fiscal year, Litton showed a loss of $11.1 million. In addition, a preliminary review of Litton's financial statements for the past several years, suggests that the company has been reporting earnings based on anticipated settlements of claims pending against the Navy. If this is correct, and Litton's claims are in fact exaggerated, the company will soon have a lot of explaining to do. Such a method of reporting profits would be highly irregular if not improper because of the uncertainty surrounding claims against the Government, especially Litton's claims. I have already written to the Securities and Exchange Commission requesting an investigation of this matter. A copy of my letter of June 19, 1972, to Commissioner William J. Casey is attached for your information.

One can easily understand why Litton so desperately needs large amount of cash and why it is making such a great effort to extract favorable settlements of its shipbuilding claims. There is considerable evidence, however, that at least part of Litton's claims are inflated and insupportable. The two claims I mentioned above, for example, total $82 million. These claims involve work at Litton's East Bank Shipyard on nuclear submarines and ammunition ships. The Navy apparently considers both claims grossly overstated as it offered to pay Litton approximately $12 million for both claims as recently as a month ago. I am informed that a review and investigation of these claims by the appropriate authorities in the Navy shows that these claims cannot be substantiated for more than the amount the Navy offered to pay.

As you know, there are about $180 million worth of claims arising out of the East Bank Shipyard, including the above two. The largest claim in the East Bank Shipyard is for $95 million for the alleged "ripple effect" on Litton's business produced by change orders to a number of submarines built at this yard several years ago. NAVSHIPS, according to my information, considers this claim totally unjustified.

The largest Litton claims, valued at $270 million based on the LHA contract, arises out of the West Bank Shipyard. This is a relatively new claim and has not yet been fully evaluated. There are other problems with the LHA contract. As you know, the original amount of this contract was about $1 billion for nine LHA ships. The current estimate to complete the work on the five ships comprising the present program is $1,441,000,000. The unit cost of this contract has risen from about $113 million to $288 million per ship. In addition to this huge over-run, the program is now estimated to be about two years behind schedule. In my judgment, the schedule delay constitutes grounds for declaring the contractor in default of his contract, and I am at a loss to understand why the Navy has not issued a 10-day cure notice. The continued failure on the part of the Navy to take action could be construed as a constructive change and could result in the loss of millions of dollars for the Government.

The delays in the LHA program have already impacted on the DD-963 destroyer program which Litton is also supposed to be performing in the West Bank Shipyard. Although it is true that a keel-laying ceremony was conducted recently for the first DD-963, I am informed that the delays and technical problems in the West Bank Shipyard are so serious that Litton has proposed to the Navy that it be permitted to construct several of the DD-963's in its older East Bank Shipyard, where nuclear submarine construction is now in progress. As you know, one of the major reasons for awarding the DD-963 contract to Litton was in anticipation of the efficiency of operations in the new and modernized West Bank Shipyard. So far as I can tell, none of the benefits expected from the West Bank Shipyard have yet been realized. Moving the destroyer program into the East Bank Shipyard would not only cast doubt on the decision to award this contract to Litton, it could have a detrimental impact on the nuclear submarine construction in the East Bank Shipyard.

It occurs to me that the only way the Navy may be able to obtain the DD-963 destroyers would be to further reduce or terminate the LHA program so that work on the DD-963 can go forward. I plan to communicate with you further on this matter.

It is not surprising that officials of Litton, including the President, the Executive Vice President, a Senior Vice President, and a Vice President, have made recent visits to high officials in the Department of the Navy circumventing the officials charged with the responsibility for negotiating claims settlements in attempts to resolve its difficulties.

In view of the distributing facts, I would like the Navy to respond to the following questions:

1. Does the Navy plan to pay unsupported and unsubstantiated shipbuilding claims to Litton or to take other steps calculated to bail out the company from its financial difficulties?

2. What is the Navy's assessment of Litton's financial capability to complete performance on its Navy contracts? Has the Navy done a cash flow study of Litton?

3. Why hasn't the Navy declared the Litton LHA contract in default?

I urge you, Mr. Secretary, not to allow Litton to become the Navy's Lockheed. A decision to allow this company to ignore its contractual obligations to the Navy will have serious consequences and will become a most unfortunate precedent. If my information and interpretation of Litton's financial situation is correct, even a $40 million settlement of Litton's inflated East Bank claims might only be the down payment on future similar unwarranted demands. The only way to assure that the public interest will be served in the settlement of claims is for the proper officials to negotiate them strictly on their merits. If an agreement cannot be reached on a claim, it should be referred to the Armed Services Board of Contract Appeals. For high officials of the Navy to be "horsetrading" claims with corporate presidents and vice presidents is both demeaning to the Navy and improper, in my judgment.

I have asked the General Accounting Office to conduct an independent investigation of Litton's financial capability to perform its contracts, and I hope you will fully cooperate with it.

Your early reply to this letter will be appreciated.

Sincerely.

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 16.—*July 12, 1972—Letter to Senator Proxmire from the Acting Secretary of the Navy setting forth Navy position regarding Litton's problems*

DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., July 12, 1972.

Hon. WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government, Joint Economic Committee, United States Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I have received your letter of June 22nd expressing your concern over the Navy's problems with the shipbuilding division of Litton Industries. You mentioned the claims against the Navy made by Litton

and its technical difficulties with the LHA and other Government programs and indicated your belief that the company is confronted with a financial crisis of major proportions.

You asked three questions concerning the foregoing, the first of which involved whether the Navy plans "to pay unsupported and unsubstantiated shipbluilding claims on Litton or to take other steps calculated to bail out the company from its financial difficulties." Only those amounts which are factually supported and to which Litton is clearly entitled after detailed review will be paid on submitted claims. Since the review and negotiation of these claims have not been completed, any comment on their validity or possible settlements will be premature. The Navy has no intention of restructuring the LHA contract, but will take the necessary action to enforce its rights thereunder and assure delivery of its ships under construction at Pascagoula.

Your second question concerned the Navy's assessment of Litton's financial capability to complete performance on its Navy contracts and whether the Navy had done a cash flow study of the company. We have continually reviewed its financial position with the company and will continue to monitor closely. Since the data is company-confidential, I consider it inappropriate for the Navy to comment on Litton's financial condition; this is a matter for the company officials to address.

You also asked why the Navy has not "declared the Litton LHA contract in default." The Navy is in the process of analyzing, evaluating, and auditing the target price re-set proposal required by the contract and submitted by Litton on March 31st. While we have expressed to Litton our dissatisfaction with certain aspects of this re-set proposal, because of the complexity of the contract and the proposal, we do not expect to have a final position before August.

Your letter further addressed the possible effect on the DD-963 destroyer program that delays in the LHA program might have. It is too early to state categorically that the admitted LHA delays have impacted the destroyer program. The possibility is real, and the Navy is reviewing all alternatives for obtaining economical delivery under the contract. Although the keel-laying you mentioned has not occurred as yet, Litton did begin construction of the DD-963 several weeks ago (earlier than scheduled) as a means of "proofing" the construction plans.

In summary, the Navy will proceed in the Litton situation in accordance with the terms of its contracts with the company and established Navy claim settlement procedures. No "horsetrading" of claims with corporate officials is taking place; and to the extent that Litton disagrees with any proposed settlement, the corporation may appeal to the Armed Services Board of Contract Appeals. The Navy will cooperate fully with the General Accounting Office in any investigation that it conducts in response to your request.

I hope that the foregoing responds satisfactorily to your letter.

Sincerely yours,

FRANK SANDERS,
Acting Secretary of the Navy.

ITEM 17.—*Sept. 5, 1973—Defense Space Daily article entitled "Proxmire Charges Admiral With Gross Misfeasance"*

Sen. William Proxmire (D-Wis.) has charged Rear Admiral Nathan Sonenshein with "gross misfeasance" in the settlement of a Lockheed shipbuilding claim during the period when Sonenshein was in charge of the Naval Ship Systems Command.

Proxmire said Sonenshein agreed in 1971 to settle for $62 million, claims filed by Lockheed in 1968 and 1969 totaling $158 million above the agreed contract prices for 5 destroyers escorts and 7 amphibious transport dock ships "despite the fact that the normal evaluations which should be performed prior to settlement of a claim against the government had not been completed at the time."

Following his settlement decision, Sonenshein, Proxmire said, authorized provisional payments to Lockheed totaling $49 million although "there had had been no audit of the claim, no technical evaluation and no memorandum of legal entitlement." Recently, Proxmire said, the Navy's contracting officer

formally decided to pay only $6.8 million on the Lockheed claim, or "about 14 percent of what the admiral actually had the Navy pay out."

Proxmire said he was formally requesting the Navy take disciplinary action against Adm. Sonenshein and that an investigation be conducted "to determine whether fraud was committed in the filing of the claim."

ITEM 18.—*Sept. 21, 1973—Congressional Record containing Senator Proxmire's speech entitled "The Lockheed Shipbuilding Claims Affair—I"*

Mr. PROXMIRE. Mr. President, 2 years ago Rear Admiral Nathan Sonenshein, as head of the Naval Ship Systems Command. personally negotiated a $62 million tentative settlement of several ship building claims filed by Lockheed Shipbuilding and Construction Co. In 1968 and 1969 Lockheed had presented the Navy with claims totaling $158 million for five destroyer escorts and seven amphibious transport dock shops. Recently the Navy, after a thorough review of the claims and the tentative settlement entered into by Admiral Sonenshein, made a formal determination to pay only $6.8 million of the $158 million originally claimed by Lockheed.

The Navy's final decision in this case raises serious questions about Admiral Sonenshein's decision to enter into a tentative settlement for $62 million and about the legitimacy of major portions of Lockheed's claims. I am convinced from the testimony that has been given before the Subcommittee on Priorities and Economy in Government and other facts surrounding this matter, that Admiral Sonenshein was guilty of gross misfeasance in entering into the tentative settlement and in authorizing the payment to Lockheed of provisional payments on the claims. As a result of Admiral Sonensein's actions $49 million in provisional payments were actually paid out to Lockheed.

DISCIPLINARY ACTION NEEDED

I am therefore formally requesting that the Navy take disciplinary action against Admiral Sonenshein and that an investigation be conducted to determine whether fraud was committeed by Lockheed in the filing of the claim.

My suspicions about the tentative settlement were first aroused when I learned that Admiral Sonenshein had agreed to it despite the fact that the evaluations which should be performed prior to settlement of a claim had not been completed at the time of his decision. Normally, at least three critical steps are taken before tentative settlements are entered into on major shipbuilding claims. First, a team of experts makes a technical evluation of the claim. Second, an audit is performed. Finally, the General Counsel prepares a memorandum of legal entitlement.

NO BASIS FOR TENTATIVE SETTLEMENT

None of these steps had been completed at the time of Admiral Sonenshein's decision that Lockheed's claim was worth $62 million. There had not been a complete technical evaluation of the claim, there had not been an audit, and no memorandum of legal entitlement had been prepared. On what basis then did Admiral Sonenshein decide that the claim was worth $62 million? And on what basis did he authorize provisional payments to be made to the contractor while the Navy was still reviewing the claim?

This question was given greater force by the most recent decision by the Navy that the claim was worth only $6.8 million rather than $62 million. I want to quote passages from the contracting officer's letter to Lockheed informing it of his decision to explain why my earlier suspicions about Admiral Sonenshein's activities have now been confirmed.

According to the contracting officer, Lockheed denied his authorized representatives access to much directly relevant cost and pricing data, refused to disclose information to support the claims, and failed to cooperate with the Navy.

FACTUAL INADEQUACIES AND LACK OF SUBSTANTIATION

In 1971 Admiral Sonenshein submitted the proposed $62 million settlement for approval to the Contract Claims Control and Surveillance Group, the duly

constituted reviewing authority for such claims. The Surveillance Group, as the contracting officer points out in his decision, after several weeks of review and deliberation concluded that the proposed tentative settlement "could not be approved because of factual inadequacies" in the area of legal entitlement and because of a "lack of substantiation of quantum with respect to the entire claim."

LOCKHEED WITHHOLDS INFORMATION

Subsequently, a team was set up in the Navy to try to obtain substantiation of the proposed settlement but for the most part Lockheed "declined to disclose cost or pricing data" and declined to disclose information "relevant to the support and substantiation of these claims."

The following excerpts from the contracting officer's letter give further emphasis to the lack of cooperation on the part of the Lockheed Shipbuilding & Construction Co., referred to as LSCC:

"In support of its allegations, LSCC has submitted little or no historical cost, production and management data to substantiate its estimates. The contracting officer and his authorized representatives have requested relevant historical cost, production and management information but, with rare exceptions, such information has not been provided. The last such request was made on 20 March 1973, at which time the Navy stated its preliminary position in writing to LSCC on each of the claim allegation issues and requested any additional comments or available supporting data LSCC might have. LSCC has not responded to the Navy position or request."

Again, the contracting officer voices his complaint over Lockheed's uncooperative attitude and its unwillingness to give the Navy full access to the information necessary to determine the real value of the claim:

"All ships procured under the instant contracts have been delivered; cost, performance and management data is now historical and should have been used to price the requested equitable adjustments. LSCC has effectively refused to use all of the available data, and, in fact, has denied authorized representatives of the contracting officer access to much directly relevant cost and pricing data."

PROVISIONAL PAYMENTS DESPITE LACK OF SUBSTANTIATION

These facts cast a dark shadow over Admiral Sonenshein's decision to pay $62 million for this claim. If he had no completed technical evaluation, no completed audit and no completed memorandum of legal entitlement, and if the claim itself contained factual inadequacies and lacked substantiation, and if Lockheed would not even cooperate with the Navy, or allow access to such cost and pricing data, then on what basis did Admiral Sonenshein decide that the Navy should pay $62 million for this claim? And on what basis did he authorize that $49 million actually be paid over to Lockheed as provisional payments on the claim?

Lockheed has appealed the Navy's decision to pay only $6.8 million to the Armed Services Board of Contract Appeals. While the appeal is pending Lockheed will retain the $49 million already paid. If it loses the appeal or is required to refund all or any part of the $49 million it will probaby not have to pay interest on the unearned portion from the time the payments were received to the date of the contracting officer's decision. It can also be anticipated that pressures to allow Lockheed to keep the $49 million will build up as the case nears completion. There may very well be an effort to bail out Lockheed, as has been done before, rather than endanger the company's financial condition by requiring it to pay back the $49 million.

GROSS MISFEASANCE

The evidence shows beyond any doubt that Admiral Sonenshein's actions amount to gross misfeasance and that he failed to properly exercise his responsibility.

These are sad times for the Government and for the Department of Defense. Scandals are being uncovered with unprecedented frequency. The public is losing confidence in and respect for its own Government. One way for the Government to win back confidence and respect is to correct abuses that have been uncovered and to take appropriate action against responsible officials.

NAVY SHOULD INVESTIGATE POSSIBILITY OF FRAUD

The Navy is to be commended for its final decision on the Lockheed claim. But it needs to take two additional steps. I urge the Navy: (1), to clean its own house in the matter of Admiral Sonenshein and the Lockheed giveaway; and (2), to investigate the possibility that the claim was based on fraudulent representations.

I ask unanimous consent, to print in the RECORD the full text of the letter dated June 14, 1973, from the Navy contracting officer to Lockheed informing it of the Navy's final decision.

DEPARTMENT OF THE NAVY,
Washington, D.C., June 14, 1973.

LOCKHEED SHIPBUILDING AND CONSTRUCTION CO.
Seattle, Wash.

GENTLEMEN: 1. In November 1968 and in January and February 1969 Lockheed Shipbuilding and Construction Company (hereafter LSCC), formerly the Puget Sound Bridge and Drydock Company, initially submitted consolidated claims for equitable adjustments under four Bureau of Ships (currently Naval Ship Systems Command, or NAVSHIPS) contracts, NObs–4785, NObs–4660, NObs–4765 and NObs–4902. The amounts claimed have been revised several times; the most recent revision being that accompanied by DD Forms 633–5 dated May 5, 1971, for a cumulative amount of $139,572,006. Other LSCC correspondence at various times stated these claims in an amount totaling as much as $158,018,440.

2. The DE 1052 Contract and Claim. Contract NObs–4785 is for the construction of five DE 1052 class ocean escort vessels. It was awarded to LSCC on July 22, 1964 as a result of formal advertising. The solicitation provided for a split award. LSCC was fourth low bidder; the three lower bidders received contracts for seven other DE 1052 class vessels each, with a balance of five vessels awarded to LSCC. Contract NObs–4785 had an initial fixed of $60,285,000 and also provided for escalation; its specified original and amended delivery dates are as follows:

Vessel	Original delivery date	Amended delivery date [1]	Actual delivery date
DE–1057	September 1968	May 1970	May 8, 1970
DE–1063	December 1968	June 1971	June 22, 1971
DE–1065	March 1969	December 1971	Dec. 30, 1971
DE–1069	June 1969	April 1972	Apr. 28, 1972
DE–1073	September 1969	August 1972	Aug. 11, 1972

[1] Bureau modification No. 3 of Feb. 8, 1965, extended these 5 vessels' delivery dates each for 5 months because of late delivery of Government-furnished equipment, viz: AN/SQS–26 sonars. Subsequent modification Nos. A–239 of July 3, 1967, and A–566 of Feb. 27, 1970, made further extensions resulting in the final amended delivery dates enumerated above, but reserved the parties' rights as to respective responsibilities for that balance of the vessel delays.

3. Since the DE 1052 class vessels constituted a new vessel class for which previous DE working plans were inapplicable, NAVSHIPS, on December 6, 1963, awarded Contract NObs–4715 to Gibbs & Cox, Inc., to prepare DE 1052 class working plans and other data. The DE 1052 vessel construction solicitation (which resulted in the split award to four shipyards) advised bidders of the Gibbs & Cox working plans contract, and provided that promptly upon execution of the lead ship (DE 1052) construction contract, the lead ship builder—which turned out to be Todd Shipyards Corporation, Seattle—was to subcontract to Gibbs & Cox for the NObs–4715 work, whereafter NObs–4715 was to be nullified. The DE 1052 vessel construction solicitation also informed bidders that on lots excluding vessel DE 1052 the standard NAVSHIPS working plan practice would be followed, namely, that such other construction contractors could either purchase working plans at the cost of reproduction from the lead ship builder or they themselves could prepare their own working plans.

4. On November 19, 1968, LSCC submitted a claim for a $30,783,460 equitable adjustment under Contract NObs–4785; by May 5, 1971, that amount had been revised to $45,181,080.

5. The LPD Contracts and Claims. The last three contracts enumerated in paragraph 1 are for the construction of amphibious transport dock (LPD) vessels and were awarded as follows:

Contract No.	Vessels	Date awarded	Price	Method	Claims
NObs-4660	LDP 9 and 10	May 23, 1963	$50,445,000	Negotiated [1]	35.1M
NObs-4765	LDP 11, 12, and 13	May 15, 1964	69,774,000	Formal adv	31.1M
NObs-4902	LPD 14 and 15	May 17, 1965	48,395,000	do	28.2M

[1] Awarded without discussion on basis of initial price. All 3 contracts are fixed price with escalation.

6. The original and amended contract delivery dates, and the actual delivery dates, for these LPDs are:

Contract No. and vessel	Original contract date	Amended contract date	Actual delivery date
NObs-4660: LPD-9	Sept. 30, 1966	Oct. 18, 1968 [1]	Oct. 18, 1968
NObs-4660: LPD-10	Dec. 31, 1966	July 7, 1969 [1]	July 7, 1969
NObs-4765: LPD-11	Apr. 15, 1967	May 1970 [2]	May 15, 1970
NObs-4765: LPD-12	July 15, 1967	Dec. 1970 [2]	Dec. 4, 1970
NObs-4765: LPD-13	Oct. 15, 1967	Dec. 26, 1969 [2]	Dec. 26, 1969
NObs-4902: LPD-14	June 17, 1968	Feb. 1971 [3]	Feb. 12, 1971
NObs-4902: LPD-15	Sept. 17, 1968	June 1971 [3]	June 25, 1971

[1] By NObs-4660 modification No. A-738 of Mar. 9, 1970.
[2] By NObs-4765 modification No. A-737 of Mar. 16, 1970.
[3] By NObs-4902 modification No. A-499 of Mar. 9, 1970.

In none of the three foregoing modifications did the parties agree upon an apportionment of respective responsibilities for these delays in deliveries.

7. a. On January 20, 1969, LSCC submitted a claim for $24,151,451 under Contract NObs-4660; this amount was subsequently revised to $35,067,992 on May 5, 1971 on a DD Form 633-5 price proposal.

b. On February 6, 1969, LSCC submitted a claim for $24,991,341 under Contract NObs-4765; the May 5, 1971 revision increased this amount to $31,137,308.

c. On February 7, 1969 LSCC submitted a claim for $20,198,260 under Contract Nobs—4902; the May 5, 1971 revision increased this amount to $28,185,626.

8. *The Course of Claim Investigation and Aborted Settlement Negotiations.* In February 1969, NAVSHIPS established a nucleus Special Task Force to investigate the three LPD claims. A different nucleus team was established to investigate the DE-1502 claim. Numerous visits to LSCC's Seattle facility were made in the course of these investigations. Commencing in December 1970 the parties sought to negotiate a settlement of these four claims. The following subparagraphs describe the events relating to the abortive settlement negotiations:

a. By Revision No. 7, of January 30, 1970, to the Navy Procurement Directives, a new paragraph 1-401.55 was added. It established requirements that NAVSHIPS (among other Navy activities) report major claims and obtain the approval of the Assistant Secretary of the Navy (Installations and Logistics) before making any commitment to a claimant on a settlement exceeding $5,000,000.

b. On December 30, 1970, then Deputy Defense Secretary Packard wrote to Senator John Stennis that,

"* * * the remaining claims (referring to Lockheed's LPD and DE 1052 claims), totaling $159.8 million, have been the subject of intensive negotiations between the Navy and Lockheed. To settle these claims, the Navy has offered Lockheed $58 million. I am hopeful that a settlement of these claims can be reached. Generally speaking, all negotiations regarding this program have also

been concluded. The single remaining issue is Lockheed's acceptance of this offer."

c. On January 5, 1971, Lockheed wrote to Mr. Packard:

"With reference to the ship construction claims, we are not prepared to accept the Navy offer of $58 million. It is our belief, however, that if both parties continue to pursue negotiations diligently a mutually acceptable solution can be achieved within a reasonable period of time."

d. Negotiations continued and on January 29, 1971, a final negotiating meeting was held with Rear Adm. N. Sonenshein, Capt. A. Holfield and Mr. R. Bates representing NAVSHIPS and Mr. R. Osborn and Mr. A, Folden representing LSCC. a tentative settlement agreement of $62 million was reached with the understanding that it was subject to required approval of higher authority. For reasons detailed below such approvals were never received.

e. On February 1, 1971, Lockheed President D. J. Houghton wrote to Lockheed shareholders: "* * * last week we reached *tentative* agreement with the Navy to settle our ship construction claims for $62 million * * *" (emphasis added).

f. In a NAVSHIPS memorandum to the Assistant Secretary of the Navy (Financial Management) dated February 12, 1971, the Acting Commander, NAVSHIPS, stated:

"b. Tentative settlement—$62 million.

"c. Provisional price increases made to date against these claims total $28.4 million.

"d. Additional provisional price increases of $21 million are in process. Provisional increases require documentation in the form of technical analysis, audit verification and legal determinations to safeguard the Government's interests, and NAVMAT approval in accordance with NPD 1–401.55(e). Hence, the authorization of provisional increases involves essentially all the steps required in final settlement.

"e. Final Settlement Date—15 March 1971. This date is largely theoretical. It is based upon completion of the extensive documentation required for each of the four contracts involved (including finalization of the Technical Advisory Reports (TAR')s DCAA final audit reports and formal legal memoranda) and submission of the post-negotiation business clearance by 10 March 1971 to NAVMAT and ASN (I&L) for approval in accordance with NPD 1–401.55. * * *"

g. On February 24, 1971, NAVSHIPS and Lockheed executed a modification to the four contracts involved in these claims for the LPDs and DE 1052s, to provide Lockheed provisional price increases on account of the claims. The modification states unequivocally that the settlement agreement of $62,000,000 was subject to approval by "* * * higher Government authorities in accordance with applicable regulations * * *" and continued:

"The parties agree that neither the above provisional increases in the contract price nor the above mentioned tentative settlement of $62 million shall be construed as an acknowledgement of the validity of any of the specific claims included in the Contractor's claims submissions under these contracts nor does the Government admit the correctness of any of the facts alleged in these submissions. Furthermore, these provisional increases in the contract prices and the proposed settlement of $62 million shall not be considered to represent the value of the Contractor's claims if the Contracting Officer shall find, in the event the supplemental agreements in corporating the proposed settlement are not executed, that the Contractor is entitled to equitable adjustments in the contract prices totaling less than the provisional increases in contract prices made to date or less than the proposed settlement of $62 million on account of the facts alleged in his claims submissions."

h. On May 20, 1971, then Defense Secretary Laird reported to Chairman Hebert of the House Armed Services Committee:

"Claims under on-going contracts for DE 1052's and LPD's totaling $159.8 million have been *tentatively* settled for $62 million. The LPD settlement has been approved and paid; the DE 1952 agreement is still in the process of review by the Navy." (emphasis added).

i. Secretary Laird's confusion about the status of review of the LPD claims by the Navy—which, incidentally, were not handled separately from the DE 1052 claim—was corrected by then Deputy Defense Secretary Packard's statement to the Secretaries of the Army and Air Force in a memoradum dated June 4, 1971:

"In June 1970, Lockheed's claims totaling $46 million for work under the five completed ship contracts were settled for $17.9 million. The settlement was reached through the Department of the Navy's established procedures for negotiating ship claims. Likewise, claims under four on-going contracts for DE 1052's and LPD's totaling $159.8 million have been *tentatively* settled for $62 million. *The LPD and the DE 1052 agreement is still in process of review by the Navy.* However, if it is assumed that a settlement of the $159.8 million claim will be for $62 million on these four contracts, the total Lockheed loss before taxes on all nine contracts will be approximately $89.6 million." (emphasis added).

j. On January 2, 1973, Lockheed prepared a four-page briefing paper on these claims, stating on page 2:

"* * * USCC and NAVSHIPS renewed and increased negotiation efforts on the remaining claims, and on January 29, 1971 Lockheed Aircraft Corporation Group Vice President R. J. Osborn, LSCC's President A. M. Folden and the Commander, Naval Ship Systems Command N. A. Sonenshein arrived at a settlement figure of $62 million. Subsequently, supplemental agreements were executed which committed LSCC to that settlement amount as of that date, and committed the Navy likewise upon approval "by higher Government authorities in accordance with the applicable regulations."

Since the date of the "hand-shake" agreement on January 29, 1971, made in the spirit and within the parameters of Secretary Packard's plan, there has been virtually no progress by the Navy in finalizing the settlement agreement. . ."

9. *Navy Review Actions.* With respect to the LSCC consolidated LPD and DE 1052 claims, the Navy took the following review actions:

a. On March 25, 1971, NAVSHIPS submitted the proposed $62 million settlement sum for the consolidated Lockheed claims for review and hopefully for approval by the duly constituted reviewers in the Naval Material Command; that group was named the "Contract Claims Control and Surveillance Group" (or CCCSG). The CCCSG, after several weeks of review and deliberation, concluded that the proposed LSCC claims tentative settlement could not be be approved by cause of factual inadequacies in LSCC provided information in the area of legal entitlement for certain claim elements and for lack of substantiation of quantum with respect to the entire claim. Accordingly, on August 3, 1971, NAVSHIPS withdrew the proposed settlement from CCCSG consideration.

b. Thereafter, in August 1971 NAVSHIPS requested the Superior of Shipbuilding, Conversion and Repair, 13th Naval District (SUPSHIP–13), whose office is the cognizant contract administration office with respect to the four LSCC contracts, to assemble a team to obtain improved substantiation of the proposed settlement in certain areas. For the most part, as described in greater specificity in paragraphs below, LSCC declined to disclose cost or pricing data to support its DD Form 633–5 price proposals for these claims, and other contract performance and production information relevant to the support and substantiation of these claims.

c. Notwithstanding the foregoing lack of cooperation from LSCC, on June 9, 1972, NAVSHIPS once again submitted the proposed LSCC claims settlement to the Naval Material Command for review and approval. On this occasion the NAVMAT reviewers were designated the NAVMAT Claims Board. On June 20, 1972, the DE 1052 portion of the submission was supplemented with the LPD portion of the submission. After six months review and consideration of these submissions, the NAVMAT Claims Board determined that the settlement was unsupported and not susceptible of approval. Accordingly, on January 24, 1973, NAVSHIPS once again withdrew the submission for NAVMAT consideration.

10. The foregoing recapitulation of events in paragraphs 8 and 9 surrounding the tentative claims settlement agreement of January 29, 1971, and the submission and resubmission of the proposed settlement to higher authority for review and approval, and the two determinations not to grant approval by NAVMAT, lead to the unavoidable conclusion that in fact both LSCC and the Navy understood that the $62 million claims settlement was not unconditional. It required review by higher authorities and approval by the Chief of Naval Material and by the Assistant Secretary of the Navy (Installations and Logistics), in accordance with Navy Procurement Directives, paragraph

1-401.55. Such approvals were never received because the NAVMAT Claims Board perceived certain general and specific inadequacies in LSCC's claims support and substantiation. Three major claim items were identified as inadequately documented in the SUPSHIP 13 letter serial 130-2904 of October 17, 1972, to LSCC. Further, in NAVSHIPS letter serial 90-02 of 26 December 1972 to LSCC the Navy stated:

"We have completed a preliminary review of this additional data submitted by your company, which, though responsive in some respects, still fails to present a clearly discernible 'cause and effect' relationship between alleged Government-responsible actions, on the one hand, and the claimed resulting increased costs to LSCC, on the other. The paucity of data showing such relationship applies also to the other elements of the LPD claims, as well as to the DE 1052 Class claim.

"To ensure consideration in this Command's final consideration of your claims, you are invited to submit to this Command, via the Supervisor, any material establishing the above-noted relationship, including any incisive rationale, supported by historical cost data."

For the foregoing reasons the tentative January 29, 1971, NAVSHIPS settlement did not receive the higher level approvals required by applicable Navy directives. Similarly, the provisional payments NAVSHIPS made to LSCC on account of these claims—for details, see paragraphs 14-15 below—were premised upon an exposition of a portion of the claim facts, specifically, LSCC's claim assertions and representations taken at their face value, without regard for a full and complete evaluation of other contemporaneous events in the performances of these contracts, many of which were later found to be attributable to non-government responsible causes. Those provisional payments were also influenced by anticipated LSCC cost overruns projected from costs incurred and to be incurred to complete contract performances as of January 1971. Accordingly, the provisional payments were found to be subject to the same deficiencies in support and substantiation as was the tentative $62 million settlement of January 1971.

11. *LSCC Claim Itemization.* LSCC has broken down its claims into subject areas of alleged Government-responsible causes of additional costs which are said to constitute entitlement to equitable adjustments in the contracts prices. Enclosure (1) sets forth the Contracting Officer's determinations and findings related to these various allegations. For convenience only, some allegations common to all contracts have been treated in the same section of the determinations and findings. Each contract, however, has been treated as a separate entity. Enclosure (2) lists and classifies alleged improper rejections of LSCC work discussed in enclosure (1). Enclosure (3) lists the change orders included in the consolidated claims; determinations and findings relative to them are included in enclosure (1).

12. In support of its allegations, LSCC has submitted little or no historical cost, production and management data to substantiate its estimates. The Contracting Officer and his authorized representatives have requested relevant historical cost, production and management information but, with rare exceptions, such information has not been provided. The last such request was made on 20 March 1973, at which time the Navy stated its preliminary position in writing to LSCC on each of the claim allegation issues and requested any additional comments or available supporting data LSCC might have. LSCC has not responded to the Navy position or request.

13. All ships procured under the instant contracts have been delivered; cost, performance and management data is now historical and should have been used to price the requested equitable adjustments. LSCC has effectively refused to use all of the available data, and in fact, has denied authorized representatives of the Contracting Officer access to much directly relevant cost and pricing data.

Since LSCC has been unable to support adequately many elements of its claims, it appears that an impasse has been reached. Accordingly, the Contracting Officer deems it necessary to make a unilateral determination of the amount due LSCC by way of equitable adjustment in the prices of the four contracts. In considering the claims as originally asserted, the Contracting Officer finds in some subject areas that there is no data to support a determination of entitlement; in other areas, when entitlement has been established, the equitable adjustments must be based on Navy-developed estimates. The Navy-

developed manhour estimates have been priced using Defense Contract Audit Agency-developed composite historical contract labor rates.

14. The Contractor has previously received provisional price increases on each contract on account of these consolidated claims as follows:

NObs	Mod.[1]	Payment
4660	8	$14,435,000
4765	7	13,128,000
4785	12	10,081,158
4902	7	11,387,000

[1] These modifications were embodied in a single supplemental agreement, executed on Feb. 24, 1971, effective Jan. 29, 1971; this modification incorporated the provisional payments made by earlier modifications and set forth the cumulative provisional payments for each LPD contract. The cumulative DE-1052 contract provisional payment of $10,081,158 was not stated in Mod. 12 to contract NObs—4785 but rather in field Mod. No. A-742 issued Feb. 5, 1971.

15. Paragraph 4 of each of the foregoing modifications provides that upon final resolution of the claim, if the equitable adjustment resulting from such resolution is less than the provisional increase, the contract price as provisionally adjusted shall be reduced by the amount of the equitable adjustment, and the balance shall immediately be refunded to the Government, or credited to the Government against existing unpaid invoices. The equitable adjustments resulting from the Contracting Officer's determinations and findings in enclosure (1) are summarized by contract in enclosure (4) and totals brought forward below. Accordingly, inasmuch as the total adjustment in the prices of contracts NObs-4660, 4675, 4902 and 4785 as determined herein do not exceed the provisional payments previously made, pursuant to paragraph 4 of the modifications cited above, the contracts' prices are hereby adjusted as follows and demand is made for the balance due:

NObs	Provisional payment	Equitable adjustment	Balance due U.S. Government
4660	$14,435,000	$1,796,805	$12,638,195
4765	13,128,000	1,832,191	11,295,809
4785	10,081,158	821,892	9,259,266
4902	11,387,000	2,334,661	9,052,339
Total	49,031,158	6,785,549	42,245,609

Notice is hereby given that, in accordance with the General Provision No. 42 of each contract "Interest", commencing thirty (30) days from receipient of this Final Decision, an interest charge at the rate of six percent (6%) per annum will be assessed on any unpaid balance.

16. LSCC's Premature May 24, 1973 "Appeal" Letter. On May 24, 1973, Mr. F. Trowbridge vom Baur, counsel for LSCC, wrote a letter to the Secretary of the Navy, with a copy to the Armed Services Board of Contract Appeals, purporting to "appeal" the LSCC claims on the DE 1052 and LPD contracts. Two bases were presented: that the Navy has not honored the January 29, 1971 contract modification settling these claims for $62 million, that Navy failure to issue a final decision of the Contracting Officer constitutes an appealable action. The factual misconceptions inherent in the first basis are rebutted in paragraphs 8, 9 and 10. With respect to the second basis, on March 20, 1973, NAVSHIPS sent LSCC a detailed 71 page explanation of the Navy's position on each element of that consolidated LPD and DE 1952 claims. That March 20th letter stated:

"You are requested to carefully review the Navy's position and to provide any comments or additional data you may have prior to April 20, 1973. Your comments will be carefully weighed and considered prior to formalization of any further settlement offer or any final decision of the Contracting Officer. Should you desire, a meeting can be arranged to allow further discussion of these matters."

By letter of April 13, 1973, LSCC requested that "* * * no further action be taken with regard to * * *" the Navy's March 20, 1973 letter. Thus although

LSCC specifically requested that a final decision on this matter be held in abeyance, NAVSHIPS received no further communication from LSCC until receipt of the foregoing May 24, 1973 "appeal" letter from Mr. Vom Baur. These facts clearly indicate that the "appeal" by Mr. Vom Baur is premature.

17. This is the final decision of the Contracting Officer. Decisions on disputed questions of fact and on other questions that are subject to the procedure of the Disputes clause may be appealed in accordance with the provisions of the Disputes clause. If you decide to make such an appeal from this decision, written notice thereof (in triplicate) must be mailed or otherwise furnished to the Contracting Officer within thirty days from the date you receive this decision. Such notice should indicate that an appeal is intended and should reference this decision and identify the contract by number. The Armed Service Board of Contract Appeals is the authorized representative of the Secretary for hearing and determining such disputes. The Rules of the Armed Services Board of Contracts Appeals are set forth in the Armed Services Procurement Regulation, Appendix A, Part 2.

W. E. SHULTZ,
Commander, Supply Corps, U.S. Navy,
Contracting Officer.

ITEM 19.—*Jan. 10, 1974—Senator Proxmire letter to Secretary of the Navy Warner expressing concern that the Navy has spent about a year investigating charges of possible fraud in connection with the Litton Shipbuilding claim and that the results of the investigation "have been lying on your desk since September." The Senator asks for a decision on referral of the matter to the Justice Department for further investigation*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., January 10, 1974.

Hon. JOHN W. WARNER,
Secretary of the Navy,
Washington, D.C.

DEAR MR. SECRETARY: In November I was assured by spokesmen for the Navy that action would be taken by your office within two weeks on alleged fraud in the submission of a shipbuilding claim by Litton Industries. The Navy has had more than enough time to make up its mind about what to do with this case and I cannot understand why action has still not been taken.

Because of the seriousness of the charges that have been made against Litton, and the facts that have been brought to my attention, I can only conclude that the Navy is dragging its feet on this matter perhaps in the hope that the difficult decision that is called for will not have to be made. I want to remind you that the Navy's Office of General Counsel undertook a study of the alleged fraud more than a year and a half ago and that the study was concluded and a report forwarded to your office in September 1973.

Equally disturbing is the fact that Navy spokesmen stated in a public hearing before a congressional committee on November 16, 1973 that action would soon be taken on this case. On that day, Assistant Secretary Jack L. Bowers, Admiral R. L. Baughan, Jr., Admiral K. L. Woodfin, Rear Admiral S. J. Evans, Captain W. J. Ryan, and the Navy's General Counsel, Mr. E. G. Lewis, testified before the Subcommittee on Priorities and Economy in Government. When I inquired into the results of the Navy's investigation of the alleged fraud, Mr. Lewis stated that the findings were being discussed with the Secretary of the Navy who would have to make the final policy decision. I asked when the Navy would take action on the matter. Mr. Lewis replied, "I would say within the next couple of weeks." This answer was allowed to stand in the corrected transcript.

My staff has made repeated inquiries to find out what the Navy has done. On December 11, 1973 we were told that a decision by the Secretary of the Navy was "imminent." I have not yet been able to learn when the Navy can reasonably be expected to act.

This long delay and foot dragging is inexcusable. In addition, I think the good faith of the Navy is called into question when promises are made to a committee of Congress in a public hearing and subsequently broken.

It is not asking too much for the Navy to move off dead center in this case. The charges that were made were serious. The Navy spent about a year investigating the charges and the results of that investigation have been lying on your desk since September. All the fact finding that the Navy can do has been done. What is awaited is your decision to refer or to not refer the matter to the Justice Department for further investigation.

Additional delays can only lead to suspicions about the motivations for sitting on the case. Once again, I urge you to act.

Sincerely yours,

WILLIAM PROXMIRE,
Vice Chairman.

ITEM 20.—*Nov. 27, 1974—New York Times article entitled "Proxmire Scores Ex-Pentagon Aide"*

(By Richard Witkin)

Senator William Proxmide criticized David Packard, a former Deputy Defense Secretary, yesterday for "actively lobbying" in the Pentagon and Congress in an effort to force the Navy to pay the Lockheed Aircraft Corporation what the Wisconsin Democrat described as an "inflated" $62-million ship-build-claim.

Senator Proxmire also said he had been told that Lockheed and Textron, Inc., had given the Pentagon an ultimatum to approve the $62-million award or the two companies would not go through with their plan for rescuing Lockheed from its financial troubles.

"Mr. Packard was a fine Deputy Secretary of Defense and served his country well," the Senator said in a statement released by his Washington office. "But his support of Lockheed at any price like a classic buddy system between Pentagon officials and retired military executives in the defense industry."

PENTAGON CAREER

Mr. Packard served in the Pentagon from 1969 through 1971. He then returned to Hewlett Packard, a California electronics company he had helped found, and is now chairman of the board.

Mr. Packard could not be reached immediately for comment.

Mr. Proxmire made public a executive sent last month to his successor in the Pentagon, saying he had worked out an over-all settlement of several "with the understanding" that the Navy would pay Lockheed the $62-million on the ship-building contract.

In the memorandum, Mr. Packard said he believed that the Navy had "a legal and a moral obligation" to make the settlement, and he urged the current Deputy Secretary of Defense, William P. Clements Jr., to urge the Navy to pay and, if necessary, to order it.

Also released were copies of letters Mr. Packard sent to the chairmen of the Senate and House Armed Services Committees, enclosing copies of the memorandum to Mr. Clements and offering to discuss the issue with them.

PROXMIRE OBJECTS

Sen. Proxmire objected strongly to Mr. Packard's writing to the committee chairmen, Senator John C. Stennis, Democrat of Mississippi, and Representative F. Edward Hebert, Democrat of Louisiana.

Senator Proxmire, a leading critic of Pentagon procurement practices, said the claims issue was still before the Armed Services Board of Contract Appeals. Noting that the two armed services committees exercised large control over the Pentagon budget, Mr. Proxmire said:

"Mr. Packard's contacts with the powerful committee chairmen could be interpreted as an effort to use political influence to alter the outcome of the administrative proceedings. The mere outcome that the letters were sent, and distributed within the Pentagon, would be enough to create pressure to settle the claim for an amount that could not be justified on the facts."

Senator Proxmire acknowledged that the dispute was complicated by what he called a "tentative agreement" that Rear Adm. Nathan Sonenshein, then head of the Naval Ship Systems Command, had made with Lockheed to pay

the $62-million. But the Senator added that Admiral Sonenshein was not authorized to commit the Navy, which he said later decided that the claim was worth only $6.8-million.

$400-MILLION IN LOSSES

This view clashed with that of Mr. Packard, who has often been accused of being extremely tough on Lockheed in the over-all 1971 Lockheed-Pentagon agreement. Under that agreement, the aerospace company absorbed losses of more than $400-million on the C-5A cargo plane and three other Pentagon projects, including the disputed ship program.

In the memorandum to his successor, Mr. Packard said that, during negotiations with the company, its bankers and Congress, he had always used the $62-million figure for the ships claim "with the understanding that it was acceptable to the Navy."

On the Proxmire charge about a Textron-Lockheed ultimatum to the Defense Department, neither company had any immediate comment.

ITEM 21.—*Dec. 2, 1974—Senate speech by Senator Proxmire, "The Lockheed Shipbuilding Claims Affair—II"*

Mr. PROXMIRE. Mr. President, on September 21, 1973, I made a Senate speech on the Lockheed Shipbuilding Claims Affair. In that speech I pointed out that the Lockheed Shipbuilding and Construction Co. had filed a vastly inflated claim against the Navy totaling $158 million. The claim allegedly covered costs legitimately incurred on various shipbuilding contracts awarded to Lockheed. In fact, the evidence shows that Lockheed ran up huge cost overruns, mostly because of its own inefficiency, and is atttempting to get reimbursement from the Navy.

I also stated in my earlier speech that before the Navy's claims review team fully investigated the claim a naval officer by the name of Adm. Nathan Sonenshein entered into a tentative agreement to pay Lockheed $62 million for the claim.

ADMIRAL SONENSHEIN'S TENTATIVE SETTLEMENT

Admiral Sonenshein was not authorized to commit the Navy to the tentative agreement and, in fact, it was later rejected by the Navy. In my judgment Admiral Sonenshein acted improperly in entering into the tentative agreement because the legal, technical, and audit analyses which are supposed to be done by the Navy before a claim is settled had not been performed at the time Admiral Sonenshein entered into the tentative agreement.

Subsequently, after the Navy's review team investigated the claim the Navy formally decided that the claim was worth only $6.8 million. Among other things, the review team found that the claim contained factual inadequacies, lacked substantiation, and that Lockheed failed to cooperate with the Navy investigators.

Lockheed appealed the decision to the Pentagon's Armed Services Board of Contract Appeals where the case is now being litigated.

DAVID PACKARD ENTERS THE PICTURE

A new factor has now complicated this strange case. David Packard, former Deputy Secretary of Defense, is now actively lobbying the Pentagon and Capitol Hill to force the Navy to pay Lockheed the larger, unwarranted sum for the shipbuilding claim. He seems to have taken the position that the Government should use the taxpayers' money to pay Lockheed the $62 million figure tentatively negotiated by Admiral Sonenshein regardless of what the facts demonstrate.

Mr. Packard is applying pressure wherever he can, in an attempt to reverse the Navy's decision that the claim is worth less than $7 million.

A few weeks ago Mr. Packard testified at the Pentagon's appeals board hearing in behalf of Lockheed.

Mr. Packard has also written letters in Lockheed's behalf to William C. Clements, Jr., Deputy Secretary of Defense, Senator John C. Stennis, and Representative F. Edward Hebert.

In his letters he urges Secretary Clements to request the Navy to settle for the higher, inflated figure, and offers to discuss the matter personally with Senator Stennis and Representative Hebert.

Mr. Packard was a fine Deputy Secretary of Defense and served his country well. But his support of Lockheed at any price looks like a case of classic "buddy system" between Pentagon officials and retired military executives in the defense industry.

By communicating directly with the chairmen of the House and Senate Armed Services Committees. Mr. Packard appears to be trying to interface with the administrative proceedings being conducted by the appeals board.

The appeals board is an arm of the Pentagon. The Armed Services Committees exercise a great deal of control over the Pentagon's budget.

Mr. Packard's contacts with the two powerful committee chairmen could be interpreted as an effort to use political influence to alter the outcome of the administrative proceedings.

The mere fact that the letters were sent and distributed within the Pentagon could be enough to create pressure to settle the claim for an amount that cannot be justified on the facts.

THE TEXTRON MERGER

Textron, another large defense contractor, has made overtures to merge with Lockheed and senior Pentagon officials would like the merger to take place.

I am informed that Textron and Lockheed have given the Pentagon an ultimatum to settle Lockheed's claim for the higher amount or the merger is off.

If my information is correct, Lockheed and Textron are engaged in a squeeze play against the Pentagon that could cost the taxpayer as much as $55 million.

It is no secret that Lockheed is in deep financial difficulty and could be forced into bankruptcy if it does not merge with another firm or obtain a new source of funds.

I ask unanimous consent to have printed in the Record the full texts of the letters referred to in my remarks.

There being no objection, the letters were ordered to be printed in the Record, as follows:

OCTOBER 13, 1974.

Hon. WILLIAM C. CLEMENTS, JR.,
Deputy Secretary of Defense, The Pentagon,
Washington, D.C.

Yesterday I testified at the trial at which Lockheed is attempting to obtain a settlement of their claim with the Navy in regard to the overall Lockheed agreement I worked out in 1970. I had not until yesterday been familiar with all of the details of the issue.

On December 30, 1970 I proposed an overall settlement for all of the Lockheed problems in a letter to Senator Stennis. I intended this to be a package deal. Prior to this date the Navy had offered Lockheed $58M in settlement of shipbuilding claims. It was my understanding at the time the $58M had been arrived at by the Navy in accord with the established practices. Lockheed did not accept the $58M and after further negotiations the Navy and Lockheed agreed on a tentative settlement of $62M. Thereafter in my discussions with Lockheed, with the bankers and with the Congressional committees I used the $62M figure with the understanding that it was acceptable to the Navy. I considered the other details of the overall Lockheed settlement were implemented with the understanding the Navy would settle with Lockheed at $62M. Subsequent disputes within the Navy apparently raised questions as to whether the $62M figure had been determined through established procedure for dealing with shipbuilding claims. Whether the $62M figure was or was not arrived at through established procedures I consider to be a matter internal to the Navy, and I believe there is both a legal and a moral obligation for the Navy to settle with Lockheed at $62M.

It is my understanding that about $49M of the $62M has already been advanced against the claim, leaving only about $13M to settle the matter as I intended it should have been settled.

I urge you to request the Navy to settle with Lockheed at the $62M figure and, if necessary, you should direct them to do so. I am sending a copy of this wire to Senator Stennis and Chairman Hebert in case you wish to discuss the matter with them before directing a settlement.

In further testimony at the trial next Monday I intend to urge the judge to rule in Lockheed's favor, because all of my testimony and discussions with Lockheed and bankers and the Congress during 1971 were based on my understanding that the Navy would settle for $62M and I believe there is a firm obligation to do so. It will be better for all concerned to settle this issue and avoid further waste of time and money on litigation.

DAVID PACKARD.

HEWLETT-PACKARD CO.,
Palto Alto, Calif., October 3, 1974.

Hon. JOHN D. STENNIS,
U.S. Senator, Senator Office Building,
Washington, D.C.

DEAR MR. CHAIRMAN: Sometime in 1973 it came to my attention that the shipbuilding claims of Lockheed discussed in my letter of December 30, 1970 to you had not yet been settled. I had known there was some problem within the Navy about the $62M settlement of the shipbuilding claims which was accepted by Mr. Haughton on January 29, 1971, but I learned about the details only within the past few weeks. I am enclosing a copy of my wire to Secretary Clements urging him to direct the Navy to settle for the figure we agreed to in 1971. If you have any questions about my advice to Secretary Clements I would be pleased to discuss the matter with you at your convenience.

Sincerely,

DAVID PACKARD.

HEWLETT-PACKARD CO.,
Palto Alto, Calif., October 3, 1974.

Hon. F. EDWARD HEBERT,
U.S. House of Representatives,
Washington, D.C.

DEAR MR. CHAIRMAN: Sometime in 1973 it came to my attention that the shipbuilding claims of Lockheed discussed in my letter of December 30, 1970 to you had not yet been settled. I had known there was some problem within the Navy about the $62M settlement of the shipbuilding claims which was accepted by Mr. Haughton on January 29, 1971, but I learned about the details only within the past few weeks. I am enclosing a copy of my wire to Secretary Clements urging him to direct the Navy to settle for the figure we agreed to in 1971. If you have any questions about my advice to Secretary Clements I would be pleased to discuss the matter with you at your convenience.

Sincerely,

DAVID PACKARD.

ITEM 22.—*Dec. 11, 1974—Letter from Assistant Attorney General Peterson to Senator Proxmire responding to the Senator's Nov. 22, 1974 letter concerning the validity of submarine construction claims filed by Litton. Mr. Peterson states that the matter has been a subject of inquiry by the Federal Bureau of Investigation and is being explored before a Federal Grand Jury. He further states, "It is contemplated that our review will give due consideration to the possible implication of inflated claims on financial statements the corporation has issued to stockholders and the public." He stated the Department of Justice had informed the Navy it would oppose any out of court settlement of the claims in question*

DECEMBER 14, 1974.

Hon. WILLIAM PROXMIRE,
United States Senate,
Washington, D.C.

DEAR SENATOR: The Attorney General has referred to me for reply your letter dated November 22, 1974, concerned with the validity of cost claims filed in relation to construction of submarines for the Department of the Navy by Ingalls Nuclear Shipbuilding Division, Litton Systems, Inc. located at Pascagoula, Mississippi.

For some time now the possibility of fraud resulting from this contract performance has been the subject of inquiry by the Federal Bureau of Investigation. More recently the inquiry has been broadened to include exploration before a Federal grand jury. In this connection, it is contemplated that our review will give due consideration to the possible implication of inflated claims on financial statements the corporation has issued to stockholders and the public.

At this time it is not possible to predict either the extent or results of that investigation. However, during its pendency we have corresponded with the Department of the Navy concerning resolution of the claim before the Armed Services Board of Contract Appeals. That Department has been advised it is the position of the Department of Justice that any out of court settlement of this claim could prejudice the criminal investigation and we would oppose such settlement.

I shall be pleased to keep you informed of significant developments.

Sincerely,

HENRY E. PETERSEN,
Assistant Attorney General.

ITEM 23.—*May 28, 1975—Senator Proxmire letter to Secretary of Defense Schlesinger stating that the Armed Services Board of Contract Appeals acted improperly and illegally in the Lockheed case and that neither Secretary Packard or the Armed Services Board of Contract Appeals had authority to order payment of $62 million to Lockheed without proof the Navy owed this unless the Secretary exercised his powers to grant extracontractual relief under Public Law 85–804. The Senator recommends that the Defense Department suspend implementation of this decision and stop payment to Lockheed*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C. May 28, 1975.

Hon. JAMES R. SCHLESINGER,
Secretary, Department Of Defense, Pentagon, Washington, D.C.

DEAR MR. SECRETARY: I understand that the Armed Services Board of Contract Appeals has recently overruled a $6.7 million contracting officer decision and ordered the Navy to pay Lockheed Shipbuilding and Construction Company $62,000,000 on shipbuilding claims. In so ruling, the Board made no attempt to assess the merits of the shipbuilding claims themselves. The Lockheed claims in question, are those involved in the infamous backroom settlement involving Admiral Sonenshein, former Commander of the Naval Sea Systems Command. If you recall, Lockheed submitted shipbuilding claims totaling $159 million. Admiral Sonenshein made a handshake tentative settlement for $62 million subject to formal review and approval by the responsible Navy officials. A detailed legal review, however, resulted in a contracting officer determination that Lockheed was entitled to only $6.7 million. Lockheed appealed this decision to the Armed Services Board of Contract Appeals. The Navy subsequently observed irregularities in the claim itself and referred it to the Department of Justice where it is presently being reviewed by the Fraud section of the Criminal Division.

I am appalled by the Board's decision. Rather than reviewing the merits of the claims themselves, the Board elected to rule in favor of Lockheed on a legal technicality, an estoppel theory—that "justice and basic fairness require that the Government be estopped to deny the legal enforceability of the $62,000,000 settlement would be approved, it reasonably relied on the signals confused and contradictory information regarding its expectation that the $62,000,000 settlement would be approved, it reasonably related on the signals ultimately given by and implicit in the conduct of the Deputy Secretary of Defense that he would take any action necessary to assure that his overall plan would be fully executed. Lockheed's reliance on those signals was precisely what Secretary Packard intended. The reliance was reasonable because Secretary Packard held the second highest office in the entire department. * * *"

But as the Board itself points out in its decision, Secretary Packard had no knowledge as to the value of Lockheed's ship claims; he assured Congress that

these claims would be double checked "to be sure the claims can be appropriately verified"; and he intended that the responsibility for settling the ships claims was the Navy's. The Board also found that Lockheed was aware that the Navy was responsible for settling the claim and that approval for settling for $62,000,000 was never given by the Navy. The Board's decision that the taxpayers should make good on Mr. Packard's "signals" that Lockheed would get the $62,000,000 is completely unjustified. Moreover, the Board has no authority to even make such a decision.

The Board has acted improperly and illegally in this case. Its decision, in addition to being unfair to the U.S. taxpayer would set an intolerable precedent. The Board is saying that the procedural safeguards that have been established within the Navy to ensure only legal expenditure of public funds can be circumvented by senior defense officials in their private discussions with corporate executives. If the Board's opinion is allowed to stand, the taxpayer can be stuck with the bill for millions of dollars without any proof that the money is properly owing under the contract any time high government officials talk with corporate executives.

If Secretary Packard believed it was in the national interest to give Lockheed $62 million without proof that the Navy owed this sum, his recourse should have been under Public Law 85–804. That law requires public reporting of actions taken under it and in the case of payments in excess of $20 million, Congress has expressly retained the right of review and disapproval.

In the current Lockheed case, the Armed Services Board of Contract Appeals apparently assumed the right to grant extra contractual relief in contravention of the statutory restrictions.

I am very disturbed that an administrative body such as the Armed Services Board of Contract Appeals would decide issues such as this one, with so many millions of dollars at stake, on a technicality. In effect the Board is saying that taxpayers' money can be spent to pay any claim where a high government official says it will be paid even if the claim is a phony one or worthless on the merits.

Further, I understand that under current rules, the Government may not have any right to appeal this critical decision to a court of law. Thus, Lockheed might never be required to demonstrate its entitlement to the $62 million.

As Secretary of Defense, you are the official responsible for the Armed Services Board of Contract Appeals. In this regard, I request that you suspend implementation of this decision (ASBCA No. 18560 of 14 May 1975) and stop payment to Lockheed on the following basis:

a. The Armed Services Board of Contract Appeals has no authority to grant extra contractual relief such as payments that may be authorized under PL 85–804. The Board's function is to settle disputes under contracts.

b. The Department of Defense has no authority to make payment in accordance with the Board's decision without first complying with the requirements of Public Law 85–804—including the requirement for prior submittal to Congress of any proposed relief in excess of $20 million. The administrative procedures of the Board cannot be used to circumvent an act of Congress.

c. The Department of Defense has no authority to make payment while the claims are still being investigated by the Department of Justice for possible fraud and it would be improper to make payment in this case. 28 USC 2514 reads in part:

"A claim against the United States shall be forfeited to the United States by any person who corruptly practices or attempts to practice any fraud against the United States in the proof, statement, establishment or allowance thereof."

I would hope that the Board's activities in the future will be confined to reviews of contract disputes and that in cases involving claims it will focus on the merits of the claims rather than on issues which are outside its authority.

I would appreciate being informed promptly of what action you intend to take in this matter.

Sincerely,

WILLIAM PROXMIRE.

ITEM 24.—*June 18, 1975—Department of Defense Counsel Hoffman letter in response to Senator Proxmire's May 28, 1975 letter to the Secretary of Defense. Mr. Hoffman points out that the Navy has filed a motion for reconsideration and that because of a Department of Justice investigation of possible fraud in connection with these claims, the Department of Justice had advised the Navy not to implement the Board's decision pending completion of the fraud investigation*

GENERAL COUNSEL OF THE DEPARTMENT OF DEFENSE,
Washington, D.C., June 18, 1975.

Hon. WILLIAM PROXMIRE,
United States Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: This is in response to your letter to Secretary Schlesinger of May 28, 1975 in which you request that implementation of the decision of the Armed Services Board of Contract Appeals in the appeal of Lockheed Shipbuilding and Construction Company issued 14 May 1975, (ASBCA No. 18460) be suspended. The principal grounds upon which you urge such action, are (1) that the Board in applying estoppel against the Government in effect undertook to grant extra contractual relief which is beyond its jurisdiction, and (2) that the Department of Defense has no authority to make payment while the claims are being investigated by the Department of Justice for possible fraud.

With respect to the first point, the decision of the Board is not final since its rules authorized a motion for reconsideration. I am advised that the Navy has filed with the Board a motion for reconsideration and for referral of the matter to the Senior Deciding Group, and requested oral argument thereon. The Senior Deciding Group consists of the chairmen, vice-chairmen and the heads of the Board's division and was established to decide significant or unusual cases. In view of the foregoing, it would not be appropriate for me to express my views on points which may be at issue while this matter is still before the Board.

As to your second point, the General Counsel for the Department of the Navy has written to the Justice Department advising them of the Board's decision and calling their attention to the ongoing fraud investigation. He requested an opinion of the Department of Justice as to whether, in light of the fraud element, the Navy should comply with the Board's decision, should the Navy be unsuccessful on its motion for reconsideration. In its reply, the Department of Justice advised the General Counsel of the Navy not to implement the Board's decision pending completion of the fraud investigation.

Accordingly, pending the Board's decision on the Navy's motion for reconsideration, and completion of the investigation by the Department of Justice, no action will be taken to implement the Board's decision.

Sincerely,

MARTIN R. HOFFMANN.

ITEM 25.—*Dec. 4, 1975—Letter by Senator Proxmire to William Middendorf, Secretary of the Navy questioning the Navy/Litton financial arrangement on the LHA contract*

Hon. WILLIAM J. MIDDENDORF,
Secretary of the Navy, The Pentagon,
Washington, D.C.

DEAR MR. SECRETARY: Two years ago, during hearings before the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee, Navy officials testified on a number of issues relating to Litton Systems, Inc. shipbuilding contracts with the Navy. It was well known at that time that Litton had experienced delays and overruns on all of its ongoing shipbuilding contracts, and had submitted claims against the Navy on these contracts. The largest claim involved the LHA contract. During the hearings, Assistant Secretary Bowers told the Subcommittee that the Navy and Litton were negotiating to establish a cap on all of Litton's LHA claims, to settle the issues involved with Litton's LHA appeal before the Armed Services Board of Contract Appeals, and to obtain a complete release of all other claims Litton had with the Navy.

The recently issued Litton annual report for fiscal year 1975 indicates that Litton needs about $300 million beyond the amount contained in the Navy's February 1973 Contracting Officer decision in order to break even on the LHA contract.

The report further notes that preparations for a trial of this matter before the ASBCA are contiuing and states: "In the interim, discussions have continued with the Navy for resolution by negotiation of some of the substantive issues involved in this appeal, as well as provisional or other interim payments to finance continuation of contract performance pending resolution of the issues involved in the appeal."

Due to the above statement, the magnitude of dollars involved and Litton's past history of shipbuilding claims and poor contract performance, I continue to be concerned about the Navy's position with respect to Litton's shipbuilding problems. I am therefore asking you the following questions:

1. Is the Navy continuing to negotiate with Litton on the LHA claim while preparing to litigate this claim before the ASBCA? If so, please provide the names of the Navy and Litton officials who have participated in the negotiations.

2. Does the Navy contemplate a negotiated settlement of the LHA claim in excess of the February 1973 Contracting Officer decision? If so, does this mean that the February 1973 Contracting Officer decision was defective?

3. How is Litton financing this $300 million overrun on the LHA contract?

4. Has Litton requested "provisional or other interim payments" from the Navy? If so, what has been the Navy's response?

5. What steps has the Navy taken to ensure that, were Litton to become insolvent, public funds would not be lost?

6. What steps has the Navy taken to ensure that the entire assets of the Litton Corporation are behind its Ingalls Shipbuilding Division so that the corporation cannot simply sever itself from its financial difficulties at Ingalls and leave the Navy holding the bag?

7. Are any financial arrangements, other than the progress and escalation payments provided under the current terms of the LHA contract, necessary to "finance continuation of contract performance pending resolution of the issues" involved in the appeal? If so, does the Navy envision it will be required to provide any such financial arrangements?

I am concerned that Litton apparently has not yet resolved its shipbuilding problems and that the taxpayers may somehow end up paying for the company's mistakes.

I would appreciate an early reply to my letter.

Sincerely,

WILLIAM PROXMIRE.

ITEM 26.—*Dec. 4, 1975—Letter to Edward Levi, Attorney General from Senator Proxmire warning of possible pressure to terminate Litton fraud investigation*

HON. EDWARD H. LEVI,
Attorney General, Department of Justice,
Washington, D.C.

DEAR MR. LEVI: I have just reviewed Litton's annual financial report for fiscal year 1975. Among the problem areas highlighted in that report is the resolution of outstanding claims on Navy shipbuilding contracts. The report makes specific reference to the Department of Justice investigation into charges of misrepresentation and possible fraud in connection with certain shipbulding contracts performed by Litton for the Navy and cites a Grand Jury investigation underway in Alexandria, Virginia.

In an earlier letter, I pointed out to your predecessor, Mr. Saxbe, the importance of the Justice Department's investigation of the Litton shipbuilding claims. Litton and several other shipbuilders have been attempting to obtain relief from their financial difficulties by attributing responsibility for substantially all of their losses to the Navy under Navy shipbuilding contracts. In the process, some contractors have submitted grossly exaggerated claims.

The Litton case is a test which will demonstrate whether this Administration intends to enforce existing statutes against the submission of false claims. It is also a test which will demonstrate whether the same standards will be

applied to large defense contractors as are applied to individual taxpayers who are exposed to criminal penalties for knowingly making false claims in their dealing with the Government.

I recognize that the Litton shipbuilding claims investigation may require considerable time to complete and that upon completion of the investigation it might appear that the amount of money to be recovered through prosecution may not be large. However, a firm stand by the Government in prosecuting any claim that appears to be false or fraudulent will serve as a powerful deterrent against such claims in the future, and could save millions of dollars in the long run.

I have held hearings in recent years on the subject of shipbuilding claims and have found the Navy is not as diligent as it should be in protecting the taxpayer. My experience has been that the Navy is generally reluctant to consider prosecution of its large contractors. I am sure you recognize the substantial influence that some large defense contractors wield within the Defense Department. During the course of the investigation you may even find Navy officials attempting to intervene in the contractor's behalf—under the guise of national defense. Please bear in mind that Navy officials themselves may not be entirely blameless in the case of inflated or fraudulent shipbuilder claims. Before the investigation is completed, you may be pressured by the company and perhaps by Government officials to terminate the investigation. Please assure me you will employ whatever personnel and resources are necessary to investigate this matter thoroughly and that it will not be terminated prematurely.

I would appreciate receiving the following information at your earliest convenience:

1. Have any Navy or DOD officials contacted your Department regarding the status of the Litton case or any of the information uncovered to date? If so, please list the officials, who in Justice they contacted, the date of all such contacts. Also, please provide a copy of their questions and your Department's response.

2. Have the Navy, the FBI, and other affected agencies fully cooperated with your Department in providing information, witnesses, and other support as needed to investigate this matter?

In view of the importance of this matter, I trust that you will give it your personal attention.

Sincerely,

WILLIAM PROXMIRE.

ITEM 27.—*Dec. 9, 1975—Letter from Senator Proxmire to Secretary of Defense Rumsfeld protesting the Armed Services Board of Contract Appeals decision in the case of Lockheed Shipbuilding. Senator Proxmire requests assurance that no claim payment is made to Lockheed in this matter pending completion of the fraud investigation currently underway in the Justice Department. He asks the Secretary's opinion as to whether, without resorting to Public Law 85–804, the Deputy Secretary or any other Department of Defense official or DOD board has the authority to give a contractor $62 million without basing the payment on the merits of the claim*

DECEMBER 9, 1975.

HON. DONALD RUMSFELD,
Secretary of Defense, The Pentagon,
Washington, D.C.

DEAR MR. SECRETARY: On May 29, 1975, I wrote to your predecessor, Dr. James R. Schlesinger, protesting an incredible decision by the Armed Services Board of Contract Appeals regarding a Lockheed Shipbuilding claim. The Board had overruled a $6.7 million Contracting Officer decision and ordered the Navy to pay Lockheed Shipbuilding and Construction Company $62 million, even though the Board made no attempt to assess the merits of the claims. Instead, the Board used a legal technicality, the theory of estoppel, to reach its conclusion that the government should not be allowed to deny that it owes $62 million.

The letter expressed my belief that the Board had acted improperly and illegally in this case. In particular, I believe:

a. The Armed Services Board of Contract Appeals has no authority to grant extracontractual relief such as payments authorized under Public Law 85–804.

The Board's decision does not determine the facts arising under the contract but constitutes an overall settlement outside the shipbuilding contract.

b. The Department of Defense has no authority to make payment in accordance with the Board's decision without first complying with the requirements of P.L. 85–804, including the requirement for prior submittal to Congress of any proposed relief in excess of $25 million. Not even the Secretary of Defense can use Public Law 85–804 for a payment of $62 million without complying with the "anti-bail out" provisions of P.L. 85–804 which require reporting the proposed action to Congress for prior review and possible disapproval. Thus, the Board has arrogated to itself authority which even the Secretary of Defense does not have.

c. The Department of Defense should not make payment while the claim is being investigated by the Department of Justice for possible fraud.

In my letter, I asked Dr. Schlesinger, as the official ultimately responsible for the Armed Services Board of Contract Appeals, to suspend implementation of that decision (ASBCA No. 18560 of 14 May 1975) and stop the payment to Lockheed.

In a letter dated June 18, 1975, the General Counsel of the Department of Defense responded for the Secretary. He promised me that no action would be taken pending the Board's decision on the Navy's motion for reconsideration and pending completion of an investigation by the Department of Justice into possible fraud by Lockheed on these same claims.

I have now been informed that in November the Armed Services Board of Contract Appeals reaffirmed its prior decision in a reconsideration requested by the Navy and has again directed payment to Lockheed. I might add that I am informed the same Board members who issued the original decision also conducted the reconsideration. I understood from your General Counsel's letter that the Board's Senior Deciding Group would be involved in the motion for reconsideration. Please explain the apparent discrepancy in the statement made by the General Counsel with regard to the reconsideration and what actually happened.

The Board concluded that the conduct of former Deputy Secretary of Defense Packard, who admitted he knew nothing of the value of the claim and made no explicit promises to the contractor, obligated the Government to pay Lockheed $62 million, without regard to the merits of the company's claim nor the Defense Department's own regulations.

Since the Armed Services Board of Contract Appeals derives its authority solely from the Secretary of Defense, and since I am unaware of any authority the Secretary of Defense has to authorize payments under these circumstances, it seems to me you cannot allow the Board's decision to stand. Otherwise, you would create a loophole in which a board of civil service lawyers within the Department of Defense can authorize payments that even the Secretary of Defense himself cannot legally authorize.

I am concerned that the Department of Defense might blindly comply with the Board's order and pay Lockheed $62 million without fully recognizing the consequences. In this regard I would like to know:

a. Have you taken steps to ensure that no claim payment is made to Lockheed on this matter pending completion of the fraud investigation currently underway in the Department of Justice? As explained earlier, your General Counsel previously assured me that the DOD would not make payment to Lockheed pending completion of that investigation.

b. What will you do to ensure that any payments to Lockheed in this matter are based either on the merits of the claim or on a formal Secretarial determination in complete accordance with the requirements of P.L. 85–804?

c. What do you intend doing to ensure that, in the Lockheed case and in all other cases, your Armed Services Board of Contract Appeals does not circumvent the requirements of P.L. 85–804 or other federal statutes by rendering decisions independent of the merits of the claim or contract dispute in question?

If it is your opinion that you, the Deputy Secretary, or any other Defense Department official or DOD board has the authority to give a contractor $62 million without basing the payment on the merits of the claim in relation to contract obligations and without notifying Congress as required by Public Law 85–804, please inform me of the legal basis for your opinion so that I may consider what action Congress should take in this specific case, and the corrective legislative action that is needed.

Finally, I would like you to provide me with the legal authority and justification for the ASBCA, its annual operating costs, a list showing the names of individual Board members, their salaries, previous experience and qualifications for membership on the Board, their tenure, and the method of appointment.

Sincerely,

WILLIAM PROXMIRE.

ITEM 28.—*Jan. 6, 1976—Letter from Deputy Secretary of Defense Clements, responding to the Senator's December 9, 1975 letter on the Lockheed decision. Mr. Clements assures the Senator that in no event will the Department of Defense implement the Board's decision in the Lockheed case until the Justice Department indicates that it is proper to do so. This letter provides data about the Armed Services Board of Contract Appeals*

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C., January 6, 1976.

Hon. WILLIAM PROXMIRE,
United States Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: This is in answer to your letter of 9 December 1975 concerning the decision of the Armed Services Board of Contract Appeals in the matter of Lockheed Shipbuilding and Construction Company's $62 million claim settlement.

Lockheed's appeal was taken to the Board on 24 May 1973, based on the Government's failure to follow through with the $62 million tentative settlement which had been reached between Lockheed and the Naval Ships Systems Command on 29 January 1971, and on the contracting officer's failure to issue a final decision. On 14 June 1973, the contracting officer issued a final decision in the matter, and Lockheed took a second appeal to the Board.

You are quite correct that the ASBCA has no authority to act pursuant to Public Law 85–804. It neither did nor did it purport to do so in the Lockheed case. A contract claim which arises either explicitly or constructively under a provision of the contract is adjusted within the terms of the contract, either by the contracting officer or, failing that, by the Board of Contract Appeals. In such case, there is no need for adjustment of the matter under Public Law 85–804 which is addressed to matters not falling within the terms of the existing contract. The Lockheed claims, originally in the amount of approximately $160 million, were matters arising under the contract and were uniformly so handled by the Navy and then the ASBCA. Lockheed argued in its appeal to the Board that these matters arising under the contract had been settled by Secretary Packard in the exercise of his contractual authority and sought to be paid as a contractual right the amount of that settlement. It was these claimed contractual rights which the Board addressed in its decision and again in its response to the motion for reconsideration.

The doctrine of estoppel, on which the Board relied in reaching its decision, is a well-established principle, not merely a legal technicality. The courts have established many conditions that must be satisfied before an estoppel will be applied against the Government and these are discussed and applied in the Board's lengthy opinion.

You mention that you understood that the Government's motion for reconsideration of the original Lockheed decision would be referred to the Board's Senior Deciding Group. In his letter to you dated June 18, 1975, the General Counsel reported that the Navy had requested that its motion for reconsideration be referred to the Senior Deciding Group. Whether such a referral was to be made was, under the Board's charter, discretionary with the Chairman of the Board and the request was not granted. The basis for the Chairman's denial I understand was his feeling that under the circumstances it was inappropriate to use the Senior Deciding Group at this late stage when such a Group had not participated in the original decision.

With respect to the ongoing fraud investigation of Lockheed by the Department of Justice, I wish to assure you that the Department of Defense is coordinating closely with Justice and in no event will the Department of Defense implement the Board's decision until it is in receipt of advice from that Department indicating that it is proper to do so.

Finally, responding to the questions in the last paragraph of your letter, the ASBCA is established by a charter promulgated jointly by the Secretaries of Defense, Army, Navy and Air Force. It exists because of the requirement in the standard contract Disputes clause for a decision by the appropriate Secretary or his duly authorized representative upon appeal from a decision of a contracting officer and the contractor's right to a hearing. The Board's annual operating costs for FY 1975 were approximately $1,160,000. Board members are appointed jointly by the Assistant Secretary of Defense (Installations and Logistics) and the corresponding Assistant Secretaries in the Military Departments. Tenure is indefinite. Brief biographical sketches on the members of the Board, indicating their experience and qualifications for membership, and date of appointment are contained in the attachment to this letter, as are copies of the Board's Charter, a separate listing of members as of 12 December 1975, and their annual salaries.

Sincerely,

W. P. CLEMENTS, Jr.

ITEM 29.—*Jan. 9, 1976—Letter to Senator Proxmire from the Secretary of the Navy replying to questions concerning Litton's finances*

DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., January 9, 1976.

HON. WILLIAM PROXMIRE,
United States Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: This is in reply to your letter of December 4, requesting information about the LHA program and the Navy's current relationship with the contractor. In the interest of clarity and completeness, I am responding to each of your questions in turn on the following pages.

It is hoped that this information will be of assistance to you.

Sincerely,

J. WILLIAM MIDDENDORF II,
Secretary of the Navy.

Enclosure.

Question 1. Is the Navy continuing to negotiate with Litton on the LHA claim while preparing to litigate this claim before the ASBCA? If so, please provide the names of the Navy and Litton officials who have participated in the negotiations.

Answer. The Navy is not negotiating the claim at this time; however, discussions are being held with Litton relative to Litton's withdrawing or suspending their appeal before the ASBCA with the expectation that the parties could reach a negotiated settlement of the LHA claim.

Question 2. Does the Navy contemplate a negotiated settlement of the LHA claim in excess of the February 1973 Contracting Officer decision? If so, does this mean that the February 1973 Contracting Officer decision was defective?

Answer. Since the ceiling price of the Contracting Officer's decision of 28 February 1973 did not include nor recognize the LHA claim, any negotiated settlement of the LHA claim would exceed the ceiling price for the LHA contract established by the Contracting Officer's decision. That decision was not defective since the decision expressly eschewed making any determination on the claim, stating, "By Navy letter of 30 August 1972, Litton's 'REA' claim was rejected because it was based upon the unacceptable 'total cost' and 'total time' basis. The Navy offered to evaluate any claim properly resubmitted 'in a more suitable form, as contemplated by the changes clause, i.e., demonstrating cause and effect * * *.'"

Question 3. How is Litton financing this $300 million overrun on the LHA contract?

Answer. The 1973 Litton Annual Report advised that the dollar amount set forth in the February 1973 Navy unilateral decision on the LHA contract was approximately $300 million less than the current estimated total costs at completion for the LHA contract. The Navy projects that Litton has presently overrun the LHA contract about $53 million which is being financed by Litton Industries through their normal lines of credit.

Question 4. Has Litton requested "provisional or other interim payments" from the Navy? If so, what has been the Navy's response?

Answer. Litton officials, in recent discussions with Navy officials, have suggested the use of a provisional payment against the LHA claim as a means of partially alleviating the serious cash deficiency stemming from the LHA program. This suggestion is currently under consideration.

Question 5. What steps has the Navy taken to ensure that, were Litton to become insolvent, public funds would not be lost?

Answer. The terms of the existing contracts protect the Government funds by limiting the funds payable to the contractor based on the progress achieved on Navy programs and the total contractor expenditures to date. Further, the contracts provide for a percentage of earnings to be retained by the Government as a performance reserve. The contract also provides, under the Default clause, for the contractor to transfer title to all contract rights and materials to the Government. We believe these protect the Government's funds including their rights.

Question 6. What steps has the Navy taken to ensure that the entire assets of the Litton Corporation are behind its Ingalls Shipbuilding Division so that the corporation cannot simply sever itself from its financial difficulties at Ingalls and leave the Navy holding the bag?

Answer. On 26 September 1968, Litton Industries executed a Guaranty Agreement by which Litton Industries, Inc. guaranteed the full and faithful performance by the contractor of all the undertakings, covenants, terms, conditions and agreements of the LHA contract, including, but not limited to, providing financing, facilities and technical assistance. This guaranty was repeated on 28 June 1971 as an inducement by Litton Industries, Inc. to obtain the Navy's consent to a proposed Novation Agreement. The Navy has repeatedly advised Litton of its intention to require Litton to live up to its obligations as the financial guarantor of its wholly-owned subsidiary, Ingalls Shipbuilding Division, Litton Systems, Inc.

Question 7. Are any financial arrangements, other than the progress and escalation payments provided under the current terms of the LHA contract, necessary to "finance continuation of contract performance pending resolution of the issues" involved in the appeal? If so, does the Navy envision it will be required to provide any such financial arrangements?

Answer. The Navy is aware that Litton is experiencing increasing difficulties in financing performance of the LHA contract. Any Navy participation in additional financing would be derived from expeditious resolution of Litton claims resulting in appropriate contract amendments. During the claim resolution period provisional or other interim payments would be considered.

ITEM 30.—*Jan. 22, 1976—Letter to Senator Proxmire from Assistant Attorney General Richard L. Thanburgh concerning the investigaion of the Litton claim*

DEPARTMENT OF JUSTICE,
Washington, D.C., January 22, 1976.

Hon. WILLIAM PROXMIRE,
United States Senate,
Washington, D.C.

DEAR SENATOR: The Attorney General has asked me to reply to your most recent letter dated December 4, 1975, concerned with the validity of cost claims filed in relation to construction of ships for the Department of the Navy by Ingalls Shipbuilding Division, Litton Systems, Inc.

First, I want to reassure you that the possibility of fraud resulting from such contract performance remains a priority concern of the Department of Justice. It continues to be the subject of intensive inquiry by the Federal Bureau of Investigation as well as a Federal Grand Jury sitting in the Eastern District of Virginia. As I stated earlier, this review and evaluation will include the possible impact of inflated cost claims on financial statements the corporation has issued to stockholders and the public.

It is still not possible to predict either the extent or results of the investigation. Only last week representatives of this Division and the United States Attorney's office conferred on the scope and direction of future inquiry in this matter.

With respect to your inquiry regarding the identities, number and dates of contracts made by the Department of Defense, it is not possible to furnish the details you request. During the period of the ongoing inquiry there have been numerous contacts between our respective agencies regarding the acces-

sibility of witnesses, availability of documents and the propriety of attempting to resolve any outstanding claims made by the contractor. None of these contacts are viewed as interference with the current inquiry. The Navy has heretofore been cautioned that any out of court settlement of certain claims related to ship construction could jeopardize the criminal investigation and the Department opposes such settlement. This remains the view of the Department of Justice.

I trust that this report will serve as a meaningful response to your letter.

Sincerely.

RICHARD L. THORNBURGH,
Assistant Attorney General.

ITEM 31.—*Apr. 9, 1976—Senator Proxmire letter to Deputy Secretary of Defense Clements registering opposition to providing shipbuilders extracontractual relief under Public Law 85–804. The letter points out that the Justice Department is presently investigating for possible fraud at least two shipbuilding claims, one filed by Lockheed and the other by Litton*

APRIL 9, 1976.

HON. WILLIAM CLEMENTS,
Deputy Secretary of Defense, Department of Defense, The Pentagon, Washington, D.C.

DEAR MR. SECRETARY: I have noticed press reports concerning your intent to exercise the authority under PL. 85–804 in order to settle the huge backlog of shipbuilding claims against the Navy, and I have also read your letter of April 2, 1976 to Senator John Stennis concerning the same matter.

I very much oppose any such proposals because it would be bad procurement policy, it would reward shipbuilders who have been demonstrably inefficient, it would be a signal to Navy procurement officials to rubber-stamp all such claims in the future, it would be a giveaway of taxpayers' money, and it would be a backdoor form of spending that would tend to exceed the President's budget request and have an inflationary impact on the economy.

As you know, a shipbuilding claim is essentially a request by a shipbuilder that the Navy pay to it more than we agreed upon in the original contract. Sometimes the shipbuilders' request may be justified because of actions taken by the government or circumstances beyond his control. But every claim must be rigorously examined to determine whether the shipbuilder is legally entitled to the extra money.

To simply decide to pay all pending claims in order to "wipe the slate clean" risks giving away public funds for the bad and upsupported claims along with those that are justified.

You are aware that the Justice Department is presently investigating at least two shipbuilding claims, one filed by Lockheed and the other by Litton, for possible fraud. The Navy itself has rejected a number of claims because they were not supported by the facts. An action to "settle" all pending claims, or many of them, in one fell swoop would inevitably require the payment of fraudulent, phoney, and baseless claims.

As the author of the provision of PL. 85–804 which requires notification to Congress of an intent to pay any contractor in excess of $25 million above his contract price, I can say that it was the intent of this legislation to discourage and deny backdoor bail outs of defense contractors.

I would appreciate being personally informed of when you intend to submit formal notification of your intent to invoke PL. 85–804 and I would also like to have a copy of the notification when it is transmitted to Congress.

In addition, I would appreciate having a complete up-to-date breakdown of all pending shipbliding claims showing the amount of each claim, the name of the shipbuilder, a description of the contract on which the claim is based including the types of ships being built under the contract, and the contract price. For each pending claim also show the status of the ship construction for the contracts that are the subject of the claim, including the numbers of the ships completed and the number still under construction.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 32.—*Apr. 15, 1976—Senator Proxmire letter to Deputy Secretary of Defense Clements inviting him to testify before the Joint Economic Committee on May 12, 1976 to explain his proposal to eliminate the backlog of shipbuilding claims under P.L. 85–804*

APRIL 15, 1976.

Hon. WILLIAM CLEMENTS,
Deputy Secretary of Defense, Department of Defense, The Pentagon
Washington, D.C.

DEAR MR. SECRETARY: This is to invite you to testify before the Subcommittee on Priorities and Economy in Government on the subject "Government—Contractor Relations." Your appearance is scheduled for Wednesday, May 12, 1976 at 10:00 a.m.

This hearing is the latest in a series on government procurement begun many years ago by this Subcommittee.

We are particularly interested in your proposal concerning the backlog of shipbuilding claims and in the role of the Department of Defense in the foreign military sales program.

As you know, this Subcommittee has received testimony in the past on both shipbuilding claims and foreign military assistance.

By the way, I am hopeful that the information requested in my letter of April 9, 1975 will be provided within the next few days so that it might be used in our preparation for the forthcoming hearings. In addition, on April 12 my staff requested from the Navy a copy of the memorandum of Admiral H.G. Rickover on the subject of shipbuilding claims which was described in an article in the *Washington Post* by Mr. George Wilson, April 11, 1976. I would appreciate being provided with a copy of this memo at your earliest convenience.

It would aid the Committee if we could have 100 copies of your statement by noon, Monday, May 10, 1976. Please send them to Mr. Michael Runde, Joint Economic Committee, Room G–133 Dirksen Senate Office Building, Washington, D.C. 20510. Mr. Richard Kaufman, 224–0377, can answer any questions concerning the hearing.

Sincerely,

WILLIAM PROXMIRE,
Subcommittee on Priorities and Economy in Government.

ITEM 33.—*Apr. 22, 1976—Deputy Secretary of Defense Clements letter to Senator Proxmire accepting his invitation to testify before the Joint Economic Committee*

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C., April 22, 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: I write to acknowledge your letters of 9 and 15 April and to accept your invitation to appear and testify before your subcommittee at 10 a.m. on Wednesday, May 12, 1976 on matters concerning the backlog of shipbuiding claims and the role of DOD in the Foreign Military Sales program. As you know, I recently responded to a letter from Senator Stennis, Chairman, Senate Armed Services Committee in which he expressed his committee's serious concern about the management problems in the Navy's Shipbuilding program and emphasized "the ultimate responsibility for approval, management, and program execution lies with the Secretary of Defense." On Thursday, 29 April, I expect to testify before the Senate Armed Services Committee on the matter of the Navy's shipbuilding claims problem and the unsatisfactory business relations which exist between the Navy and the shipbuilding industry. The Secretary of Defense and I believe that this situation constitutes a serious problem for our national defense and we recognize our responsibility to initiate corrective action on a timely and prudent basis.

Following the recent press reports concerning the Navy's shipbuilding claims problems and my 2 April letter to Chairman Stennis, I have received several

interesting and constructive memoranda and letters which I believe you will find of value in preparation for the hearings of your Subcommittee. One of these is Admiral Rickover's notes for his discussion with me on 7 April which you requested. In addition, I have letters from Mr. Lloyd Bergeson, former executive of Ingalls Shipbuilding Corp., Pascagoula, Mississippi and General Dynamics Corp., Quincy, Massachusetts; from Mr. P. E. Atkinson, President, Sun Shipbuilding and Dry Dock Co., Chester, Pennsylvania; and from Mr. Joseph P. Ruppel, President, Boland Marine and Manufacturing Company, Inc., New Orlean, Louisiana.

Mr. Gordon Rule, the Director, Procurement Control and Clearance Division, Navy Material Command, has recently written several very cogent memos which specifically address the many facets of the serious problems which beset the Navy's shipbuilding program. I, philosophically, agree with the thrust of Mr. Rule's ideas and recommendations. I believe we are beginning already to implement some of these, but much needs to be done.

As enclosures I have included copies of the memos and letters referred to above. I think there is a common theme in all of these which may be summarized as:

(a) There is a serious problem facing the Navy, the DoD, and the national defense.

(b) There is a need for immediate and forthright action.

(c) The Government's (and the people's) interest are paramount—there shouldn't be, and there cannot be, a "bail out" for inefficiency and mismanagement on the part of shipbuilders involved in major Government ship acquisition contracts.

(d) It is not 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 and more particularly where there is mutual fault.

Concerning DoD's role in the foreign military sales program, much review activity of the DoD program has been underway under my immediate supervision in the past year. I will be pleased to discuss this activity with your committee, but I would prefer to address this issue at a subsequent hearing.

Mr. Chairman, I think it most appropriate that your subcommittee will enquire into the background, the problem (and the remedies thereto), of DoD's shipbuilding program. While I am happy to formally appear before the Committee on 12 May, I would also like to meet informally with you prior to that time either in your office or perhaps, if you could find it convenient, at lunch with me here in my office at the Pentagon.

Sincerely,

W. P. CLEMENTS, Jr.

ITEM 34.—*Apr. 30, 1976—Deputy Secretary Clements' letter to Senator Proxmire forwarding a copy of Mr. Clements' Apr. 29, 1976 statement to the Senate Armed Services Committee*

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C., April 30, 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: This is a follow-up note to my letter of April 22nd. As you know, I appeared before the Senate Armed Services Committee yesterday, 29 April, to testify in matters concerning the Navy's shipbuilding program and the action I propose to take by utilizing the authority of P.L. 85–804 to remedy the serious and critical problems in that program which threaten the national defense. Although you may already have seen my statement to the Senate Armed Service Committee, I take this opportunity to forward two copies to you because I think it is appropriate back-up material and very germane to the hearing which you plan to conduct commencing on 12 May.

In addition, I am also enclosing a copy of a special study entitled "Report to the Deputy Secretary of Defense, A Survey of the Navy Shipbuilding Claims Problem, July 1974." In September, 1974, I furnished copies of this study to the chairmen of our principal oversight committees in the Senate and the

House. I believe you will find the study quite comprehensive and still very much in date.

Again, Mr. Chairman, I would like to express my strong desire to have an opportunity to meet with you informally prior to the hearing on 12 May—either in your office or, if convenient to you, I would be pleased to have you join me for lunch here in the Pentagon.

Sincerely,

BILL CLEMENTS.

ITEM 35.—*May 4, 1976—Letter from Assistant Secretary of Defense (I&L) to Senator Proxmire forwarding detailed information on pending Navy shipbuilding claims*

ASSISTANT SECRETARY OF DEFENSE,
Washington, D.C., May 4, 1976.

Hon. WILLIAM PROXMIRE,
Chairman, Subcommitte on Priorities and Economy in Government, Congress of the United States, Joint Economic Committee, Washington, D.C.

DEAR MR. CHAIRMAN: This is in furtherance of Deputy Secretary of Defense Clements' letter of April 22, 1976 and provides the data on the shipbuilding claims which you requested in your letter of April 9, 1976.

Sincerely,

Assistant Secretary for Installation and Logistics.

PENDING SHIPBUILDING CLAIMS

Shipbuilder	Number	Type	Contract description: Ship type: Description	Hull	Contract price: Original	Contract price: Current	Status: Number companies	Status: Number in construction	Status: Percent of companies	Claim amount: Original	Claim amount: Current
Ingalls Shipbuilding Div	N00024-C-0283	FPIS	Amphibious assault ship.	LHA	$1,012,500,000	$807,600,000	0	5	82.7	$270,000,000	$504,847,301
				1	(based on 9				98.0		
				2	ships)				89.7		
				3					82.2		
				4					71.9		
				5					71.0		
Newport News Shipbuilding	N00024-68-C-0355	FPIE	Guided missile Cruiser (nuclear)	CGN	175,000,000	179,971,886	2	0	100.0	35,036,981	151,040,521
				36					100.0		
				37					100.0		
Do	N00024-70-C-0252	FPIE	Guided missile	CGN	300,000,000	303,082,196	0	4	55.6	159,774,936	(2)
				38					93.1		
				39					67.1		
				40					48.0		
				41	84,400,000	100,900,000			14.3	(3)	
Do	N00024-70-C-0269	FPIE	Attack submarine (nuclear).	SSN 688	83,300,000	86,900,000	0	1	96.6	46,203,379	78,543,149
Do	N00024-71-C-0270	FPIE	do	SSN	249,500,000	253,400,000	0	4	63.2		
				689					81.0	96,277,734	191,567,199
				691					70.0		
				693					55.4		
				695					46.2		
Do	N00014-67-C-0325	FPIE	Aircraft carrier (nuclear).	CVN	760,000,000	791,300,000	1	2	90.5	221,280,223	(2)
				68					100.0		
				69					80.0		
				70	(4)				7.0	(3)	
Do	N00024-69-C-0307	FPIE	Attack submarine (nuclear).	SSN 686	96,800,000	98,350,000	2	0	100.0	92,099,492	(2)
				687							
Boland Marine [5]	N00024-74-C-0241	FPI	Guided missile frigate	DLG-10	22,365,000	26,723,099	0	1	78.0	3,297,114	3,297,114

[1] Based on 9 ships.
[2] No change.
[3] Not included in claim.
[4] Not definitized.
[5] Modern and conversion.

Notes:
FPI=Fixed Price Incentive.
FPIE=Fixed Price Incentive with Escalation.
FPIS=Fixed Price Incentive Successive Target.

Shipbuilder	Number	Type	Contract description: Ship type: Description	Contract description: Ship type: Hull	Contract description: Contract price: Original	Contract description: Contract price: Current	Status: Number completed	Status: Number in construction	Status: Percent of completed	Original claim amount	Current appeal amount
Ingalls Shipbuilding Division	NObs-4374	FFPE	Submarine, nuclear	SSN-621	$23,405,750	$54,125,125	1	0	100		
	NObs-4510	FFPE	do	SSN-639	29,500,000	56,638,908	1	0	100		
	NObs-4582	FFPE	do	SSN-648,652	59,971,870	98,898,751	2	0	100		
	NObs-4625	FFPE	Amphibious transp. dock.	LPD-7, 8	51,458,000	61,707,757	2	0	100	$94,536,717	$107,820,866
	NObs-4616	FFPE	Amphibious assault ship.	LPH-10	31,972,000	34,841,166	1	0	100		
	NObs-21(A)	FFPE	do	LPH-12	37,874,000	43,782,697	1	0	100		
	NObs-4924	FFPE	Dock landing ship	LSD-36	24,374,150	26,115,676	1	0	100		
Do	N00024-68-C-0342	FPIE	Submarine, nuclear	SSN-680,2,3	107,416,500	140,998,934	3	0	100		(1)
Do	N00024-69-C-0283			(2)						(3)	(2)
Lockheed Shipbuilding Construction Co.	NObs-4660			(4)							(4)
	NObs-4765										
	NObs-4785										
	NObs-4902										
Merrit-Chapman & Scott (formerly New York Shipbuilding)	NObs-3920	FPE	Guided missile destroyer.	DDG-4,5,6	49,123,500	(5)	3	0	100		
	NObs-4247	FPE	Guided missile frigate.	DLG-19, 20	49,886,594	(5)	2	0	100		
	NObs-4268	FPER	Submarine, nuclear	SSN-603,4	45,389,098	(5)	2	0	100		
	NObs-4294	FPE	Guided missile destroyer.	DDG-15,16,17	47,313,996	(5)	3	0	100	3,761,696	6,844,000
	NObs-4356	FPE	Submarine, nuclear	SSN-612	26,133,753	(5)	1	0	100		
	NObs-4569	FPE	Guided missile frigate nuclear.	DLGN-35	53,987,001	(5)	1	0	100		
	NObs-4655	FPE	Fast combat support	AOE-2	48,484,000	(5)	1	0	100		
Todd Shipbuilding, Seattle	N00024-69-C-0256	FFP	Oceanographic Research.	AGOR-16	13,950,000	(5)	1	0	100	2,888,342	2,965,000

[1] ASBCA decision of April 16, 1976 determined the adjusted claim to be $30,335,136 and further determined $17,175,764 to be due contractor.
[2] Withdrawn from docket to permit further negotiations. Included in "Pending Shipbuilding Claims".
[3] Suspended from docket.
[4] Award by ASBCA to contractor but not yet paid due to allegation of possible fraud.
[5] Unable to obtain final contract price. Information is not ready available.

Note.—FPIE=Fixed Price Incentive with Escalation.
FPE=Fixed Price, Escalation.
FPER=Fixed Price Escalation, Redeterminable.
FFPE=Firm Fixed Price with Escalation.

SHIPBUILDING CLAIMS—ASBCA DECISIONS

Shipbuilder	Number	Type	Contract description: Ship type: Description	Contract description: Ship type: Hull	Contract description: Contract price: Original	Contract description: Contract price: Current	Status: Number of companies	Status: Number in construction	Status: Percent of companies	Original claim amount	Current appeal amount
General Dynamics (Quincy)	NObs–4509	FPE	Submarine, nuclear	SSN–638	$28,456,000	(1)	1	0	100	$10,300,000	$23,416,246
	NObs–4583	FPE	do	SSN–649	33,500,000	(1)	1	0	100	9,500,000	(2)
Lockheed Shpbldg. & Construction Co.	NObs–4660	FFP	Amphibious Transport Dock.	LPD–9, 10	50,445,000	$68,004,933	2	0	100	24,151,451	[3] 38,211,262
	NObs–4765	FFP	do	LPD–11, 12, 13	69,774,000	86,017,218	3	0	100	24,991,341	39,777,809
	NObs–4785	FFP	Escort Ship	DE–1057, 63, 65, 69, 73	60,285,000	68,877,000	5	0	100	30,783,460	59,253,650
	NObs–4902	FFP	Amphibious Transport Dock.	LPD–14, 15	48,395,000	63,201,935	2	0	100	20,198,260	32,949,817

[1] Unable to obtain final contract price. Information is not readily available.
[2] ASBCA denied contractor's claim. Suit has been filed with the U.S. Court of Claims.
[3] Award made by ASBCA to contractor. Not yet paid due to allegation of possible fraud.

Note.—FFP=Firm Fixed Price.

ITEM 36.—*May 18, 1976—Senator Proxmire speech to the Senate "Shipbuilding Claims Against the Navy; A Manufactured Crisis"*

Mr. PROXMIRE. Mr. President, William P. Clements, Deputy Secretary of Defense, has formally notified Congress that the Pentagon is invoking its national emergency powers under Public Law 85–804 to pay over half a billion dollars to two Navy contractors. The two contractors, Newport News Shipbuilding & Drydock Co. and the Ingalls Shipbuilding Division of Litton, have filed $1.4 billion worth of shipbuilding claims against the Navy.

In addition, Mr. Clements says that about $300 million in claims is about to be filed by the Electric Boat Division of General Dynamics. These claims have not yet been received by the Navy.

THE CLAIMS HAVE NOT BEEN FULLY AUDITED

Part of Mr. Clements' argument in support of emergency treatment of the claims, rather than the normal settlement procedures followed by the Navy, is that the claims represent long-standing disputes and therefore must be quickly resolved. The impression has been created that the claims are old and that they have been unresolved for a long period of time.

The facts are that most of Newport News' claims were either filed for the first time or revised this year, and that the backup documentation for Litton's claims has still not been submitted to the Navy.

What this means is that the Navy has still not had a chance to fully audit or analyze the claims. For the Government to pay the claims wholly or in part without a full audit and analysis would be like buying a pig in a poke.

Such an action is objectionable as a matter of principle. The taxpayer should not have to pay for unaudited, unanalyzed claims.

Paying these particular claims before they are fully audited is especially objectionable.

A MANUFACTURED CRISIS

After reviewing the facts and the sequence of events in this matter, I am forced to conclude that the Pentagon is conspiring with the shipbuilders to manufacture a crisis designed to cover up cost overruns and possible false claims that could cost the taxpayer hundreds of millions of dollars.

The facts surrounding the $1.4 billion in claims filed by Newport News and Litton against the Navy show that they are based at least in part on vague estimates, phony assertions and inflated figures.

The facts also show that the timing of many of the claims coincide with pressures applied to get them quickly settled and that the Pentagon is now trying to exempt the contractors from audits of their claims and pay them under a national emergency law.

CLEMENTS' PROPOSAL IS FOR A BAILOUT

The Pentagon's purpose seems to be to bail out two defense contractors who have incurred huge cost overruns because of their own inefficiency and failures to deliver on time.

I am confident that if the claims were thoroughly audited, they would be revealed as largely a mixture of hocum and hot air.

The squeeze play engineered by Clements and the shipbuilders has already resulted in recent provisional payments of nearly $20 million to Litton based on an incomplete analysis of partial information.

Litton asserts that the Navy agreed in a March 1976 meeting to pay the company $50 million in provisional payments. I am informed that Navy officials deny making any such agreements.

SHIPBUILDERS HAVE WITHHELD RECOMMENDATION

Part of Litton's and Newport News' strategy has been to withhold supplying the Navy with the documentation of their claims in order to delay or prevent Government auditors from examining them. Three-fourths of Newport News' $894 million in claims were either filed for the first time or substantially revised this year. Newport News began preparing its claims years ago, sat on them for months after the paperwork was completed, and then dumped most of them in the Navy's lap last February and March.

In January, Clements met personally with J. P. Diesel, president of Newport News, to discuss the claims before most of them had even been filed. Early in February Clements ordered Adm. James L. Holloway, Chief of Naval Operations, to come up with the plan to resolve the claims dispute with Newport News in 30 days. Some of the largest claims had still not been filed.

NUCLEAR CARRIER CLAIM FILED FEBRUARY 1976

Newport News' largest single claim—$221 million for the aircraft carriers *Nimitz* and *Eisenhower*—was filed on February 19, 1976, together with 16 thick volumes of documentation. On February 20, Diesel wrote to the Navy threatening to stop work on other Navy ships unless there was progress toward settlement of its claims.

NUCLEAR SUBMARINE CLAIMS FILED MARCH 1976

Newport News' $92 million claim for the nuclear submarines SSN 686 and SSN 687 was not filed until March 1976. I am informed that Newport News completed its price estimates for this claim in May 1975.

Another curious fact about the SSN 686 and SSN 687 claims is that General Dynamics built four submarines of the same class, in the same time period, in accordance with the same designs. Yet General Dynamics has no significant claims against the Navy for its submarines.

NEWPORT NEWS CLAIMS FILLED WITH DISCLAIMERS

Other disturbing facts about the Newport News claims are:

First, the statements accompanying the claims are filled with disclaimers indicating the company would not be able to prove the Navy owes the amounts alleged.

Second, with regard to its $160 million claims on the cruisers CGN 33, 39, and 40, documentation "includes the team's analysis of contemporary documents and working files which might be lost when the project goes into final completion stages." The contractor also admits "some errors may have been made" in its estimates, and that the specific impact of what the Navy is alleged to have done "is difficult to identify."

Third, Newport News also admits "some errors may have been made" in its nuclear submarine claim, that its conclusions cannot be proven with certainty, and that it may be evaluated differently by the Government.

Fourth, Newport News refuses to certify its claim although Navy regulations require that contractor certify that their claims are "current, complete and accurate" in a sworn affidavit.

LITTON LHA CLAIM STILL NOT FULLY DOCUMENTED

Litton's claim on the helicopter carrier program—LHA—was originally $270 million in 1972 and was revised upwards three times until it reached the total of $505 million in April 1975.

The Navy rejected Litton's original claim in 1973 on the grounds that it had failed to substantiate its allegations with facts. The Navy did agree to pay Litton $109.7 million for cancellation costs when the LHA program was cut back from nine ships to five ships. Litton appealed the decision to the Armed Services Board of Contract Appeals instead of providing the Navy with supporting facts.

In January 1976, the Navy and Litton agreed that the contractor would withdraw its appeal, begin documenting the LHA claim, and resume negotiations after the Navy examined the backup data. Litton's documentation began arriving in March, enabling the Navy for the first time to begin analyzing the facts behind the claim. In the latter part of March, Secretary Clements pulled the rug out from beneath the Navy by deciding the Government should provide financial relief to Newport News and Litton through its national emergency powers.

EARLIER LITTON CLAIM UNDER INVESTIGATION BY JUSTICE DEPARTMENT

Among the disturbing facts about Litton are the following:

First, an earlier Litton claim on a submarine contract was referred by the Navy to the Justice Department for investigation of possible fraud. That investigation is now taking place.

Second, in 1972 Roy Ash, president of Litton, urged the Navy to ask Congress for $1 billion to $2 billion to solve LHA and other shipbuilding problems. Ash said he discussed such a program with a Mr. Conally, who was quoted as saying that it should be positively presented, "on a grand scale—make it bigger than the Congress."

Third, only a fraction of the supporting data to the LHA claims has been submitted to the Navy.

Fourth, Litton's shipyard facility has been proven to be inefficient and poorly managed by a number of Government investigations. This is the same company that ordered a ship cut in half so that when welded back together Litton could claim that it had been built according to modern, modular construction techniques.

THE REAL ISSUE—WHO IS TO BLAME FOR DELAYS AND COST OVERRUNS?

I believe Secretary Clements is a man of high integrity and that he is dedicated to the public interest. I also feel certain that the Navy must share some of the responsibility for the problems in the shipbuilding program. The real issue is, who is to blame for the schedule delays and the cost overruns?

THE CLAIMS MUST BE FULLY AUDITED AND ANALYZED

There is no way to decide this issue until the claims are thoroughly audited and analyzed.

The contractors should have nothing to fear from a Navy audit if the claims are legitimate.

The taxpayer should not have to pay anything for unaudited, unanalyzed and unsubstantiated claims.

Under the law the Senate and the House each have 60 days of continuous session to adopt a resolution disapproving the Pentagon's proposal. Clearly, there is no national emergency justifying the wholesale bailout of the shipbuilding industry proposed by Mr. Clements. It is also of interest that the shipbuilders themselves have not asked for the kind of relief contemplated by the law that is being invoked.

The Senate should reject the Clements proposals.

ITEM 37.—*May 19, 1976—Senator Proxmire letter to Senator Stennis requesting that the Defense Department withdraw the Public Law 85–804 notification until all pertinent facts and information the Congress needs are available*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., May 19, 1976.

HON. JOHN C. STENNIS,
U.S. Senate,
Washington, D.C.

DEAR JOHN: I thought it might be useful if I explained my position on Secretary Clements' proposal with regard to shipbuilding claims, in view of our recent conversation.

Let me say at the outset that I do not question anyone's motives on this matter. The problem is a complex one and there is room for differences of opinion on many of the questions involved. In addition, serious consideration must be given to the requirements of national defense and the needs of the Navy for ships.

On the other hand, there are fundamental principles at issue with regard to the responsibility of Congress for public funds. I am sure you will agree that certain prerequisites should be met before any taxpayer's money is used to reimburse a contractor for a claim against the government. The first prerequisite is that government should be certain that the claim is accurate and that there is government liability.

The fact is that the government has not conducted a full audit and a comprehensive analysis of either the Newport News claims, which total $894.3 million, or the Litton claim, which totals $504.8 million. The reason the government has not yet done its audit is that in the Newport News case three-fourths of its claims have been filed only this year or have been revised this year. As you know, it takes many months and sometimes years for a company

to prepare a major claim. It has simply not been possible for the Navy to complete an audit of the claims that have been so recently filed.

In Litton's case, although the claim was originally filed in 1972, it has been revised substantially on three different occasions and, in addition, the complete documentation of the claim has still not been supplied to the Navy.

I find it very hard to justify any proposal that would pay out large sums of money to government contractors for unaudited claims.

Another disturbing aspect of this matter is the fact that statements have been made suggesting the shipbuilders might be forced to stop work on Navy ships because of their losses on ship contracts and their overall negative cash flow situation. This seems to be the basis for invoking PL 85–804 which provides extraordinary relief for government contractors.

Here too, there has been little, if any, substatiation of the assertions that have been made.

Finally, I am deeply concerned over the way PL 85–804 has been invoked by Secretary Clements in light of the 1973 amendment to PL 93–155. You will recall that the 1973 amendment was adopted to give Congress 60 days of continuous session to decide whether to adopt a resolution disapproving proposals such as the present one.

As one of the authors of that amendment. I can say that it was clearly intended for Congress to have all the information, including the full facts and details of any such proposal, before it during the 60 days. In this case, however, we still do not have the full facts and details of the proposal. Secretary Clements has said he would provide more information in June.

I find this procedure highly irregular and in violation of the intent of the law. It is simply not possible for Congress to consider whether to approve a proposal during a 60 day period if the full facts of the proposal are not available during the same 60 day period.

I would suggest that, at the very least, the proposal be withdrawn and resubmitted when the Defense Department has all the pertinent facts and information that Congress needs in order to consider it.

I also feel very strongly, as I am sure you do, that major claims against the government should not be paid unless the claims have been fully documented and audited, and there has been a determination of legal liability. Moreover, in order to invoke PL 85–804, which provides for extraordinary relief to government contractors experiencing financial difficulties, the fact that the contractors are having financial difficulties entitling them to their extraordinary relief should be fully established.

I would like to work with you further in a constructive way to help resolve these problems.

Sincerely,

WILLIAM PROXMIRE, *United States Senator.*

ITEM 38.—*May 27, 1976—Senator Proxmire letter to Secretary of the Navy Middendorf requesting information about a news report that Thomas G. Corcoran, a prominent lawyer/lobbyist for Tenneco, had been approached by Navy officials how they could get Rickover out of the hair of the shipbuilders*

MAY 27, 1976.

HON. J. WILLIAM MIDDENDORF II,
The Secretary of the Navy,
The Pentagon, Washington, D.C.

DEAR MR. SECRETARY: The May 19, 1976 issue of the *New York Times* contains in article entitled "Rickover Wants Shipyards to Comply With Contracts." The article quoted from a letter Admiral Rickover sent to a Member of Congress on the Defense Department's decision to pay shipbuilding claims by use of Public Law 85–804 instead of using the normal claims settlement procedures.

Admiral Rickover is quoted as saying, "A well-known Washington lawyer under retainer to Tenneco last year lobbied extensively in Congress and in the executive branch in an effort to dissuade the Secretary of the Navy from extending me on active duty when my reappointment came up for renewal last January." The article continued:

Thomas G. Corcoran, a prominent lawyer-lobbyist who for more than a decade has represented Tenneco, said in an interview that he had been approached by Navy officials about 'how could they get Rickover out of the hair

of the shipbuilders' and he had replied: 'Why don't you make him Commandant of the Navy Academy?'

Mr. Corcoran, whose Washington connections go back to New Deal days, insisted that he had not lobbied in Congress against another two-year tour of active duty for the 76 year old admiral, who he said 'regrets me as a personal enemy because I have been standing in the way of his effort to nationalize the shipyards."

I have had a long standing concern about undue influence on the defense establishment exercised by some large defense contractors. The current Defense Department proposal to try to pay claims under Public Law 85–804 apparently grows out of such pressure by Navy shipbuilders.

In this regard I would like answers to the following questions:

1. Did you or anyone else in the Navy or Defense Department ever contract Mr. Corcoran to ask his advice on how you could get Admiral Rickover "out of the hair of the shipbuilders?" If so, why was he thus approached? Who in the Navy or Defense Department approached him? When? What specific questions was he asked? What advice did he render? What action did the Navy or DOD take as a result?

2. Did Mr. Corcoran or other representatives or officials of Newport News or Tenneco express their views on the advisability of giving Admiral Rickover a different assignment to you or any other Navy or Defense Department officials? If so, which Navy or Defense officials were contacted and when? What specific company officials or representatives were involved? What was their advice? Were there any company actions suggested, such as a refusal to do Navy work or take additional Navy business, if Admiral Rickover were reappointed.

3. Have you or other Navy or Defense Department officials had any discussions with Mr. Corcoran or any other lobbyist, representative or official of Newport News or Tenneco about the difficulties Newport News is experiencing with its Navy shipbuilding contracts? If so, please state the date and location of such discussions and briefly describe them.

I would appreciate your prompt response to the above questions.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 39.—*June 8, 1976—Letter from Navy General Counsel E. Grey Lewis to Senator Proxmire taking exception to Admiral Rickover's testimony regarding the Navy's legal services*

DEPARTMENT OF THE NAVY,
OFFICE OF THE GENERAL COUNSEL,
Washington, D.C., June 8, 1976.

Hon. WILLIAM PROXMIRE,
United States Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: During his June 7 testimony on shipbuilding claims before the Joint Economic Committee's Subcommittee on Priorities and Economy in Government, Admiral H.G. Rickover raised an issue that he has been pursuing for some time regarding the Navy's legal services. His opening remarks seem intended to convey the impression that the Navy Office of the General Counsel is vastly understaffed in the areas of claims and litigation, and during questioning he expressed his support for Section 703 of the House DOD Authorization Bill to enable the Navy to hire outside counsel.

This is a subject upon which I have taken strong exception to Admiral Rickover's views. I believe he has inaccurately portrayed the ability of this Office to carry out its duties, and that the remedial legislation he supports is unnecessary and would not be in the best interests of the Navy. I have recently set forth my own views in the attached letter to the Chief Counsel for the Senate Committee on Armed Services, and in view of the introduction of this subject into your Subcommittee's hearings I am taking the liberty of furnishing a copy of that letter for your information.

Sincerely,

E. GREY LEWIS,
General Counsel.

ITEM 40.—*June 11, 1976—Senator Proxmire letter to Navy General Counsel Lewis acknowledging Mr. Lewis' letter of June 8, 1976. Senator Proxmire suggests that the claims filed against the Navy by Newport News Shipbuilding may be based on fraudulent representations*

JUNE 11, 1976.

Mr. E. GREY LEWIS,
General Counsel, Department of the Navy,
Washington, D.C.

DEAR MR. LEWIS: Thank you for your letter of June 8, 1976 concerning the statements made by Admiral H.G. Rickover in the hearings on shipbuilding claims.

You stated that Admiral Rickover inaccurately portrayed the ability of your office to carry out its duties and that the legislation he supports which would authorize the Navy to hire outside counsel to represent it with disputes in government contractors, is unnecessary. Let me assure you that I intend to study your views and the material you forwarded.

In the meantime, you may be aware that the testimony we received in the June 7 hearing on shipbuilding claims strongly suggests that the claims filed against the Navy by Newport News shipbuilding in the amount of $894 million may be based on fraudulent representations.

The testimony showed that the claims contain inflated figures, unsupported allegations, attempts to charge the Navy with the costs of commercial activities and possible double counting.

These are serious charges which I feel confident your office will want to immediately investigate.

You may also know that on two prior occasions I asked the Navy to investigate possible fraud in shipbuilding claims. On both of those occasions the Navy forwarded the claims to the Justice Department for criminal investigations following the Navy inquiries.

I have enclosed a copy of the letter I sent to Secretary Middendorf requesting a formal Navy investigation of the Newport News claims. I look forward to your early response.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities
and Economy in Government.

ITEM 41.—*June 11, 1976—Letter from Senator Proxmire to Secretary of the Navy Middendorf pointing out testimony from Admiral H. G. Rickover and Mr. William C. Cardwell during the June 7, 1976 Joint Economic Committee hearings. Senator Proxmire requests a formal investigation to determine whether the shipbuilding claims filed by NewPort News Shipbuilding may be based on fraudulent representations*

JUNE 11, 1976.

Hon. J. WILLIAM MIDDENDORF II,
Secretary of the Navy, The Pentagon,
Washington, D.C.

DEAR MR. SECRETARY: This is to request a formal investigation to determine whether there is substantial evidence that the shipbuilding claims filed by Newport News Shipbuilding may be based on fradulent representations.

As you may know, the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee held hearings on Monday, June 7, 1976 concerning the shipbuilding claims. Testimony was received from Admiral H.G. Rickover and Mr. William C. Cardwell, a former official at Newport News.

The evidence received by the Subcommittee strongly suggests a possibility that the claims may be based on false or fraudulent representations.

The testimony shows that the claims contain inflated figures, unsupported allegations, attempts to charge the Navy with the costs of commercial activities, and possible double counting. According to the sworn testimony of Mr. Cardwell, although the company has blamed the Navy for most of the delays and disruptions that took place in the construction of the ships, the company itself was responsible for most of the delays and the disruptions. Mr. Caldwell testified that Navy change orders were considered to be very costly for purposes of the claims when, in fact, they were not.

You may also know that on two prior occasions I have requested the Navy to investigate the possibility of false claims. In both cases, involving Lockheed and Litton, the claims were referred to the Justice Department for criminal investigation following inquiries by the Navy.

Sincerely,

WILLIAM PROXMIRE.

ITEM 42.—*June 15, 1976—Deputy Secretary of Defense Clements' letter to Senator Proxmire forwarding Newport News President Diesel June 14, 1976 letter to Deputy Secretary of Defense Clements. In that letter, Mr. Diesel explains his reasons for rejecting the Pubic Law 85–804 settlement offer*

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C., June 5, 1976.

Hon. WILLIAM PROXMIRE,
United States Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: The attached are forwarded for your information in connection with our recent discussions on Navy Shipbuilding Claims.

Sincerely,

W. P. CLEMENTS, Jr.

Attachment.

JUNE 14, 1976.

Hon. WILLIAM P. CLEMENTS,
Deputy Secretary of Defense, The Pentagon,
Washington, D.C.

DEAR SECRETARY CLEMENTS: Confirming our discussion on June 2, the negotiations between Newport News Shipbuilding and the Shipbuilding Executive Committee have reached a stalemate. By separate letter this date to Admiral Michaelis, I am reviewing the status of the outstanding nuclear shipbuilding contracts and our proposed course of action.

I had hoped that the parties concerned would fully embrace your concept that there is enough fault to go around for everyone. More specifically, I had expected that the Navy was prepared to propose a solution which would provide for the Government taking responsibility for certain inflation—amounting to some $200,000,000 in current estimates. On the other hand, the Company was prepared to be responsible for the other cost growth and therefore would release our claims—amounting to substantially more than $200,000,000. This would have resulted in a break even situation for Newport News for constructing $2.5 billion worth of nuclear ships for the Navy. This solution has not been reached, and our offer to do so is withdrawn.

From my point of view, the root of the problem is that the Navy's offer does not compensate Newport News for escalation costs to the same degree as would be anticipated under a new Navy shipbuilding contract or perhaps under other existing contracts with other shipbuilders. I recognize that the Committee has offered a clause that is, in form, substantially the same one contained in the recent contract for Destroyer Tenders. However, two principal features of this clause are (i) that the rate of compensable escalation stops at the contract delivery date, and (ii) that the amount of escalation stops when the unescalated costs of the contractor reach the ceiling price. Thus, in order for the clause to be equitable, both the delivery dates and the ceiling prices must be realistic.

This needed realism was not present in the Committee's proposal to Newport News. The Committee's offer cuts off escalation growth at existing contract delivery dates which, in some cases, have already passed. In addition, it cuts off escalation compensation at the current contract ceiling which in all cases, except the Carrier contract, is unrealistically low as a benchmark for escalation.

We have offered every manner of compromise which would alleviate the constraints of these two items but so far have been unsuccessful. If, for example, as I discussed with you and as is the case with Electric Boat, our 688 class claims were settled prior to including escalation, the result would have been acceptable.

I wish to also point out that the Committee proposal had numerous other features that we found objectionable.

For example, the treatment of the pricing of change orders—although contained in some escalation clauses currently in effect—works a severe inequity in our situation. It compounds the delivery date and ceiling price problems already referred to, as well as reverses certain equitable price adjustments that have already been made to our contracts.

In addition, the release language is particularly onerous and bears no relationship to the ordinary and reasonable dealings between the Navy and its contractors—or even to the release language set forth in the Armed Services Procurement Regulation.

Another feature of the proposal is to settle outstanding changes without consideration of any additional delays which could occur. This, in effect, not only absolves the Navy of responsibility for those change orders involving the whole issue of "cumulative impact," but also fails to recognize several major change orders involving critical design deficiencies by the Government that have had direct delay impact and that will cost tens of millions of dollars in lost time.

Finally, we find unacceptable the proposal's attempt to directly involve the Navy in the basic right of management to allocate manpower.

The problems I've addressed so far involve essentially formal contractual matters. But there is another basic issue about which I am equally concerned—the significant and serious deterioration of day-to-day relationships between the Navy and our Company. The Navy has failed to establish new contract provisions that would eliminate, or at least minimize, in the future the lengthy disputes which have characterized the past. A clause for full escalation would, of course, alleviate these disputes.

I see no evidence to indicate a more reasonable approach by the Navy to our mutual problems. I see only the grim prospects of a continuation of the current adversary relationship, with the attendant grave implications not only for the Company, but also for the Navy, the defense industry as a whole and, importantly, for our thousand of employees.

Our best efforts to date have met only with failure. Rancor and recrimination have been the only results obtained, and this raises the serious question of whether our Company and the Navy can ever again achieve a productive and mutually satisfactory relationship.

A great deal has been said about the problems attendant to a timely evaluation of our claims, although we have emphasized that the subject matter of these claims has generally been raised with the Government as the problems arose during the construction period. Perhaps the most prudent step for the Navy would be to have a one-year hiatus in the nuclear Naval shipbuilding program which would give the Navy time to straighten out its affairs. In addition, hopefully it would afford them access to the funds necessary to properly fund their existing obligations.

Notwithstanding the efforts at the very highest level of the Department of Defense, there is no progress towards curing the underlying problems. In the face of that fact, I have reluctantly reached the conclusion that continued one-sided contract performance by Newport News subjects this Company to irreparable demage, I consider that there exists a fundamental breach on the part of the Navy of its obligation to provide equitable compensation for its actions. This includes not only *full* compensation, but *prompt* compensation.

I have today sent to Admiral F. H. Michaelis a summary of the status of our Nuclear Naval shipbuilding contracts, including a brief statement of our proposed course of action with regard to each of them. Included in that letter is a description of a method to achieve an orderly withdrawal from our continued participation in the Nuclear Naval shipbuilding program if we are unable to promptly reach a reconciliation. This proposal includes cooperation in transferring the CVN70 to Puget Sound Naval Shipyard and of the follow-on SSN711–715 ships to Mare Island Naval Shipyard. We anticipate that our position is correct with regard to DLGN41 and that it will be cancelled.

This will enable me to redirect the efforts of our Company to enterprises which at least hold out the promise of mitigating our damages and shorten the time frame in which we will be exposed to that continued Navy conduct which now threatens our survival. I trust you will use your good offices to make this transition as amicable as possible.

Yours very truly,

J. P. DIESEL,
President.

ITEM 43.—*June 24, 1976—Reply to Senator Proxmire's letter of May 27, 1976 by Secretary of the Navy Middendorf asking about the extent of involvement of Mr. Thomas Corcoran and Tenneco in the Navy's decision to extend Admiral Rickover*

THE SECRETARY OF THE NAVY,
Washington, D.C., June 24, 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: This is in reply to your letter of May 27, 1976, concerning the retention of Admiral Hyman G. Rickover, U. S. Navy (Retired), on active duty. Admiral Rickover is currently serving on active duty under an extension which was approved in October, 1975; this extension was for a two-year period—from January, 1976, until January, 1978.

Your letter posed several questions concerning Admiral Rickover's extension. I will attempt to provide answers in the order which you posed the questions.

1. "Did you or anyone else in the Navy or Defense Department ever contact Mr. Corcoran to ask his advice or how you could get Admiral Rickover 'out of the hair of the shipbuilders?'" I have queried the members of the Navy Secretariat to ascertain whether any such advice was ever sought, and all answers were in the negative. I have asked the Chief of Naval Operations to conduct a similar inquiry, and he advises me that no member of his staff requested such advice from Mr. Corcoran. Since your question applied to the entire Defense Department, I queried Deputy Secretary Clements' office similarly. Based on their replies, I am able to assure you that, to the best of my knowledge and belief, no senior official of the Department of Defense or the Department of the Navy contacted Mr. Corcoran to ask his advice on how to terminate Admiral Rickover's active-duty status. In view of this conclusion, the remaining questions under your paragraph number 1 are not applicable.

2. "Did Mr. Corcoran or other representatives or officials of Newport News or Tenneco express their views on the advisability of giving Admiral Rickover a different assignment to you or any other Navy or Defense Department officials?" There has been considerable contact between representatives of the Navy and Newport News/Tenneco. Admiral Rickover has, himself, had contact with officials of Newport News and other shipbuilders in the private sector. In the course of discussions between Navy Department officials and the shipbuilders, the subject of Admiral Rickover undoubtedly surfaced many times.

It is certainly possible that conversations took place during which representatives of the nuclear shipbuilding industry suggested that relationships with the Navy would be improved if they did not have to deal with Admiral Rickover. Both Admiral Holloway and I had separate conversations with Mr. Corcoran during which Mr. Corcoran suggested that Admiral Rickover be assigned as Superintendent of the Naval Academy. These conversations occurred in November, 1975.

In question 2, you also ask, "Were there any company actions suggested, such as a refusal to do Navy work or take additional Navy businesses, if Admiral Rickover were reappointed." During the conversations Admiral Holloway and I had with Mr. Corcoran, he made no suggestions concerning probable company action if Admiral Rickover were to be reappointed. It is noted that these conversations occurred after the October 1975 approval of Admiral Rickover's extension.

I will note that, in 1975, the Navy found it necessary to initiate action in the Federal courts to ensure that Newport News continued work on certain nuclear-powered ships then under construction. However, I have no evidence to suggest that the refusal of Newport News to continue the work—such refusal precipitating the Navy's taking legal action—was connected specifically to Admiral Rickover's reappointment.

In question 3, you ask, "Have you or other Navy or Defense Department officials had any discussions with Mr. Corcoran or any other lobbyist, representative or official of Newport News or Tenneco about the difficulties Newport News is experiencing with its Navy shipbuilding contracts? If so, please state the date and location of such discussions and briefly describe them." The answer to this question is, obviously, yes. I suspect that there have been many conversations between representatives of the Defense and Navy Departments

and representatives of Newport News or Tenneco about difficulty Newport News has experienced with shipbuilding contracts. I, myself, had telephone conversations with Mr. Corcoran on the DLGN–41 and –42. These conversations were an attempt on my part to convince Newport News that we, in the Navy, wanted the company to move out and build the DLGN–41 and –42. I know that many officials have had similar conversations with other representatives of Newport News. However, I am simply unable to reconstruct the record and advise you of the date, locations, and substance of the conversations.

If you have any more specific subjects with dates and participants, I will make every effort to obtain what information we have. However, I am unable to provide anything more specific at this time.

Sincerely,

J. WILLIAM MIDDENDORF II.

ITEM 44.—*July 2, 1976—Senator Proxmire's statement to the Senate "Admirals Dispute Clements on Shipbuilding Claims"*

ADMIRALS DISPUTE CLEMENTS ON SHIPBUILDING CLAIMS

Mr. PROXMIRE. Mr. President, important differences between the Navy and Deputy Defense Secretary William P. Clements, over the issue of how to handle nearly $2 billion in shipbuilding claims, are beginning to emerge as Navy officials are given an opportunity to comment on the facts and voice their views.

Despite concerted efforts by some of the larger shipbuilders and Secretary Clements to divert attention from the merits of the claims, more and more questions are being raised about the claims as the facts come to the surface.

Last Friday, on June 25, 1976, the Subcommittee on Priorities and Economy in Government received testimony from Secretary Clements, Adm. Robert C. Gooding, Adm. Stu Evans (retired), and Adm. Kenneth L. Woodfin (retired).

Earlier on June 7, 1976, the subcommittee heard testimony from Adm. H. G. Rickover and William Cardwell, a former official at the Newport News Shipbuilding Division of the Tenneco Co.

NEED FOR AN AUDIT OF CLAIMS

Among the major facts established in the hearing thus far are the following:

First, none of the pending shipbuilding claims have been fully audited, analyzed or evaluated by the Navy.

Second, there have been serious allegations by persons familiar with the Newport News claims that they are based on inflated figures, unsupported allegations, attempts to charge the Government with the costs of commercial activities and possible double counting.

Third, at least two of the shipbuilders, Newport News and Litton, have gone to extreme lengths to apply political pressure on the Navy and the Defense Department to extract payments without regard to legal enttilement.

POLITICAL PRESSURE TACTICS

Among the tactics employed by the shipbuilders has been direct communication with top level Pentagon officials in an attempt to circumvent the Navy's claims review process, harsh personal attacks against Navy officials who have attempted to examine the merits of the claims, and threats to stop work on Navy projects unless the claims are immediately paid.

Unfortunately, Secretary Clements has played into the hands of the shipbuilders. He has agreed to deal with the contractors personally and has thereby undercut the responsible Navy officials who have attempted to resolve the disputes with the shipbuilders.

In doing so, Secretary Clements has perpetuated a myth that the claims in question are of long standing and that the Navy has failed to make progress with them. The facts are that most of the claims filed by Newport News were received by the Navy only in the past few months and that Litton began providing the Navy with documentation for its claims only in the past few months.

ADMIRALS SAY CONTRACTS FAIR

Secretary Clements has also tended to lend substance to the allegations by the shipbuilders that their contracts are inherently inequitable and therefore

should not be enforced. The facts are, as four Navy admirals have now testified, that the contracts with the shipbuilders are fair and generous, and not inequitable.

CLEMENTS PROPOSES A BAILOUT

What Secretary Clements and the shipbuilders have been attempting to present to Congress has familiar characteristics. Many of my colleagues have seen tracks of this animal before.

It walks like a bailout, it sounds like a bailout, it looks like a bailout, and I dare say that those of my colleagues who look closely at this specimen will conclude with me that it is a bailout.

Another corporate bailout, in the tradition of Penn Central and Lockheed, hardly seems an appropriate or logical action for the Government to take at a time when there is continued concern with inflation and unnecessary Government spending, and during a period of growing awareness of false claims and other fraudulent misrepresentations designed to unjustly enrich individuals and businesses at the expense of the taxpayers.

TESTIMONY OF ADMIRAL WOODFIN

One of our witness last Friday, Adm. Kenneth L. Woodfin, presented testimony in direct conflict with the assertions of the shipbuilders.

Admiral Woodfin stated that "shipbuilding claims figures can be misleading and should not be accepted at face value. Typically shipbuilding claims are greatly exaggerated and viewed by many contractors simply as a starting point for negotiation."

Admiral Woodfin disagrees with the view that the shipbuilding contracts are inequitable and that therefore the contracts are unenforceable, Admiral Woodfin was also critical of the shipbuilders' pressure tactics and of the devices they have employed to shortcut the normal claims review procedures.

Admiral Woodfin stated:

"I fear that as long as shipbuilders can achieve a vastly superior position by going to high level Government officials they have little incentives 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 seem to be acceptable to the GAO)."

I ask unanimous consent that the prepared testimony of Adm. Kenneth L. Woodfin be printed in the RECORD at the close of my remarks. I also ask unanimous consent to have printed in the RECORD at the close of my remarks an article in the Washington Post, June 26, 1976, by Dan Morgan entitled "Admirals Dispute Pentagon on Shipbuilding Claims," an article from the Newport News-Hampton Daily Press, June 26, 1976, by Ross Hetrick, entitled "Claims Spark Hearing Fury," and an article from the Washington Post, June 29, 1976, by Marquis Childs, entitled "Rickover and the Carter Connection."

There being no objection, the material was ordered to be printed in the RECORD, as follows:

STATEMENT OF REAR ADM. KENNETH L. WOODFIN, BEFORE THE SUBCOMMITTEE ON PRIORITIES AND ECONOMY IN GOVERNMENT, JOINT ECONOMIC COMMITTEE

I am Rear Admiral Kenneth L. Woodfin, Supply U.S. Navy Retired. 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. June 1976, I resigned from NASA and accepted a position as Vice President for Business Management, 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). During that period I consider that real progress was made in resolving the Navy's shipbuilding claim 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 battle 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 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 P.L. 85–804 to correct the so-called inequities quickly and thereby promote better relations between the shipbuilders and the Navy and facilitate carrying out the Navy's new shipbuilding program. This is a unique approach since, as I recall, the use of P.L. 85–804 requires that all 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 P.L. 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 and should not be accepted at face value. Typically shipbuilding claims are greatly exaggerated and viewed by many contractors simply as a starting point for 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-priced incentives contract. Under such contracts, how much more the contractor is actually 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 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 claim settlement depends on what kind of a claims release is obtained so any proposed settlement should be carefully reviewed in this regard.

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.

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 through 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. Unfortunately, some shipbuilders have refused to price changes in order to retain these entitlements as a backbone for future claims.

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 basis to request similar relief.

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 shipbuilder 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 turnover problems, 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 constraint 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. I cannot recall any situation where the Navy knowingly outwitted and out-negotiated 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 built its ships. But, I prefer this limited competition to none at all.

Some shipbuilders complain to high levels of the Defense Department and to 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 fact-finding process, recent data indicates that even complex claims could be settled in approximately a year. Fact finding remains the key, particularly in the complex shipbuilding atmosphere, and I can visualize no real short-cuts to the process of determining what acts or inacts of the Government have caused the basis for a contract change.

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 the obvious overuns on the 1967–1971 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 multi-year 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 shipbuilder's 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.

As I stated earlier, I can appreciate the Defense Departments 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 P.L. 85–804 for this purpose. I recognize also that it is, of course, possible that a P.L. 85–804 settlement could be obtained under certain circumstances that would be equitable to the Government. However by announcing publically that the Navy contracts are inequitable, announcing a decision to provide extra-contractual relief, setting a date for competion 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 negotiations 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 merit, in accordance with establishing Navy procedures (which seem to be acceptable to the GAO). Thus, I cannot accept the theory that by use of P.L. 85–804 we can expect to resolve Navy differences with its major shipbuilders. Instead it appears we should proceed to an accelerated settlement of the claims in the established manner, while at the same time ensuring that our new contracts do not create the same bases for claim assertion.

Thank you, Mr. Chairman, that concludes my statement.

KENETH L. WOODFIN,
Rear-Admiral, SC, U.S.N. (Ret.).

ITEM 45.—*July 20, 1976—Letter from Senator Proxmire to Mr. Gordon W. Rule in response to Mr. Rule's July 13, 1976 letter criticizing the Joint Economic Committee hearings. Senator Proxmire urges the Navy to follow the spirit as well as the laws enacted by Congress and to observe its own rules and procedures in its procurement programs, including those requiring a comprehensive audit, technical analysis, and a memorandum of legal entitlement*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., July 20, 1976.

Mr. GORDON W. RULE,
NMAT,
Arlington, Va.

DEAR MR. RULE: In your letter of July 13, 1976 you raised questions about the purpose and objective of the June 25 hearing by the Subcommittee on Priorities and Economy in Government.

The June 25 hearing was a continuation of the inquiry begun on June 7 when the Subcommittee received testimony from Admiral H. G. Rickover and Mr. William Cardwell. One of our principal purposes is to inquire into the substantive issues in the dispute over approximately $2 billion in shipbuilding claims filed or about to be filed against the Navy. The claims involve both nuclear and conventionally powered ships.

Many if not most of the statements made by spokesmen of the Department of Defense have neglected to deal with the substantitive issues such as the merits of the claims. Instead, Defense Department spokesmen and the contractors have avoided these issues by making personal attacks and alluding to the "inequitable" contracts and the need to rewrite them so as to allow for greater reimbursement than is provided for in the current contracts.

Of course, if the contracts are rewritten the effect will be to reimburse the shipbuilders for hundreds of millions of dollars in cost overruns, whether rewriting the contracts is viewed as "equitable adjustments" or claims settlements.

Such an action would seriously increase the Navy's costs for the ships in question and could have even larger consequences for the Navy's future ship construction program. In addition, the decision in this controversy could adversely influence defense procurement generally.

A decision to reimburse the shipbuilders for their cost overruns made prior to a determination of responsibility for the cost overruns, would be a disastrous precedent for anyone interested in economy in government. It is, there-

fore, essential that the merits of the claims and the question of legal entitlement be thoroughly aired.

To argue that shipbuilders might refuse to build Navy ships if they are not paid for their overruns begs the question of legal entitlement. It is important that the Navy have a good working relationship with its contractors. But such a relationship cannot be based on a policy of paying for unaudited or unjustified claims.

You will recall that during the June 25 hearing I asked Secretary William Clements whether the Navy could get its ships built if the contractors carried out their threats to stop work and whether steps were being taken to meet that contingency. I was satisfied with Secretary Clements' assurance on these points.

Any decision to pay defense contractors' claims against the government prior to an audit would be improper. The possibility that contractors were simply bailed out of their own financial difficulties could never be erased if such a procedure were followed before a final decision is made.

As you point out, Congress has the responsibility, under the Constitution, to provide and maintain a Navy. In accordance with this fundamental guideline, Congress annually authorizes and appropriates funds for this purpose. Congress also passes laws expressing public policy, requiring accountability for monies expended, and providing rules to be followed by the Defense Department and the Navy.

The responsibility of the Navy in carrying out its programs is to follow the policies and laws set down by Congress in accordance with good management practices. The Navy has adopted a great variety of procurement rules and procedures toward this end. Had Congress' wishes and the Navy's own rules and procedures been followed by the responsible officials, the shipbuilding claims problem might have been avoided. A resumption of orderly procedures is the only hope for a lasting resolution of the current controversy.

I strongly urge the Navy to follow the spirit as well as the laws enacted by Congress and to observe its own rules and procedures in its procurement programs. There are specific, detailed Navy rules for handling shipbuilding claims. The Navy should follow those rules. They provide, you will recall, for a comprehensive audit, a technical analysis, and a memorandum of legal entitlement.

If these rules and procedures are followed, and if the contracts are properly enforced, the Navy will have done its duty. Should the government then be faced with contractors who refuse to live up to their responsibility and demand instead extra-contractual relief from their contractual obligations, Congress may be required to step in.

Secretary William Clements' original proposal to resolve the controversy through PL 85–804, was ill-advised and I am pleased that he has withdrawn that proposal. The proper course is for the Navy to enforce its contracts, to pay contractors for claims that can be substantiated and to refuse to pay for unsubstantiated claims.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 46.—*July 21, 1976—Senator Proxmire letter to Deputy Secretary Clements asking whether Admiral Rickover or the President of Newport News, Mr. John P. Diesel, had been ordered to "step aside" as indicated in a July 2, 1976 New York Times article entitled "Pentagon Showdown"*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C. July 21, 1976.

HON. WILLIAM CLEMENTS,
Deputy Secretary of Defense, Department of Defense, The Pentagon, Washington, D.C.

DEAR SECRETARY CLEMENTS: The July 2, 1976 issue of the *New York Times* carries a John Finney article entitled "Pentagon Showdown: Clements Asserts He Spiked Rickover or Shipyards." In the article you are quoted as having

had a showdown meeting with Admiral Rickover. The article states "as described by Mr. Clements, he succeeded in silencing Admiral Rickover in his criticism of the Navy's shipbuilders, in particular the Newport News Shipbuilding Company which builds most of the Admiral's nuclear-powered warships."

In testimony before the Joint Economic Committee, Admiral Rickover testified that the Newport News claims were inflated and that these claims should be audited and settled on their legal merits. The article quotes you as ordering Admiral Rickover "to step aside and keep his silence as the Navy attempted to work out its claims problems with the Newport News, Virginia company, a subsidiary of Tenneco, Inc."

"Mr. Clements said he had come to the conclusion that, if the claim procedure were to work, it was necessary to remove the two parties that have been providing most of the acrimony—namely Admiral Rickover and John P. Diesel, president of Newport News."

I need not elaborate on the serious implications of the article if it accurately portrays what you have actually said and done. However, I recognize that press accounts are sometimes inaccurate. Therefore, I would appreciate answers to the following questions:

a. Have you in fact ordered Admiral Rickover to "step aside and keep his silence" as the Navy attempts to resolve the Newport News claims? If so, how do you justify such a gag order?

b. How have you in fact ordered Mr. John P. Diesel, president of Newport News to disassociate himself from the claims? If so, by what authority are you able to take such action?

c. Why have you gone out of your way to imply that Admiral Rickover is a major cause of the shipbuilding claims problem, when most of the Navy's shipbuilding claims in the past five years have been submitted by shipyards that are not involved in construction of nuclear ships? How could he have contributed to the Litton claims problem when that firm is building only non-nuclear ships?

I would also appreciate it if you would either confirm or deny the accuracy of the *New York Times* article. Any specific statements in the article which you consider to be either inaccurate or misleading should be identified and clarified.

I notice that Gordon Rule has been placed in charge of the negotiations of the CGN–41 contract dispute with Newport News. I have enclosed an exchange of letters between Gordon Rule and myself in which there is some discussion of the responsibilities of Congress and the Navy with regard to the Navy's shipbuilding program.

Part of the Navy's responsibility is to enforce the contracts it awards and to follow established procedures in accordance with good management practices. The CGN–41 contract dispute falls under the same principles.

Government bailouts of large corporations have taken many forms in the past several years. One form has been to simply not enforce government contracts. The effect, as in the case of payments for unsubstantiated claims is to confer valuable benefits on contractors in return for inadequate or no consideration.

I am encouraged by the recent establishment of the Navy claims settlement board which has been given authority to act independent of outside pressure in accordance with the established procedures for auditing and reviewing claims. It should be understood that it is just as important to negotiate contract disputes in accordance with normal procedures as it is to negotiate claims. Any decision in the CGN–41 case should avoid setting a bad precedent just as decisions on claims should avoid setting a bad precedent.

I would like to have your assurance that no action will be taken in the CGN–41 case which will set a bad precedent concerning the enforcement of government contracts or which will have the effect, directly or indirectly, of bailing out the contractor.

I am looking forward to your prompt response.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 47.—*July 27, 1976—Adm. S. J. Evans letter to Senator Proxmire commenting on Deputy Secretary of Defense testimony to Joint Economic Committee on June 25, 1976*

HON. WILLIAM PROXMIRE, JULY 27, 1976.
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' opinions 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 conclusions.

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 projected 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 imminently 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 mutualy 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.

ITEM 48.—*July 29, 1976—Senator Proxmire letter to Attorney General Levi requesting the Attorney General to designate a team of investigators within the Justice Department to review the transcript of the Joint Economic Committee hearings and other evidence and to interview individuals who may have additional information to determine if the Newport News claims are based on fraud*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., July 29, 1976.

Hon. EDWARD H. LEVI,
Attorney General, Department of Justice,
Washington, D.C.

DEAR MR. LEVI: On June 7 and June 25, 1976 the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee held hearings concerning certain claims made by shipbuilders against the Navy.

In the course of our hearings a significant body of testimony and evidence was developed which I believe raises a clear possibility that the claims of one of the shipbuilders, Newport News Shipbuilding, a division of Tenneco, may be based on fraud. The purpose of this letter is to formally request that you designate a team of investigators within the Justice Department to review the transcripts of the hearing and other evidence and to interview individuals who may have additional information, including present and past employees of the firm, to determine if the claims are based on fraud.

On June 11, 1976, I wrote to the Secretary of the Navy requesting a formal investigation into this matter. I do not believe there is any likelihood that the Navy will conduct such an investigation, based on the response I received from the Navy.

As you may know, Newport News has filed six claims against the Navy for a total of $894 million.

Admiral H. G. Rickover, who is responsible for part of the procurements on which the claims are based and who is familiar with the claims documents, testified to the Subcommittee that the claims are "greatly exaggerated and unsupported," that they are based on inflated figures, unsubstantiated allegations, attempts to charge the Navy with commercial costs and possible double counting. Admiral Stuart J. Evans, recently retired, testified that after reading the documents supplied by Newport News in support of one of its claims, he found "no connection in the claims itself between the recitation of facts and the consequences that the company alleged flowed from the facts."

Finally, Mr. William Cardwell, who was employed at Newport News for eighteen years prior to being laid off early in 1976 testified that at least part of the claims were prepared with exaggerated, unsupported or inaccurate figures, and that this was accomplished at the direction or with the knowledge of the company. Mr. Cardwell had been a member of the team assigned to prepare one of the claims.

I believe that anyone who reads the 64 volumes of documentation supplied by Newport News to the Navy in support of its claims will conclude that major portions of the claims are not only exaggerated but that they are based on absurd theories. As an illustration the company asserts that the Navy owes the company nearly $100 million as reimbursement for the low productivity of its own work force. Citing "Parkinson's Law," Newport News argues that their workers' motivation declined when the delivery dates for the ships were extended by the Navy.

I have been holding hearings on shipbuilding claims against the Navy since 1969. The Newport News claims raise the most serious questions of possible fraud than any of the claims I have seen.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 49.—*Aug. 6, 1976—Letter from Deputy Secretary of Defense Clements to Senator Proxmire in response to the Senator's July 21, 1976 letter regarding the New York Times article. Mr. Clements states he has not ordered Admiral Rickover or Mr. Diesel to step aside or be silent*

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C., August 6, 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 21, 1976 refers to an article which appeared in the New York Times on July 2, 1976 and requests certain information.

In reply to the questions on page 2 of your letter, I have not ordered Admiral Rickover or Mr. Diesel to step aside or to be silent. Each of them occupies a position of authority in which they have specific responsibilities. I expect them to exercise the authority vested in their positions and to act in a responsible manner. I have not "gone out of my way" to imply that Admiral Rickover is a major cause of the Navy's shipbuilding problem.

We are working diligently to resolve our problems with the Navy shipbuilding contractors. I do not believe they can be solved by newspaper articles or other news media. It will take firm resolve by both parties in a spirit of mutual interest and with firm determination to achieve the end result. That end result must be a settlement of the claims on an equitable basis—equitable to both parties.

As I advised you when I appeared at the hearing on June 25th, "I am positively not bailing out anybody." And, we are proceeding "to bring about an accommodation with the shipyards based on the merits of the situation and in the interests of national security.

Sincerely,

W. P. CLEMENTS, Jr.

ITEM 50.—*Aug. 16, 1976—Assistant Attorney General Thornburg letter to Senator Proxmire in response to the Senator's July 29, 1976 letter requesting investigation of the possibility of fraud in connection with Newport News shipbuilding claims*

DEPARTMENT OF JUSTICE,
Washington, D.C., August 16, 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: The Attorney General has asked me to reply to your letter dated July 29, 1976 concerning the validity of cost claims filed in rela-

tion to construction of ships for the Department of the Navy by Newport News Shipbuilding, a division of Tenneco.

Since you believe testimony and evidence developed by the Subcommittee raise the clear possibility of fraud, you request that a team of Justice Department investigators review the results of the Subcommittee inquiry and conduct any additional indicated interviews. I have designated Mr. Calvin B. Kurimai, an attorney in the Fraud Section, to make the initial contact and confer with representatives of your staff. Upon completion of a preliminary evaluation of the inquiry, the Department can better determine an adequate commitment of personnel to pursue the matter to a logical conclusion, including Federal Bureau of Investigation involvement or grand jury exploration, if that seems in order.

Your interest in writing is very much appreciated.

Sincerely,

RICHARD L. THORNBURGH,
Assistant Attorney General, Criminal Division.

ITEM 51.—*Aug. 24, 1976—Letter from Senator Proxmire to Attorney General Levi expressing concern that in attempting to resolve the CGN 41 dispute quickly precedents might be set which could compromise the Government's ability to enforce contracts. Senator Proxmire suggests that the Attorney General arrange to be kept fully informed by the Navy of any negotiations in that case and that the Attorney General review any settlement offer to insure that it is on sound legal ground and in the public interest before the Government becomes party to it*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., August 24, 1976.

HON. EDWARD LEVI,
Attorney General, Department of Justice,
Washington, D.C.

DEAR MR. LEVI: In my letter of July 29, 1976, I requested that your Department investigate the possibility of fraud in connection with shipbuilding claims submitted by the Newport News Shipbuilding and Dry Dock Company, a subsidiary of Tenneco. I understand your Department is also litigating a case in which Newport News has refused to honor a Navy contract for construction of the nuclear-powered guided-missile cruiser, CGN–41.

In recent news article quoted the Deputy Secretary of Defense, William P. Clements, as stating that he expected to resolve the CGN–41 issue by September 1. I am concerned that in the process of the Department of Defense attempting to resolve the CGN–41 dispute quickly, precedents might be set which could compromise the Government's ability to enforce contracts. I am also concerned that efforts may be underway within the Navy to settle the CGN–41 dispute without the full knowledge or participation of the Justice Department.

During testimony before the Joint Economic Committee, it was obvious that there is a considerable amount of misinformation being put forth by senior defense officials with regard to shipbuilding claims in general and the CGN–41 in particular. In short, the testimony of senior defense officials, who were advocating congressional approval for a quick settlement with Newport News beyond the terms of the contracts, was at odds with the testimony of expert Navy witnesses who were directly involved with the contracts in question. In this regard, I thought you should be aware of a July 27, 1976 letter I received from Rear Admiral S. J. Evans, former Deputy Chief of Naval Material for Procurement and Production. Attached is a copy of his letter.

Admiral Evans was among the Navy experts who testified at the June 25, 1976 Joint Economic Committee hearings. At my request, Admiral Evans has also reviewed and commented on the testimony given by Deputy Secretary of Defense Clements at these same hearings. Admiral Evans is uniquely qualified to speak on matters concerning the CGN–41 dispute as he was assigned in October, 1975 as the Navy's Chief Negotiator for the CGN–41 dispute. He is intimately familiar with the case.

According to Admiral Evans, the CGN–41 option was not unfair as the shipyard has contended. He contends that the escalation provisions which Newport News and senior defense officials had termed "inequitable" are in fact fair and reasonable, providing ample protection against the effects of inflation as long as the contractor meets contract schedules. He pointed out that the CGN–41 escalation provisions were even more liberal than those used in the past.

Although the Navy has established a special claims board to handle the Newport News shipbuilding claims, the CGN–41 dispute was not included among the matters referred to the board. Instead, the Navy assigned Mr. Gordon W. Rule as Chief Negotiator for CGN–41 to again pursue a negotiated settlement with the company. As you may have read in the press or elsewhere, Mr. Rule has not been exactly impartial in his views regarding the shipbuilding claims problem in general. Mr. Rule has laid responsibility for the Newport News shipbuilding claims problems directly on the Navy and has advocated settlement of claims independent of contractual merits. My specific concern, therefore, is that a man who holds such views might agree to a settlement with Newport News on the CGN–41 case that would undermine the Government's ability to enforce contracts. During the June 25th hearings, both Rear Admiral S. J. Evans and Rear Admiral K. L. Woodfin refuted allegations regarding alleged inequities and unfairness in Navy shipbuilding contracts. As the top military procurement officials in the Navy, both men speak from experience and expertise. For your information I have enclosed Admiral Woodfin's prepared statement to the joint Economic Committee.

I understand that the Department of Justice has sole responsibility within the Government for approving out-of-court settlements involving Government matters under litigation. I assume that the Justice Department will review any such settlements proposed by the Navy in the CGN–41 case. However, in view of the importance of the CGN–41 case to the overall shipbuilding claims problem, I request that you direct the Navy to keep you fully informed of any negotiations and that you review any settlement offer to ensure that it is on sound legal ground and in the public interest before the Government becomes a party to it.

It is apparent to me that there are officials in the Defense Department who would sacrifice the public interest by turning over to the shipbuilders sums of money far in excess of the amounts agreed to in the contracts. This can be accomplished in the CGN–41 case by simply rewriting the contract in a way advantageous to the shipbuilder.

The testimony before my Subcommittee shows that the CGN–41 contract is fair and equitable. Revising any of its terms in a way that would increase the costs, without sufficient consideration would therefore amount to a bailout and a giveaway of taxpayers' money. I am confident the Justice Department would not want to participate in any such action.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 52.—*Sept. 16, 1976—Attorney General Levi letter to Senator Proxmire in response to the Senator's Aug. 24, 1976 letter. Mr. Levi states that the Justice Department intends to review any proposal and/or papers before submission to the court and that the Department would request the court to approve any settlement only "if we are satisfied that it is on sound legal ground and in the public interest"*

OFFICE OF THE ATTORNEY GENERAL,
Washington, D.C., September 16, 1976.

Hon. WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government, Joint Economic Committee, United States Congress, Washington, D.C.

DEAR MR. CHAIRMAN: This responds to your August 24, 1976 letter with regard to litigation involving Newport News Shipbuilding and Drydock Company, and particularly, litigation over the CGN–41. (*United States of America* v. *Newport News Shipbuilding and Drydock Co., and Tenneco, Inc.*, E.D. Va.,

Civil No. 75–88–NN). Your letter indicates that you assume the Justice Department will review any out-of-court settlement proposed by the Navy in the CGN–41 case. Your letter requests that I direct the Navy to keep me fully informed of any negotiations and that I review any settlement offer to insure that it is on sound legal ground and in the public interest. The Justice Department intends to review any proposal and/or papers before submission to the court. We would request the court to approve any settlement only if we are satisfied that it is on sound legal ground and in the public interest.

Sincerely,

EDWARD H. LEVI,
Attorney General.

ITEM 53.—*Oct. 12, 1976—Letter from Senator Proxmire to Secretary of the Navy Middendorf questioning the Navy with regard to the purported CGN 41 agreement between Mr. Gordon Rule and Newport News*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., October 12, 1976.

Hon. J. WILLIAM MIDDENDORF II,
Secretary of the Navy, Department of the Navy, Pentagon Building, Washington, D.C.

DEAR MR. SECRETARY: I understand that on October 7, 1976 Mr. Gordon Rule, who Deputy Secretary of Defense Clements selected to negotiate the CGN 41 dispute for the Navy, signed a contract modification with Newport News which purports to settle the CGN–41 matter. I also understand that Mr. Rule acted in violation of written directions from his Navy superiors and that neither the Navy legal counsel, the Justice Department or any other legal authority had determined the modification to be legally acceptable. I also understand that the Navy has disavowed the Rule agreement, removed him from the CGN–41 assignment and withdrawn his contracting officer warrant. Finally, I am informed that Newport News officials are in possession of the document signed by Mr. Rule and have thus far refused to return it to the Navy.

The latest developments raise the most serious questions about procurement policy and the safeguarding of the taxpayers' interests in the resolution of contract disputes. I therefore request a prompt report setting forth the actual facts. I would like answers to the following questions:

(1) Did Mr. Rule have authority to sign such an agreement? If so, please furnish me a copy of all documentation of such authority.

(2) Did any of his Navy superiors authorize him to sign such an agreement orally or in writing? If so, who and in what matter? Did any of his Navy superiors instruct him not to sign such an agreement? If so, who and in what manner?

(3) Is the contract modification Mr. Rule signed with Newport News in accordance with the terms of the CGN 41 contract existing before this modification? If not, what is the compensating benefit?

(4) What was the status of the Navy legal review at the time Mr. Rule signed the contract modification?

(5) Did the Justice Department review and approve the contract modification before it was signed?

(6) Is it true that Newport News has refused a Navy request to return the signed contract modification they obtained from Mr. Rule?

(7) Does the Navy consider Mr. Rule's agreement legally binding?

(8) What safeguards are in effect to insure that Government officials involved in this matter do not commit the Government beyond their legal authority?

(9) Were Mr. Rule's actions known and/or approved in advance by the Deputy Secretary of Defense or any member of his staff? If so, give the details.

(10) What action has the Navy taken to preserve the Government's rights in view of Mr. Rule's actions?

(11) How much would the contract modification add to the Navy's estimate of the end cost of the CGN 41? What is the exact source of the additional funds?

(12) In your judgment should the contract modification be submitted to Congress for approval under PL 84-805?

Please do not limit your response to the above questions. I desire all information pertinent to this issue. In view of the importance of this matter, I request that you provide me the requested information along with a copy of the purported contract modification no later than Monday, October 18, 1976.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 54.—*Oct. 14, 1976—Senator Proxmire letter to Attorney General Levi. The Senator states that on October 7, 1976, Mr. Rule signed a contract modification implementing a CGN 41 agreement with Newport News without consultation with the Department of Justice lawyers and over the objections of his Navy superiors. Senator Proxmire states "of greater concern is the appearance of a steady pattern of behavior by Secretary Clements and Mr. Rule calculated to damage the Government's case in the pending litigation*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., October 14, 1976.

HON. EDWARD H. LEVI,
Attotrney General of the United States, Department of Justice, Washington, D.C.

DEAR SIR: On August 24, 1976, I wrote to you about the CGN-41 contract dispute which is the subject of current litigation between Newport News Shipbuilding and Dry Dock Company, a subsidiary of Tenneco, and the Navy.

In July, Defense Deputy Secretary William Clements personally selected Mr. Gordon Rule to attempt to negotiate a settlement of the dispute. As neither Secretary Clements nor Mr. Rule has been impartial with regard to shipbuilding contracts and claims against the Navy—both have stated that the Navy's contracts are unfair and inequitable to the shipbuilders—I am concerned that the negotiations in this case could result in a decision to turn over to Newport News sums of money far in excess of the amount agreed to in the contract. Secretary Clements has repeatedly inserted himself into the dispute over this Navy contract and seems determined to force the Navy to settle on terms favorable to Newport News.

In my letter, I requested that you direct the Navy to keep you fully informed of the negotiations and that you review any settlement offer to ensure that it is on sound legal ground and in the public interest before the government becomes a party to it.

Soon after my letter, Newport News announced that an agreement in principle had been reached with the Navy. However, the details of the agreement were not released. You may know that those details have been the subject of much controversy within the Navy. I understand that the Navy legal counsel is critical of the proposed agreement because it would provide more funds to Newport News than it is entitled to under the contract, and that you have been so advised.

In your letter of September 16, 1976, you stated the Justice Department intends to review any proposal and/or papers before submission to the court and you would request the court's approval of a settlement only if you are satisfied that it is on sound legal grounds and in the public interest.

I have now learned that on October 7, 1976, Mr .Rule "executed" the agreement by signing a contract modification with Newport News with the apparent acquiescence of Secretary Clements despite the views of the Navy legal counsel and without consultation with the Department of Justice lawyers handling the case.

It is apparent that the Justice Department was not fully informed about the negotiations prior to the announcement of the agreement in principle by Newport News nor was Justice informed of Mr. Rule's execution of the contract modification until several days after it took place.

You may be interested in knowing that Mr. Rule's superiors in the Navy were also not informed of his action until after the fact. Indeed, upon learn-

ing of the action, Admiral Frederick H. Michaelis, Chief of Naval Material Command, asked Newport News to return the signed modification. Newport News has refused to do so.

Mr. Rule's action was apparently in violation of his instructions from his Navy superiors. Admiral Michaelis established a group to review the earlier tentative agreement. Mr. Rule's action was taken prior to the completion of the review and without the approval of Admiral Michaelis.

Mr. Rule's action is also inconsistent with representations made by Secretary Clements to you. In his letter of September 28, Secretary Clements said that the tentative agreement was being reviewed by the Navy General Counsel and "contingent on the outcome of this review, the Chief of Naval Material will make recommendations to the Secretary of the Navy and to me regarding the implementation of the negotiators' agreement in principle." Clearly, Mr. Rule's action was intended to present the Navy review group and Justice Department with a fait accompli before completion of the review process.

Secretary Clements also said in his letter that "we in DOD have no intention to by-pass or withhold from your department any information which you determine that your department needs in connection with legal proceedings under the court order." The facts show that Secretary Clements and Mr. Rule have withheld pertinent information from you on at least two occasions.

Of greater concern is the appearance of a studied pattern of behavior by Secretary Clements and Mr. Rule calculated to damage the government's case in the pending litigation. I can think of nothing more injurious to the government's case than for DOD and Navy officials to assert that Navy shipbuilding contracts are inequitable or unfair, or for a Navy official who has made such statements to be placed in charge of the negotiations of a ship building contract dispute, or for the negotiator to sign a contract modification purporting to settle the dispute in violation of his Navy superior's orders and without the knowledge of his Navy superiors.

Because of the seriousness of these matters and the possibility that the Clements/Rule-Newport News settlement could result in an unwarranted corporate bailout, I would like specific answers to the following questions:

1. What steps have you taken to require your client, the Department of the Navy, to keep you fully informed of the CGN–41 negotiations? Do you plan to take any such steps?

2. In your opinion, have the statements or actions by Secretary Clements, Mr. Rule or other DOD and Navy officials damaged the government's case in the CGN–41 litigation? Have they increased the government's litigative risk? Please explain your answer.

3. What steps have you taken to prevent DOD and Navy officials from further damaging the government's case? Do you plan to take any such steps?

4. Are there any laws or regulations which prohibit government officials from taking actions which could damage the government's case in pending litigation? Would it constitute a criminal conspiracy for two or more government officials to agree to take such actions with intent to damage the government's case?

5. What procedures are normally followed by the Justice Department to ensure that officials in client-agencies do not make statements or take actions which could damage the government's case in pending litigation?

Sincerely,

WILLIAM PROXMIRE,
U.S. Senate.

ITEM 55.—*Oct. 14, 1976—Navy Office of Legislative Affairs letter to Senator Proxmire acknowledging receipt of his October 12, 1976 letter*

DEPARTMENT OF THE NAVY,
HEADQUARTERS NAVAL MATERIAL COMMAND,
Washington, D.C., October 14, 1976.

HON. WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Goverment, Joint Economic Committee, Congress of the United States, Washington, D.C.

DEAR SENATOR PROXMIRE: This is an interim reply to your letter of October 12th to the Secretary of the Navy concerning Mr. Gordon Rule's negotiation

with Newport News on the CGN–41. A further response is being prepared which you may expect to receive in the near future.

If I can be of any assistance pending preparation of a complete reply, please let me know.

Sincerely,

NORMAN HANSON,
Legislative Affairs Officer.

ITEM 56.—*Nov. 17, 1976—Acting Secretary of the Navy Macdonald letter to Senator Proxmire declining to answer the questions raised in Senator Proxmire's October 12, 1976 letter to the Secretary of the Navy on the basis that the CGN 41 dispute is in litigation. This letter forwards the Government's brief and selected affidavits recently filed by the Department of Justice in the CGN 41 case*

DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., November 17, 1976.

Hon. WILLIAM PROXMIRE,
United States Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: This is in reply to your letter of October 12, 1976, concerning negotiations between the Navy and Newport News Shipbuilding and Dry Dock Company relative to the CGN–41 shipbuilding contract.

The CGN–41 is currently in litigation in the U.S. District Court, Eastern District of Virginia, and most of the questions raised in your letter are issues involved in that case. Accordingly, it would be inappropriate for the Department of the Navy to formally discuss those questions. Enclosures (1) and (2) are the Government's brief and selected affidavits recently filed by the Department of Justice which I trust will provide most of the information you are seeking.

Sincerely,

DAVID R. MACDONALD,
Acting Secretary of the Navy.

ITEM 57.—*Dec. 7, 1976—Attorney General Levi letter to Senator Proxmire in response to the Senator's letter of Oct. 14, 1976. This letter states that the Department of Justice has rejected the proposed CGN 41 settlement and forwards for information a copy of the Justice Department's brief*

OFFICE OF THE ATTORNEY GENERAL,
Washington, D.C., December 7, 1967.

Hon. WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government, Joint Economic Committee, United States Congress, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your letter of October 14, 1976, regarding the CGN–41 contract dispute at issue in *United States* v. *Newport News Shipbuilding & Dry Dock Company*, E.D. Va., Civil No. 75–88–NN.

As you may know, defendants Newport News Shipbuilding & Dry Dock Company and Tenneco, Inc., filed on October 14, 1976, a Motion for Entry of Judgment or, in the Alternative, for Dismissal with Prejudice. This Department's memorandum in opposition to that motion was filed with the Court on November 8, 1976. Since the opposition filed by us addresses certain of the issues raised in your letter, I enclose a copy for your information.

The memorandum submitted by this Department on November 8 noted that a Defense Department recommendation for a proposed settlement of the pending litigation was under consideration. The proposed settlement has since been rejected by this Department.

Sincerely,

EDWARD H. LEVI,
Attorney General.

ITEM 58.—*Apr. 26, 1977—Letter from Senator Proxmire to Attorney General Bell urging that the Justice Department appeal the decision of the Federal Judge of the Eastern District Court of Virginia regarding the CGN 41 case. The letter also recommends the Department "conduct a full investigation to determine whether the officials who apparently have compromised the Government's case have violated Federal statutes." (A copy of the District Court's decision is included in the Miscellaneous Documents appendix.)*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., April 26, 1977.

Hon. GRIFFIN B. BELL,
The Attorney General, Department of Justice,
Washington, D.C.

DEAR JUDGE BELL: Attached are letters I sent to your predecessor concerning the CGN 41 contract dispute involving Newport News Shipbuilding and Dry Dock Company and the U. S. Navy. In these letters I expressed my concern at the manner in which the Defense Department was handling the CGN 41 dispute. Deputy Secretary of Defense Clements and the CGN 41 negotiator, Mr. Gordon Rule, appeared bent on a course of action aimed at undermining the Government's case. It appears that retired Vice Admiral Eli Rich, a consultant to the Deputy Secretary of Defense, was also intimately involved. In response to my letters the Attorney General assured me that any proposed settlement of the CGN 41 litigation would not be implemented by the Defense Department without the prior review and approval of the Attorney General.

Notwithstanding these assurances, Mr. Rule negotiated a settlement. Then, in violation of the written orders of his Navy superiors and without complying with the Armed Services Procurement Regulation as required by his Contracting Officer warrant, he signed and delivered to Newport News a contract modification purporting to implement that settlement. Newport News presented the signed contract modification to the court and requested that the Government be required to honor it.

The Justice Department argued in court that Mr. Rule did not have the legal authority to enter into such an agreement; that the Department of Justice considered the Government did not receive adequate consideration in the proposed Rule settlement; that the Attorney General had rejected the proposed contract modification as a settlement for litigation involving the United States; and that the settlement agreement was not enforceable.

A Federal Judge in the Eastern District Court of Virginia dismissed the Justice Department's objections, and ruled that the Government is bound by the Rule settlement. By so doing the Judge legitimized the actions of the Deputy Secretary of Defense and the CGN 41 negotiator in circumventing the procurement laws and regulations, bypassing the cognizant Navy officials and outmaneuvering the Justice Department. The Judge's ruling means that these two officials succeeded in undermining the Government's cases and as a result were able to bind the Government to pay sums which your own Department considers are excessive. They were able to evade successfully the provisions and safeguards required by statute when extraordinary contractual relief is deemed necessary to facilitate the national defense. I might add that I question whether the Court's ruling in this case is binding on Congress.

I have followed the CGN 41 case closely and have been shocked by the conduct of certain senior Government officials. I am also fearful of the possible implications of the Judge's decision in this case for other procurements. How can we tolerate a situation wherein Government officials can make extracontractual settlements without the normal safeguards that we in Congress have been led to believe are applicable? The idea that a Government official can effectively bind the Government to settlement terms under which the Government does not get fair value in return could potentially undermine the basis of all Government contracts.

I understand the Justice Department has until May 8 to appeal the Judge's decision. In view of the tainted history of this dispute and the potential ramifications of the court decision, I presume that the Justice Department will appeal the decision, to the Supreme Court if necessary. I request your confirmation that this is so. I am also interested in knowing what recommendations, if any, the Secretary of the Navy has made in this regard. If the De-

partment loses an appeal, it is obvious that corrective legislation will be needed. The Government cannot afford to operate on the basis of the precedents established in this case.

In addition, it appears to me that the Department of Justice should conduct a full investigation to determine whether the officials who apparently have compromised the Government's case have violated Federal statutes. I would also like to know what additional safeguards the Justice Department has implemented to prevent a recurrence of incidents of this type and the status of the Justice Department's investigation of the Newport News claims which was begun last year.

I would appreciate hearing your views on these matters at your earliest convenience.

Sincerely,

WILLIAM PROXMIRE,
United States Senate.

ITEM 59.—*Dec. 30, 1978—Letter from Senator Proxmire to Secretary of the Navy Claytor criticizing Assistant Secretary Hidalgo's actions in removing the Electric Boat claims from the purview of the Navy Claims Settlement Board just as the Board was about to complete its review of these claims. The letter requests a meeting with Secretary Claytor to discuss the Navy's claims review procedures before this matter gets out of hand*

Hon. W. GRAHAM CLAYTOR,
Secretary of the Navy, Pentagon, Washington, D.C.

DEAR MR. SECRETARY: The hearings I conducted on Shipbuilding Claims, December 29, 1977, contain testimony that raises the most serious questions about the integrity of the Navy's claims review process.

I am writing to you directly because after questioning Assistant Secretary Edward Hidalgo I am convinced that he is not properly aware of the background of the claims issue nor does he understand the importance of assuring the taxpayers that their interests are being protected by the Government.

Mr. Hidalgo has already undermined the effectiveness of the Navy Claims Settlement Board. This Board was established in 1976 after it became apparent that such an entity, headed and staffed by career officers and civilian employees, was essential to achieve objectivity and impartiality in the review and negotiation of claims. Mr. Hidalgo's explanation for taking the Electric Boat Company claims out of the Board just before the Board was about to complete its review was unsatisfactory, and his statement during the hearing that he intended to involve himself personally in negotiations with Newport News was most unfortunate. One of the main reasons the Board was found to be necessary was so that the claims review process could be insulated from the kind of outside pressures and influences that seem to be emanating from Mr. Hidalgo's office.

I found Mr. Hidalgo to be evasive or non-responsive in many of his replies, and to be poorly informed and unprepared to discuss some of the more important issues.

He seemed insensitive to the possibility that one or more of the pending claims may be based on fraud, as alleged by several career Navy officials. Mr. Hidalgo would not even assure me that the Navy would not take any action that constitutes a give-away or a bail-out to the shipbuilders.

I remain hopeful that an even-handed, objective approach to the claims problem is still possible and that the orderly claims review procedures put into effect a year and a half ago can be reestablished.

Before this matter gets out of hand I suggest that you and I discuss it together. If you think such a meeting can be useful I suggest having one in my office during the afternoon of January 11, 1978.

Sincerely,

WILLIAM PROXMIRE.

ITEM 60.—*Jan. 13, 1978—Letter from Senator Proxmire to Secretary of the Navy Claytor subsequent to their Jan. 12, 1978 meeting. The letter requests information concerning the Navy's handling of shipbuilding claims, including: the role of the Navy Claims Settlement Board in completing its review of the Electric Boat claims, the referral of any allegations of fraud to the Justice Department, the Government's right to appeal ASBCA decisions, the analysis of Litton's LHA claim, the Navy's use of "litigative risk" as a factor in settling claims, and the Secretary's views relative to granting extra-contractual relief*

Hon. W. GRAHAM CLAYTOR, Jr.,
Secretary of the Navy, The Pentagon, Washington, D.C.

DEAR SECRETARY CLAYTOR: I was pleased that we had the opportunity to discuss the shipbuilding claims problem in an informal and candid way on January 12. As I mentioned at the close of our meeting I think it will be useful for me to summarize in this letter the areas of agreement and disagreement between us.

You stated there would be no giveway or bailout by the Navy of the shipbuilders in the resolution of the claims disputes. I fully approve of this decision.

You stated that the Electric Boat claims have been returned to the Navy claims Settlement Board so that it can complete its review of the claims. I fully approve of this decision nad I also understand that the Board will be permitted to carry out its responsibilities and exercise the authority granted to it when it was established in 1976. Please confirm my understanding.

I am hopeful that under leadership claims against the Navy will be reviewed in accordance with the orderly procedures followed by the Claims Settlement Board, and that new claims will be referred to the Board as was done when the Electric Boat claim was filed. Please let me know whether you plan to follow this approach.

I was also pleased to learn of your determination to act promptly to dispose of the allegations of fraud that have been made with respect to the Newport News and Electric Boat claims, and of any additional allegations that may be made, by referring them to the Justice Department unless they are found to be obviously frivolous. I understand that the fraud changes will be referred to Justice in the near future where they can be appropriately reviewed, regardless of the disposition of the claims themselves, and that neither you nor your subordinates will make any statements or take any actions that could jeopardize any possible justice investigation or prosecution. Please confirm my understanding concerning this matter.

I was disappointed with your statement that the Litton claim will not be reviewed in detail and that an "overall settlement" will be attempted. I suggested that the Litton claim, which now totals $1.1 billion, be referred to the Board. As the claim was revised upwards by over $300 million only last September, and as the Navy has only recently been provided with the full documentation for this claim, it would be appropriate for the claims Settlement Board to be given responsibility for the review.

If you decide not to refer the Litton claim to the Board, I request that you provide a detailed explanation for your decision including, but not limited to, the procedures being followed to review the claim, how you plan to carry out the law directing the Navy not to pay any claim over $5 million unless it "has been thoroughly examined and evaluated by officials" responsible for doing so, the official presently responsible for the review and the names of each person involved in the review and his or her qualifications and experience in handling shipbuilding claims matters, the estimated time required to complete hte review, and why the Litton claim seems to be receiving preferential treatment by not being referred to the claims Settlement Board.

I remain concerned about whether the Navy will vigorously protect the taxpayers' interests in the resolution of the claims disputes. As a lawyer and former businessman, you are aware of how important it is for the party against whom a claim is made to require the claimant to fully substantiate any claim. The burden should be on the shipbuilders to prove every element of their claims and to demonstrate the government's legal liability. The Navy should be prepared to take the matter to court, if necessary, should it become apparent that any shipbuilder is demanding more than it is entitled to. Frankly, I fail to detect that resolve so far.

If it appears necessary to provide extra-contractual relief, in the interests of national defense, that conclusion should be immediately transmitted to Congress so that it can approve or disapprove. I am pleased to learn that you intend to so notify Congress of any such conclusion on the Navy's part. Please confirm my understanding.

I believe you will agree that it is important to carefully distinguish between a settlement on the merits of a claim and a grant of extra-contractual relief.

Government procurement will be irreparably damaged if extra-contractual relief is granted under the guise of a claims settlement. Please let me know whether you agree or disagree with this point.

The use of "litigative risk" as a factor in determining the value of a claim or making a settlement offer tends to confuse extra-contractual relief with a settlement on the merits. It is a highly subjective factor which could become a subterfuge for a bailout. Please explain the rules and criteria used for determining litigative risks, and how the determination can be qualified in view of the fact that the Navy has never litigated a major claim in a court of law.

You mentioned the fact that the Justice Department advised the Navy it could, under certain circumstances, appeal an adverse ruling from the Armed Services Board of Contract Appeals. I assume you refer to the Lockheed claim and that you are aware that the Board's ruling was not based on the merits of the claim but on a theory of equitable estoppel related to a public utterance made by a former Defense official. Please provide me with a copy of the Justice Department opinion and state whether the Navy plans to pursue its right to appeal the Board's decision.

I share your apprehensions about the prospects for any takeover of private shipyard facilities although I understand that such an action has not been ruled out in the event it becomes necessary for reasons of national security. Please confirm this understanding.

You are, of course, correct that studies showed Navy shipyard costs were higher than private shipyards during the period when the Navy was building its own major ships. However, it is also true that there were no significant claims problems during that period and it is obvious that cost overruns, when claims are taken into account, have skyrocketed in recent years. I recall that Secretary William Clements ordered a study in 1976 of how the Navy would satisfy its shipbuilding requirements in the event yards such as Newport News or Litton carried out their threats to stop building Navy ships. Please tell me the status of that study and provide me with a copy if it has been completed.

I will appreciate your early response.

Sincerely,

WILLIAM PROXMIRE.

ITEM 61.—*Jan. 25, 1978—Letter from Secretary of the Navy Claytor to Senator Proxmire responding to the Senator's Jan. 13, 1978 letter concerning the Navy's handling of shipbuilding claims. The letter reports that the Electric Boat claims were returned to the Navy Claims Settlement Board on January 9 for the purpose of completing their evaluation; that the Litton LHA claim was being reviewed by a separate Navy review team under Assistant Secretary Hidalgo's oversight; and that allegations of fraud were being considered. In addition, the letter states that "litigative risk" is always a factor in negotiating the settlement of any claim or other controversy which will go to litigation if not disposed of by agreement"*

THE SECRETARY OF THE NAVY,
Washington, D.C.

HON. WILLIAM PROXMIRE,
Joint Economic Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR PROXMIRE: I enjoyed the opportunity we had on January 12 to discuss the subject of Navy shipbuilding claims and believe your letter of the following day summarizes some of the points we covered. I wish to elaborate on a few of them.

The Electric Boat claims were returned to the Navy Claims Settlement Board on January 9 for the purpose of completing their evaluation and providing recommendations to the Steering Group of Assistant Secretaries of the Navy Edward Hidalgo and George Peapples, as well as General Counsel Togo D. West, Jr., Vice Admiral Donald Davis, and Vice Admiral Vincent Lascara. The disposition of future shipbuilding claims will have to be determined as each case arises since, as you are aware, the Navy Claims Settlement Board was established with the hope that it would not have to be made a permanent organization and that the administration of shipbuilding contracts could eventually be returned to normal procedures.

From its origin over four years ago, the Litton LHA claim has been entrusted to a highly experienced team within the Naval Sea Systems Command, presently

headed by Captain R. A. Jones, USN, an acknowledged expert on shipbuilding contracts, claims analysis and negotiation. His team presently numbers about 168 and its analysis of the claim is expected to be completed in April of this year. Assistant Secretary Hidalgo is personally overseeing this massive effort, and I share his opinion that it is being professionally conducted in the most efficient manner possible while still ensuring that the Government's interests are fully protected.

As I hope I made clear in our meeting in your office, I am totally committed to finding resolutions to these claims problems which sacrifice neither the interests of the American public nor the Navy in the name of expediency.

If reasonable settlements cannot be reached with the shipbuilders, we are quite prepared for litigation, and, indeed, three major claims are in various stages of trial at present. If extra-contractual relief should prove to be necessary, Congress will promptly be notified as required by law, as it has been in the case of the interim LHA payment arrangement which I submitted to the House and Senate Armed Services Committees on January 19. Other alternatives, such as the "takeover of private shipyard facilities" which you mentioned, would likewise have to be considered on a case-by-case basis.

The allegations of fraud which have been raised in connection with current claims are being examined by the Office of the General Counsel, in coordination with Department of Justice attorneys, precisely to ensure that they are analyzed thoroughly and without influence of the claims settlement process. In the course of our efforts to resolve the claims problems, nothing is going to be done which would jeopardize the Government's position should any of the claims be found to merit formal referral to the Department of Justice. The Armed Services Board of Contract Appeals decision in the Lockheed case is another subject presently being discussed with the Justice Department, and may be one upon which we can give you a more definitive status report in the near future.

I note that a special concern mentioned in your letter is "litigative risk," one of a number of factors used by the Navy Claims Settlement Board in arriving at a figure for a proposed settlement. "Litigative risk" is always a factor in negotiating the settlement of any claim or other controversy which will go to litigation if not disposed of by agreement. It is based on an evaluation of a party's exposure to an outcome from litigation different from that which would result from a proposed settlement. I, as well as the other experienced Navy lawyers involved, am quite familiar with the concept and its application to contractual disputes. I will not allow it or any other factor to be utilized as a "subterfuge" for unjustified action.

I have been unable to identify the specific Clements 1976 Study on shipbuilding alternatives to which you refer in your letter.

I appreciate your continuing interest in the Navy's shipbuilding programs and hope we can count upon your support as we search for solutions to these problems of grave concern to all of us.

Sincerely,

W. GRAHAM CLAYTON, JR.,
Secretary of the Navy.

ITEM 62.—*February 28, 1978—Excerpt from the February 2, 1978 issue of the Congressional Record, Senate entitled, "The Great Shipbuilding Bailout-I"*

Mr. PROXMIRE. Mr. President, the three largest shipbuilding firms who build ships for the Navy—Newport News, Electric Boat and Litton—are all experiencing financial difficulties. Their difficulties stem, in part, from the large cost overruns they have incurred on Navy ships. They are also faced with declining orders for new commercial ships.

$2.7 BILLION IN CLAIMS FILED AGAINST THE NAVY

In order to recoup their potential losses each of the big three shipbuilders have filed claims against the Navy alleging that the Government is responsible for the cost overruns. A total of about $2.7 billion in claims is now pending. This is not only the largest amount of claims ever to be on file at one time, the total will probably grow.

PRESSURE TO SETTLE THE CLAIMS WITHOUT REGARD TO THEIR MERITS

For years the shipbuilders have exerted pressure on the Navy for favorable settlements. From time to time Pentagon and Navy officials have helped the shipbuilders to favorable settlements which could not be substantiated by the facts.

The game has been to force a settlement without regard to the merits of the claims. The most outrageous effort to do this was led by Deputy Secretary William Clements in 1976. At that time the claims totaled $1.4 billion. Mr. Clements asked Congress for approval of a plan to settle them all without a prior Government audit or assessment as to their true worth.

Congress wisely rejected the Clements plan for a massive bailout.

Now the Navy, at long last, is showing some signs that it is beginning to stand up to the shipbuilders.

But the Navy will backslide into a bailout approach to the problem unless it gets its act together and faces up to the charges of fraud.

NAVY ADMIRALS WARN OF POSSIBLE FRAUD

On December 29, 1977, I chaired hearings on shipbuilding claims and heard testimony from two Navy admirals both of whom warned that some of the claims may be based on fraud.

Assistant Secretary Edward Hidalgo also testified but I was not satisfied with many of his answers to my questions.

ELECTRIC BOAT CLAIMS TAKEN AWAY FROM NAVY CLAIMS SETTLEMENT BOARD

Among other things, Mr. Hidalgo said that he ordered the Electric Boat Co. claims taken away from the Navy Claims Settlement Board shortly before the Board was about to complete its year-long review of the claims.

SECRETARY CLAYTOR SAYS THERE WILL BE NO BAILOUT

On January 12, 1978, Navy Secretary W. Graham Claytor, Jr., and I met to discuss the Navy's shipbuilding claims problems.

In the meeting Secretary Claytor gave me his personal assurance that there will be no giveaway or bailout by the Navy in the resolution of claims disputes.

ELECTRIC BOAT CLAIMS RETURNED TO NAVY CLAIMS SETTLEMENT BOARD

The Secretary also told me that the Electric Boat Co. claims had been returned to the Navy Claims Settlement Board so that the Board can complete its review of the claims.

In a followup letter to me, Secretary Claytor states.

"If reasonable settlements cannot be reached with the shipbuilders, we are quite prepared for litigation, and, indeed, three major claims are in various stages of trial at present."

Secretary Claytor assured me in his letter that Congress will be promptly notified of any Navy decision to request extra-contractual relief for a contractor.

Secretary Claytor also states in his letter that with regard to allegations of fraud, the Navy will do nothing "which would jeopardize the Government's position should any of the claims be found to merit formal referral to the Department of Justice."

Secretary Claytor's assurances and preliminary actions are a most welcome change from the days when former Deputy Secretary of Defense William Clements seemed to be doing everything in his power to weaken the Government's position in the claims disputes.

CLAIMS SETTLEMENT SHOULD BE BASED STRICTLY ON THE MERITS

The first principle in the handling of a claim against the Government should be that it will be fully evaluated and that an official determination will be made as to its worth.

It ought to follow that any claim settlement will be based strictly on the merits of the claim and that responsible allegations of fraud will be promptly referred to the Justice Department for investigation.

Justice will have to investigate if they are referred.

It is only delaying the Navy's decision to get Justice into the act at this point.

Why cannot the Navy do its own work with regard to the fraud charges?

I ask unanimous consent that copies of my recent correspondence with Secretary Claytor be printed in the Record.

There being no objection, the letters were ordered to be printed in the Record, as follows:

U.S. SENATE,
Washington, D.C., December 30, 1977.

Hon. W. GRAHAM CLAYTOR,
Secretary of the Navy, Department of the Navy,
Pentagon, Washington, D.C.

DEAR MR. SECRETARY: The hearings I conducted on Shipbuilding Claims, December 29, 1977, contain testimony that raises the most serious questions about the integrity of the Navy's claims review process.

I am writing to you directly because after questioning Assistant Secretary Edward Hidalgo I am convinced that he is not properly aware of the background of the claims issue nor does he understand the importance of assuring the taxpayers that their interests are being protected by the Government.

Mr. Hidaglo has already undermined the effectiveness of the Navy Claims Settlement Board. This Board was established in 1976 after it became apparent that such an entity, headed and staffed by career officers and civilian employees, was essential to achieve objectivity and impartiality in the review and negotiation of claims. Mr. Hidaglo's explanation for taking the Electric Boat Company claims out of the Board just before the Board was about to complete its review was unsatisfactory, and his statement during the hearing that he intended to involve himself personally in negotiations with Newport News was most unfortunate. One of the main reasons the Board was found to be necessary was so that the claims review process could be insulated from the kind of outside pressures and influences that seem to be emanating from Mr. Hidaglo's office.

I found Mr. Hidalgo to be evasive or non-responsive in many of his replies, and to be poorly informed and unprepared to discuss some of the more important issues. He seemed insensitive to the possibility that one or more of the pending claims may be based on fraud, as alleged by several career Navy officials. Mr. Hidalgo would not even assure me that the Navy would not take any action that constitutes a give-away or a bail-out to the shipbuilders.

I remain hopeful that an even-handed, objective approach to the claims problem is still possible and that the orderly claims review procedures put into effect a year and a half ago can be reestablished.

Before this matter gets out of hand I suggest that you and I discuss it together. If you think such a meeting can be useful I suggest having one in my office during the afternoon of January 11, 1978.

Sincerely,

WILLIAM PROXMIRE.

JOINT ECONOMIC COMMITTEE,
Washington, D.C., January 13, 1978.

Hon. W. GRAHAM CLAYTOR, Jr.
Secretary of the Navy,
Pentagon, Washington, D.C.

DEAR SECRETARY CLAYTOR: I was pleased that we had the opportunity to discuss the shipbuilding claims problem in an informal and candid way on January 12. As I mentioned at the close of our meeting I think it will be useful for me to summarize in this letter the areas of agreement and disagreement between us.

You stated there would be no giveaway or bailout by the Navy of the shipbuilders in the resolution of the claims disputes. I fully approve of this decision.

You stated that the Electric Boat claims have been returned to the Navy Claims Settlement Board so that it can complete its review of the claims. I fully approve of this decision and I also understand that the Board will be permitted to carry out its responsibilities and exercise the authority granted to it when it was established in 1976. Please confirm my undertaking.

I am hopeful that under your leadership claims against the Navy will be reviewed in accordance with the orderly procedures followed by the claims Set-

tlement Board and that new claims will be referred to the Board as was done when the Electric Boat claim was filed. Please let me know whether you plan to follow this approach.

I was also pleased to learn of your determination to act promptly to dispose of the allegations of fraud that have been made with respect to the Newport News and Electric Boat claims, and of any additional allegations that may be made, by referring them to the Justice Department unless they are found to be obviously frivolous. I understand that the fraud charges will be referred to Justice in the near future where they can be appropriately reviewed, regardless of the disposition of the claims themselves, and that nether you nor your subordinates will make any statements or take any actions that could jeopardize any possible justice investigation or prosecution. Please confirm my understanding concerning this matter.

I was disappointed with your statement that the Litton claim will not be reviewed in detail and that an "overall settlement" will be attempted. I suggested that the Litton claim, which now totals $1.4 billion, be referred to the Board. As the claim was revised upwards by over $300 million only last September, and as the Navy has only recently been provided with the full documentation for this claim. It would be appropriate for the claims Settlement Board to be given responsibility for the review.

If you decide not to refer the Litton claim to the Board. I request that you provide a detailed explanation for your decision including, but not limited to, the procedures being followed to review the claim, how you plan to carry out the law directing the Navy not to pay any claim over $5 million unless it "has been thoroughly examined and evaluated by officials" responsible for doing so, the official presently responsible for the review and the names of each person involved in the review and his or her qualifications and experience in handling shipbuilding claims matters, the estimated time required to complete the review, and why the Litton claim seems to be receiving preferential treatment by not being referred to the claims Settlement Board.

I remain concerned about whether the Navy will vigorously protect the taxpayers' interests in the resolution of the claims disputes. As a lawyer and former businessman, you are aware of how important it is for the party against whom a claim is made to require the claimant to fully substantiate any claim. The burden should be on the shipbuilders to prove every element of their claims and to demonstrate the government's legal liability. The Navy should be prepared to take the matter to court. If necessary, should it become apparent that any shipbuilder is demanding more than it is entitled to. Frankly, I fail to detect that resolve so far.

If it appears necessary to provide extracontractual relief, in the interests of national defense, that conclusion should be immediately transmitted to Congress so that it can approve or disapprove. I am pleased to learn that you intend to so notify Congress of any such conclusion on the Navy's part. Please confirm my understanding.

I believe you will agree that it is important to carefully distinguish between a settlement on the merits of a claim and a grant of extra-contractual relief. Government procurement will be irreparably damaged if extra-contractual relief is granted under the guise of a claims settlement. Please let me know whether you agree or disagree with this point.

The use of "litigative risk" as a factor in determining the value of a claim or making a settlement offer tends to confuse extra-contractual relief with a settlement on the merits. It is a highly subjective factor which could become a subterfuge for a bailout. Please explain the rules and criteria used for determining litigative risks, and how the determination can be quantified in view of the fact that the Navy has never litigated a major claim in a court of law.

You mentioned the fact that the Justice Department advised the Navy it could, under certain circumstances, appeal an adverse ruling from the Armed Services Board of Contract Appeals. I assume you refer to the Lockheed claim and that you are aware that the Board's ruling was not based on the merits of the claim but on a theory of equitable estoppel related to a public utterance made by a former Defense official. Please provide me with a copy of the Justice Department opinion and state whether the Navy plans to pursue its right to appeal the Board's decision.

I share your apprehensions about the prospects for any takeover of private shipyard facilities although I understand that such an action has not been

ruled out in the event it becomes necessary for reasons of national security. Please confirm this understanding.

You are, of course, correct that studies showed Navy shipyard costs were higher than private shipyards during the period when the Navy was building its own major ships. However, it is also true that there were no significant claims problems during that period and it is obvious that cost overruns, when claims are taken into account, have skyrocketed in recent years. I recall that Secretary William Clements ordered a study in 1976 of how the Navy would satisfy its shipbuilding requirements in the event yards such as Newport News or Litton carried out their threats to stop building Navy ships. Please tell me the status of that study and provide me with a copy if it has been completed.

I will appreciate your early response.

Sincerely,

WILLIAM PROXMIRE.

SECRETARY OF THE NAVY,
Washington, D.C., January 25, 1978.

Hon. WILLIAM PROXMIRE,
Joint Economic Committee, U.S. Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: I enjoyed the opportunity we had on January 12 to discuss the subject of Navy shipbuilding claims and believe your letter of the following day summarizes some of the points we covered. I wish to elaborate on a few of them.

The Electric Boat claims were returned to the Navy Claims Settlement Board on January 9 for the purpose of completing their evaluation and providing recommendations to the Steering Group of Assistant Secretaries of the Navy Edward Hidalgo and George Peapples, as well as General Counsel Togo D. West, Jr., Vice Admiral Donald Davis, and Vice Admiral Vincent Lascara. The disposition of future shipbuilding claims will have to be determined as each case arises since, as you are aware, the Navy Claims Settlement Board was established with the hope that it would not have to be made a permanent organization and that the administration of shipbuilding contracts could eventually be returned to normal procedures.

From its origin over four years ago, the Litton LHA claim has been entrusted to a highly experienced team within the Naval Sea Systems Command, presently headed by Captain R. A. Jones, USN, an acknowledged expert on shipbuilding contracts claims analysis, and negotiation. His team presently numbers about 168 and its analysis of the claim is expected to be completed in April of this year. Assistant Secretary Hidalgo is personally overseeing this massive effort, and I share his opinion that it is being professionally conducted in the most efficient manner possible while still ensuring that the Government's interests are fully protected.

As I hope I made clear in our meeting in your office, I am totally committed to finding resolutions to these claims problems which sacrifice neither the interests of the American public nor the Navy in the name of expediency.

If reasonable settlements cannot be reached with the shipbuilders, we are quite prepared for litigation, and, indeed, three major claims are in various stages of trial at present. If extracontractual relief should prove to be necessary, Congress will promptly be notified as required by law, as it has been in the case of the interim LHA payment arrangement which I submitted to the House and Senate Armed Services Committees on January 19. Other alternatives, such as the "takeover of private shipyard facilities" which you mentioned, would likewise have to be considered on a case-by-case basis.

The allegations of fraud which have been raised in connection with current claims are being examined by the Office of the General Counsel, in coordination with Department of Justice attorneys, precisely to ensure that they are analyzed thoroughly and without influence of the claims settlement process. In the course of our efforts to resolve the claims problems, nothing is going to be done which would jeopardize the Government's position should any of the claims be found to merit formal referral to the Department of Justice. The Armed Services Board of Contract Appeals decision in the Lockheed case is another subject presently being discussed with the Justice Department, and may be one upon which we can give you a more definitive status report in the near future.

I note that a special concern mentioned in your letter is "litigative risk", one of a number of factors used by the Navy Claims Settlement Board in arriving at a figure for a proposed settlement. "Litigative risk" is always a factor in negotiating the settlement of any claim or other controversy which will go to litigation if not disposed of by agreement. It is based on an evaluation of a party's exposure to an outcome from litigation different from that which would result from a proposed settlement. I, as well as the other experienced Navy lawyers involved, am quite familiar with the concept and its application to contractual disputes. I will not allow it or any other factor to be utilized as a "subterfuge" for unjustified action.

I have been unable to identify the specific Clements 1976 Study on shipbuilding alternatives to which you refer in your letter.

I appreciate your continuing interest in the Navy's shipbuilding programs and hope we can count upon your support as we search for solutions to these problems of grave concern to all of us.

Sincerely,

W. GRAHAM CLAYTOR, JR.

ITEM 63.—*Feb. 3, 1978—Letter from Senator Proxmire to Secretary Claytor reiterating questions raised in the Senator's January 13, 1978 letter to which Secretary Claytor's January 25, 1978 failed adequate to respond*

U.S. SENATE,
Washington, D.C., February 3, 1978.

Hon. W. GRAHAM CLAYTOR,
Secretary of the Navy, Department of the Navy,
Pentagon Building, Washington, D.C.

DEAR SECRETARY CLAYTOR: As your letter of January 25, 1978, did not respond to many of the questions raised in my January 13th letter to you, I believe a follow-up letter is in order.

I had asked you to confirm my understanding that the Navy Claims Settlement Board will be permitted to carry out its responsibilities and exercise the authority granted to it when it was established in 1976. The Board's original charter provided that it was to be independent. Navy and DOD officials were instructed not to interfere with the Board. The Board was to evaluate the claims on their merits; attempt to negotiate a settlement; and failing that, issue Contracting Officer decisions subject to approval of the Chief of Naval Material.

Your January 25th response stated "The Electric Boat claims were returned to the Navy Claims Settlement Board on January 9th for the purpose of completing their evaluation and providing recommendations to the Steering Group of Assistant Secretaries of the Navy Edward Hidalgo and George Peapples, as well as General Counsel Togo D. West Jr., Vice Admiral Donald Davis, and Vice Admiral Vincent Lascara." From this statement, it appears that the Board's authority has been reduced to analyzing the Electric Boat claim and providing information for Mr. Hidalgo's Steering Group. Has the Board's authority been reduced and has the Steering Group taken over the job of negotiating claim settlements? If so, please explain why you and Secretary Hidalgo have stripped the Navy Claims Settlement Board of its negotiation and settlement authority and thereby compromised the Board's efforts.

At our meeting on January 12th, I was pleased to learn of your determination to act promptly to dispose of the allegations of fraud that had been made with respect to Newport News and Electric Boat claims. I was under the impression that you would be forwarding these fraud allegations to the Justice Department in the near future unless the Navy's Office of General Counsel found them to be obviously frivolous. I asked that you confirm this understanding. Your response was vague. You stated that the allegations of fraud are being examined by the Office of General Counsel in coordination with the Department of Justice attorneys and also that in the course of your efforts to resolve the claims problems "nothing is going to be done which would jeopardize the Government's position should any of the claims be found to merit formal referral to the Department of Justice."

I do not understand why the Navy is presently engaged in some apparently informal review procedure with the Department of Justice. I am concerned that such an action may only delay the necessary detailed investigation of these

allegations by professionals trained to look into possible crimes and thus could posibly jeopardize the Government's position. Since the first report from a Navy official concerning possible fraud was issued many months ago, it seems that the Navy has had ample time to perform its review. I would like to know the specific date by which you will have completed your review of the fraud reports and I will have determined what action you are going to take. I would also like to be informed promptly in the event these reports are not going to be sent to the Justice Department.

I pointed out that it is important to distinguish carefully between a settlement on the merits of a claim and a grant of extra-contractual relief. I stated that Government procurement would be irreparably harmed if extra-contractual relief is granted under the guise of a claims settlement and asked you to let me know whether or not you agreed or disagreed with this point. Your letter of January 25th ignored my request. I would appreciate an answer.

I also asked that you explain the rules and criteria used for determining litigative risk in a settlement offer. You responded as follows: "I, as well as the other experienced Navy lawyers involved, am quite familiar with the concept and its application to contractual disputes. I will not allow it or any other factor to be utilized as a 'subterfuge' for unjustified action." I am happy to know this but it is not responsive to my question. I would appreciate an answer to my original question.

I asked that you provide me with a copy of the Justice Department opinion that the Navy could in certain circumstances appeal an adverse ruling from the Armed Services Board of Contract Appeals. You responded, "The Armed Services Board of Contract Appeals decision in the Lockheed case is another subject presently being discussed with the Justice Department, and may be one upon which we can give you a more definitive status report in the near future." I will look forward to receiving that status report in the near future. In the meantime, I would still appreciate a copy of the Justice Department opinion that the Navy may be able to appeal adverse rulings from the Armed Services Board of Contract Appeals.

I pointed out that I was under the impression that Secretary William Clements ordered a study in 1976 of how the Navy would satisfy its shipbuilding requirements in the event yards such as Newport News and Litton carried out their threats to stop building Navy ships. You replied that you were unable to identify the specific Clements 1976 study on shipbuilding alternatives to which I referred. I presume that the Navy or Department of Defense has contingency plans as to how to get their ships in the event major shipbuilders refused to accept future contracts in order to force settlement of shipbuilding claims on their own terms. If Mr. Clements did not conduct such a study, as he had implied in prior testimony, then I would appreciate being informed of what plans presently exist for that eventuality.

I would appreciate your early response.

Sincerely,

WILLIAM PROXMIRE.

ITEM 64.—*Mar. 13, 1978—Letter from Secretary Claytor to Senator Proxmire providing additional responses to the questions raised in the Senator's letters of Jan. 13, 1978 and Feb. 3, 1978*

THE SECRETARY OF THE NAVY,
Washington, D.C., March 13, 1978.

Hon. WILLIAM PROXMIRE,
U.S. Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: Your letter of February 3 raises additional questions growing out of our meeting of January 12 and my response of January 25 to your letter of January 13.

In regard to your question concerning negotiation of the Electric Moat claims, the direct responsibility for this important matter rests with Assistant Secretary of the Navy Edward Hidalgo. This assumption of responsibility and action by the Navy Secretariat was not designed to compromise the Navy Claims Settlement Board's efforts but rather to address the urgency of complex problems, larger than the claims themselves, arising out of the nuclear submarine construction at the Electric Boat Shipyard. The Navy Claims Settlement Board was

never intended, nor is it presently designed to conceive and implement fundamental solutions to the problems which underlie the shipbuilding claims.

The Navy review of allegations of fraud, about which you have expressed concern, does not impede or delay appropriate investigation by the Justice Department but rather aids the investigation by providing for the gathering of evidence and the review of allegations by those in the Navy conversant with the complex issues of government contract law. The Justice Department is, of course, apprised of all allegations of fraud prior to completion of a review and can request immediate transfer of the review at its discretion; otherwise the decision as to formal referral is made by the General Counsel of the Navy on a case-by-case basis.

I assure you that no settlement involving extracontractual relief would be concluded which would not identify the amount to be paid attributable to the Government's analysis of the claims.

You have requested a more detailed explanation of the determination of litigative risk. Rear Admiral Manganaro is addressing this subject in some detail in response to certain additional questions you have proposed for inclusion in the record of the recent hearings of the Joint Economic Committee.

You have requested a copy of a Justice Department opinion as to whether the Navy could in certain circumstances appeal an Armed Services Board of Contract Appeals decision. As is evidenced by the testimony of Irving Jaffe, Deputy Assistant Attorney General, on November 10, 1977, before the Subcommittee on Administrative Law & Governmental Relations, House Committee on the Judiciary, this area of the law remains unsettled. There is, however, no written formal Justice Department opinion to Navy with respect to the Government's right to appeal an ASBCA decision.

To my knowledge, no contingency plan exists which establishes how the Navy would satisfy its shipbuilding requirements should a major shipbuilder(s) refuse to accept future contracts. The Navy response would depend on then existing capacity of the industry, the capabilities of the particular shipyard which refused to build Navy ships, the status and capacity of Navy shipyards, and the make-up of a given shipbuilding program.

Sincerely,

W. GRAHAM CLAYTOR, JR.

ITEM 65.—*May 3, 1978.—Excerpt from the Congressional Record—Senate entitled, "The Great Shipbuilding Bailout-II: The Question of Fraud"*

Mr. PROXMIRE. Mr. President, the signs are increasing that the Navy is preparing the ground for a massive bailout of the shipbuilding industry. For many months I and others have been urging the Navy and the Defense Department to resolve the shipbuilding claims mess in an orderly, businesslike way. Instead, the White House appointees in the Navy seem determined to repeat the mistakes of the past. Apparently, they can think of no other approach than to simply bailout the three large shipbuilders who have filed $2.7 billion in claims against the Government.

BAILOUTS ARE INFLATIONARY

A bailout of the shipbuilding industry will cost hundreds of millions of dollars. It will be inflationary and will contribute to higher budget deficits.

Responsibility for the shipbuilding claims mess can be divided between the shipbuilders themselves and the Navy. As I have stated many times, the Navy should pay whatever it owes to its contractors by way of claims provided the claims are substantiated by audits and provided there is legal entitlement. The bailout approach blurs over the question of how much, if anything, the Government owes.

One of the Navy's problems is that its laxity in the handling of claims has encouraged the filing of claims.

INEPTNESS IN THE NAVY'S OFFICE OF GENERAL COUNSEL

For example, ineptness and procrastination within the Navy's General Counsel's office amount to a standing invitation for shipbuilders to make false or inflated claims against the Government and are impeding the efforts of the Justice Department.

Questions of fraud in claims filed against the Navy have been raised repeatedly by high Navy officials.

THE LITTON AND LOCKHEED CLAIMS

Prior to this year two shipbuilding claims cases—involving Litton and Lockheed—were referred to the Justice Department for investigation of possible fraud.

The Litton investigation resulted in an indictment against the company, which is pending. But the Navy spent a full year investigating the matter and then wasted another 6 months before referring to the Justice Department.

The Navy also spent at least a year "investigating" the Lockheed claim. It was finally referred to Justice in 1974. I understand the Justice Department's Lockheed investigation is nearing completion.

THE TENNECO AND GENERAL DYNAMICS CLAIMS

In the past several weeks the Navy has referred charges of possible fraud against two other shipbuilders—Tenneco and General Dynamics—to the Justice Department.

The long delays that have occurred within the Navy's General Counsel's office after the receipt of complaints of possible fraud, and the inept handling of the complaints, have complicated the task of the Justice Department and deprived the public and the shipbuilders of their right to a speedy disposition of the charges.

As the old legal maxim puts it, "Justice delayed is justice denied."

THE NAVY INVESTIGATES—ON A PART-TIME BASIS

A year ago questions of possible fraud were raised within the Navy with regard to claims filed by Tenneco's Newport News Shipbuilding Division. The General Counsel's response was to assign the matter to two attorneys in his office. The two attorneys had many other responsibilities and thus could devote only part of their time to the question of fraud.

Later in 1977 questions of possible fraud were raised within the Navy with regard to claims filed by General Dynamics Electric Boat Division. The General Counsel referred the matter to the same two attorneys, again on a part-time basis.

Weeks and months elapsed before any real efforts were made by the Navy to investigate the allegations of possible fraud.

NAVY "INVESTIGATIONS" DELAY JUSTICE

Why does the Navy's Office of General Counsel engage in these time-consuming investigations anyway?

The General Counsel does not have subpena power.

He does not have access to the shipbuilders' company records except when the Navy is involved in litigation with a company.

The General Counsel's Office cannot interview present or former employees of a shipbuilder except on a voluntary basis.

The General Counsel simply does not have the legal authority or the staff resources to conduct thorough or even constructive investigations of possible fraud.

It is doubtful whether any useful purpose is served through the half-hearted and half-baked inquiries of the Navy's General Counsel.

The appropriate agency to conduct investigations of possible fraud is the Justice Department. There is no need for two Government agencies to investigate the same facts or for one to preinvestigate it before it gets to the Justice Department. Once serious allegations are made by responsible officials the Navy's duty should be to refer them to the Justice Department without delay.

The Navy's foot dragging and apparent reluctance to move quickly are encouraging shipbuilders to file claims that are carelessly prepared, grossly inflated or intentionally deceptive.

I ask unanimous consent that the written responses to questions addressed to the Navy's General Counsel, Togo D. West, Jr. for inclusion in the record of the Joint Economic Committee's hearings of December 29, 1977, on shipbuilding claims, be printed in the Record at the close of my remarks.

The PRESIDING OFFICER. Without objection, it is so ordered.

(See exhibit 1.)

Mr. PROXMIRE. Mr. President, I also ask unanimous consent that an article from the New York Times, April 16, 1978, written by Anthony Marro, about the problem of fraud in Federal programs, also be printed in the Record at the close of my remarks.

The PRESIDING OFFICER. Without objection, it is so ordered.

(See exhibit 2.)

Mr. PROXMIRE. Among Mr. Marro's findings is that few agencies have taken steps to minimize the potential for fraud or to make detection easier.

The article goes on to say that according to J. Roger Edgar, head of the fraud section of the Justice Department's Civil Division, fraud in defense contracts accounts for 30 percent to 40 percent of his workload.

EXHIBIT 1

GENERAL COUNSEL OF THE NAVY,
Washington, D.C., April 13, 1978.

Hon. WILLIAM PROXMIRE,
U.S. Senate, Washington, D.C.

DEAR SENATOR PROXMIRE: You have requested that I provide you with answers to questions for inclusion in the record of the Joint Economic Committee's hearings of December 29, 1977, on shipbuilding claims.

The responses are enclosed.

Sincerely,

TOGO D. WEST, Jr.

QUESTIONS AND ANSWERS

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 outset 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 investigate 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 claims?

Answer. This Office can properly evaluate the allegations based on the existing Navy evidence in order to determine whether 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 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 claims 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. Hidalgo 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 will discuss with him each of the fraud or false claim 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 allegations 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 responsiblity 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 Instruction 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 cost 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 years 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.

EXHIBIT 2

FRAUD IN FEDERAL AID MAY EXCEED $12 BILLION ANNUALLY, EXPERTS SAY

(By Anthony Marro)

WASHINGTON, April 15.—Fraud in Federal aid programs has grown to the point at which, some experts say, its annual cost may exceed $12 billion. But many agencies have not yet established the mechanisms to detect, let alone prevent, fraud in their programs.

That is the assessment of a cross section of prosecutors, Congressional investigators and Government officials who said in recent interviews that the Federal Government has been so negligent in monitoring its own grants that it has permitted itself to become a major victim of white collar crime.

For the most part, the fraud is occurring in programs designed to provide services, training and aid to the disadvantaged: food stamps, health care, job training and housing aid.

But it is not the classic case of the welfare mother who cheats. Much of the fraud is committed not by the poor persons receiving the benefits, but by relatively well-to-do doctors, pharmacists and businessmen who have contracted with the Government to provide services and then set out to defraud it intentionally and systematically.

There are no precise figures for the amounts lost each year because of fraud. Mark M. Richard, chief of the fraud section of the criminal division of the Justice Department, says that the mechanisms for detecting fraud in many agencies are so weak that "the data base just isn't there."

"FRAUD, ABUSE AND WASTE"

But a recent report by the Inspector General of the Department of Health, Education and Welfare estimates that at least $6.3 billion to $7.4 billion was lost through "fraud, abuse and waste" last year in that agency alone.

An official of the General Accounting Office, the investigative arm of the Congress, estimated that outright fraud in Federal economic assistance programs could amount from $12 billion to $15 billion a year and perhaps as much as $25 billion a year. The current annual budget of the State of New York is $12 billion.

Largely because of attention generated by a series of dramatic Congressional hearings and a string of critical audits by the accounting office, there has been a growing awareness of the extent of such fraud.

Among the problems and weaknesses cited repeatedly by persons familiar with fraud against the Government were these:

Relatively few resources have been committed to fight the problem. The fraud section of the Justice Department's civil division, for example, has only 13 staff attorneys and three supervisors to handle a load of about 1,200 active cases and a backlog of about 4,000 referrals.

Although the great bulk of the money in these programs comes from the Federal Government, the primary responsibility for policing them is often left to state and local prosecutors, who may lack the resources and expertise, and sometimes the enthusiasm, to do it. "The fact is that the public is more concerned with so-called street crime," Mr. Richard says.

With the exception of the Department of Housing and Urban Development, which was the victim of major program frauds in the early 1970's, few agencies have redesigned their programs to minimize the potential for fraud or to make detection easier.

DIFFERENCES ON SCOPE OFFENSES

There is some evidence that many of those engaged in fraud do not consider it theft, or at least see it as a crime less serious than robbery or mugging.

"There's a feeling that people have that they can rip off the Government and it doesn't matter, that it isn't really a crime," says John Ois, the G.A.O. official who cited the $12 billion to $15 billion estimate. "But the fact is that every dollar lost in this way is a dollar that doesn't go to someone who needs it and who is entitled to it."

Mr. Richard, the Federal prosecutor, says that fraud against the Government results in social costs beyond the money involved.

"It's not only a violation of law, but it's an attempt to subvert a program, and this sort of things affects us all," he said. "When someone manages to subvert a Federal program, he's done something to undermine the integrity of the system over and above the actual dollar cost."

Some evidence of the extent to which the "integrity of the system" has been subverted can be seen in the report by H.E.W., in prosecutions and civil suits by the Justice Department, in Congressional hearings and in audits by the G.A.O.

THOUSANDS COMMITTING FRAUD

Taken together, they present a picture of thousands of persons—many of them well-educated, middle-class citizens—engaged in schemes that range from penny-ante abuses of food stamp programs to alleged fraud in massive, multi-million-dollar grain deals.

They include William C. Sibert, a former employee of the Department of Transportation who was charged with embezzling some $856,000 by putting his own name on checks intended for the construction of a subway in Atlanta.

Asked by a judge how this could happen, the Federal prosecutor is said to have replied: "Your honor, he posed as a subway system."

The cases include that of a doctor who allegedly billed H.E.W. for seven tonsillectomies on the same patient; the daughter of a Civil War widow who continued to collect "widow's benefits" for two decades after her mother had died and the officials of a health plan in California who persuaded some people to sign enrollment forms by telling them that they were signing petitions to impeach Ronald Reagon, who was then the Governor.

They also include the case of William F. Wilson, a dentist in South Carolina who is now in prison after being charged with, among other things, extracting healthy teeth from poor children so that he could collect fees from a Medicaid dental plan.

"It was just awful," said Joel W. Collins, the Assistant United States Attorney who prosecuted that case. He said the dentist had been found to have billed the Government for thousands of dollars worth of work not actually performed as well as for work that was not required.

"BROKE YOUR HEART"

"There was one girl about 13 years old who only had about three teeth left in her mouth," Mr. Collins said. "Looking at her just broke your heart."

Many of the cases disclosed in recent prosecutions and investigations are far more complex and involve larger sums of money.

Item: The Federal Government is trying to recover $24 million in damages from Cook Industries, which it contends defrauded the Government on grain shipments to 32 foreign countries. The suit, which is the largest civil suit the Justice Department is pressing in a fraud case, charges the company with having short-weighted, misgraded or adulterated grain shipments.

Item: The H.E.W. report, while saying that the estimates of dollars lost through "fraud, waste and abuse" might have been more than 5.4 percent of its total budget of $136.1 billion, nonetheless concedes that the percentage was far higher in some programs. It said, for evample, that at least 24 percent of its Medicaid funds had been misspent and concluded on the basis of a preliminary and hurried investigation that "criminal prosecution potential" exists in cases involving at least 200 physicians and 245 pharmacists.

Item: After paying nearly $5 million in vocational training benefits for veterans enrolled in a "barber's school", in Puerto Rico, the Veterans' Administration discovered that the bulk of the 1,000 veterans it intended to aid had never actually taken the courses and that the "school" was little more than a store-front.

The proprietor, Romanita Garcia, eventually was jailed, and the Government has since recovered about $500,000 through a civil suit. But the rest was lost in what Federal prosecutors say was a classic case of fraud, much of it going to veterans who were not taking the courses they had reported taking, and much of it going to the businesswoman who was not providing the instruction she had promised.

Many fraud cases are fairly uncomplicated, relying less on careful planning than on the assumption that the Government cannot or will not audit its expenditures.

In many of the Medicaid fraud schemes, for example, doctors simply billed the Government for services not rendered or overcharged for services that were rendered. In many of the vocational education frauds, schools, sometimes with the aid of "students" who shared their Government benefit checks, simply enrolled veterans and billed the Government for training, even though the veterans never attended classes.

Often, this has involved some collusion with persons in the bureaucracy. In its investigation of prepaid health plans in California, a subcommittee headed by Senator Sam Nunn, Democrat of Georgia, discovered an official of H.E.W. who allegedly had accepted money and a car from a contractor whose grants he had approved. And as a result of an investigation of fraud in its educational training programs last year, the Veterans Administration, according to a recent report, meted out to its employees "one suspension, two demotions, 16 reprimands, 15 admonishments and 26 counseling."

FEW INSIDE ACCOMPLICES

Virtually all of those familiar with the programs agreed, however, that outsiders did not need, and in most cases did not have, inside accomplices to help them defraud the Government.

The fraud is not confined to social welfare and economic assistance programs. Although there are no estimates of fraud in military contracts and other forms of procurement, J. Roger Edgar, the head of the fraud section of the Justice Department's civil division, estimates that fraud in defense contracts accounts for 30 percent to 40 percent of his workload.

One typical case handled by his office resulted in the Government's recovery of $600,000 from a contractor who had been accused of using scrap metal rather than new materials in the catapults that launch aircraft from the carrier U.S.S. Forrestal.

In the past, Government officials say, the public and law enforcement figures were more concerned with other crimes, particularly organized crime and narcotics and street crimes, and fraud was not perceived as a major problem.

Even where there was heavy policing of fraud programs, they said, it often focused on welfare mothers who were believed to be obtaining benefits to which they were not entitled rather than on calculated and sophisticated fraud.

According to Richard L. Thornburgh, a former head of the criminal division, the Department of Justice did not even have a strategy for dealing with program fraud before 1972 and thus failed to detect many of the schemes to defraud Federal programs that are now known to have taken place.

"ERROR" OR "ABUSE"

One reason that estimates of the amount of fraud are so vague, sources said, is that many Government officials refuse to call fraud what it is, preferring to dismiss it as "error" or "abuse."

Another is that Federal audit cycles are so long that often fraud is not detected until years after it has taken place. In the case of Mr. Sibert, who allegedly embezzled the $856,000 from the Department of Transportation, the program that the money was taken from was not scheduled to be audited until eight years later, though the applicable statute of limitations runs only five years.

"It was a fluke, that we caught him," said one Federal prosecutor. "If he hadn't aroused so much suspicion by spending so much money, the statute of limitations would have lapsed before we even knew the money was gone."

According to many of the sources, the problem is not just with the agencies, but with a lack of commitment by the Justice Department.

An indication of this can be seen in the limited resources of the civil fraud section headed by Mr. Edgar. Last year, it managed to recover about $8 million through civil suits against persons accused of defrauding the Government. It won numerous other suits against persons who did not have the resources to pay.

* * * * * * *

"There are a lot of cases that are going to have to be handled, and I'd like to know who is going to handle them," said one recently retired prosecutor. "If you start talking about a $6 billion problem at H.E.W., where are the bodies going to come from?"

A number of prosecutors and former prosecutors agree, noting that last year H.E.W. found suggestions of fraud by more than 13,000 persons in one welfare program alone and that since then several other agencies have begun similar internal investigations.

Griffin B. Bell, the Attorney General, has said repeatedly since taking office 14 months ago that fraud against the Government is a major concern and will be a top priority of the Justice Department.

To date, he has assigned nearly 200 agents to the Federal Bureau of Investigation to audits of health care programs and has added 13 staff lawyers, at least temporarily, to the 33-person staff in the criminal fraud section headed by Mr. Richard.

Although most of those interviewed argued that many more resources would be needed at both the state and Federal level, Mr. Richard said that he believes a strong commitment has now been made.

"You're dealing with an area that has been virtually ignored over the years in deference to other priorities," he said. "We are playing catch-up ball, and it's not going to be done overnight."

APPENDIX E

Documents relating to the CGN 41 contract dispute between Newport News and the Navy

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28–844—78——30

ITEM 1.—*Oct. 31, 1975—Under Secretary of the Navy D. S. Potter Memorandum for Assistant Secretary of the Navy Jack L. Bowers; General Counsel of the Navy E. Gray Lewis; Chief of Naval Material Admiral F. H. Michaelis; Commander, Naval Sea Systems Command Admiral R. C. Gooding; and Admiral H. G. Rickover. The memorandum establishes a Navy Department Steering Group as a final decision authority with respect to resolution of matters in dispute between the Navy Department and Newport News regarding construction of CGN 41. RADM S. J. Evans is appointed chairman of the Navy Department negotiating team to conduct negotiations with Newport News in issues in dispute*

DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., October 31, 1975.

COMNAVSEASYCOM

Subject: CGN–41 Contract Negotiation Steering Group.

1. I am establishing a Navy Department CGN–41 Steering Group as the final decision authority with respect to resolution of matters in dispute between the Navy Department and the Newport News Shipbuilding and Drydock Company relating to construction of CGN–41. Addressees are requested to serve as Steering Group members. The Vice Commander or Deputy Director may serve as an alternate member during the absence of military principals, and each Secretary will designate a similar alternate member to Captain Orem, Project Manager, Anti Air Warfare Ship Acquisition, Secretary of the Steering Group.

2. Rear Admiral S. J. Evans, DCNM (P&P) was appointed as Chairman of a Navy Department Negotiating Team to conduct negotiations with Newport News on issues in dispute. A copy of the specific direction and authority granted RADM Evans may be found in Navy Department files.

3. The Steering Group will be convened in the near future to approve a plan of action currently under preparation by the Evans team. Follow meetings will be held as determined necessary by the Steering Group to provide guidance to the team. Your office will be contacted by Captain Orem relative to date and time of initial meeting.

D. S. POTTER,
Under Secretary of the Navy.

ITEM 2.—*Oct. 31, 1975—Memorandum from Assistant Secretary of the Navy Bowers to Rear Admiral Stuart J. Evans, Deputy Chief of Naval Material. The memorandum establishes the objectives of the CGN 41 negotiations and provides guidance for the conduct of these negotiations*

DEPARTMENT OF THE NAVY,
OFFICE OF THE ASSISTANT SECRETARY,
Washington, D.C., October 31, 1975.

From: Assistant Secretary of the Navy (I&L).
To: Rear Admiral Stuart J. Evans, Deputy Chief of Naval Material (P&P).
Subject: Resolution of dispute with Newport News Shipbuilding and Dry Dock Company in conjunction with construction of CGN–41.

1. You are hereby appointed the Navy's representative to conduct such negotiations as you consider appropriate with authorized representatives of Newport News Shipbuilding and Dry Dock Company, in order to achieve the following specific objectives:

a. Comply with the spirit and letter of the District Court Order of 29 August 1975, in conducting negotiations with Newport News in good faith in all matters contained in the stipulation set forth in the court order.

b. Negotiate to achieve construction of the CGN–41 in accordance with the terms of the contract between the Navy Department and Newport News, including such modification required by its terms or otherwise authorized by law or the Armed Services Procurement Regulation.

c. Achieve resolution of outstanding issues of CGN–41 options between the Navy and Newport News at the earliest practicable date.

d. Obtain stipulation by Newport News of the CGN–41 option validity under any settlement achieved pursuant to sub-paragraph 1a above.

e. Concurrent with good faith negotiations under sub-paragraph 1a above, you shall assure that all necessary and proper arrangements have been made to pursue the CGN–41 controversy in the appropriate legal forum, as may be in the best interest of the Navy.

2. In achieving the foregoing you shall:

a. Present an outline plan to the Under Secretary of the Navy, and such other representatives as he may designate, to achieve the foregoing objectives.

b. Report regularly the status of all actions taken under this plan.

3. In the discharge of assigned duties, you are hereby authorized to:

a. With the concurrence of the Chief of Naval Material, Commander Naval Sea Systems Command and the Navy General Counsel, as appropriate, designate such individuals of the Naval Material Command, the Sea Systems Command, and the Office of the General Counsel as are necessary for the proper conduct of this assignment.

b. With appropriate assistance of the Office of General Counsel, conduct liaison with the Department of Justice for matters relating to actions pending in the District Court.

c. In conjunction wtih such individuals as you designate, act as the sole authorized Navy Department agent in any and all discussions/negotiations with Newport News on issues relating to the current dispute relating to CGN–41.

4. By copy of this memorandum, the Chief of Naval Material is requested to establish organizational and support arrangements to facilitate the requirements of these instructions.

JACK L. BOWERS.
Assistant Secretary of the Navy
(Installations & Logistics).

ITEM 3.—*Nov. 18, 1975—Memorandum from ADM Evans to the CGN 41 Steering Group recommending that the Navy ask the Justice Department to file necessary papers to obtain the Court's ruling on the validity of the CGN 41 contract. This recommendation was disapproved by Assistant Secretary Bowers in a memorandum dated 19 November 1975 urging ADM Evans to "bend all efforts toward reaching a settlement"*

DEPARTMENT OF THE NAVY,
HEADQUARTERS NAVAL MATERIAL COMMAND,
Washington, D.C., November 18, 1975.

Subj: Amended Pleadings.

1. During the initial meeting of the Steering Group, a rationale for amending the CGN–41 complaint prior to a determination by GAO was discussed.

The Steering Group requested a rationale for amending at this time which included both pros and cons.

2. The rationale with pros and cons is attached.

3. During discussions with the General Counsel on 14 November 1975, agreement was reached to explore amending the complaint with the Department of Justice. At a meeting of OGC and Justice representatives on same date the latter agreed to proceed with amending the complaint and set forth the documentation they required to do so. This has been prepared and forwarded separately to the General Counsel.

4. The negotiating team is unanimous in their desire to push ahead on the amendment of pleadings as soon as possible and to so advise Mr. Diesel at a meeting now scheduled with Vice Admiral Gooding on Friday, 21 November 1975.

5. Since it will be difficult to call a meeting in the absence of Dr. Potter, it is requested that the remaining members of the steering group indicate their concurrence to move ahead with the amended pleading.

Very respectfully,

S. J. EVANS,
RAdmiral, SC, USN.

ITEM 4.—*Nov. 19, 1975—Assistant Secretary of the Navy Bowers Memorandum for Rear Admiral Stuart J. Evans. The memorandum expresses the need for a "good atmosphere for the negotiations ordered by the court" and urges that amended pleadings be considered for "some future time" to preclude stalled negotiations*

THE ASSISTANT SECRETARY OF THE NAVY,
INSTALLATIONS AND LOGISTICS,
Washington, D.C., November 19, 1975.

Subject: Amended Pleadings—CGN–41.

Your memorandum of 18 November 1975 on the subject of Amended Pleadings has been submitted to the members of the CGN–41 Negotiating Steering Group as requested in order to set out reasons for and against.

Examination of the reasons cited lead me to the following conclusions:

1. The major reason for is that cited under (iii) "It is believed essential to send a signal to Newport News * * *"

2. The reasons against are primarily focused in (ii) and (iii), which are concerned with how the action would be regarded by the court and by Newport News, respectively.

After carefully considering the reasons for and against, I am in complete agreement that the amended pleadings are necessary to an eventual complete court case but that the timing is inappropriate now. I do not believe we need to get Newport News' attention. There has been no display of weakness in our negotiating posture. We negotiated for several months last spring. We provided them with a firm letter, and when they stopped work we went to court extremely rapidly. With those evidences of firmness, I feel we need no more. On the other hand, we do need a good atmosphere for the negotiations ordered by the court.

You are urged to bend all efforts toward reaching a settlement and to consider amended pleadings for some future time if you feel it will assist in stalled negotiations or it will certainly be required when and if a court confrontation is considered to be the only resort.

Signed,

JACK L. BOWERS.

ITEM 5.—*Apr. 22, 1976—Memorandum from the Navy General Counsel to the DOD General Counsel informing him that statements by the Deputy Secretary in support of the Public Law 85–804 effort could undermine the Government's position in the CGN 41 litigation and also undermine other Navy contracts*

DEPARTMENT OF THE NAVY,
OFFICE OF THE GENERAL COUNSEL,
Washington, D.C., April 22, 1976.

From: General Counsel, Department of the Navy.
To: General Counsel, Department of Defense.
Subject: Pending Navy Litigation.

1. On April 19, 1976, members of my staff, together with attorneys from the Department of Justice, participated in a pre-trial conference in the United States District Court for the Eastern District of Virginia (Newport News Di-

vision) in the case of *U.S.* v. *Newport News Shipbuilding & Dry Dock Co., et al.* This case involves the validity of the option by which the Government contends that Newport News is obligated to construct and deliver the CGN-41. At the pre-trial conference a proposed litigation schedule was adopted looking toward argument of the Government's motion for a preliminary injunction on August 16, 1976, and for trial of the case itself commencing December 13, 1976. Although these dates appear to us to be extremely tight, we are preparing for trial on the basis that they will be met.

2. In the course of discussing the projected length of the trial, the Defendant's counsel (Martin Worthy, Esquire, of the Washington firm of Hamel, Park, McCabe and Saunders) indicated that the trial would last "at least several weeks." The Government responded that the presentation of its case would be considerably shorter. Mr. Worthy replied that he did not see the matter as that simple, citing the fact that the Deputy Secretary of Defense had made a formal finding that "these contracts were fundamentally unfair." A statement to this effect was in the Deputy Secretary of Defense letter to Senator Stennis of April 1976.

3. The allegation of "unfairness" is central to the Newport News defenses in this suit. Under the varying labels of commercial impracticability, unconscionability, mutual mistake, unilateral mistake, and other descriptions. Newport News has insisted that they are not obligated to construct and deliver the CGN-41 because such an obligation would entail ruinous and unforeseen losses. The statements of the Deputy Secretary of Defense and the various documents in support of the proposed P.L. 85-804 relief to shipbuilders can thus be used by NNSDDC to buttress their defense to the Navy's action in the Federal Courts to enforce this contract. The statements, documents, and anticipated testimony in support of the 85-804 effort can also be expected to be used by the defendants in the event of a work stoppage by either Litton, in the use of the DD-963 or LHA's, or Newport News in the case of the CVN-70. "The testimony" of the Deputy Secretary of Defense and others in support of the 85-804 effort thus have the potential for seriously undermining the Navy's position with respect to the duty of shipbuilders to perform under these contracts, whether or not the 85-804 effort is successful. The Department of Justice is not entirely informed on the dimensions of this problem, but they have already expressed their concern.

4. As you know, when we press our motions for Temporary Restraining Orders and Preliminary Injunctions, the Federal Courts sit in equity. It is axiomatic in this arena that the moving party have "clean hands." Thus, the Navy is in the awkward position of asking the Federal Court for an extraordinary order compelling these corporations to return to work under a contract that the Deputy Secretary of Defense has found to be unfair. In addition, at the time of trial on the merits of the option, Newport News' position re unconscionability will have been made for them by people within OSD and the Navy through letters and testimony to Congress. As a practical matter, it is difficult for us to refute Newport News' defense when the leaders of the Defense Department have publicly agreed with their position.

5. One has only to read the recent ASBCA opinion awarding Lockheed $62 million on the theory of estoppel because of pronouncements by the Deputy Secretary of Defense to realize the weight and authority given by the Courts to findings of that office. In my opinion, the situation at bar is very analogous.

6. At your convenience, I would very much appreciate discussing with you possible approaches to this problem.

E GREY LEWIS,
General Counsel.

ITEM 6.—*May 13, 1976—Letter from ADM Evans to Newport News summarizing the results of his negotation efforts on the CGN 41*

DEPARTMENT OF THE NAVY,
NAVAL SEA SYSTEMS COMMAND,
Washington, D.C.

Subject: CGN-41.
MR. C. E. DART,
Senior Vice President, Newport News Shipbuilding and Dry Dock Company, Newport News, Va.

DEAR MR. DART: In my letter to you dated 7 January 1976, I stated in part:

"My review of the record indicates that the applicable changes subsequent to P00018 were not incorporated in the CGN 41 before the court because Newport News frustrated Navy efforts to negotiate the appropriate equitable

adjustments for these changes. Newport News would not negotiate the changes unless the Navy agreed to overall reformation of the P00018 contract option."

I concluded by stating:

"In summary, I do not see how any of the changes issued subsequent to P00018 have contributed to delay in the construction of CGN–41 or how any of the changes have impacted orderly procurement of the subcontracted components as you allege they have."

Your letters dated 15 and 16 January 1976, supplementing your letter of 5 December 1975, reiterated allegations that changes caused or contributed to substantial amounts of delay in delivery of CGN–41. Your letters reiterated assertions of Newport News' "positive commitment" to incorporate changes; provided a rationale for allocating substantial amounts of unrelated delay and other costs to these changes; reiterated a legal theory that failure of the Government to agree to incorporate the changes under conditions dictated by Newport News invalidated the option; and provided an analysis explaining why the delivery schedule "must be changed from October 1978."

In prior discussions and correspondence, the Navy has disagreed with these Newport News' allegations and positions. I have reviewed the information you have provided in these latest letters. I find that they add little that has not been addressed or discussed in prior correspondence, court proceedings, negotiations, and discussions. Therefore, these letters provide no basis for my changing the previously stated Navy conclusions. It is simply not reasonable to conclude that these changes and other Government actions alleged in your letters caused the delay and increased costs of CGN–41, as Newport News alleges. Detailed comments on your 16 January 1976 letter on a paragraph-by-paragraph basis appear in enclosure (1). Detailed comments on your 15 January 1976 letter appear in enclosure (2).

Since assuming responsibility for the CGN–41 negotiations in November 1975, I have tried to obtain information that relates the Newport News' positions to the provisions of the CGN–38 Class contract under modification P00018 in order to see if any reasonable relation between the Newport News position and the contract provisions can be established as a basis for an agreement. However, I have not been able to find one.

Your 16 January 1976 letter suggests that a maximum effort be made at our next meeting to agree on a realistic ship construction period and delivery date without regard to contractual responsibility. I note, however, in mid-1974, Newport News rescheduled CGN–41 without Navy's agreement; Newport News also delayed purchase order placement, thus delaying the ship, without Navy agreement. Newport News' correspondence has indicated a 1980 delivery date is now inevitable. Since delivery of CGN–41 is controlled by delivery of contractor furnished equipment and the application of shipyard manpower, items over which the Navy has no control, and since Newport News has unilaterally already established schedules, it appears to me that, without addressing responsibility, such a meeting would not assist in resolving the issues at hand.

Finally, the last paragraph of your letter dated 16 January 1976 proposed that we should concentrate on ways to effect an overall settlement of all DLGN–41 matters rather than continue to pursue individual elements such as the impact of changes." Such an "overall settlement" presumably could involve but three possible actions, either:

(a) Reformation of the existing contract as Newport News requests, i.e., not on the basis of responsibility, or individual elements, but on the basis of what Newport News is willing to agree to do. As the Navy has stated before, the Navy does not consider that the facts relating to this matter provide a sufficient, valid and reasonable basis for an adjustment of the existing contract to new terms, such as the terms Newport News has insisted Newport News requires.

(b) Extra contractual reformation by the Secretary of Defense under Public Law 85–804. I understand that discussions leading to a possible overall settlement have been conducted between Newport News and representatives of the Office of the Secretary of Defense. Such discussions are not under my authority or cognizance.

(c) Establishment of a new contract arising from a legal determination that what the Navy maintains is a valid contract for construction of CGN–41 is in

fact not legally valid. This determination is a matter of law, and Newport News has referred this matter to Federal District Court. Discussions are being held between the Court and attorneys for Newport News and the Navy. Discovery proceedings are taking place.

If the above is an accurate representation of the only three actions by which you would settle, then I do not see how our scheduling additional formal negotiation sessions would be fruitful. However, if Newport News indicates its willingness to address and resolve the matter on the merits of the individual elements, or on any basis under the terms of the contract, additional negotiation sessions may prove worthwhile. The Navy continues to desire a fair and equitable resolution of this matter. I shall remain available for discussions in case there are matters that need clarification or you have any new matters that warrant discussion.

Sincerely,

S. J. EVANS,
RADM, SC, U.S.

Enclosure: (1) Specific Comments on Newport News letter dated 16 January 1976. Subj: CGN–41; with Attachment (1) Navy Detailed Comments on Specific Changes Newport News Alleges Caused Impact.

(2) Navy Comments on Newport News letter dated 15 January 1976. Subj: CGN–41.

ITEM 7.—*July 6, 1976—Letter from Secretary of the Navy Middendorf to the Attorney General pointing out the importance of the CGN41 to the Navy and citing the CGN 41 dispute as a major element in "our worsening relations with Newport News." The letter requests recommendations and assistance of the Justice Department on seeking a satisfactory resolution*

JULY 6, 1976.

Hon. EDWARD H. LEVI,
Attorney General,
Washington, D.C.

DEAR MR. ATTORNEY GENERAL: The Navy Department is currently being represented by the Department of Justice in litigation with the Newport News Shipbuilding and Dry Dock Company concerning the CGN–41 nuclear-powered Guided Missile Cruiser.

After failing to reach agreement with the Navy on the validity of the contract option involved, Newport News stopped work on this vessel in August of 1975. Your Department promptly requested and received a restraining order enjoining Newport News to continue production and directing the parties to negotiate in good faith to settle their differences during a one-year period. In the latter part of 1975 and the early part of this year the parties were engaged in meetings to explore opportunities for agreement. Progress has been negligible. This is due largely to the fact that it has been the Government's belief that a valid contract exists and that negotiations should be limited to those areas expressly left open within the contract. Newport News has taken the position that no contract exists and that a settlement equitable to both parties should be reached without regard to the terms of the contract.

Recently we had hoped that through the use of Public Law 85–804 a broad settlement could be reached with Newport News and other shipbuilders on a wide range of outstanding Navy shipbuilding problems, including the CGN–41. This effort was unsuccessful, however, and has been at least temporarily withdrawn. Now seeking rapid settlement on the CGN–41 and other contractual issues, Newport News has threatened to ask the court to vacate its original order on the grounds that the Navy has not negotiated in good faith. The Navy, on its part, feels that it is Newport News which has failed to negotiate several issues which might create an environment for settlement.

The CGN–41 is itself extremely important to the Navy and may be even more important as a major element in our worsening relations with Newport News, the Government's single supplier of surface nuclear vessels. For this reason it is of the utmost importance that the current deadlock be broken, and the Navy would appreciate the recommendations and assistance of the Justice Department in seeking a satisfactory resolution. Our General Counsel,

Mr. E. Grey Lewis, will be pleased to supply you with whatever assistance you may require in this regard.

Sincerely,

J. WILLIAM MIDDENDORF II,
Secretary of the Navy.

ITEM 8.—*July 12, 1976—Memorandum from Secretary of the Navy Middendorf to the Chief of Naval Material, the Assistant Secretary of the Navy (Installations and Logistics), and the General Counsel of the Navy, disbanding the CGN 41 Contract Negotiation Steering Group which was established on 31 October 1975*

DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., July 12, 1976.

Subject: CGN–41 Contract Negotiation Steering Group.

By letter of 6 July 1976, the Attorney General has been requested to provide additional assistance in seeking resolution of the dispute between the Navy and Newport News Shipbuilding and Dry Dock Company on the CGN–41. Lack of progress in negotiations has been cited. It is expected that the Justice Department, assisted by the Navy General Counsel, will assure responsibility for direct negotiations with the company.

Accordingly, Navy roles will change and the CGN–41 Contract Negotiation Steering Group established on 31 October 1975 by the Under Secretary of the Navy is hereby disestablished.

J. WILLIAM MIDDENDORF, II.

ITEM 9.—*July 13, 1976—Letter from Attorney Generay Levi to Secretary of the Navy Middendorf responding to the Secretary's July 6, 1976 letter regarding the CGN 41 litigation. The Attorney General states the Justice Department is engaged in discovery and requests Navy views on what issues are the cause of the deadlock and the Navy's analysis of each issue*

OFFICE OF THE ATTORNEY GENERAL,
Washington, D.C. July 13, 1976.

Hon. J. WILLIAM MIDDENDORF II,
Secretary of the Navy,
Washington, D.C.

DEAR MR. SECRETARY: Thank you for your July 6, 1976 letter regarding *United States of America* v. *Newport News Shipbuilding and Dry Dock Company, et al.*, E.D. Va., Civil, No. 75–88–NN. As you are aware, the factual context of that litigation is complex in view of the magnitude of the contractual undertaking to build a nuclear-powered guided missile cruiser. I appreciate the concern you have expressed about the importance of this ship to the Navy and that you desire the Justice Department to take all feasible action to break "the current deadlock". Your letter indicates that you would appreciate our recommendations and assistance "in seeking a satisfactory resolution".

We are presently engaged in discovery which may clarify the basis for the factual contents which Newport News is raising in the course of the litigation. In addition, we would appreciate receipt of information from the Navy Department indicating its view as to what issues are the cause of the deadlock and the Navy's analysis of each issue. This information should enable the Justice Department and the Navy Department to further consider what action to take to protect the Government's interests. In the interim, the Civil Division is continuing to work on all aspects of the litigation with Navy Department personnel.

Sincerely,

EDWARD H. LEVI,
Attorney General.

ITEM 10.—*July 15, 1976—Vice Admiral Eli Reich (Ret.) Memorandum for the Record, subject: Meeting regarding Navy shipbuilding claims problems. This memorandum records a July 13, 1976 meeting between Deputy Secretary Clements and senior Navy officials during which Mr. Clements castigated the Navy, set forth his views with regard to the shipbuilding claims, urged that Mr. Rule be assigned to work on the CGN 41 contract dispute*

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C., July 15, 1976.

Subject: Meeting re Navy Shipbuilding Claims Problems:

A meeting was held at 1700, Tuesday, 13 July, in Mr. Clements' office to discuss the present status of Newport News Shipbuilding and Dry Dock Company claims. Those in attendance are listed on the attached sheet.

Mr. Clements opened the meeting by asking what RADM Manganaro is doing. ADM Michaelis stated that Manganaro had just reported to NavMat and has begun laying out the program. He is going to Newport News for personal discussions on Thursday.

Then Mr. Clements stated that he is irrevocably committed to solving this problem; unlike ADM Rickover, he is very much involved. He has been at it for more than three years and the problem is unresolved.

He was disappointed to learn from Diesel last Friday that there seems to be an entire lack of progress at Newport News. This is 180 degrees from what ADM Michaelis and Mr. Bowers had told him on July 2nd. Mr. Clements said that Diesel's visit with him on Friday, 9 July, was not for the purpose of negotiating with him but was to report to him at first hand Diesel's evaluation of the situation. Mr. Clements said, "We are not going to get there unless we understand each other." (i.e., Navy and Newport News)

Mr. Clements said, "Diesel wants to settle the overall problems he has with the Navy and get on with the business of building ships. I'm positive he wants to settle." However, Diesel has an order of priorities. First is the 688. Mr. Clements believes that this is capable of being accomplished quickly; the GD 688 settlement is a precedent; the material has been submitted; intent of parties can be established; good faith and proper attitude can be shown; a provisional payment can be made. He asked, "Is there anything wrong with this?" Both ADM Michaelis and Mr. Bowers responded, "We are going to do it." To which Mr. Clements retorted, "Why in the hell haven't you done it?"

ADM Michaelis explained that in the initial discussions between the Navy and Newport News, the 688 meant the contract for the lead ship—SSN 688. Now, however, Newport News interprets it to be the 688 lead ship contract and the follow-on production contract for four more SSNs of the 688 class. When ADM Michaelis indicated an ability to be ready to negotiate in 13 weeks, he had in mind the contract for the 688 lead ship contract. He inferred that the time element has therefore been lengthened. He went on to state that the Navy is planning to give the company a $10.4 million provisional payment this week on the 688. They hope to make a provisional payment on the follow-on contract for four 688 class subs this fall. He said, "We want to settle but I don't think we will ever get them done as fast as Diesel wants. We have to assess the litigative risks." Mr. Clements' response was, "This is the first time I have heard you say this positively." VADM Lascara said that the Navy had said it in their plan.

VADM Reich stated that ADM Michaelis was talking about claim procedures. He mentioned TARs, legal memoranda and then averred that if the Navy follows the same old dogmatic procedures it would take 13 weeks and longer, possibly 13 months. He stated that whoever is vested with the settlement authority must be given flexibility in the application of procedures, resources, etc. VADM Lascara pointed out that this fact was clearly stated in the charter of the Board.

Mr. Bowers stated that it was time to tell Mr. Clements where the Navy stood and that there was an 180° difference between Diesel's discussion with them on Thursday (Diesel talked with ADM Michaelis by telephone) and Diesel's discussion with Mr. Clements on Friday. He added that Diesel's people talked the same way with the Navy on Wednesday as Diesel did on Thursday. Bowers said that on Wednesday the Navy advised Newport News

of the three man special Claims Settlement Board, plans for settling the CGN–41 and the CVN–70. Mr. Creech of Newport News asked for the Navy's schedule. Creech insisted on having the Navy's schedule to take back to Newport News. The Navy was most reluctant to give him it because the schedule was tentative and had not been reviewed with or approved by ADM Manganaro. Finally, however, due to his strong urging, they gave Creech the schedule advising him that it was very tentative. The tentative schedule calls for processing the claims in the order in which most of the analysis has been done which is in the order they were received by the Navy. (Bowers in a parenthetical comment said that the Navy probably should have known as a result of the recent 85–804 negotiations that Newport News priorities were different from that.)

Bowers continued, stating that ADM Michaelis, after his telcon with Diesel on Thursday, told him it was the most constructive talk he had had with Diesel. When ADM Michaelis phoned Diesel on Monday, 12 July, Diesel advised him in connection with Diesel's visit to Mr. Clements that he was going to do everything to put pressure on the Navy. Bowers then said that the new special Settlement Board will have authority and flexibility to do it their way. RADM Manganaro will report only to ADM Michaelis and no one else. They plan to discuss affidavits tomorrow (14 July) with Manganaro. The real claim settlement schedule will be mutually worked out with Newport News by RADM Manganaro.

Mr. Clements advised Bowers that he must change momentum and that there is no way for him to understand Diesel without talking to him. Diesel advised Mr. Clements on 9 July that he had not talked with Bowers since March. Bowers stated that he had a telephone conversation with Diesel about two weeks ago. Mr. Clements replied, "You have to talk with him directly—eyeball to eyeball."

Mr. Clements stated that nothing was as important to the Navy as solving the claims problem. He informed all present that he has been advised by the chairman and some of the members of the Senate and the House oversight committees that they have lost absolute confidence in what the Navy is doing and they are not going to approve any Navy new shipbuilding programs unless they get this claims mess cleaned up. He said that he has been "pleading" with the Navy for more than three years, that he can step in but he does not want to. He wants the Navy to solve it. He added that if RADM Manganaro, who is to head up the Board wants to get something done, he should talk to them and *not* write letters. He emphasized that he wants action and reminded them that he has authority to step in. He said that he was only talking about Newport News, not Litton; Newport News is willing to settle and he believes they are willing to be reasonable. He said, "I'll support you; Stennis will support you; Price will support you. I want you to clean up this mess. But October 1977 dates won't walk."

ADM Michaelis stated that the Navy is going to make a 688 provisional payment ($10.6 million) this week. Mr. Clements, in response, advised Navy to make all the provisional payments that equitably can be made in a prompt and decisive way. He asserted that they have been financing the Navy for years. The Navy's practical demonstration of intent to reasonably and promptly negotiate their differences with Newport News is extremely important. He is convinced that Newport News is serious in their threat to stop building ships for the Navy if things do not improve: In this regard, Mr. Clements stated that he agrees with Newport News that the Navy has not negotiated in good faith on the CGN–41 dispute and is aware now that Newport News has formally gone to Court with their contention of bad faith on the Navy's part.

Mr. Grey Lewis, Navy General Counsel, stated that the settlement of the CGN–41 matter which he had said at the 2 July meeting with Mr. Clements would very probably be settled in 30 days is not possible. His earlier statement was based on the assumption of the use by the Department of Justice of its broader settlement authority based on litigative risk. Unfortunately, the Department of Justice has subsequently advised Mr. Lewis that they have insufficient information available to them now to determine the litigative risk and it would probably take at least three months or more before it could be determined.

Mr. Lewis then stated that the Navy has three options concerning the CGN–41 dispute, namely, (1) settle outside of contract provisions under P.L. 85–804; (2) settle under provisions of contract with consideration; (3) by

Department of Justice under their broader settlement authority based on litigative risk. Mr. Wiley said that the CGN–41 is a business problem which requires the Navy to make a business judgment. Wiley said that time is running out for the CGN–41 Court Order—in fact, it runs out on August 1st. Lewis stated that Newport News' outside counsel had indicated a willingness to join with Navy in a request for a one year extension but recent events seem to rule this out.

Mr. Clements asked, "Why not reform the CGN–41 contract?" He continued, "You wanted the Department of Justice to do it for you. You were passing the buck to the Department of Justice." Bowers answered that this was not so, to which Mr. Clements replied that Secretary Middendorf and Bowers both have authority under P.L. 85–804. Mr Wiley interjected that all that is needed is "some consideration." This is based on an OSD Counsel's opinion which has been concurred in by GAO counsel. Mr. Clements continued by stating that if the Navy does not do it, he will do it for them. He referred to Mr. Packard's P.L. 85–804 action in the Lockheed case and of the ASBCA's recent decision upholding Mr. Packard's action in favor of Lockheed regarding the $62 million settlement of certain Navy shipbuilding claims.

Mr. Bowers stated that he needed to get some additional legal briefing with regard to this. A discussion ensued with respect to "legal consideration" and just what constituted adequate consideration.

Mr. Clements asked Mr. Rule for his opinion. Rule replied that it is his belief that Newport News would extend the time if the Navy exhibits "good intent' but we need to have new people, new faces doing this negotiating. He said that the Navy has gotten back from the FAA the same fellow to work the problem as they had on it before (Bob Walsh). Newport News wants to see some new faces. Mr. Clements reiterated his strong belief that Newport News wants to settle. Bowers stated that Diesel wants $25 million. Lewis stated that they want $25–30 million. Lewis says Newport News doesn't want to take a loss, but they are willing, he believes, to accept a breakeven deal.

Mr. Clements stated that he wants to see four changes incorporated in the CGN–41 contract, viz; (1) new escalation clause; (2) a new "changes" clause; (3) new ceiling price; and (4) new delivery schedule.

Concerning the handling of pricing and paying for change orders, Mr. Bowers stated that the Navy wants to provide that changes will be negotiated and priced out before they go ahead with the changed work but Newport News will not agree. Newport News insists that they cannot estimate the ultimate delay and disruption that will result from certain changes and will not fully price such changes and sign away what they consider to be their legal rights for ultimate cost recovery.

Mr. Clements responded that time, labor, material and overhead can be pretty well fixed and delay can and ought to be negotiated. He said the first part (labor, material, overhead) of the cost of a change order should be promptly determined and promptly paid. The delay portion of the change cost can be negotiated within reasonable time periods, e.g., 90–120 days after payment of hard costs. Such delay settlements may not be exact but over a period of time, the overs and unders will balance out with the right relationship. Bowers replied that Diesel is unwilling to do that. VADM Reich pointed out that in the past the Navy withheld payment of any part of the agreed upon change unless the company agrees to the whole thing. In this regard, ADM Michaelis stated that SupShip had given the company two propositions on 9 July which would accomplish much of Mr. Clements' scheme and the company has not yet responded to either one. Mr. Bowers stated that the contract did not have to be changed to accomplish this, to which Mr. Clements replied, "How can that be?"

Mr. Grey Lewis then referred to "cross-contract" impact or the so-called ripple effect—stating that the Navy has rejected it because it is a big legal issue and the Navy has an ASBCA case in support of its position. He went on to say, however, that the Navy is recognizing it to some extent. He alluded to the Litton Project X case which he characterized as the company's attempting to get the Navy to pay the additional costs on all contracts—commercial as well as Navy.

Mr. Clements stopped this discussion and referred again to the four items in the CGN–41 contract which need to be changed. He averred that there will not be any settlement if these four items are not addressed and nego-

tiated. Also, Newport News will not sign the CVN–70 contract until the Navy indicates what it is going to do concerning the CVN–68 & 69 REAs. Mr. Clements emphasized that Newport News needs to know the Navy's intent and attitude. He believes that Newport News is not kidding and will fight all the way to the U.S. Supreme Court if necessary if they do not sense a real desire and intent of the Navy to join in bringing about a reasonable and equitable overall settlement.

Concerning the various issues and disputes which involve the Government and Newport News, Mr. Rule stated that he would not settle one at a time. There is a lot more flexibility if they are settled as a whole. He again emphasized that what is needed are "new faces." He emphasized that we must stay away from the Courts.

Mr. Clements stated that Newport News said they have $200 million of their own invested and that we should be able to pay some of it back. He suggested dividing the claims into two parts—the hard core and the delay and disruption .He believes you should have a good feel for the hard core within 30 days. Enough so that you can determine the amount of a provisional payment. What is important is attitude and intent.

VADM-Reich stated that since SupShip at Newport News is and has been so close to the situation that they should have a good current feel for the situation on all the issues. Also, the NavSea negotiations and the SHAPMs who have been involved for a long time should be quite knowledgable. It should not take too long for the Government to broadly assess the import and content of the totality of the issues between the Government and Newport News.

Mr. Bowers stated, "We are going to get it." VADM Lascara thought that with half a chance, RADM Manganaro could get there. Mr. Clements indicated a lack of confidence stating that there is no reason to—he has heard the same story for over three years.

Mr. Clements said that he wants to see definite progress. At the same time he wants the Government's interest fully protected. He wants Mr. Bowers to personally devote his time to this problem. He went on to say that the President and Congress are losing confidence in the Navy. The Navy is hurting itself. Although he does not want to be required to do it, if the Navy won't settle these claims, he will. Mr. Bowers responded saying that he and ADM Michaelis must meet with Diesel on a monthly basis but to start would meet on a weekly basis.

Mr. Clements suggested that Mr. Rule be assigned as a coordinator and that Rule and VADM Reich meet with Mr. Clements on a daily basis to keep him abreast of progress and problems. He stated that Rule can help and can make a significant contribution. After some discussion it was agreed that Mr. Rule would be assigned to work on the CGN–41 contract dispute on a full-time basis and that ADMs Lascara and Reich would meet with Mr. Clements every day at 0915 to report progress. ADM Michaelis indicated that he has been devoting about 90% of his time to this problem.

Mr. Clements advised Mr. Wiley and Mr. Shrontz to continue to monitor the situation and to make any suggestions they might have or develop. He expects them to be his special advisors when specific issues arise that cannot be resolved with the present organization.

Before the meeting concluded, ADM Michaelis stated that he wanted to advise Mr. Clements that they have been working diligently on the overall problem and as a matter of showing progress he would like to report that the Navy made a final settlement offer to Newport News last week on the CGN 36–37 claim.

ELI T. REICH,
Vice Admiral, USN (Ret.).

Attachment.

ATTENDEES AT MEETING IN MR. CLEMENTS' OFFICE ON 13 JULY 1976 AT 1700

Mr. W. P. Clements, DepSecDef.
RADM Kenneth Carr, Mil. Asst. to DepSecDef.
Mr. Jack Bowers, ASN (I&L).
ADM Frederick Michaelis, CNM.
VADM Vincent Lascara, DCNM.
E. Grey Lewis, Navy, GC.
Frank Shrontz, ASD (I&L).

Richard Wiley, OSD, GC.
Tod Hullin, Prin. Dep. ASD (PA).
Gordon Rule, Off NavMat.
RADM Francis Manganaro, Chmn. Sp. Claims Board.
VADM Eli T. Reich (Ret.), Consulant to DepSecDef.
C. A. Buehrle, Consultant to DepSecDef.

ITEM 11.— *July 16, 1976—Memorandum from Assistant Secretary of the Navy Bowers to the Chief of Naval Material assigning Mr. Gordon Rule as primary negotiator with Newport News for the CGN 41*

THE ASSISTANT SECRETARY OF THE NAVY,
Washington, D.C., July 16, 1976.

Subject: CGN–41 Negotiations with Newport News Shipbuilding & Dry Dock Company.

As a result of discussions with the Justice Department and further consideration of means by which subject negotiations can be brought to an early conclusion, the Navy will continue direct discussions with Newport News.

Supplementing my memorandum of 12 July 1976 on the same subject, the Office of the Chief of Naval Material will be responsible for these discussions and Mr. Gordon Rule is hereby assigned as primary negotiator with Newport News for the CGN–41. He will be assisted by the Naval Sea Systems Command and the Navy General Counsel as required.

JACK L. BOWERS,
Assistant Secretary of the Navy
(Installations & Logistics).

ITEM 12.— *July 16, 1976—Memorandum from Gordon W. Rule to Deputy Secretary of Defense Clements reporting the results of his first meeting with Newport News the day before*

UNITED STATES GOVERNMENT
July 16, 1976.

To: Mr. W. P. Clements, Jr., VADM V. A. Lascara.
From: Gordon W. Rule.
Subject: Visit to Newport News Shipbuilding and Dry Dock Company, 15 July 1976.

1. I spent the day in conference with Mr. Diesel, President, Mr. Dart, Senior President, and General Counsel Ewell.

2. The purpose of my visit was (i) to commence negotiations for a mutually agreeable settlement of the differences surrounding the building of the DLGN–41 and (ii) to restore a climate of good faith and fairness to the settlement of this problem.

3. I am proceeding on the premise that the Navy wants the DLGN–41 and Newport News wants to build the DLGN–41.

4. The time was spent reading documents and talking about the circumstances and negotiations concerning the DLGN 38–39–40 contract and 41 option. I asked for certain information to be prepared.

5. I am satisfied with the first day's activity.

6. My failure to contact the SUPSHIP was not accidental.

GORDON W. RULE,
Director, Procurement Control
and Clearance Division.

ITEM 13.—*July 19, 1976—Memorandum from Gordon W. Rule to Deputy Commander for Contracts, SEA 02, requesting, within 48 hours, a brief description of what the Navy considers the CGN 41 issues requiring negotiation*

To: Deputy Commander for Contracts SEA–02.
From: Gordon W. Rule, MAT 022.
Subject: DLGN–41—Request for Information Concerning.

1. I need certain information from your NAVSEA 02 files for my negotiations with Newport News to build subject ship and I need it within 48 hours if I am to carry out my terms of reference and conduct negotiations ASAP.

2. I request (i) a brief description of what the Navy considers the issues requiring negotiation to be—one word, such as "escalation" or "delivery dates" will suffice, and (ii) a capsule statement of the Navy negotiation position that has been made known to Newport News concerning each separate issue, arranged as follows:

Issue and Navy Negotiation Position

1.
2.
3.
Etc.

3. I do not want a dissertation of reasons, justification, arguments, etc. for negotiation positions. At this time I want to get a very clear picture of how far apart—or how close—the Navy and Newport News are. Moreover, I want to be able to distinguish between issues of substance and others.

4. Your cooperation will be appreciated.

5. In the near future, I am going to require the assistance of one of your best negotiators from SEA 022 with knowledge of the subject matter.

GORDON W. RULE,
Director, Procurement Control and Clearance Division.

ITEM 14.—*July 20, 1976—Letter from Gordon W. Rule to President of Newport News J. P. Diesel thanking him for the frank and helpful discussions in their meeting on 16 July 1976*

DEPARTMENT OF THE NAVY,
HEADQUARTERS NAVAL MATERIAL COMMAND,
Washington, D.C., July 20, 1976.

Mr. J. P. DIESEL,
President, Newport News Shipbuilding,
Newport News, Va.

DEAR MR. DIESEL: I want to thank you for the frank and helpful discussions with you and Messrs. Dart and Ewell last Thursday at your office. When grown men will sit down together and talk over the pros and cons of a mutual problem—in this case, your building the DLGN–41 for the Navy—with respect for each other's views and opinions, as we did, there is not just hope, there is every reason to believe that our differences can and will be resolved satisfactorily.

I also wish to thank you for your letter to the District Court dated 16 July 1976 asking the Court to stay action on your 13 July 1976 petition because of some evidence of good faith negotiations as a result of action taken by Mr. Clements.

You and I know that all the good faith negotiations in the world cannot guarantee a mutually agreeable settlement. But I am sanguine that such negotiations, to which I am committed—and understand—are far more likely of success than the presently existing adversary attitude on the part of certain Navy representatives.

I look forward to receiving the requested data which I am informed will be delivered Wednesday of this week. You will hear from me as soon as I have digested that information and worked out a plan for proceeding.

Sincerely,

GORDON W. RULE,
Director, Procurement Control and Clearance Division.

ITEM 15.—*July 20, 1976—Newport News Times Herald article entitled "Navy Names Rule Yard Negotiator"*

(By Stu Henigson)

The Navy today announced the appointment of its chief civilian procurement officer to negotiate directly with Newport News Shipbuilding over the disputed contract for the cruiser CGN41.

Navy officials reported there has already been progress in the negotiations after a pair of meetings between the procurement officer, Gordon Rule, and Charles Dart, shipyard vice president for marketing, following 18 months of fruitless talks on the cruiser's contract.

Rule is a strong advocate of quickly resolving Newport News' $894 million in backlogged contract claims against the Navy, and his appointment last week as the new Navy negotiator in the cruiser dispute is seen as a good sign by the shipyard.

"We view the appointment of a new negotiator as a hopeful positive step towards timely and equitable resolution of the long standing problems associated with the CGN41," said a yard spokesman today in response to the announcement.

The yard has already asked that its week-old request to a U.S. District Judge to be permitted to stop work on the cruiser be held in abeyance on the basis of the progress evidenced in a preliminary meeting with Rule.

"On the basis of preliminary discussions we held with Mr. Rule," the spokesman said, "our legal counsel * * * requested our motion be held in abeyance until further notice."

The shipyard said the contract claims are not being discussed in Rule's negotiations.

The option for CGN41 was part of the contract for the Virginia-class nuclear powered cruisers, CGN38–40.

But when the Navy attempted to exercise the option in January 1975, at a price and delivery date previously agreed upon, the yard declared the option invalid because the price was too low and the delivery date was too soon.

Work continued under an agreement to negotiate a resolution to the issues. When negotiations broke down, the yard stopped work on the ship in August 1975, pushing the matter into U.S. District Court.

Work resumed two days later under a court order, after the Navy and the shipyard again agreed to negotiate a final contract.

But the yard now maintained the Navy did not negotiate in good faith, and returned to court to ask to be permitted to stop work on the ship in an effort to force what it considers serious negotiations. The yard has blamed Adm. H. G. Rickover, head of the Navy's nuclear propulsion program, for the failure of the CGN41 talks.

In a letter to the Navy last month Dart charged Rickover's office, "the dominant force in the Navy," with overriding Rickover's superiors in fighting any settlement of the CGN41 dispute.

Rule, who is a outspoken critic of Rickover, is the fourth negotiator on the CGN41 contract.

ITEM 16.—*July 21, 1976—Newport News Daily Press article "Shipyard Asks Court Not to Act on Stoppage Bid"*

Newport News Shipbuilding has asked Federal District Court to hold in abeyance a motion it made a week ago to be allowed to stop work on the guided missile cruiser CGN–41.

The shipyard's request comes after the appointment of the Navy's chief civilian procurement officer, Gordon Rule, to negotiate directly with the yard over the disputed cruiser.

Rule has been a strong supporter of settling $894 million worth of claims filed against the Navy by the shipyard.

Both the shipyard's request and Rule's appointment came July 16.

"We view the appointment of a new negotiator as a hopeful, positive step towards timely and equitable resolution of the long standing problems associated with the CGN–41," a yard spokesman said Tuesday.

"On the basis of preliminary discussions we held with Mr. Rule," the spokesman continued, "our legal counsel * * * requested our motion be held in abeyance until further notice."

The conflict over the cruiser began in January, 1975, when the Navy exercised an option to build the nuclear powered cruiser. The shipyard balked, saying not enough money was available and the delivery date was too soon.

The yard attempted to stop work on the cruiser in August, 1975. However the Navy obtained a court injunction against the stoppage.

ITEM 17.—*Aug. 20, 1976—Gordon W. Rule's prepared statement for the comment of CGN 41 negotiations*

STATEMENT BY GORDON W. RULE, ON 20 AUGUST 1976, AT THE COMMENCEMENT OF NEGOTIATIONS WITH NEWPORT NEWS TO REACH AGREEMENT FOR THE BUILDING OF THE CGN–41

Thank you gentlemen for coming to Washington to open negotiations for the building of the CGN–41.

I would like to make very clear that Messrs. Burdick, Chapin and Lee here with me share my views on what the term "negotiation" means.

The record of this CGN–41 controversy is replete with allegations that the Navy has not engaged in good faith negotiations.

You have my word that as long as I have anything to say about or do about these negotiations, you will never have cause to say that again.

Although it is possible we may fail to reach agreement it will not be because of any lack of good faith effort on our part.

I desire to make a very important and appropriate comparison. Rear Admiral Woodfin, retired—who incidently had a great deal to do with this unenviable CGN–41 history, when he was SEA–02—had the following to say in testimony before Senator Proxmire on 25 June 1976:

"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.*"

The dictionary defines "adversary" as opponent, enemy, etc. The Admiral was never more wrong in his life, but knowing his background, I am sure he meant just what he said. *And therein lies the key to the cause of why every nuclear shipbuilding contract in existence today has or will have a claim filed against it.*

That attitude towards the negotiation of shipbuilding contracts is the finest "cause and effect" any claim could be bottomed on.

Let me contrast the Admiral's concept of negotiations with mine. In 1962 I wrote a book entitled "The Art of Negotiations" in which I wrote in Chapter II entitled "What is Negotiation" the following:

"Negotiation is a peaceable procedure for reconciling, and/or compromising known differences. It is the antithesis of force and violence. A negotiation will be fruitful or completely meaningless, depending upon the existence of two essential elements. There are other less important elements but two are absolutely essential.

"These two elements are good faith and flexibility. Both must be present on both sides of the table—one without the other on either side is a fatal defect.

"Obviously, differences of opinion or disagreement must exist or there would be no need for a negotiation in the first place. In this situation the parties have concluded that they should try and act as grown and mature men and attempt to settle their differences amicably through negotiation.

"Good faith and flexibility cover many facets. By good faith is meant an honest desire to reach agreement on the differences which exist through compromise and a realization that the agreement thus reached should be fair and reasonable for both sides, if the agreement is to endure.

"*A negotiation must not be viewed as an adversary proceeding, such as a case in court, where one party wins and the other loses.*

"If one party at the table is trying to take an unfair advantage of the other party, the element of good faith is not present, hence you have no real negotiation."

* * * * * * *

"The second essential element of flexibility is the heart of a negotiation."

* * * * * * *

"If a negotiator is unable to obtain any concessions whatsoever from the tabled positions, then either the element of flexibility is missing or the negotiator is inept, in which event you find yourself with no negotiation at all."

* * * * * * *

"The proof of good faith and flexibility are established at the negotiating table, not by self-serving statements or protestations, either before or during the negotiations. A good negotiator knows that only by tangible manifestations can these elements be shown to exist."

For our part here today, we feel that good faith and flexibility are present on both sides of the table and therefore we are sanguine concerning the results of this negotiation.

I promise you one thing—if we do reach agreement by negotiation of the conditions and terms of how the CGN–41 will be built—those terms and conditions will be patently fair to both the Navy and Newport News.

So saying, let us negotiate, gentlemen.

ITEM 18.—*Aug. 24, 1976—Letter from Senator Proxmire to Attorney General Levi expressing concern that in attempting to resolve the CGN 41 dispute quickly precedents might be set which could compromise the Government's ability to enforce contracts and requesting that the Attorney General review any settlement offer to insure that it is on sound legal ground and in the public interest before the Government becomes party to it*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., August 24, 1976.

HON. EDWARD LEVI,
Attorney General, Department of Justice,
Washington, D.C.

DEAR MR. LEVI: In my letter of July 29, 1976, I requested that your Department investigate the possibility of fraud in connection with shipbuilding claims submitted by the Newport News Shipbuilding and Dry Dock Company, a subsidiary of Tenneco. I understand your Department is also litigating a case in which Newport News has refused to honor a Navy contract for construction of the nuclear-powered guided-missile cruiser, CGN–41.

A recent news article quoted the Deputy Secretary of Defense, William P. Clements, as stating that he expected to resolve the CGN–41 issue by September 1. I am concerned that in the process of the Department of Defense attempting to resolve the CGN–41 dispute quickly, precedents might be set which could compromise the Government's ability to enforce contracts. I am also concerned that efforts may be underway within the Navy to settle the CGN–41 dispute without the full knowledge or participation of the Justice Department.

During testimony before the Joint Economic Committee, it was obvious that there is a considerable amount of misinformation being put forth by senior defense officials with regard to shipbuilding claims in general and the CGN–41 in particular. In short, the testimony of senior defense officials, who were advocating congressional approval for a quick settlement with Newport News beyond the terms of the contracts, was at odds with the testimony of expert Navy witnesses who were directly involved with the contracts in question. In this regard, I thought you should be aware of a July 27, 1976 letter I received from Rear Admiral S. J. Evans, former Deputy Chief of Naval Material for Procurement and Production. Attached is a copy of his letter.

Admiral Evans was among the Navy experts who testified at the June 25, 1976 Joint Economic Committee hearings. At my request, Admiral Evans has also reviewed and commented on the testimony given by Deputy Secretary of Defense Clements at these same hearings. Admiral Evans is uniquely qualified to speak on matters concerning the CGN–41 dispute as he was assigned in October, 1975 as the Navy's Chief Negotiator for the CGN–41 dispute. He is intimately familiar with the case.

According to Admiral Evans, the CGN–41 option was not unfair as the shipyard has contended. He contends that the escalation provisions which Newport

News and senior defense officials had termed "inequitable" are in fact fair and reasonable, providing ample protection against the effects of inflation as long as the contractor meets contract schedules. He pointed out that the CGN–41 escalation provisions were even more liberal than those used in the past.

Although the Navy has established a special claims board to handle the Newport News shipbuilding claims, the CGN–41 dispute was not included among the matters referred to the board. Instead, the Navy assigned Mr. Gordon W. Rule as Chief Negotiator for CGN–41 to again pursue a negotiated settlement with the company. As you may have read in the press or elsewhere, Mr. Rule has not been exactly impartial in his views regarding the shipbuilding claims problem in general. Mr. Rule has laid responsibility for the Newport News shipbuilding claims problems directly on the Navy and has advocated settlement of claims independent of contractual merits. My specific concern, therefore, is that a man who holds such views might agree to a settlement with Newport News on the CGN–41 case that would undermine the Government's ability to enforce contracts. During the June 25th hearings, both Rear Admiral S. J. Evans and Rear Admiral K. L. Woodfin refuted allegations regarding alleged inequities and unfairness in Navy shipbuilding contracts. As the top military procurement officials in the Navy, both men speak from experience and expertise. For your information I have enclosed Admiral Woodfin's prepared statement to the Joint Economic Committee.

I understand that the Department of Justice has sole responsibility within the Government for approving out-of-court settlements involving Government matters under litigation. I assume that the Justice Department will review any such settlements proposed by the Navy in the CGN–41 case. However, in view of the importance of the CGN–41 case to the overall shipbuilding claims problem, I request that you direct the Navy to keep you fully informed of any negotiations and that you review any settlement offer to ensure that it is on sound legal ground and in the public interest before the Government becomes a party to it.

It is apparent to me that there are officials in the Defense Department who would sacrifice the public interest by turning over to the shipbuilders sums of money far in excess of the amounts agreed to in the contracts. This can be accomplished in the CGN–41 case by simply rewriting the contract in a way advantageous to the shipbuilder.

The testimony before my Subcommittee shows that the CGN–41 contract is fair and equitable. Revising any of its terms in a way that would increase the costs, without sufficient consideration would therefore amount to a bailout and a giveaway of taxpayers' money. I am confident the Justice Department would not want to participate in any such action.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 19.—*Aug. 24, 1976—Admiral Rickover Memorandum for the Chief of Naval Material reporting rumors of a CGN 41 agreement between Mr. Rule and company representatives on terms that Admiral Rickover considered to be unfavorable to the Navy*

DEPARTMENT OF THE NAVY,
NAVAL SEA SYSTEMS COMMAND,
Washington, D.C., August 24, 1976.

Subject: CGN–41 Option Negotiations with Newport News.

1. As I stated in my telephone call late yesterday afternoon ,I have been hearing persistent rumors since last Friday that Mr. Gordon W. Rule has made an agreement with officials of Newport News to settle the CGN–41 option dispute. Prior to my call to you, the Commander, Naval Sea Systems Command told me that he had also heard rumors of an agreement but knew nothing more. The terms of the purported "handshake" agreement are so unfavorable to the Navy that I telephoned you to determine whether an agreement had been made. You assured me that no agreement had ben made. In a subsequent telephone conversation, the Vice Chief of Naval Material also confirmed that no CGN–41 settlement has been made.

2. According to the rumors I had heard, in a meeting in Naval Material Command Headquarters on 20 August 1976 with senior Newport News officials, Mr. Rule agreed to settle the CGN–41 option dispute on the following basis:

a. Reform the escalation article now in the contract for CGN–41 to eliminate escalation tables and to substitute the escalation language of the SSN 711–715 contract for the escalation language now in the contract for the CGN–41. The escalation index would be capped at August 1980, but payments would continue until completion of the contract. This contract reformation would have the effect of accepting as government responsibility all delays in the CGN–41 from the present contract delivery date of October 1978 to a date six months beyond the current Newport News scheduled delivery date of February 1980. In this regard it should be borne in mind that the record, as documented in the letter dated 13 May 1976 from the Navy's CGN–41 Negotiator to Newport News, clearly shows that the government is not responsible for the delay of CGN–41 beyond the present contract delivery date of October 1978.

b. Reform the CGN–41 contract to provide for payment outside of the basic contract ceiling price for employee fringe benefits. Since payment for employee fringe benefits is already included in the original contract ceiling price, this contract reformation would seem to give Newport News a windfall.

c. Reform the CGN–41 contract to provide for payment outside the basic contract ceiling price for increased energy costs. Since payment for energy costs is already included in the original contract ceiling price, this contract reformation would also seem to give Newport News a windfall.

d. In return for the contract reformations discussed above, Newport News would give the Navy a claims release on CGN–41 as of the settlement date. Since very little work has been done on the CGN–41 by Newport News to date, the value to the government of such a claims release is negligible.

3. I appreciate fully the desirability and difficulty of achieving a negotiated settlement of the CGN–41 dispute with Newport News within the contract terms. However, to my knowledge, Newport News has refused to negotiate on this basis.

4. Prior to the appointment of Mr. Rule as the Navy Negotiator, two separate Navy negotiating teams, including technical personnel and counsel, were appointed to negotiate CGN–41 matters with Newport News. These teams explored in depth the numerous allegations made by Newport News as the basis for requesting new contract agreements. They found the Newport News position to be essentially without merit. Navy counsel agreed. The Coomptroller General has also reviewed many of the Newport News allegations and has issued a decision in the Navy's favor. The records of these negotiations and reviews are available.

5. In my opinion, the rumored agreement, if implemented, would show that the Government will not require Newport News to honor its contracts. This precedent would encourage other defense contractors who want to reform their contracts to follow the approach taken by Newport News in this matter. Such a settlement would result in the taxpayers incurring costs which are not their responsibility. To modify the contract without adequate consideration, short of a proper court determination, could compromise the government contract system.

6. In view of the above, I consider that any proposed settlement should be carefully reviewed to ensure that it is consistent with the terms of the CGN–41 contract, unless the provisions of P.L. 85–804 are invoked. Accordingly, I recommend that, prior to approval, any proposed CGN–41 settlement be referred formally to the Naval Sea Systems Command for review and comment by knowledgeable personnel directly responsible for the work in question. In this regard I will be glad to provide assistance based on my own knowledge of the events in question.

H. G. RICKOVER.

ITEM 20.—*Aug. 25, 1976—Newport News Press Release announcing resolution of the CGN 41 dispute on August 20th*

NAVY–NEWPORT NEWS REACH ACCORD ON MISSILE CRUISER

Newport News, Va.—Following is a statement by John P. Diesel, president, chairman of the board and chief executive officer, Newport News Shipbuilding:

Newport News Shipbuilding and the U.S. Navy have negotiated an acceptable resolution of their dispute concerning the nuclear-powered guided missile cruiser CGN–41. The agreement was reached on August 20 as a result of good faith

negotiations conducted pursuant to the order of the U.S. District Court. The parties have agreed to sign a definitive contractual document embodying the negotiated agreement for the construction of CGN–41. We are now required by the Court to present to the judge for his signature an order concluding this litigation. The settlement document along with such an order will be presented to the Court in the near future.

While this amicable settlement disposes of one matter at issue between the Company and the Navy, there are still outstanding many other issues which should be resolved—and, from the Company's point of view, can be resolved—in a similar manner without resort to litigation. Thus, a great deal still needs to be done before the relationship between the Company and the Navy can return to a reasonable and normal business basis.

ITEM 21.—*Aug. 26, 1976—Newport News Times Herald article "Proxmire Asks Review"*

(By Stu Henigson)

Sen. William Proxmire, D.-Wis., has asked the U.S. attorney general to review the Navy's contract with Newport News Shipbuilding for the construction of the nuclear-powered, guided missile cruiser CGN–41.

The contract agreement, announced Wednesday by the shipyard, ended a dispute that dates to 1974 over the price and delivery date in the contract option for the ship.

The original contract option was "fair and equitable" Proxmire said, according to testimony of Navy witnesses before his subcommittee of the Joint Economic Committee last June.

"Revising any of its terms in a way that would increase its costs, without sufficient consideration, would therefore amount to a bailout and a giveaway of taxpayers' money," Proxmire wrote to Levi.

He asked the Justice Department to "review any settlement offer to ensure that it is on sound legal ground and in the public interest before the government becomes a party to it."

The Justice Department already is acting on an earlier Proxmire request for an evaluation of the shipyard's claims for possible fraud.

The terms of the cruiser agreement, which the yard termed an "acceptable resolution" to the dispute, have not been revealed. Proxmire sent his letter Tuesday, before the agreement had been announced.

Though the yard had agreed to the price and delivery date in the option, it later declared the option "invalid" because changing economic conditions made it "commercially impossible" to build the ship under those terms.

The dispute reached the courts a year ago when the yard stopped work on the vessel.

The Navy got an injunction ordering work to resume, with the stipulation the Navy negotiate its differences with the yard.

But negotiations remained at an impasse until the appointment last month of Gordon Rule, the Navy's top civilian procurement officers, to head the talks.

Proxmire charged Rule with blaming the Navy for the cost over-runs that have generated $894 million in contract claims by Newport News.

"My specific concern, therefore, is that a man who holds such views might agree to a settlement with Newport News on the CGN–41 case that would undermine the government's ability to enforce contracts," Proxmire wrote.

Rule has been sharply critical of Proxmire and Adm. H.G. Rickover for alleged efforts to block a just settlement with the yard for the contract claims.

The yard had blamed Rickover, head of the Navy's nuclear propulsion program, for stymying the CGN–41 negotiations prior to Rule's appointment.

Though "officially" appointed by the Navy, Rule was assigned to the shipyard case at the direction of Deputy Defense Sec. William Clements over the objection of some top uniformed Navy officials, according to Washington sources.

Clements also has stressed the importance of reaching a quick settlement of the $1.9 billion in outstanding contract claims against the Navy.

He predicted the CGN–41 contract and the contract for the aircraft carrier USS Vinson (CVN–70) would be finalized and a preliminary agreement reached on one $80-million shipyard claim by Sept. 1.

ITEM 22.—*Aug. 26, 1976—Memorandum from Deputy Secretary of Defense Clements to Adm. James L. Holloway, Chief of Naval Operations, instructing him to look into the "flap" caused by Admiral Rickover's August 24 memorandum and let Mr. Clements know "what action is indicated." The Deputy Secretary's memorandum stated that the Rickover memorandum was "destructive criticism," and "counter productive"*

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C., August 26, 1967.

Subject: Admiral Rickover's Memo of 24 August 1976 Concerning the CGN–41 Negotiations with Newport News.

On 13 February 1976, I met with you, Under Secretary Potter, Assistant Secretary Bowers and Admiral Michaelis to inform you of my considered view of the unsatisfactory status of the management of the Navy's shipbuilding program. At that meeting I declared that if we believe it is necessary to build up the Navy (and a large naval shipbuilding program for the next 5–8 years is essential to do so) the present situation re the relationship of the Navy to the shipbuilding industry is intolerable. I said that this problem is the single most important problem facing the Navy leadership—both civilian and military.

You will recall that in late March following that meeting and subsequent discussions with the Navy leadership that I approved and took the lead in proposing to the Congress a plan to take action under P.L. 85–804 to bring about an early resolution of this serious problem. As you know, this effort was unsuccessful and in withdrawing my proposal I informed the Congress on 9 June that I would continue my close surveillance of this problem and would examine what other steps including contractual action might be appropriate. I assured the Congress that the Navy would proceed expeditiously to process the shipbuilders' claims in hand.

On 29 June I met with you and Adm Rickover and again discussed the seriousness of the Navy's shipbuilding problem and the need for the Navy to give the highest priority towards its resolution. We discussed the concept of establishing a three man Navy claims negotiating team fully authorized and responsible to resolve the claims on an accelerated basis and all agreed that this should be done. It was emphasized that the efforts of this team would not be preempted by actions, discussions, appeals or decisions by other sources within the Navy or the OSD. Further, it was and is my clear understanding that both you and Admiral Michaelis, in early July, advised Admiral Rickover of the nature of the Navy's plan to resolve the many issues at Newport News and requested his cooperation in support of this plan. You assured me you received Admiral Rickover's full support.

On 2 July and on 13 July I met with Mr. Bowers, Admiral Michaelis, and other senior Navy officials to be informed of the Navy's plans and progress towards resolving the several problems with the major shipbuilders with special emphasis on those with the Newport News Shipbuilding and Dry Dock Company and the Litton Corporation. At the 13 July meeting it was determined that Mr. Gordon Rule would be assigned to negotiate the CGN–41 contract dispute and that he would report directly to the Chief, NavMat, in this assignment. I have been kept informed of Mr. Rule's progress since that time by VAdm Lascara, Deputy Chief, NavMat.

I have recited all the foregoing so that you will understand my disappointment when I read Admiral Rickover's memo of 24 August. This memo constitutes destructive criticism by an officer of the Navy of highest rank who has no contractual responsibility in the matter. The memo is counter productive and implies bad faith on the part of the Navy and its designated representative by suggesting that Mr. Rule's performance and knowledge as the Navy's negotiator on the CGN–41 matter has been highly suspect and not in the interest of the Government.

I am thoroughly conversant with Admiral Rickover's background and abilities and also his great contributions to the Navy in the field of nuclear propulsion. I feel sure that Admiral Rickover has ready access to you, and he knows he can contact me any time. In this instance he has chosen to make formal and wide distribution of his opinions without giving you or me an opportunity to receive his advice or counsel whch I consider to be a breach of his agreement with us. Certainly his gratuitous memo violates the spirit of his commitment to respond only as requested. Will you please look into this "flap" and let me know what you find and what action might be indicated.

W. P. CLEMENTS, Jr.

ITEM 23.—*Sept. 12, 1976—Washington Star article "Did the Navy Bow to Shipbuilders in Contract Dispute?"*

DID THE NAVY BOW TO SHIPBUILDER IN CONTRACT DISPUTE?

(By Vernon A. Guldry, Jr.)

A controversial agreement for construction of a nuclear powered cruiser has inflamed an already smoldering internal Pentagon fight over Navy shipbuilding.

The immediate issue is construction of the cruiser designated CGN41 by the Newport News Shipbuilding & Dry Dock Co. The Navy has acknowledged that a settlement in principle has been reached but the details still are officially under wraps.

Reports of those details, however, have been enough to prompt severe reaction. One of those reactions has come from no less a figure than Adm. Hyman Rickover. According to sources, Rickover wrote his superiors late last month in slashing terms.

If true, sources quoted Rickover as saying, the new terms could mean a windfall for the shipbuilder, charges to the taxpayer that are not justified, and ultimately perhaps the compromise of the government contracting system.

Opponents of the Rickover viewpoint charged that he doesn't want the settlement, and they say that some way must be found to pull the Navy from the bog of acrimony, claims and charges into which its shipbuilding program has fallen.

Negotiators for the Navy, headed by Gordon W. Rule, and those for Newport News Shipbuilding, reached agreement Aug. 20. Before those talks, he top price to be paid for the cruiser was $100.9 million. Critics estimate that tens of millions could be added if the reported settlement details are finally accepted.

The CGN41 is one of a series of similar craft. After building the earlier ships of the class, the Navy exercised its option for the CGN41. And therein lies the heart of the dispute. The Navy has until now maintained that it has a firm option on the CGN41 that left little of consequence to be negotiated. Newport News Shipbuilding has maintained that the option left large questions to be negotiated.

In August 1975 the issue came to a head and Newport News Shipbuilding stopped work on the ship. The Navy went to court and won an order directing the shipyard to continue construction while negotiations with the Navy went on.

This dispute over shipbuilding involves a clash of personalities as well as viewpoints. That surfaced in June and hearings before the Joint Subcommittee on Priorities and Economy in Government headed by Sen. William Proxmire, D-Wis. The protagonists were Rickover and Deputy Defense Secretary William D. Clements.

Rickover was severely critical of Newport News Shipbuilding and large private shipyards in general. Clements, on the other hand, made it clear that he was determined to be accomodating to the shipyards.

Clements was particularly upset over Rickover's sharp language, maintaining "that kind of acrimonious atmosphere is the very, very gut issue of what is happening here."

Clements told Proxmire that if claims and disputes with shipyards are allowed to take their normal, lengthy administrative and judicial routes, "I want you to know right now, in my judgment * * * it is going to be more costly in the long run to us than reforming the contracts."

Clements said the largest part of the Navy's problems could be solved by reforming or rewriting the clauses in contracts which provide for additional money to cover inflation could have hit shipbuilding particularly hard.

It is against this backdrop that Rule was named the new negotiator on the issue in July. Two previous Navy negotiators had tried and failed because of what the Navy characterized as a failure by Newport News Shipbuilding to negotiate. The Navy negotiator immediately before Rule was a rear admiral, now retired, named S.J. Evans.

Evans now takes sharp exception to Clements' claims in regard to Newport News Shipbuilding. Clements has called the contract inequitable and has maintained that the option for the CGN41 "had to be renegotiated as to price and then-existing conditions. * * *"

Evans and Navy men before and since disagree and point out that Clements was giving aid and comfort to Newport News Shipbuilding which is in court against the Navy on this very point.

After the congressional hearing, Evans wrote Proxmire a letter in which he said the option was fair and equitable and "the only items open to negotiation under the terms of the option are a downward revision in the price, the specific escalation (inflation) tables to be used * * * and some minor administrative provisions * * *"

This was the background against which word filtered out on the details of the Aug. 20 settlement negotiated by Rule in Newport News.

Rickover's memorandum to the Chief of Naval Material came on Aug. 24. "In my opinion, the rumored agreement, if implemented, would show that the government would not require Newport News to honor its contracts. This precedent would encourage other defense contractors who want to reform their contracts to follow the approach taken by Newport News in this matter." Rickover wrote.

"Such a settlement would result in the taxpayers incurring costs which are not their responsibility. To modify the contract without adequate consideration, short of a proper court determination, could compromise the government contract system," according to Rickover's memorandum.

Chief among the reported details of the settlement are changes in the provisions to allow more money for inflation—the area targeted by Clements for Navy concessions. The original delivery date for the CGN41 was October 1978. Under the terms of the existing contract the inflation payments stop if the builder doesn't deliver the ship when it's due.

According to reports, the inflation payments for the CGN41 will be continued at least until August 1980.

Another reported change will provide for payments for employe fringe benefits outside the ceiling price determined for the ship. "This contract reformation would seem to give Newport News a windfall," Rickover is said to have written in one of his memoranda, some of which received wide distribution.

These criticisms by Rickover had been greeted in the harshest terms by Rule, the man who negotiated the settlement in principle.

Rule believes that Clements has hit on the only way out of the shipbuilding mess. "We aren't going to build the ships the Navy needs in court." Rule said in a telephone interview. "We've got to get out of the court and get squared away so we can build ships."

ITEM 24.—*Sept. 14, 1976—Jack Anderson and Les Whitten article entitled "Clements Moves for Ship Sattlement"*

Shouting profanities, Deputy Defense Secretary William P. Clements Jr. browbeat the highest naval procurement officials this summer into supporting the disputed claim of a gigantic oil conglomerate.

His voluble assault on the officials took place behind closed Pentagon doors. He never expected the public to find out about it. We have obtained a copy, however, of the detailed, confidential minutes.

Clements accused an assistant Navy secretary and an admiral of dragging their feet on a deal, that could cost the taxpayers as much as $1 billion. "Why in the hell haven't you done it?" he demanded.

Clements took the side of the Newport News Shipbuilding Co. against Navy lawyers. The company is a subsidiary of the huge Tenneco oil and gas combine. It may be a coincidence that Clements made his fortune in the oil industry.

The Tenneco subsidiary has been building cruisers, carriers and nuclear submarines for the Navy. The company claims the Navy owes it almost $900 million for construction changes and other cost escalations. A Tenneco settlement could set a precedent for payouts to other companies. The claims total $1.8 billion.

In an hour-long talk with us, Clements denied his past oil industry ties had anything to do with his pressure for a settlement. "Absolutely not. Hell no!" he spluttered. His only interest, he said, was in getting Navy ships built.

However, the confidential minutes show that he tried to rush through a settlement on terms favorable to Tenneco. He summoned a dozen admirals and civilian officials into his office on July 13. With fiscal abandon, he opened up on Adm. Hyman G. Rickover, who has tried to hold shipyards to their contracts without excessive cost adjustments.

Then Clements confided that had met with the Newport News company's president, John Diesel. They discussed a settlement, which happens to be the subject of a legal battle between the company and the Navy. Yet the Navy and Justice Department lawyers responsible for the litigation weren't invited to the tete-a-tete.

Glaring at the procurement people in his office, Clements declared: "Diesel wants to settle the overall problems he has with the Navy and get on with the business of building ships." As a first step, Clements directed that "a provisional payment can be made" to Tenneco on a submarine claim.

If the Navy refused to settle the claims, he warned, he would do it. He cited as a precedent the Pentagon's celebrated multimillion dollar bailout of Lockheed.

Assistant Navy Secretary Jack L. Bowers and Adm. Frederick Michaelis appeared to be cowed by Clements. "We are going to do it," they told him, meaning they would begin payments to Tenneco.

"Why in the hell haven't you done it?" growled Clements.

Michaelis responded, "I don't think we will ever get them done as fast as Diesel wants."

Bowers volunteered that he had spoken to Diesel on the telephone. Phone conversations, grumped Clements, weren't enough. "You have to talk with him directly—eyeball to eyeball," he said.

He invoked the names of Senate Armed Services Chairman John C. Stennis (D-Miss.), and House Armed Services Chairman Melvin Price (D-Ill.) "They have lost absolute confidence in what the Navy is doing, and they are not going to approve any Navy new shipbuilding programs unless they get this claims mess cleaned up," Clements said.

If the Navy would just move faster to oblige Tenneco, Clements promised, "I'll support you; Stennis will support you; Price will support you. I want you to clean up this mess."

Clements said he was "convinced that Newport News is serious in their threat to stop building ships for the Navy if things do not improve."

At the close of the meeting, the irascible Clements noted almost as an afterthought that he "wants the government's interest fully protected." But he immediately added: "The President and the Congress are losing confidence in the Navy." The minutes summed up Clements' comments tersely: "If the Navy won't settle these claims, he will."

Meanwhile, Sen. William Proxmire (D-Wis.), chairman of the Joint Economy in Government Subcommittee, has asked Attorney General Edward H. Levi to investigate possible fraud in the Tenneco claims.

ITEM 25.—*Sept. 16, 1976—Attorney General Levi letter to Senator Proxmire in response to the Senator's Aug. 24, 1976 letter. The letter states that the Justice Department intends to review any proposal and/or papers before submission to the court and that the Department would request the court to approve any settlement only "if we are satisfied that it is on sound legal ground and in the public interest"*

OFFICE OF THE ATTORNEY GENERAL,
Washington, D.C., September 16,1967.

HON. WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government, Joint Economic Committee, United States Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This responds to your August 24, 1976 letter with regard to litigation involving Newport News Shipbuilding and Drydock Company, and particularly, litigation over the CGN–41. (*United States of America* v. *Newport News Shipbuilding and Drydock Co., and Tenneco, Inc.*, E.D. Va., Civil No. 75–88–NN). Your letter indicates that you assume the Justice Department will review any out-of-court settlement proposed by the Navy in the CGN–41 case. Your letter requests that I direct the Navy to keep me fully informed of any negotiations and that I review any settlement offer to insure that it is on sound legal ground and in the public interest. The Justice Department intends to review any proposal and/or papers before submission to the court. We would request the court to approve any settlement only if we are satisfied that it is on sound legal ground and in the public interest.

Sincerely,

EDWARD H. LEVI,
Attorney General.

ITEM 26.—*Sept. 28, 1976—Letter from Deputy Secretary of Defense Clements to Attorney General Levi commenting on Senator Proxmire's Aug. 24, 1976 letter. Mr. Clements defends Mr. Rule and states "Let me assure you we in the DOD have no intention to bypass or withold from your Department any information which you determine that your Department needs in connection with legal proceedings under the court order"*

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C., September 28, 1976.

HON. EDWARD LEVI,
Attorney General, Department of Justice,
Washington, D.C.

DEAR MR. LEVI: In his letter to you dated 24 August 1976, Senator Proxmire alleges that "there are officials in the Defense Department who would sacrifice the public interest by turning over to the shipbuilders sums of money far in excess of the amounts agreed to in the contracts." He has reference to ongoing negotiations between the Navy and Newport News Shipbuilding and Dry Dock Company with regard to the CGN–41 contract. This is a serious charge which is unfounded in fact and which implies that certain officials in the DoD are irresponsible, if not unfaithful to the public trust. I am doubtful that the Senator himself coined these words, rather they seem to have been inspired by a zealous staffer, and as a consequence I am taking this opportunity to let you know the actions we have taken and are taking as they relate to the matters discussed by Senator Proxmire.

As you know, the shipbuilder (Newport News) took action to stop work on the CGN–41 in August 1975. The Navy immediately sought an injunction in the U.S. District Court for the Eastern District of Virginia. As a result of that legal action, the District Court judge directed Newport News and Navy to continue the CGN–41 construction project on an interim 12 month modus operandi basis wherein the shipbuilder is reimbursed for his costs plus a fee and the parties are directed to conduct good faith negotiations to reach mutual agreement on the CGN–41 contract. Unfortunately, little progress in these negotiations was achieved through June of this year and the parties mutually petitioned for, and the court granted, a 12 month extension of the interim modus operandi basis. In late June, Newport News filed a motion with the court charging that the Navy was not complying with the court's order to negotiate in good faith and asking the court to appoint a master to oversee the negotiations.

In early July discussions with Navy Department officials, I was informed of the Navy's plans for addressing the claims and contract problems with Newport News. As regards the CGN–41 contract, it was a result of my suggestion that Mr. Gordon Rule of the Navy Material Command was assigned as the senior negotiator on a full time basis. Newport News, on learning of this development, expressed its agreement to re-open negotiations and requested the District Court to hold in abeyance Newport News' recent motion. After an extensive investigation and analyses during July and early August, Mr. Rule and his team conducted negotiations with Newport News in August.

On 23 August I was informed that Mr. Rule and the Newport News negotiators had reached agreement in principle. This negotiators' agreement is now under review in the Navy. The Navy General Counsel's office is participating fully in that review. Contingent on the outcome of this review, the Chief of Naval Material will make recommendations to the Secretary of the Navy and to me regarding the implementation of the negotiators' agreement in principle. I have asked the DoD General Counsel to be prepared to advise me on any legal aspects related to these recommendations.

I have reviewed the above events in the CGN–41 matter to emphasize the premature nature of any criticism or suggested action by parties other than those acting under the direction of the District Court of the Eastern District of Virginia.

I think it important that you also have a background as relates to the connection that RADMs K. L. Woodfin and S. J. Evans have with the CGN–41 matter. RADM Woodfin was Deputy Commander for Contracts in the Naval Ship Systems Command from August 1970 to June 1973 and then became Deputy Chief of the Naval Material Command for Procurement and Production from June 1973 to April 1975, when he retired. RADM Evans relieved RADM Woodfin in the Naval Material Command and served until 31 May 1976, when he retired. RADM Woodfin was the senior contracting officer in NavShips when

the CGN 38–40 contract was signed in 1971 with options for the CGN–41 and 42. RADM Evans was assigned as the Navy's senior negotiator with Newport News in November of 1975 to negotiate the CGN–41 contract as directed by the District Court order. While both RADM Woodfin and RADM Evans are experienced Navy supply officers with significant procurement experience, they have not had, however, any official responsibilities or part in the current negotiations.

Senator Proxmire in his letter suggests that Mr. Gordon Rule is not impartial and that he might not act in the Government's interest but would so act as to undermine the Government's ability to enforce contracts. This is a serious charge by the Senator and defames both the character and competence of Mr. Rule. As I have indicated, it was at my suggestion that Mr. Rule was appointed by the Navy as the senior negotiator in the CGN–41 matter. I know Mr. Rule's background and work experience during his years as a Navy procurement official, and I am familiar with his current work as the CGN–41 negotiator. I consider Senator Proxmire's remarks regarding Mr. Rule groundless, ill-tempered and unworthy of a member of the U.S. Senate.

Finally, as you know, we became your client in August of 1975 in connection with the injunctive hearing on the CGN–41 matter in the District Court of Virginia. We fully recognize that our ability to fulfill our obligations under the court order will require the continued cooperation and assistance, which we have received to date, from your department. Let me assure you that we in DoD have no intention to by-pass or withhold from your department any information which you determine that your department needs in connection with legal proceedings under the court order.

W. P. CLEMENTS, Jr.

ITEM 27.—*Oct. 5, 1976—Memorandum from Gordon W. Rule to the Chief of Naval Material requesting approval of his proposed settlement*

DEPARTMENT OF THE NAVY,
HEADQUARTERS NAVAL MATERIAL COMMAND,
Washington, D.C., October 5, 1976.

Subject: CGN–41 Negotiated Settlement.
Reference: (a) NAVMAT 022/GWR 1 Sep 1976 Contracting Officer Memo to CNM. (b) ASN(I&L) Memo of 16 Jul 1976 to CNM.
Enclosed: (1) NAVSEA Memo 01G/GHM Ser 64 of 4 Oct 1976 to MAT 022."
(2) NAVSEA 01G22 Memo Ser 42 of 8 Sep 1976 to MAT 022.[1]

1. The purpose of this memorandum is to forward for your approval the estimated dollar impact of subject negotiated settlement as outlined on pages 11 and 12 of reference (a). (The changes in law clause has been withdrawn by Newport News.)

2. The Navy negotiating team consisted of the following individuals who were enlisted pursuant to the authority of reference (b) :

Gordon W. Rule, Negotiator and Contracting Officer.
R. S. Burdick, Team Member (MAT 0222).
I. Lee, Team Member (NAVSEA 0226).
J. Chapin, Team Member (NAVSEA 01G22).

3. The Navy negotiating team acted pursuant to the Order of the United States District Court as follows:

"The parties agree to negotiate in good faith to reach an agreement as rapidly as possible to modify those contract provisions requiring amendment or to take other appropriate action."

In addition, the Navy negotiating team acted pursuant to the direction of DEPSECDEF as follows:

"Mr. Clements stated he wants to see four changes incorporated in the CGN–41 contract, viz., (1) new escalation clause; (2) a new 'changes' clause; (3) new ceiling price; and (4) new delivery schedule."

4. Since the negotiated settlement of 20 August 1976, it has been necessary to further pursue three areas looking to final action on the settlement:

(i) Confirmation from the Office of General Counsel of the Contracting Officer's professional and personal approval of the adequacy of consideration (equity and litigative risk) for the negotiated settlement. This was undertaken by them on 30 August 1976.

(ii) General agreement by the negotiating team, the DCAA and Newport News of the dollar impact of the negotiated settlement. This has involved

several meetings with the DCAA and the contractor which culminated on 29 September 1976.

(iii) Work on an actual draft modification to be turned over to OGC for final review and approval.

5. At the conclusion of a meeting between the team and DCAA on 29 September 1976, Mr. Chapin was requested by the Contracting Officer to finalize the computer runs estimate contained in his memorandum to MAT 022 dated 8 September 1976 and to let the Contracting Officer see the results in draft form.

6. Mr. Chapin was unable to comply with the request of the Contracting Officer as he had done so effectively since the negotiating team was formed. Rather, a group of individuals from SEA 01, SEA 08, and the Project worked for hours preparing enclosure (1).

7. This enclosure is unsatisfactory to the undersigned Contracting Officer in that (i) it does not show the estimated increase in cost of the negotiated settlement vs. that of the existing contract, (ii) it does not tell the reader that the $90.1 million figure for escalation contains a 10% contingency factor which makes the figure $81.9 million, (iii) it contains many assumptions which are incomprehensible, (iv) it is the product of many views known to be antithetic to the negotiated settlement of the CGN–41, and (v) it provides gratuitous directions to the Contracting Officer which are presumptuous and improper.

8. It is not understood by the undersigned Contracting Officer why, in response to a legitimate request for official estimates from SEA 01G, it is necessary to bring in the Program Manager and Leighton from SEA 08 in order to comply with that request. Their position on the merits of the CGN–41 negotiation are well known and their participation in the reply to my request cannot be construed as necessary or helpful to the assignment I was directed to accomplish.

9. As a Navy procurement official and as the Contracting Officer for the CGN–41 negotiations, I am shocked to see how the very important official estimating function of NAVSEA can be and is compromised by outside influences being permitted to partake in that estimating function, whose views are in opposition to a DOD and/or Navy directed objective.

10. Enclosure (2),[1] uprepared and signed by Mr. J. Chapin of SEA 01G22 for the negotiating team on 8 September 1976, with one update figure, is far more responsive and understandable than enclosure (1) and will be the basis of the Contracting Officer's decision and recommendation for your approval.

11. A change is required to the $188.9M cost of the negotiated settlement shown in enclosure (2) :[1]

(i) An addition of $15.8M to the $66.1M shown for escalation for a total escalation of $81.9M. This $15.8M is made up of $11M escalation for the fringe benefit adjustment to base cost made when computing whether base costs have reached the ceiling limitation for payment of escalation and $4.8M for a different projected expenditure curve.

(ii) Thus, the $188.9M plus the $15.8M equals $204.7M as the estimated cost to build the CGN–41 under the negotiated settlement.

(iii) The $212.9M cost to build the CGN–41 by reason of the negotiated settlement as shown in enclosure (1) is misleading. It should be shown as $204.7M when the ten percent escalation contingency is removed, i.e., $212.9M—$8.2M= $204.7M.

(iv) As stated above, Newport News has withdrawn the changes in law clause which answers paragraph 6 of enclosure (2).[1]

(v) The Newport News estimated cost at completion is $203.7M vs. the $204.7M Government estimate.

(vi) Page 2 of enclosure (2) [1] shows the SEA 01G22 estimate of cost under the existing contract as $170.8M and the difference between that estimate and the $204.7M is $33.9M as the estimated cost of the negotiated settlement.

12. The ceiling of $100.9M while not negotiated upward, will naturally be adjusted for changes and also by energy payments which may amount to five, six or seven million dollars.

13. Your concurrence in the negotiated settlement is requested. All that remains is the final approval of the mod itself and the concurrence by Counsel in my decision as Contracting Officer that adequate legal grounds for the mod exist either in equity or litigative risk, i.e., consideration.

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[1] May be found in Navy Department files.

14. It is my professional and also my personal opinion as Contracting Officer with unlimited authority to negotiate a settlement of the CGN–41 matter, that the United States District Court in Norfolk, Virginia, sitting as a Court in Equity, will not require Newport News to build the CGN–41 under the terms and conditions of the existing contract.

15. Similarly, it is my opinion that any order of the Court other than the negotiated settlement, will cost the Navy an amount equal to or in excess of the estimated $34M cost of the settlement negotiated on 20 August 1976.

GORDON W. RULE,
Negotiator and Contracting Officer.

ITEM 28.—*Oct. 7, 1976—General description of events leading to and including the period Oct. 7, 1976–Oct. 8, 1976 excerpted from the Justice Department's Brief of Nov. 8, 1976 (For the full transcript, see Miscellaneous documents appendix)*

From the time of his appointment until August 19, 1976, Mr. Rule advised his superior, Admiral Lascara, that he was securing information from both Navy and Newport News officials in an effort to prepare himself for the negotiations. During this period, Admiral Lascara cautioned Mr. Rule on at least one occasion that any agreement he might negotiate would require review and approval of higher authority. Lascara Affidavit, ¶ 7.

On August 19, 1976, Captain Gerald J. Thompson issued a Certificate of Appointment to Mr. Rule as a contracting officer for the purpose of formally vesting in him authority to negotiate with Newport News on the DLGN–41 controversy. The form Certificate limited the appointment by making it: "subject to the limitations contained in the Armed Services Procurement Regulation and to any further limitations set forth" in the Certificate itself. Mr. Rule's warrant also stated that he had: "Unlimited authority with respect to *negotiations* with Newport News Shipbuilding and Dry Dock Company for construction of CGN–41 under Contract N00024–70–C–0252." (Emphasis added.) Captain Thompson employed the language "Unlimited authority with respect to *negotiations* * * *" (emphasis added) for the express purpose of showing, on the face of the Certificate, that Mr. Rule's authority was to conduct negotiations only. Affidavit of Capitain Gerald J. Thompson, ¶¶ 5, 6, 7, dated November, 1976 (hereinafter "Thompson Affidavit").

On August 20, 1976, Mr. Rule met in Washington with representatives of Newport News to commence negotiations with respect to the DLGN–41. Affidavit of Charles E. Dart, dated October, 1976, ¶ 29(a), filed by defendants [hereinafter "Dart October Affidavit,"]; Transcript of Deposition of Mr. Gordon W. Rule, p. 83.[1] A preliminary oral agreement in principle was negotiated between Mr. Rule and Newport News on a number of items which were specifically established by the prior written Contract N00024–70–C–0252, as modified, for the construction of the DLGN–41. For example, Mr. Rule tentatively agreed, among other matters, to a later delivery date for the DLGN–41 and an escalation clause which was more favorable to Newport News. Tr. Rule Dep., p. 88. At the conclusion of the meeting on August 20, 1976, Newport News agreed to prepare the first written draft covering the items agreed to in principle. Dart October Affidavit, ¶ 29 (p).

On August 23, 1976, Mr. Rule briefed Admiral Lascara on the details of the proposal for settlement. Admiral Lascara again advised him that any proposal for settlement would have to be submitted for higher approval and that a business clearance for that purpose should be prepared. Lascara Affidavit, ¶ 9.

Also, on August 23, 1976, Mr. Rule stated at his deposition that he informed Deputy Secretary of Defense William P. Clements of the progress of the DLGN–41 negotiations. Contrary to the representations made by Newport News in paragraph 30(a) of the Dart October Affidavit, however, Mr. Rule states that Mr. Clements did not approve the agreement in principle. Rather, Mr. Clements, after his briefing, responded: " 'Fine. We've got a lot to work out.' " Tr. Rule Dep., p. 91.

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[1] The deposition of Mr. Rule was taken by defendants on October 21, 22, and 26, 1976. Although the transcript of the deposition may not yet have been filed with the Court, we attach a copy of the transcript hereto and refer to it throughout this Brief since signature has been waived and the transcript should be filed shortly. The transcript of the Rule deposition will be referred to hereinafter as "Tr. Rule Dep."

Subsequently, on August 25, 1976, Assistant Secretary of the Navy Bowers telephoned Mr. John P. Diesel, President of Newport News, and informed Mr. Diesel that he was perturbed by a press release issued by Newport News indicating a settlement of the DLGN–41 dispute. Dart October Affidavit, ¶35. Mr. Bowers informed Mr. Diesel that Navy was going to issue a press release that would say the matter was an agreement in principle only, subject to review by higher authority. Dart October Affidavit, ¶ 35; Lascara Affidavit, ¶ 12.

On August 30, 1976, Newport News provided Mr. Rule with the first draft of a proposed Contract Modification, labeled Modification P00031. Dart October Affidavit, ¶ 38. On that same day, Admiral Michaelis, by memorandum formalized the procedure for review of the proposal of settlement by appointing Admiral Lascara, who was to be assisted by named personnel, to review the DLGN–41 proposed agreement in principle. Michaelis Affidavit, ¶ 6. The memorandum further provided that Mr. Rule was to submit: "the proposed contract amendment, the business clearance justifications, and other supporting papers for review prior to signature by the contracting officer." Lascara Affidavit, ¶ 13; Michaelis Affidavit, ¶ 6. Subsequently on August 30, Admiral Lascara advised Mr. Dart of the team which had been established to review Mr. Rule's proposal of settlement. Dart October Affidavit, ¶ 39; Lascara Affidavit, ¶ 13.

Between August 30, 1976 and October 7, 1976, Mr. Rule and Newport News officials met on a number of occasions concerning a series of changes in various items which were negotiated in general principle on August 20. Those revisions included a deletion of the "changes in law component" of the agreement in principle and a major change in the proposed escalation clause. Dart October Affidavit, ¶¶ 38, 46, 48, 50, 51; Tr. Rule Dep., pp. 90, 113–115, 249, 252–255.

On September 1, 1976, Admiral Lascara met with Mr. Clements and reported on the status of the DLGN–41 negotiations. Mr. Clements reiterated that the negotiations between Mr. Rule and Mr. Dart must be reviewed by proper authority in the Navy Department and that he personally wants to see the overall final impact of the proposed contract amendments. Lascara Affidavit ¶ 15.

On September 27, 1976, a second draft of the proposed settlement was delivered to Mr. Rule by Newport News official Dart October Affidavit, ¶ 49. The need for further revisions in the second draft was discussed between Newport News officials and Mr. Rule on October 1, 1976. Dart October Affidavit, ¶ 50.

In late September, 1976, Mr. Rule received a copy of an analysis prepared by the Defense Contract Audit Agency which set forth the first estimate of costs to the Government of the proposed settlement agreement. Tr. Rule Dep., pp. 249–251, 254–255, 281. Mr. Rule immediately informed Mr. Dart of Newport News that the analysis showed a serious problem with the escalation clause contained in drafts of the proposed agreement. Tr. Rule Dep., pp. 114–115, 252–255. The analysis showed that under the drafts of the escalation clause in the proposed settlement, "we would be paying escalation costs that they [Newport News] hadn't incurred." Tr. Rule. Dep., p. 255. Mr. Rule then informed Mr. Dart that unless Newport News would agree to a change in the escalation clause so that the Government would pay on the basis of the contractor's actual experience or the BLS Indices times 1.25, whichever is less, there could be no agreement between the parties. Tr. Rule Dep., p. 253. Mr. Dart told Mr. Rule he would only agree to that change if it was the "hingepoint" to any agreement. Tr. Rule Dep., pp. 115, 253, 255.

On October 7, 1976, Newport News delivered to Mr. Rule a document entitled Modification P00031, executed by Mr. Dart on behalf of Newport News. Dart October Affidavit, ¶ 51. The document delivered to Mr. Rule did not include the change in the escalation clause earlier discussed by Mr. Rule with Mr. Dart. Tr. Rule Dep., p. 253.

Also on October 7, 1976, Admiral Michaelis sent a memorandum to Mr. Rule which stated:

1. This will acknowledge receipt of reference (a), which requests my approval of the arrangement that you have negotiated with NNSBDDC. Unfortunately, neither I nor the review group that I appointed to assist me have a copy of the proposed modification that accurately reflects the results of your efforts. In addition, as you know, the legal review by OGC of reference (b) was submitted to the Justice Department on 5 October 1976 for review and assessment of the litigative risk.

2. Pending completion of these actions and the subsequent review specified in reference (c), final government approval or disapproval of the proposed modification of the CGN–41 contract cannot be consummated. Accordingly, please

submit the proposed modification documents and such other documents as may be required by my review group.

Mr. Rule received the memorandum on that same day. Michaelis Affidavit, ¶ 8; Lascara Affidavit, ¶ 18; Tr. Rule Dep., 285.

At approximately 5:00 p.m. on October 7, 1976, Mr. Rule informed Admiral Lascara that he had received an executed copy of proposed Modification P00031 from Newport News. Lascara Affidavit, ¶ 18. After discussing that fact with Admiral Michaelis, Admiral Lascara immediately wrote a memorandum to Mr. Rule, dated October 7, 1976, which stated:

I would like to reiterate that you do not have the authority to bind the Government contractually on the proposed modification to the CGN–41 contract until the legal and business reviews have been completed and you have been advised accordingly. If there is any doubt about this, please discuss it with me.

The events which occurred on October 7, 1976, after Mr. Rule met with Admiral Lascara, were set forth vividly by Mr. Rule at his deposition:

And I went back upstairs, and I think on that same day Admiral Michaelis sent another memorandum about what we had done having to be reviewed by this review group, and I thought a lot about it all afternoon. I could see, in my opinion, I could see what was happening to this whole negotiated settlement. I knew the object of the negotiation. I knew why I had been picked to negotiate a settlement pursuant to the order of the court, which I had done. I could see the Rickover-Proxmire, et al., influence at work everywhere.

And I finally decided that, if the desires of the Department of Defense as embodied by Mr. Clements, his desire to build ships and get out of the courts; if there was even to be any meaning to that, he has, after all, told the Armed Services committees of the Congress that this ship and these ships involved in the controversy, the nuclear ships with Newport News—that this is a matter—these are a matter that will constitute a vital interest to the national defense. And when he wraps that mantle of national defense to the extent that he has done around the negotiation of this ship and the other ships, I'm frank to say I fall in line.

And I decided those things all—those things all ran through my mind—I wasn't unmindful of the roadblocks and the lack of cooperation that I had gotten and was getting from the office of General Counsel. When my Contracting Officer's statement was turned over to the Office of General Counsel for their review, they then asked me for substantiating documents. I gave them those documents which you have. They were requested by Admiral Lascara to please not write anything until we can get together and discuss this: Let's at least discuss it. Rule had said one thing. Now, review it and let's get together and discuss it before you write anything.

They never did. They wrote a 85-page document. They had lawyers working their butts off. They wrote an 85-page document and turned it over to the Department of Justice. And I don't know what it says today. They won't tell me. These are my own lawyers that are supposed to be helping me. They've never told me what was in there.

Well, on the 7th of October when these things ran across my face, before my eyes, I said: Something's got to be done. I'm a Contracting Officer. I've got the authority. Now I'm going to sign the goddam thing. And I signed it.

Tr. Rule Dep., pp. 99–101.

On October 8, 1976, at approximately 7:30 a.m., Mr. Rule met with Admiral Lascara in Lascara's office. Admiral Lascara then handed to Mr. Rule the memorandum, dated October 7, 1976, which Admiral Lascara had written to Mr. Rule the previous evening. Lascara Affidavit, ¶ 19; Tr. Rule Dep., p. 103. Mr. Rule informed Admiral Lascara that he already had executed the proposed Modification given him by Newport News. Tr. Rule Dep., p. 105. Admiral Lascara directed Mr. Rule to give him the executed document to put in his safe, and Mr. Rule countered by offering to place it in Mr. Clement's office for safekeeping. Admiral Lascara had to depart for a meeting with Mr. Clements at the Pentagon at that point. Lascara Affidavit, ¶ 19; Tr. Rule Dep. pp. 104–105.

According to Mr. Rule, at the end of his meeting with Admiral Lascara: "I went back upstairs and again started thinking. And I finally decided to take the Mod out of the drawer and hand it to Newport News. I think it was Mr. Ewell," who was apparently waiting in Mr. Rule's office. Tr. Rule Dep., p. 105; Affidavit of Vincent F. Ewell, Jr., ¶ 4 dated October, 1976, filed by defendants in support

of their present motion [hereinafter "Ewell October Affidavit"]. With representatives of Newport News in his office, Mr. Rule then called his secretary and dictated, in front of them, a letter which was to accompany the proposed Modification which had executed. Ewell October Affidavit, ¶ 4, Tr. Rule Dep., p. 106. The letter which was dictated in front of Newport News representatives stated, *inter alia*, that:

This Mod has been executed by me as Contracting Officer on two conditions as follows:

(i) That ultimate approval must be received from Deputy Secretary of Defense Clements, and

(ii) That escalation under this Mod will be paid by the Government on the basis of the contractor's actual experience or the BLS Indices times 1.25, whichever is less.

Ewell October Affidavit, ¶ 4, and attachment thereto. Mr. Rule then gave to Newport News the Proposed Modification P00031 which he had signed and shortly thereafter the letter which he had dictated. Tr. Rule Dep., pp. 106–107 and Exh. 39 thereto.

At approximately 10:00 a.m. on October 8, 1976 ,Mr. Rule was called back to Admiral Lascara's office and informed that Mr. Clements wanted the document which Mr. Rule had signed given to the Under Secretary of the Navy. Mr. Rule responded that he already had given it to Newport News representatives who had been waiting in his office. Lascara Affidavit, ¶ 19; Tr. Rule Dep., p. 106. Subsequently on October 8, 1976, by Memorandum, Captain Gerald J. Thompson formally revoked Mr. Rule's contracting officer's warrant to negotiate in the DLGN–41 dispute. Thompson Affidavit, ¶ 8.

Between 10:00 a.m. and 12:00 a.m. on October 8, 1976, Mr. E. Grey Lewis, General Counsel for Navy, spoke with Newport News officials and informed them that Mr. Rule had no authority to act finally in the DLGN–41 dispute. Ewell October Affidavit, ¶6. Similarly, on October 8, Admiral Michaelis, when he was informed that Mr. Rule had delivered a fully executed copy of proposed Modification P00031 to Newport News, telephoned Mr. Dart to explain the situation to him and asked that the signed copy of the proposed Modification be returned. Mr. Dart said that he would respond later in the day. Michaelis Affidavit, ¶ 9. Admiral Michaelis also, in the afternoon of October 8, 1976, sent a letter to Mr. Diesel, President of Newport News, which stated, *inter alia*, that the:

Modification has not yet received requisite reviews and approvals by the Department of the Navy, the Department of Defense and the Department of Justice, all of which are steps you have previously been advised would be necessary conditions to its execution. Accordingly, it was executed without authority to bind the Government and should not be mistakenly relied upon by you as committing the Government to the proposed CGN–41 settlement reflected therein.

Michaelis Affidavit, ¶ 9.

On October 15, 1976, Mr. Clements forwarded the proposed Modification P00031 to the Department of Justice for its consideration and action.

ITEM 29.—*Oct. 7, 1976—Memorandum from Chief of Naval Material Michaelis to Mr. Gordon Rule requesting the proposed contract modification documents and such other documents as may be required by the Admiral's review group, The memorandum withholds approval or disapproval of the proposed settlement*

DEPARTMENT OF THE NAVY,
HEADQUARTERS NAVAL MATERIAL COMMAND,
Washington, D.C., October 7, 1976.

From: MAT–00.
To: MAT–022.
Subject: CGN–41 Negotiations.
Reference: (a) MAT–022 Memorandum of 5 Oct 1976. (b) MAT–022 Memorandum of 1 Sep 1976. (c) MAT–00 Memorandum 559–76 of 30 Aug 1976.

1. This will acknowledge receipt of reference (a), which requests my approval of the arrangement that you have negotiated with NNSBDDC. Unfortu-

nately, neither I nor the review group that I appointed to assist me have a copy of the proposed modification that accurately reflects the results of your efforts. In addition, as you know, the legal review by OGC of reference (b) was submitted to the Justice Department on 5 October 1976 for review and assessment of the litigative risk.

2. Pending completion of these actions and the subsequent review specified in reference (c), final government approval or disapproval of the proposed modification of the CGN–41 contract cannot be consummated. Accordingly, please submit the proposed modification documents and such other documents as may be required by my review group.

F. H. MICHAELIS.

ITEM 30.—*Oct. 7, 1976—Memorandum from V. A. Lascara, Vice Chief of Naval Material, to Mr. Gordon Rule stating that Mr. Rule did not have the authority to bind the Government on the proposed modification until the legal and business reviews had been completed and Mr. Rule had been so advised*

DEPARTMENT OF THE NAVY,
HEADQUARTERS NAVAL MATERIAL COMMAND,
Washington, D.C., October 7, 1976.

From: MAT–09.
To: MAT–022.

Subject: Authority to bind the government contractually.
Reference: (a) NNS ltr Ser 601/C1–1–2 of 7 OCT 76 to Mr. Gordon Rule.

1. Since reference (a) has been brought to my attention, I would like to reiterate that you do not have the authority to bind the government contractually on the proposed modification to the CGN–41 contract until the legal and business reviews have been completed and you have been advised accordingly. If there is any doubt about this, please discuss it with me.

V. A. LASCARA,
Vice Chief of Naval Material.

ITEM 31.—*Oct. 8, 1976—Gordon W. Rule letter to Mr. C. E. Dart, Executive Vice President, Newport News Shipbuilding forwarding an executed copy of the contract modification implementing the proposed agreement*

DEPARTMENT OF THE NAVY,
HEADQUARTERS NAVAL MATERIAL COMMAND,
Washington, D.C., October 8, 1976.

Subject: DLGN–41 Contract N00024–70–C–0252.
Mr. C. E. DART,
Executive Vice President, Newport News Shipbuilding,
Newport News, Va.

DEAR MR. DART: I have your letter of 7 October 1976 with the enclosed Modification P00031 to the subject contract executed on behalf of your Company. You stated that this Mod "reflects the settlement agreement we reached on August 20, 1976" and you requested that I return immediately a fully executed copy.

Returned herewith is an executed copy of Mod P00031 which I have executed as Contracting Officer and which does contain the substance of our negotiated agreement of 20 August 1976.

This Mod has been executed by me as Contracting Officer on two conditions as follows:

(i) That ultimate approval must be received from Deputy Secretary of Defense Clements, and

(ii) That escalation under this Mod will be paid by the Government on the basis of the contractor's actual experience or the BLS Indices times 1.25, whichever is less.

Sincerely,

GORDON W. RULE,
Contracting Officer.

ITEM 32.—*Oct. 8, 1976—Letter from Chief of Material Michaelis to Newport News President Diesel, stating that proposed Modification POOO31 has not received requisite Government reviews and approvals and should not be mistakenly relied upon by Newport News as committing the Government to the proposed CGN 41 settlement*

DEPARTMENT OF THE NAVY,
HEADQUARTERS NAVAL MATERIAL COMMAND,
Washington, D.C., October 8, 1976.

Mr. J. P. DIESEL,
President and Chief Executive Officer, Newport News Shipbuilding and Dry Dock Co., Newport News, Va.

DEAR MR. DIESEL: I am writing to confirm advice conveyed earlier today to your General Counsel, Mr. Vincent Ewell, by Mr. E. Grey Lewis, Navy General Counsel, regarding proposed Modification P00031 to Contract N00024–70–C–0252 conditionally signed by Mr. Gordon W. Rule and apparently furnished to your representatives this morning.

That modification has not yet received requisite reviews and approvals by the Department of the Navy, the Department of Defense and the Department of Justice, all of which are steps you have previously been advised would be necessary conditions to its execution. Accordingly, it was executed without authority to bind the Government and should not be mistakenly relied upon by you as committing the Government to the proposed CGN–41 settlement reflected therein.

We will advise you as soon as possible regarding future action on this matter.

Sincerely,

F. H. MICHAELIS,
Admiral, U.S. Navy.

ITEM 33.—*Oct. 8, 1976—Letter from C. E. Dart, Newport News Shipbuilding, to Chief of Naval Material Michaelis stating that the company will not return the settlement modification signed by Mr. Rule and delivered to the company*

NEWPORT NEWS SHIPBUILDING,
Newport News, Va., October 8, 1976.

Re: DLGN–41 Settlement.

Admiral FREDERICK H. MICHAELIS,
U.S. Navy, Chief Naval Materials,
Washington, D.C.

DEAR ADMIRAL MICHAELIS: Words are inadequate to express my dismay at today's events. I will say, however, that, in view of what has transpired, this Company is constrained to refer the entire matter to the United States District Court and will do so at an early date. I see no justification for your demand that we return to you the fully executed copy of Modification P00031 which was delivered to us at 10:00 A.M. today, and I decline to do so.

Very truly yours,

C. E. DART,
Executive Vice President.

ITEM 34.—*Oct. 11, 1976—Gordon Rule Memorandum for Deputy Secretary of Defense Clements. Mr. Rule states that he has notified Newport News that unless the company hears from Mr. Clements by the close of business on Oct. 12, 1976, the condition included in the Rule settlement requiring Mr. Clements' approval will be removed*

DEPARTMENT OF THE NAVY,
HEADQUARTERS NAVAL MATERIAL COMMAND,
Washington, D.C.. October 11, 1976.

Subject: CGN–41—Execution by Contracting Officer on 7 October 1976 of Contract Mod to Build.
Ref: (a) NAVMAT 022/GWR Contracting Officer Memo of 5 Oct 1976 to CNM.

1. On 7 October 1976, as Contracting Officer, acting on behalf of the Government, I executed Mod P00031 to Contract N00024–70–C–0252, which Mod contains

the substantive negotiated terms and conditions under which Newport News Shipbuilding and Dry Dock Company will build the CGN–41. This executed mod was transmitted to the contractor by letter dated 8 October 1976, and was personally delivered by me to a company representative at exactly 10:00 a.m. on 8 October 1976.

2. The letter of transmittal contained a condition that you must ultimately approve the execution of this mod. This condition was put in my letter of transmittal only because the VCNM so advised me of your desire. I had not previously known of this requirement.

3. Despite the fact that Captain Thompson, DCNM for Procurement and Production withdrew my Contracting Officer's Warrant at 11:50 a.m. on 8 October 1976, I consider it incumbent on me to resolve this condition to my execution of Mod P00031.

4. Mr. Secretary, it is now my opinion from a review of the record and from my own recollection of what was said at the 13 July 1976 meeting in your office, that the VCNM is confused by a remark you made at that meeting. Reference to the second paragraph on page 4 of the minutes of that meeting shows that as part of an exchange that the Navy appeared to be passing the buck to the Department of Justice to settle the CGN–41 matter, you told Mr. Bowers that if the Navy does not take the necessary action to settle this question, you will do it for them.

5. I do not construe that statement or any others made at the meeting as your saying that no negotiated settlement could be signed by the authorized Contracting Officer without your approval. I placed that condition in my transmittal letter only in deference to the understanding of the VCNM.

6. So far as I am concerned, you wanted prompt and proper action by the Navy to negotiate a good faith settlement of the CGN–41 controversy, as the District Court had ordered. You directed that I undertake to negotiate such a settlement. This was done and a prompt, proper and good faith negotiated settlement agreement was reached with Newport News on Friday, 20 August 1976, at which time they were led to believe that my unlimited negotiating authority as Contracting Officer enabled me to conduct the negotiations and to sign a contract mod to finalize the negotiations.

7. Neither the contractor nor I were ever advised, nor was it even intimated, prior to the 20 August 1976 negotiated settlement that a special review of my negotiations would be required. As the Director of the Procurement Control and Clearance Division in the Headquarters, Naval Material Command, it is my regular and normal duty to review negotiated procurement actions. I have unlimited authority to approve any dollar amount. Thus, I expected to review this CGN–41 negotiated agreement for which there is ample precedent.

8. On 24 August 1976—four days following the negotiated agreement—Admiral Rickover wrote to Admiral Michaelis urging a formal review of the negotiated agreement. As a consequence, Admiral Michaelis did set up a special formal review group to review my negotiation. Both the contractor and I have informed, Admiral Michaelis in no uncertain terms, that this after-the-fact, change in procedure is considered highly questionable and typical of Navy actions in this CGN–41 matter for the last five years, namely, road block and delay tactics initiated by Admiral Rickover. Moreover, the placing of individuals on this newly minted special review group, whose views and actions are clearly in opposition to any setting of a new delivery date with escalation for the CGN–41 is likewise considered questionable. As you will recall, I urged new faces to handle this negotiation. It was agreed and I was put in charge. To then put two of the old faces, with known dug-in positions on this group to review the work of the new face would be laughable were it not such a serious matter.

9. Mr. Wiley, the DOD General Counsel, stated in the 13 July 1976 meeting in your office "the CGN is a business problem which requires the Navy to make a business judgment." I agree with his appraisal and as (i) the Contracting Officer and (ii) the Navy official responsible for implementing the Navy check and balance contract control mechanism, I made the business judgment that the negotiated settlement of the CGN–41 controversy, as embodied in the executed Mod P00031, is prudent, is in the best interests of the Navy and carries out the order of the United States District Court to negotiate a good faith agreement.

10. As Contracting Officer, I also made the decision that if legal consideration is required—in addition to the equity grounds present in this case—ample con-

sideration exists because of the litigative risk of success by the Navy in a trial of the merits. Reference (a) contains the substance of the negotiated agreement.

11. The condition in my letter of 8 October 1976 transmitting the executed Mod to the contractor which requires you to give ultimate approval, I have determined to be unnecessary and not a requirement, as I was told it was by VCNM. Newport News has officially rejected Admiral Michaelis' request to return the executed contract mod that I signed on 7 October 1976 and have advised him that they are taking the executed mod to the United States District Court in Norfolk the week of 11 October 1976 and no later than 14 October 1976.

12. I have informed Newport News that if they have no word from you by the close of business 12 October 1976, that condition is removed.

GORDON W. RULE,
Negotiator and Director,
Procurement and Clearance Division.

ITEM 35.—*Oct. 12, 1976—Letter from Senator Proxmire to Secretary of the Navy Middendorf questioning the Navy with regard to the purported CGN 41 agreement between Mr. Gordon Rule and Newport News*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., October 12, 1976.

Hon. J. WILLIAM MIDDENDORF II,
Secretary of the Navy, Department of the Navy, Pentagon Building, Washington, D.C.

DEAR MR. SECRETARY: I understand that on October 7, 1976, Mr. Gordon Rule, who Deputy Secretary of Defense Clements selected to negotiate the CGN 41 dispute for the Navy, signed a contract modification with Newport News which purports to settle the CGN 41 matter. I also understand that Mr. Rule acted in violation of written directions from his Navy superiors and that neither the Navy legal counsel, the Justice Department or any other legal authority had determined the modification to be legally acceptable. I also understand that the Navy has disavowed the Rule agreement, removed him from the CGN 41 assignment and withdrawn his contracting officer warrant. Finally, I am informed that Newport News officials are in possession of the document signed by Mr. Rule and have thus far refused to return it to the Navy.

The latest developments raise the most serious questions about procurement policy and the safeguarding of the taxpayers' interests in the resolution of contract disputes. I therefore request a prompt report setting forth the actual facts. I would like answers to the following questions:

(1) Did Mr. Rule have authority to sign such an agreement? If so, please furnish me a copy of all documentation of such authority.

(2) Did any of his Navy superiors authorize him to sign such an agreement orally or in writing? If so, who and in what manner? Did any of his Navy superiors instruct him not to sign such an agreement? If so, who and in what manner?

(3) Is the contract modification Mr. Rule signed with Newport News in accordance with the terms of the CGN 41 contract existing before this modification? If not, what is the compensating benefit?

(4) What was the status of the Navy legal review at the time Mr. Rule signed the contract modification?

(5) Did the Justice Department review and approve the contract modification before it was signed?

(6) Is it true that Newport News has refused a Navy request to return the signed contract modification they obtained from Mr. Rule?

(7) Does the Navy consider Mr. Rule's agreement legally binding?

(8) What safeguards are in effect to insure that Government officials involved in this matter do not commit the Government beyond their legal authority?

(9) Were Mr. Rule's actions known and/or approved in advance by the Deputy Secretary of Defense or any member of his staff? If so, give the details.

(10) What action has the Navy taken to preserve the Government's rights in view of Mr. Rule's actions?

(11) How much would the contract modification add to the Navy's estimate of the end cost of the CGN 41? What is the exact source of the additional funds?

(12) In your judgment should the contract modification be submitted to Congress for approval under PL 84–805?

Please do not limit your response to the above questions. I desire all information pertinent to this issue. In view of the importance of this matter, I request that you provide me the requested information along with a copy of the purported contract modification no later than Monday, October 18, 1976.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

ITEM 36.—*Oct. 14, 1976—Senator Proxmire letter to Attorney General Levi expressing concern over "the appearance of a steady pattern of behavior by Secretary Clements and Mr. Rule calculated to damage the Government's case in the pending litigation"*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., October 14, 1976.

Hon. EDWARD H. LEVI,
Attorney General of the United States, Department of Justice, Washington, D.C.

DEAR SIR: On August 24, 1976, I wrote to you about the CGN–41 contract dispute which is the subject of current litigation between Newport News Shipbuilding and Dry Dock Company, a subsidiary of Tenneco, and the Navy.

In July, Defense Deputy Secretary William Clements personally selected Mr. Gordon Rule to attempt to negotiate a settlement of the dispute. As neither Secretary Clements nor Mr. Rule has been impartial with regard to shipbuilding contracts and claims against the Navy—both have stated that the Navy's contracts are unfair and inequitable to the shipbuilders—I am concerned that the negotiations in this case could result in a decision to turn over to Newport News sums of money far in excess of the amount agreed to in the contract. Secretary Clements has repeatedly inserted himself into the dispute over this Navy contract and seems determined to force the Navy to settle on terms favorable to Newport News.

In my letter, I requested that you direct the Navy to keep you fully informed of the negotiations and that you review any settlement offer to ensure that it is on sound legal ground and in the public interest before the government becomes a party to it.

Soon after my letter, Newport News announced that an agreement in principle had been reached with the Navy. However, the details of the agreement were not released. You may know that those details have been the subject of much controversy within the Navy. I understand that the Navy legal counsel is critical of the proposed agreement because it would provide more funds to Newport News than it is entitled to under the contract, and that you have been so advised.

In your letter of September 16, 1976, you stated the Justice Department intends to review any proposal and/or papers before submission to the court and you would request the court's approval of a settlement only if you are satisfied that it is on sound legal grounds and in the public interest.

I have now learned that on October 7, 1976, Mr. Rule "executed" the agreement by signing a contract modification with Newport News with the apparent acquiescence of Secretary Clements despite the views of the Navy legal counsel and without consultation with the Department of Justice lawyers handling the case.

It is apparent that the Justice Department was not fully informed about the negotiations prior to the announcement of the agreement in principle by Newport News nor was Justice informed of Mr. Rule's execution of the contract modification until several days after it took place.

You may be interested in knowing that Mr. Rule's superiors in the Navy were also not informed of his action until after the fact. Indeed, upon learning of

the action, Admiral Frederick H. Michaelis, Chief of Naval Material Command, asked Newport News to return the signed modification. Newport News has refused to do so.

Mr. Rule's action was apparently in violation of his instructions from his Navy superiors. Admiral Michaelis established a group to review the earlier tentative agreement. Mr. Rule's action was taken prior to the completion of the review and without the approval of Admiral Michaelis.

Mr. Rule's action is also inconsistent with representations made by Secretary Clements to you. In his letter of September 28, Secretary Clements said that the tentative agreement was being reviewed by the Navy General Counsel and "contingent on the outcome of this review, the Chief of Naval Material will make recommendations to the Secretary of the Navy and to me regarding the implementation of the negotiators' agreement in principle." Clearly, Mr. Rule's action was intended to present the Navy review group and Justice Department with a fait accompli before completion of the review process.

Secretary Clements also said in his letter that "we in DOD have no intention to by-pass or withhold from your department any information which you determine that your department needs in connection with legal proceedings under the court order." The facts show that Secretary Clements and Mr. Rule have withheld pertinent information from you on at least two occasions.

Of greater concern is the appearance of a studied pattern of behavior by Secretary Clements and Mr. Rule calculated to damage the government's case in the pending litigation. I can think of nothing more injurious to the government's case than for DOD and Navy officials to assert that Navy shipbuilding contracts are inequitable or unfair, or for a Navy official who has made such statements to be placed in charge of the negotiations of a shipbuilding contract dispute, or for the negotiator to sign a contract modification purporting to settle the dispute in violation of his Navy superior's orders and without the knowledge of his Navy superiors.

Because of the seriousness of these matters and the possibility that the Clements/Rule-Newport News settlement could result in an unwarranted corporate bailout, I would like specific answers to the following questions:

1. What steps have you taken to require your client, the Department of the Navy, to keep you fully informed of the CGN–41 negotiations? Do you plan to take any such steps?

2. In your opinion, have the statements or actions by Secretary Clements, Mr. Rule or other DOD and Navy officials damaged the government's case in the CGN–41 litigation? Have they increased the government's litigation risk? Please explain your answer.

3. What steps have you taken to prevent DOD and Navy officials from further damaging the government's case? Do you plan to take any such steps?

4. Are there any laws or regulations which prohibit government officials from taking actions which could damage the government's case in pending litigation? Would it constitute a criminal conspiracy for two or more government officials to agree to take such actions with intent to damage the government's case?

5. What procedures are normally followed by the Justice Department to ensure that officials in client-agencies do not make statements or take actions which could damage the government's case in pending litigation?

Sincerely,

WILLIAM PROXMIRE,
U.S. Senate.

ITEM 37.—*Oct. 15, 1976—Deputy Secretary of Defense Clements letter to Attorney General Levi forwarding the Rule settlement for approval and such legal action as may be necessary to obtain ratification*

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C., October 15, 1976.

Hon. EDWARD LEVI,
Attorney General, Department of Justice,
Washington, D.C.

DEAR MR. LEVI: This letter forwards a proposed settlement of the CGN–41 litigation negotiated pursuant to Court Order. As you know, I have been deeply committed to efforts to settle the Navy's on-going disputes with the shipbuilding industry and have undertaken a number of initiatives to this end. In

a meeting on 13 July 1976, senior Navy officials, with my approval, appointed Mr. Gordon W. Rule of the Naval Material Command as the principal negotiator of this particular matter. Mr. Rule has negotiated a proposed modification to the contract with Newport News, on the CGN–41.

In view of the long-standing, acrimonious, and disruptive controversy between the Navy and its sole present new construction surface nuclear warship contractor, I consider it vital to the national defense that this dispute be resolved as quickly as possible. I consider the proposed modification a reasonable resolution to this complex matter.

Attachment (1) provides a comparative financial estimate of the proposed settlement. While attachment (2) indicates a difference of $22.7M I believe it is reasonable to assume that a Court might grant Newport News, as a minimum, an extension of the existing escalation coverage to an achievable contract delivery date (e.g., August 1980) ; consequently, the difference in the settlement could be reduced another $7.5M, to $15.2M. We have not included any other assessment of litigative risk since this is a matter under your purview. Quantifying the latter could further reduce or eliminate the $15.2M differential noted above.

In any event, the District Court instructed the parties as follows: "The parties agree to negotiate in good faith to reach an agreement as rapidly as possible to modify those contract provisions requiring amendment or to take other appropriate action". Mr. Rule, in the spirit of this order, negotiated a contract modification which, if approved, would undoubtedly facilitate the construction of the badly needed CGN–41.

Accordingly, I am forwarding the results of these negotiations for your approval and such legal action as may be necessary to obtain ratification.

W. P. CLEMENTS, Jr.

Attachment.

COMPARATIVE FINANCIAL ESTIMATES: THE APPROXIMATE FORECASTED COST TO THE NAVY FOR CGN–41 BEFROE AND AFTER MODIFICATION P00031 CAN BE SUMMARIZED

[In millions of dollars]

Element	Before	After	Difference
Ceiling price	$100.9	$100.9	
Energy growth		5.1	$5.1
Subtotal	100.9	106.0	5.1
Escalation (at ceiling)	69.9	[1] 81.9	12.0
Fringe benefit growth		[2] 16.8	16.8
Changes in law growth	5.4		−5.4
Total [3]	176.2	204.7	[4] 28.5

[1] Does not include 10 pct contingency factor required by NAVSEA budget policy.
[2] Includes cost growth of changes in laws before P00031.
[3] Does not include cost of anticipated changes.
[4] Total difference is reduced to $22,700,000 if Newport News accepts revised escalation payment basis (Rule 8 Oct. letter).

ITEM 38.—*Nov. 17, 1976—Acting Secretary of the Navy Macdonald letter to Senator Proxmire declining to answer the questions raised in Senator Proxmire's October 12, 1976 letter to the Secretary of the Navy on the basis that the CGN 41 dispute is in litigation*

DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., November 17, 1976.

HON. WILLIAM PROXMIRE,
United States Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: This is in reply to your letter of October 12, 1976, concerning negotiations between the Navy and Newport News Shipbuilding and Dry Dock Company relative to the CGN–41 shipbuilding contract.

The CGN–41 is currently in litigation in the U.S. District Court, Eastern District of Virginia, and most of the questions raised in your letter are issues involved in that case. Accordingly, it would be inappropriate for the Department of the Navy to formally discuss those questions. The Government's brief and selected affidavits were recently filed by the Department of Justice which I trust will provide most of the information you are seeking.

Sincerely,

DAVID R. MACDONALD,
Acting Secretary of the Navy.

ITEM 39.—*Nov. 30, 1976—Letter from Deputy Attorney General to Deputy Secretary of Defense stating that the proposal that the Justice Department approve the contract modification signed by Rule "as a settlement of the pending litigation has been considered by this Department and rejected"*

OFFICE OF THE DEPUTY ATTORNEY GENERAL,
Washington, D.C., November 30, 1976.

Hon. WILLIAM P. CLEMENTS,
Deputy Secretary of Defense, Department of Defense,
The Pentagon, Washington, D.C.

DEAR MR. CLEMENTS: This has reference to your letter of October 15, to the Attorney General regarding *United States* v. *Newport News Shipbuilding & Dry Dock Company* (E.D. Va., Civil Action No. 75–88–NN).

The proposal that this Department approve a document labeled modification P00031 to contract N00024–70–C–0252, as a settlement of the pending litigation, has been considered by this Department and rejected.

Very truly yours,

HAROLD R. TYLER, Jr.,
Deputy Attorney General.

ITEM 40.—*Nov. 30, 1976—Times Herald article "Yard Agreement a 'Giveaway'"*

(By Stu Henigson)

Sen William Proxmire, D.-Wis., today charged two top Pentagon procurement officials with a "lame duck giveaway" to Newport News Shipbuilding in the contract dispute over the nuclear cruiser CGN–41.

Proxmire focused his criticism on a contract modification proposed by the Navy's senior civilian contract reviewer, Gordon W. Rule.

The proposed modification, backed by Deputy Defense Sec. William P. Clements, Jr., would add between $20 million and $30 million in inflation payments to the shipyard for the cruiser.

"Deputy Sec. Clements has been working so zealously to settle the claims disputes between the Navy and its shipbuilders that he appears to have lost sight of the importance of protecting the public interest," Proxmire said in a prepared statement.

"Recently he directed (Rule) to settle the CGN–41 dispute with Newport News regardless of the rules and regulations governing settlements between the Navy and its contractors," Proxmire said.

Charging the Navy's 1973 option for the cruiser is invalid, the shipyard has been demanding more favorable contract terms since before work started on the vessel in February 1975.

Until Rule appeared on the scene, however, the Navy had refused to talk about raising the inflation payments, even after the shipyard stopped work in August 1975 and a federal judge directed both parties to keep negotiating while work resumed.

After the shipyard complained to the court in July 1976 about a lack of progress in negotiations, Clements directed the Navy to appoint Rule to negotiate the dispute.

Rule negotiated the proposed settlement in a matter of weeks.

When Rule signed the contract modification in October, however, his uniformed Navy boss, Chief of Naval Material Adm. F. H. Michaelis, repudiated the agreement. He said it had not received requisite Navy "legal and business review," and pulled Rule off the dispute.

A week later, Clements overruled Michaelis and sent the agreement to the Justice Department, which has final say in legal dealings of the Defense Department.

The shipyard already had filed the document in court, asking the judge to enforce it despite the Navy's objections.

"Both Mr. Clements and Mr. Rule have deliberately tried to undermine the government's rights under the Navy's contract with Newport News," Proxmire said.

"The problem goes far beyond the CGN-41 dispute. Newport News has filed (ship contract) claims against the Navy totaling $885 million * * * Any action taken on the CGN-41 claims could become precedents for other claims," Proxmire said.

"I am concerned that the 'lame duck' officials now in office may be packaging a going-away present for Newport News," Proxmire added, referring to the virtual certainty that Clements, a former Texas fund-raiser for Richard Nixon, will be replaced by the Jimmy Carter administration.

Meanwhile, the Justice Department reportedly is continuing its review of Rule's proposed settlement, and sources say a decision should be made within several days.

According to Navy Under Secretary David R. MacDonald, the Justice Department must weigh whether avoiding the legal battle over the validity of the contract is enough "consideration" for boosting the price of the ship.

Justice Department lawyers have held the shipyard at bay by arguing that Rule didn't have authority to sign the contract modification, even though MacDonald publicly has said the Navy will stand behind the agreement whether Rule had the authority or not.

ITEM 41.—*Nov. 30, 1976—Washington Star article—"Cruiser Settlement Plan Rejected"*

(By Vernon A. Guldry, Jr.)

Despite a strong endorsement by the Pentagon's second-ranking civilian, the Justice Department has rejected a controversial proposed settlement in a potentially far-reaching shipbuilding dispute.

Justice is the Defense Department's lawyer in litigation over a nuclear cruiser being built by Newport News Shipbuilding and Dry Dock Co.

According to knowledgeable persons, Justice said the proposal endorsed by Deputy Defense Secretary William P. Clements Jr. was not acceptable as a settlement of the Navy's contract dispute with the shipbuilder over the cruiser, which is designated the CGN41.

The Navy, it was understood, has not yet received the letter written at Justice detailing the reasons for the rejection. A spokesman for the Justice Department declined comment on the report, saying the department's position would be made clear in papers to be filed in the case, which is being heard in U.S. District Court in Norfolk, Va.

Clements has strenuously advocated swift settlement of the Navy's shipbuilding disputes, which go beyond the CGN41 and beyond Newport News. It was at his urging that the Navy named its chief civilian contract review officer, Gordon Rule, an outspoken maverick within the Navy, as a last-chance negotiator in the CGN41 dispute.

The product of Rule's negotiations and his methods brought him the animosity of several elements within the Navy, with some critics claiming that his actions to change the contract under which the ship was being built would set a precedent that could cost hundreds of millions in unwarranted claims later.

Supporters of the Clements-Rule position countered, however, that the CGN41 contract was unfair, and in any event the Navy would not be able to build the fleet it needs if it had to get a court order for construction of each ship.

Rule's proposed settlement would add some $20 million to $30 million to the cost of the ship by changing provisions for compensating for inflation, and by extending the delivery date. Particular problems with the proposal include a question of whether the company will forego excess payments for inflation included inadvertently, and how to deal with language in the proposal that would require the Navy to pay twice for some items.

Despite these problems, Clements on Oct. 15 endorsed the proposed settlement and asked Atty. Gen. Edward H. Levi to take steps to give it force. Justice first

became involved when in the summer of 1975 the shipyard stopped work on the CGN41 and the Navy had to go to court to force the yard to continue work on the ship. The court ordered the parties to get down to honest negotiation.

The key point involved in evaluating the settlement, according to a number of observers, is that of what "consideration" the Navy would receive under the settlement. That is, is the Navy getting back enough in return for what it is giving up.

Rule came to the conclusion that the risk of losing the court case was so great that the Navy would benefit in the long run by paying more for the ship in a negotiated settlement.

Asked about the report of the Justice Department decision to reject the settlement, Rule said that if it were true, it represented "a tragic setback for the shipbuilding program of the real United States Navy which must and will ultimately prevail for the good of our country."

Rule said such an action by Justice would represent a "short-term win for Adm. Hyman Rickover, czar of the nuclear Navy construction establishment, who has been in sharp conflict with Rule over the settlement.

As far as the settlement itself was concerned, Rule said "the settlement I negotiated and signed with Newport News for the building of the CGN41 was a fair one * * * Deputy Defense Secretary Clements would not have forwarded it to the Department of Justice for approval had it not been."

Sen. William Proxmire, D-Wis., held hearings this summer on the Navy's disputes with Newport News. Today, Proxmire charged that Clements was attempting to force the Navy and the Justice Department to accept "a lame duck shipbuilding claim giveaway."

Proxmire also said that Clements was dragging his feet in making records pertaining to the issue available to the Justice Department.

ITEM 42.—*Dec. 7, 1976—Attorney General Levi letter to Senator Proxmire in response to the Senator's letter of Oct. 14, 1976. The letter states that the Department of Justice has rejected the proposed CGN 41 settlement and forwards for information a copy of the Justice Department's brief. (For Justice Department brief and related affidavits, see "Miscellaneous documents appendix)*

OFFICE OF THE ATTORNEY GENERAL,
Washington, D.C., December 7, 1976.

Hon. WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government, Joint Economic Committee, United States Congress, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your letter of October 14, 1976, regarding the CGN–41 contract dispute at issue in *United States* v. *Newport News Shipbuilding & Dry Dock Company*, E.D. Va., Civil No. 75–88–NN.

As you may know, defendants Newport News Shipbuilding & Dry Dock Company and Tenneco, Inc., filed on October 14, 1976, a Motion for Entry of Judgment or, in the Alternative, for Dismissal with Prejudice. This Department's memorandum in opposition to that motion was filed with the Court on November 8, 1976. Since the opposition filed by us addresses certain of the issues raised in your letter, I enclose a copy for your information.

The memorandum submitted by this Department on November 8 noted that a Defense Department recommendation for a proposed settlement of the pending litigation was under consideration. The proposed settlement has since been rejected by this Department.

Sincerely,

EDWARD H. LEVI,
Attorney General.

ITEM 43.—*Jan. 13, 1977—Times Herald article—"Yard. U.S. Back in Court"*

(By Stu Henigson)

The attempted resolution of a long-standing dispute between Newport News Shipbuilding and the Navy rejected by the Department of Justice was only a "proposed modification," government lawyers argued today.

In a hearing before U.S. District Court Judge John A. MacKenzie, government attorney Patricia N. Blair asserted that the Pentagon's top procurement office did not approve the proposed change to the contract for the nuclear cruiser CGN–41.

The shipyard has been building the ship for nearly two years without a contract while the Navy and the shipyard tried to settle a dispute over the initial contract terms.

Today's hearing was on a request by the shipyard that the contested contract modification be enforced despite Justice Department objections.

Shipyard attorney K. Martin Worthy rejected the Justice Department's argument that it has final say over Navy disputes in litigation.

After 19 months of fruitless talks—during which the shipyard stopped work and then resumed it two days later under court order—a Navy negotiator, Gordon W. Rule, reached an agreement with the shipyard Aug. 20.

The agreement would extend delivery date for the ship by 22 months, increasing payments to the shipyard by $20 million to $30 million.

The shipyard has said it would lose $37 million in building the ship under the original contract terms.

Top Navy officials first repudiated Rule's agreement and then later accepted it at the insistence of Rule's sponsor. Deputy Defense Sec. William P. Clements, Jr.

But the Justice Department, which represents the Navy in legal matters, has rejected the proposed settlement. It claims the government gets too little in return for the increased payments.

"This case has been resolved . . . by persons experienced in government contracting matters," Worthy argued, recalling MacKenzie's admonition to both sides in a pretrial conference last month to settle the case out of court.

Worthy said that Clements' endorsement of Rule's agreement waived armed services regulations that a contracting officer's decision be reviewed by higher Navy authorities.

Worthy also said, "The Justice Department has no authority to block an agreement between the government and a private party that moots a government law suit."

Ms. Blair responded that Clements did not approve the agreement, but specifically referred it to the Justice Department for consideration.

She noted that Clements, the highest ranking procurement official in the Pentagon, referred to the agreement as a "proposed modification" in his forwarding letter.

Oral arguments on the motion from both sides are expected to continue through today.

ITEM 44.—*Jan. 14, 1977—Daily Press article—"Judge Hits Navy Position"*

(By Ross Hetrick)

Federal District Judge John A. MacKenzie took some of the wind out of the Navy's sails Thursday in its dispute over construction of the nuclear-powered cruiser CGN–41 by rejecting one of its main arguments.

Though he did not make a decision Thursday, MacKenzie said he would not consider whether the government is getting just compensation in exchange for altering contract provisions.

MacKenzie also characterized the dispute as petty and said the main reason no agreement has been reached is a personality clash.

MacKenzie's statements came at the end of a four-hour hearing on a motion by Newport News Shipbuilding that a contract modification must be enforced or the yard should be allowed to stop work on the ship.

The contract modification was signed by the yard and Navy negotiator Gordon W. Rule Oct. 7. It would add between $20 million and $30 million to the cruiser's $337 million price tag and extend the delivery date by 22 months.

Shipyard attorney K. Martin Worthy contended the agreement is valid and should be enforced or the yard should be released from the contract because the Navy has not bargained in good faith.

Justice Department attorney Patricia N. Blair countered by saying Rule did not have the authority to settle the dispute and the final decision rests with the Justice Department. Justice rejected the proposal because it does not give the government enough in return for the contract changes, she said.

The CGN–41 contract has been involved in litigation since August, 1975, when the shipyard was ordered back to work on the ship with the understanding that good faith negotiations would take place between the Navy and the yard.

The yard had stopped construction, contending the option exercised by the Navy to build the ship was not valid because of the many changes in the original design.

The yard is currently building two sister cruisers and has delivered one, the USS Virginia (CGN–38).

In presenting the shipyard's case, Worthy said the controversy has been resolved by the Rule-Dart agreement.

Worthy said the shipyard was engaged in fruitless negotiations with the Navy from Aug., 1975, to July, 1976.

With the appointment of Rule, the yard was convinced negotiations would finally advance and Rule would make the final decision on the agreement.

However, after the two sides reached an oral agreement on Aug. 20, the shipyard was told certain Navy and Justice officials had to review the agreement. Worthy maintains the oral understanding was binding.

"The cynical indifference of the government," Worthy said, was illustrated by statements by Deputy Defense Secretary William P. Clements to the effect that the Navy had been dealing in bad faith and then the government saying the Rule-Dart agreement was not valid.

Miss Blair said the contract modification was not binding because there was no meeting of the minds, nor was the document properly approved.

Blair also said if a contractor's provisions are changed, according to federal law, there has to be consideration for the government.

In this case, the government is relieved of any further law suits concerning this cruiser. However, the Justice Department has decided this is not enough.

By saying he will not let the matter of consideration sway his decision MacKenzie may be gutting the Navy's case.

At present, Navy officials have approved the contract modification and the only block is the Justice Department's insistence on consideration.

MacKenzie did not set a deadline for his decision, but said, "I hope I can come to a decision fairly quickly."

If the Navy's position is upheld, the original matter of whether the option was valid will go to court Aug. 15.

MacKenzie urged the two sides to get together without the court's assistance. He also said the dispute was taking its toll on the average worker in the yard, who is apprehensive about his future employment.

ITEM 45.—*Jan. 14, 1977—Times Herald article—"Judge Sympathetic to Yard's Argument"*

(By Stu Henigson)

A federal judge has unofficially spurned part of the U.S. Justice Department's objection to a proposed settlement of a Navy-Newport News Shipbuilding contracting dispute.

U.S. District Judge John A. MacKenzie Thursday said he would quickly make an official decision on whether new contract terms for the nuclear-powered, guided-missile cruiser CGN–41 are binding on the government.

In off-the-record remarks following the three-hour hearing, MacKenzie said he thought the new terms were fair to both sides, despite Justice Department statements to the contrary.

"It appears to me that * * * the settlement is one both of you could live with in all its terms," MacKenzie told Justice Department and shipyard lawyers.

The proposed settlement, negotiated in August by Gordon W. Rule for the Navy, would extend delivery date on the cruiser by 22 months.

It also would increase payments to the shipyard by up to the $33.9 million in reimbursements for inflation.

In exchange, the shipyard would abandon its contention that the Navy's original contract option for the ship is invalid—the original point of the 17-month-old case.

Justice Department lawyer Patricia N. Blair, who is representing the Navy in the litigation, said that exchange would give the government too little in return for the larger inflation payments.

Miss Blair said the government's only "new consideration" (benefit) was avoiding the "litigative risk"—that is the risk of losing the case over the option's validity.

Terming the shipyard's position "weak," Miss Blair said, "The government doesn't believe Newport News Shipbuilding has a claim to abandon."

The settlement "is almost totally one-sided in favor of Newport News," Miss Blair wrote in a brief filed last week.

"In exchange for the promise by Newport News to build the same vessel covered by the contract * * * the government agrees to pay millions of dollars more than the amount called for by that contract," the brief continued.

K. Martin Worthy, a Washington, D.C. attorney representing the shipyard, told the judge in the hearing in Newport News federal courtroom yesterday, that the government doesn't require equal consideration for the increase in contract payments, as long as it got some benefit.

MacKenzie apparently agreed.

In a comment on Miss Blair's argument, he said, "I wasn't given to pay much attention to the proposition of whether Rule's settlement is supported by adequate consideration."

Miss Blair also argued that even on Oct. 7, the two negotiators hadn't resolved exactly how much inflation reimbursement the shipyard should receive.

According to Justice Department estimates, at current inflation rates the terms of the new inflation clause would give the shipyard a windfall of $9.4 million.

Worthy said, however, that under the new terms it might be possible for the Navy actually to save money, rather than lose the $9.4 million, if shipyard wage rates rise quickly enough.

An entirely separate issue—whether the Navy acted in bad faith by refusing to negotiate a new delivery date for 16 months, until Rule was named to the job—also faces MacKenzie.

The judge set Aug. 15 for a trial date in case he rejects the shipyard's motion to enforce Rule's agreement on the government, adding, "It may well be that it won't get that far."

He expressed annoyance that the "essentially petty argument" was dragging out so long.

"The average wage earner in Newport News Shipbuilding is on a fine edge" with reports of threats of breaking off of Navy work.

ITEM 46.—*Apr. 26, 1977—Letter from Senator Proxmire to Attorney General Bell urging that the Justice Department appeal the decision of the Federal Judge of the Eastern District Court of Virginia regarding the CGN41 case. (For text of District Court decision see "Miscellaneous" documents appendix)*

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., April 26, 1977.

Hon. GRIFFIN B. BELL,
The Attorney General, Department of Justice,
Washington, D.C.

DEAR JUDGE BELL: Attached are letters I sent to your predecessor concerning the CGN 41 contract dispute involving Newport News Shipbuilding and Dry Dock Company and the U.S. Navy. In these letters I expressed my concern at the manner in which the Defense Department was handling the CGN 41 dispute. Deputy Secretary of Defense Clements and the CGN 41 negotiator, Mr. Gordon Rule, appeared bent on a course of action aimed at undermining the Government's case. It appears that retired Vice Admiral Eli Reich, a consultant to the Deputy Secretary of Defense, was also intimately involved. In response to my letters the Attorney General assured me that any proposed settlement of the CGN 41 litigation would not be implemented by the Defense Department without the prior review and approval of the Attorney General.

Notwithstanding these assurances, Mr. Rule negotiated a settlement. Then, in violation of the written orders of his Navy superiors and without complying with the Armed Services Procurement Regulation as required by his Contracting Officer warrant, he signed and delivered to Newport News a contract modification purporting to implement that settlement. Newport News presented the signed contract modification to the court and requested that the Government be required to honor it.

The Justice Department argued in court that Mr. Rule did not have the legal authority to enter into such an agreement; that the Department of Justice considered the Government did not receive adequate consideration in

the proposed Rule settlement; that the Attorney General had rejected the proposed contract modification as a settlement for litigation involving the United States; and that the settlement agreement was not enforceable.

A Federal Judge in the Eastern District Court of Virginia dismissed the Justice Department's objections, and ruled that the Government is bound by the Rule settlement. By so doing the Judge legitimized the actions of the Deputy Secretary of Defense and the CGN 41 negotiator in circumventing the procurement laws and regulations, bypassing the cognizant Navy officials and outmaneuvering the Justice Department. The Judge's ruling means that these two officials succeeded in undermining the Government's cases and as a result were able to bind the Government to pay sums which your own Department considers are excessive. They were able to evade successfully the provisions and safeguards required by statute when extraordinary contractual relief is deemed necessary to facilitate the national defense. I might add that I question whether the Court's ruling in this case is binding on Congress.

I have followed the CGN 41 case closely and have been shocked by the conduct of certain senior Government officials. I am also fearful of the possible implications of the Judge's decision in this case for other procurements. How can we tolerate a situation wherein Government officials can make extra-contractual settlements without the normal safeguards that we in Congress have been led to believe are applicable? The idea that a Government official can effectively bind the Government to settlement terms under which the Government does not get fair value in return could potentially undermine the basis of all Government contracts.

I understand the Justice Department has until May 8 to appeal the Judge's decision. In view of the tainted history of this dispute and the potential ramifications of the court decision, I presume that the Justice Department will appeal the decision, to the Supreme Court if necessary. I request your confirmation that this is so. I am also interested in knowing what recommendations, if any, the Secretary of the Navy has made in this regard. If the Department loses an appeal, it is obvious that corrective legislation will be needed. The Government cannot afford to operate on the basis of the precedents established in this case.

In addition, it appears to me that the Department of Justice should conduct a full investigation to determine whether the officials who apparently have compromised the Government's case have violated Federal statutes. I would also like to know what additional safeguards the Justice Department has implemented to prevent a recurrence of incidents of this type and the status of the Justice Department's investigation of the Newport News claims which was begun last year.

I would appreciate hearing your views on these matters at your earliest convenience.

Sincerely,

WILLIAM PROXMIRE,
United States Senate.

ITEM 47.—*May 4, 1977—Letter from Navy General Counsel West to Assistant Attorney General Babcock urging an appeal be taken from the Eastern District Court of Virginia ruling of March 8, 1977*

DEPARTMENT OF THE NAVY,
OFFICE OF THE GENERAL COUNSEL,
Washington, D.C., May 4, 1977.

Re: *United States v. Newport News Shipbuilding and Dry Dock Company*, et al., Civil Action No. 75-88-NN, U.S.D.C., E.D. Virginia.

BARBARA ALLEN BABCOCK, Esquire,
Assistant Attorney General, Civil Division, Department of Justice, Washington, D.C.

DEAR MS. BABCOCK: Your letter of March 14, 1977, requested the recommendation of the Department of the Navy regarding appeal of the Order and Memorandum Opinion entered March 8, 1977, in the above-captioned case.

We have reviewed this matter at length and are concerned that if this decision is allowed to become final and binding it will adversely affect the conduct of Navy business. Accordingly, we urge that an appeal be taken.

Sincerely,

TOGO D. WEST, Jr.

ITEM 48.—*May 13, 1977—Washington Star article entitled "Proxmire Is Seeking Navy Cruiser Probe"*

NEWPORT NEWS, Va. (UPI)—Sen. William Proxmire, D-Wis., has called for an investigation into the Navy's compromise settlement with Newport News Shipbuilding Co. on cost overruns.

Proxmire asked Atty. Gen. Grffin B. Bell to study the settlement on cost overruns for a nuclear cruiser which he said could cost the Navy $30 million.

He said former deputy Defense Secretary William P. Clements, Jr. and Gordon W. Rule, a Navy troubleshooter, circumvented naval procedures.

"It appears to me that the Department of Justice should conduct a full investigation to determine whether the officials who apparently have compromised the government's case have violated federal statutes," Proxmire said.

Proxmire made the comment in a letter to Bell which was disclosed by the Newsport News Times-Herald.

Last week the Navy asked the Justice Department to appeal U.S. District Court Judge John A. MacKenzie's decision to validate the settlement, reached last year by Rule at Clements' direction.

The Justice Department, which represents the Navy, filed a protective notice of appeal May 5 to meet a May 9 filing deadline. The Justice Department argued that Rule signed the agreement without the required approval of his Navy superiors. But MacKenzie decided Rule was authorized to sign the agreement.

Proxmire wrote Bell, "The judge's ruling means that these two officials succeeded in undermining the government's case and as a result were able to bind the government to pay sums which your own department considers are excessive.

"The idea that a government official can effectively bind the government to settlement terms under which the government does not get fair value in return could potentially undermine the basis of all government contracts," he said.

ITEM 49.—*Feb. 27, 1978—Decision of United States Court of Appeals for the Fourth Circuit, reversing Judge MacKenzie's decision of Mar. 8, 1977*

No. 77-1748

UNITED STATES OF AMERICA, APPELLANT

v.

NEWPORT NEWS SHIPBUILDING AND DRY DOCK COMPANY, AND TENNECO, INC., APPELLEES

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF VIRGINIA, AT NEWPORT NEWS, JOHN A. MACKENZIE, DISTRICT JUDGE

ARGUED OCTOBER 4, 1977, DECIDED FEBRUARY 27, 1978, BEFORE HAYNSWORTH, CHIEF JUDGE, BUTZNER, CIRCUIT JUDGE, AND FIELD, SENIOR CIRCUIT JUDGE

Patricia N. Blair, Attorney, Civil Division, Department of Justice (Barbara Allen Babcock, Assistant Attorney General; William B. Cummings, United States Attorney; Leonard Schaitman & Stuart E. Schiffer, Attorneys, Civil Division, Department of Justice on brief) for appellant; K. Martin Worthy (John G. DeGooyer, Mark Sullivan, III, John H. Spellman, Jeffrey M. Petrash, Larry M. Mitchell, Hamel, Park, McCabe & Saunders; William McL. Ferguson, Ferguson & Mason on brief) for appellees.

Butzner, Circuit Judge:

The United States appeals from an order of the district court enforcing an oral settlement purportedly reached between the Department of the Navy and the Newport News Shipbuilding and Drydock Co., and dismissing as moot the government's suit for specific performance of a contract for construction of a vessel. We vacate this order because we conclude that the parties' negotiators did not settle the case orally and because the Attorney General, whose approval was essential, rejected the terms that were ultimately reduced to writing.

I

This litigation arises from the Navy's attempt to exercise an option for construction of the DLGN–41, the fourth ship in a class of nuclear powered guided missile frigates. As part of an agreement to negotiate a number of disputed matters, the final date for exercising this option was extended to February 1, 1975. In the meantime, the Navy authorized the shipyard to start preconstruction work. In August 1974, however, the shipyard notified the Navy that for a variety of reasons it considered the option invalid. The Navy disagreed, and on January 31, 1975, it formally undertook to exercise the option. The parties then signed a memorandum of understanding obligating the shipyard to continue its preconstruction work while they negotiated. August 1975, the shipyard exercised its right to cancel the memorandum of understanding because it was dissatisfied with the progress of the negotiations.

As a result of the cancellation, the Navy filed this suit seeking specific performance of the contract and a temporary restraining order directing the shipyard to resume work on the vessel. At a hearing on August 29, 1975, the district court adopted as its order a stipulation by the parties providing for continued work on the ship, for continued payment for work performed, and for negotiations "in good faith to reach an agreement as rapidly as possible to modify those contract provisions requiring amendment or to take other appropriate action."

The shipyard, again dissatisfied with the Navy's negotiating tactics, filed a motion on July 13, 1976, for enforcement of the court's order to negotiate in good faith. It also sought to have its obligation to continue work suspended until the Navy complied. The Navy countered by designating as its negotiator Gordon W. Rule, an experienced civilian official in the procurement office. In view of this development, the shipyard requested the court to reserve ruling on its motion.

Rule began negotiating with the shipyard on July 15, 1976, and subsequently the Navy issued him a contracting officer's warrant granting him "unlimited authority with respect to negotiations." On August 20, 1976, the parties reached what Rule and the shipyard's negotiators considered to be an oral agreement in principle which the Navy later estimated would increase the cost of the ship by about 22.7 million dollars.

The shipyard prepared a written first draft of the oral agreement which Rule received on August 30, 1976. The negotiators then met on several occasions to discuss revisions. A second draft was circulated on September 27, 1976, and further discussions concerning revisions were held. On October 7, 1976, the shipyard executed a third draft of the agreement and sent it to Rule. Although Rule signed the draft as presented by the shipyard, he conditioned his execution of the document by the following provisions set forth in his letter returning it to the shipyard:

> (i) That ultimate approval must be received from Deputy Secretary of Defense Clements, and
>
> (ii) That escalation under this Mod [i.e., modification of the contract] will be paid by the Government on the basis of the cotractor's actual experience or the BLS Indices times 1.25, whichever is less.

On October 15, 1976, Deputy Secretary Clements forwarded a copy of the compromise to the Attorney General with the recommendation that it be approved. The Attorney General, however, disapproved it on November 24, 1976.

During the negotiations dissension had arisen concerning the scope of Rule's duties. Rule thought he possessed plenary authority both to negotiate and to bind the government to any agreement he reached. Immediately after his appointment, he told the shipyard that this was the extent of his power. The Navy agreed that Rule possessed unlimited authority to negotiate, but it denied granting him unreviewable authority to bind the government to a settlement. Alerted by a news report that the shipyard considered the law suit to have been settled on August 20, Rule's superiors explicitly cautioned him several times that any agreement he reached would require approval by higher authorities. The Navy also informed representatives of the shipyard about the necessity for review and approval.

Rule himself appears to have recognized that his authority was not as unrestricted as he first supposed. In a memorandum dated October 5, 1976, he submitted the proposed agreement to the Chief of Navel Material for approval and referred to obtaining "final review and approval" from the Office of General Counsel of the Navy. Finally, the letter addressed to the shipyard accompany-

ing Rule's executed copy of the agreement expressly conditioned his execution of the document on approval by Deputy Secretary Clements.

Shortly after Rule executed the agreement, and even before the Deputy Secretary transmitted his recommendation to the Attorney General, the shipyard moved the district court to enforce the compromise and dismiss the government's action for specific performance. In the alternative, it moved to dismiss the action on the ground that the Navy had failed to negotiate in good faith.

The court considered the shipyard's motion to enforce the settlement without conducting an evidentiary hearing. Relying on affidavits and discovery depositions, it found that Rule had authority to bind the government to the settlement he negotiated; that agreement was reached orally on August 20, 1976, and subsequently memorialized; that Deputy Secretary Clements approved the agreement; and that the Attorney general "is estopped to deny the settlement."

II

We find no reversible error in the Navy's complaint that the district court should have held an evidentiary hearing on the motion to enforce the settlement. When there is no real dispute about the facts, a court has inherent power to enforce summarily a compromise terminating pending litigation. *Meetings & Expositions, Inc.* v. *Tandy Corp.*, 490 F. 2d 714, 717 (2d Cir. 1974). The only conflict of any significance concerned Rule's duties. We have some doubt that the law and the evidence support the conclusion that the Deputy Secretary vested him with authority to commit the Navy to the expenditure of additional millions of dollars for the construction of the vessel. This issue, however, is not material to our decision. The uncontradicted evidence establishes that by August 25, the Navy had notified the shipyard of the necessity for review and approval of any settlement Rule negotiated. The critical question therefore is whether the August 20 oral agreement was a binding settlement as the shipyard insists and the district court found.

III

Parties to contractual negotiations may enter into an enforceable oral contract that is later to be expressed in writing if, intending to be bound, they reach agreement on all major issues. *Orient Mid-East Great Lakes Service* v. *International Export Lines, Ltd.*, 315 F. 2d 519, 522–23 (4th Cir. 1963); In Re: ABC-Federal Oil & Burner Co., 290 F. 2d 886, 889–90 (3d Cir. 1961); 1 A. Corbin, Contracts §§ 29, 30 (1963); Restatement (Second) of Contracts §§ 26, 32 (Tent. Draft, 1973). Applying this principle to the uncontradicted facts discloses that the parties did not intend to commit themselves irrevocably to an oral settlement of the case on August 20.

First, the draft agreement prepared by the shipyard after the August 20 negotiating session contained an escalation clause that computed payments by using indices prepared by the Bureau of Labor Statistics from data concerning steel vessel construction throughout the country. The Navy soon determined, however, that the shipyard's actual costs had increased less than the BLS indices. In subsequent discussions Rule insisted that the escalation clause be changed to award payments based on the shipyard's actual experience or 1.25 of the BLS indices, whichever was less. Estimating that the difference between the two clauses amounted to about 9.4 million dollars, Rule aptly characterized this issue as substantive. The final draft submitted to Rule on October 7 retained the shipyard's version of the escalation clause, and Rule expressly conditioned his execution of the draft on acceptance of the government's position. Although the shipyard had represented during the negotiations that it would relent if this issue "became . . . the hinge point" for the whole settlement, it did not accede to the condition Rule imposed. In January 1977, at the hearing on enforcement of the August 20 oral agreement, it pressed for the clause awarding the higher escalation payments.

The shipyard's final draft was essentially an offer of settlement. Rule accepted this offer subject to a condition concerning the escalation clause. Under these circumstances, the following principle of law applies: "when an offer or a counter-offer is accepted subject to a condition or reservation, neither party is bound to an agreement until the condition or reservation has been withdrawn or satisfied." *Orient Mid-East Great Lakes Service* v. *International Export Lines, Ltd.*, 315 F. 2d 519, 522 (4th Cir. 1963).

Second, by his letter of October 8 transmitting the executed agreement to the shipyard, Rule indicated that he did not intend the government to be bound either by the results of the August 20 negotiations or by his execution of the final draft. In this letter he conditioned his execution of the document by the statement that "ultimate approval must be received from Deputy Secretary of Defense Clements." To sustain its thesis that the August 20 agreement bound the government, the district court construed this condition to mean that Deputy Secretary Clements must "approve the document as memorializing the compromise agreement between the parties." This restrictive view of the Secretary's function is not supported either by the plain language of the letter or by any action of the Deputy Secretary. He played a far more responsible role than simply determining whether the executed document prepared by the shipyard conformed to the terms of the oral negotiations. Moreover, the Deputy Secretary did not undertake to commit the government to the settlement that Rule had negotiated. In his letter to the Attorney General of October 15, 1976, which is set forth as an appendix, he recognized that final approval rested with the Attorney General.

IV

Title 28 U.S.C. §§ 516 and 519 authorize the Attorney General to supervise all litigation involving an agency of the government unless the law otherwise directs. As an incident to this broad grant, he has authority to agree to dismissal of actions brought by the government. *See* Confiscation Cases, 74 U.S. (7 Wall) 454, 458 (1868). His authority to compromise and settle any case referred to the Justice Department was expressly confirmed by § 5 of Executive Order No. 6166, June 10, 1933, 5 U.S.C. § 901.[1]

Notwithstanding these well established principles, the district court held that the Attorney General was estopped from disapproving the settlement for two reasons. First, it noted that during oral argument the Department of Justice stipulated that when Rule was appointed he had authority to bind the United States. The government, however, protests that it made no such stipulation or concession. It points to portions of the transcript where it specifically denied that Rule could bind the government while recognizing that he had authority to negotiate with the shipyard. The shipyard in its brief does not claim that the government made such a concession, and we have been unable to find it in the record.

The second reason the district court assigned for its ruling is that the Justice Department took no action to fulfill its obligation to negotiate in good faith pursuant to the court's order "except through its implicit delegation of any authority it had to settle this litigation to the Department of Defense." We conclude that this reason does not provide a sufficient basis for invoking estoppel.

The negotiations concerning settlement of the litigation between the shipyard and the Navy covered many technical issues about the construction of the vessel, the computation of its cost, and a feasible date for its delivery. It was therefore reasonable for the Justice Department attorneys to leave discussion of these complex subjects to Navy officials who had the expertise to deal with them. But another important question was whether the government should press its suit for specific performance of the initial contract instead of compromising, in view of the millions of dollars involved. The answer to this question depended on careful analysis of the strength of the government's claim from both evidentiary and legal standpoints. In turn, the disclosures of that survey had to be weighed against the results of Rule's negotiations. The final product of this study was an assessment of the litigative risk.

The Attorney General did not, either personally or through his subordinates, delegate to Rule the authority to make this critical decision. Moreover, Deputy Secretary Clements, who was the source of Rule's authority, understood that the responsibility for evaluating the litigative risk and consequently for ultimately approving or disapproving the settlement remained with the Attorney General. We therefore conclude that the record does not support the court's ruling that the Attorney General was estopped. The law pertaining to the At-

[1] Section 5 of Executive Order No. 6166 provides in part:

> As to any case referred to the Department of Justice for prosecution or defense in the courts, the function of decision whether and in what manner to prosecute, or to defend, or to compromise, or to appeal, or to abandon prosecution or defense, now exercised by any agency or officer, is transferred to the Department of Justice.

torney General's control over cases referred to the Department of Justice by other agencies of the government fully sustains his authority to disapprove the proposed compromise.

V

As an alternative ground for dismissing the government's suit for the specific performance of the construction contract, the district court held that the government was barred by the doctrine of unclean hands because it did not negotiate in good faith. The controversy about the government's negotiating tactics centers on the parties' August 29, 1975, stipulation which was incorporated in the court's order. In view of the dispute about the validity of the Navy's option, the parties stipulated that they would "negotiate in good faith to reach an agreement as rapidly as possible to modify those contract provisions requiring amendment or to take over appropriate action." The nub of the issue is the clause "to take other appropriate action." The shipyard contends that this language was intended to impose a duty on the parties to renegotiate the basic contract for the construction of the vessel. Although there was some difference of opinion in its ranks about the meaning of the language, the Navy asserted, at least until the time Rule was appointed its chief negotiator, that it was required to bargain over the basic contract only if the shipyard offered some new legal consideration or demonstrated governmental responsibility justifying more favorable terms.

The Navy's claim of good faith is altogether consistent with paragraph five of the stipulation, which provided, "This stipulation and any action taken by either party pursuant hereto shall be without prejudice to the rights or legal positions of either party." The Navy was not obligated to abandon its legal position in order to demonstrate good faith bargaining if its insistence was sincerely held. NLRB v. Almeida Bus Lines, Inc., 333 F. 2d 729, 731 (1st Cir. 1964). Although the underlying facts were not in dispute, there was a controversy as to the inferences that could properly be drawn from them. In the context of this controversy, the clause "to take other appropriate action" is ambiguous; there is a genuine dispute about its meaning. Under these circumstances, summary disposition of the case on the basis of the defense of unclean hands is inappropriate. American Fidelity and Casualty Co. v. London and Edinburgh Insurance Co., 354 F.2d 214, 216 (4th Cir. 1965).

The judgment of the district court is reversed, and the case is remanded for further proceedings consistent with this opinion.

APPENDIX

THE DEPUTY SECRETARY OF DEFENSE,
Washington, D.C., October 15, 1976.

Hon. EDWARD LEVI,
Attorney General, Department of Justice, Washington, D.C.

DEAR MR. LEVI: This letter forwards a proposed settlement of the CGN–41 litigation negotiated pursuant to Court Order. As you know, I have been deeply committed to efforts to settle the Navy's on-going disputes with the shipbuilding industry and have undertaken a number of initiatives to this end. In a meeting on 13 July 1976, Senior Navy Officials, with my approval, appointed Mr. Gordon W. Rule of the Naval Material Command as the principal negotiator of this particular matter. Mr. Rule has negotiated a proposed modification to the contract with Newport News, attachment (1), on the CGN–41.

In view of the long-standing, acrimonious, and disruptive controversy between the Navy and its sole present new construction surface nuclear warship contractor, I consider it vital to the national defense that this dispute be resolved as quickly as possible. I consider the proposed modification a reasonable resolution to this complex matter.

Attachment (2) provides a comparative financial estimate of the proposed settlement. While attachment (2) indicates a difference of $22.7M I believe it is reasonable to assume that a Court might grant Newport News, as a minimum, an extension of the existing escalation coverage to an achievable contract delivery date (e.g., August 1980); consequently, the difference in the settlement could be reduced another $7.5M, to $15.2M. We have not included any other assessment of litigative risk since this is a matter under your purview. Quantifying the latter could further reduce or eliminate the $15.2M differential noted above.

In any event, the District Court instructed the parties as follows: "The parties agree to negotiate in good faith to reach an agreement as rapidly as possible to modify those contract provisions requiring amendment or to take other appropriate action." Mr. Rule, in the spirit of this order, negotiated a contract modification which, if approved, would undoubtedly facilitate the construction of the badly needed CGN-41.

Accordingly, I am forwarding the results of these negotiations for your approval and such legal action as may be necessary to obtain ratification.

W. P. CLEMENTS, Jr.

Attachments.

ITEM 50.—*Mar. 1, 1978—Virginia-Pilot Article Entitled "Navy Wins Appeal on Overruns"*

RICHMOND (AP)—A federal appeals court has reversed an order that would have forced the Navy to pay Newport News Shipbuilding $20 million to $30 million in cost overruns involving the construction of a $337-million nuclear cruiser.

In an opinion dated Monday and released Tuesday, the U.S. 4th Circuit Court of Appeals overturned a ruling by U.S. District Judge John A. MacKenzie.

The lower court judge had decided that the Navy failed to negotiate in good faith with the Newport News shipyard in connection with construction of the fourth of the so-called Virginia class warships.

Writing for a panel of three, Circuit Judge John D. Butzner Jr. said MacKenzie's order was vacated "because we conclude that the parties' negotiators did not settle the case orally and because the (U.S.) attorney general, whose approval was essential, rejected the terms that were ultimately reduced to writing."

Joining with Butzner were Chief Judge Clement F. Haynsworth Jr. and Senior Circuit Judge John A. Field Jr. The three judges sent the case back to MacKenzie for further proceedings.

The shipyard, Virginia's largest private employer, stopped work on the nuclear cruiser in August 1975 because of changes in plans it said made the contract void.

The Navy filed suit. After a brief hearing in Norfolk before MacKenzie, the Navy and shipyard agreed to abide by the judge's order that they negotiate the dispute in good faith.

In his later ruling, however, MacKenzie said the Navy had failed to obey his good-faith order.

In a 36-page decision, MacKenzie ordered the Navy to adhere to a compromise reached in mid-1976 between shipyard officials and Gordon W. Rule, who was at the time senior contracting official for the Navy. That agreement increased the price by the $20 million to $30 million. The Navy had refused to abide by the agreement worked out by Rule.

APPENDIX F

Documents Relating to General Dynamics' Submarine Shipbuilding Claims

CONTENTS

ITEM 1.—*April 14, 1978—Groton News article entitled "General Dynamics Has Record Quarter"*

ST. LOUIS, Mo.—General Dynamics Corporation reported Tuesday that its first quarter earnings for 1976 were the highest of any first quarter in the company's history.

David S. Lewis, chairman and executive officer of the company, told shareholders at the annual meeting that the results are attributable to outstanding performance by the company's aerospace and tactical missile divisions, and significant improvement in earnings from the marine operations, primarily in the increased level of sales on the Trident submarine program.

The Electric Boat division was awarded the contract for the Navy's fourth Trident submarine in February. Also contributing to the good showing by the division is a just-announced $97 million contract settlement for the first seven 688-class submarines. More contract claims are pending for those subs and the next eleven under contract to EB.

"We believe that the negotiated contract price increases will insure that EB will complete this major program without incurring any loss, and until we have more experience on the program we plan to continue our policy of accruing no earnings on the 688s for the foreseeable future," Lewis said.

Lewis told the stockholders that earnings for the quarter ending March 31, 1978 were $17.24 million, or $1.59 per share. Net earnings for the same quarter last year, which also set a record, were $13.7 million, or $1.31 per share. The figures for last year have been recomputed to conform to a change in accounting for foreign currency translations.

Sales for the first quarter this year were over $568 million, compared with last year's figure of $509 million.

While the company has invested a half billion dollars in new or improved facilities over the past few years, at the same time it has been reducing long-term debt and increasing the individual shareholders' equity in the corporation by 69 percent.

The record $6.1 billion funded and unfunded backlog at the end of 1975 included just $413 million for the new F–16 air combat fighter program. Lewis said, even though the 998 aircraft being planned for the air forces of the U.S. and four NATO allies have a value of at least ten times that amount.

Discussing some of the significant events of recent months, Lewis noted that the Convair division won a two-year competition for a $35 million development contract for the Navy's new Tomahawk strategic and tactical cruise missile. The Strategic Arms Limitation Talks II with the Soviet Union will have a direct bearing on future production, he noted.

In the marine divisions, Lewis noted that in recent months the company has been exploring various arrangements which could lead to contracts for more than eight liquified natural gas tankers to be built at the Quincy, Mass. shipyard, at the same time allowing for profitsharing from partial company ownership of the ships.

Progress was also noted in the signing of an agreement to construct, own and operate two LNG tankers between Algeria and the Gulf of Mexico in cooperation with two other companies.

Summarizing General Dynamics' overall position, Lewis said it is good and getting better, with 40 percent of the business in commercial and nongovernmental operations.

ITEM 2.—*Mar. 22, 1977—New London Day article entitled "'Team' Has EB Claims"*

(By Joan Poro)

WASHINGTON.—General Dynamics-Electric Boat's contract claims of $544 million have been referred to a special claims settlement team in an effort by the Navy to settle them as promptly as possible.

This was disclosed today by Adm. Frederick H. Michaelis, chief of naval material in testimony before the defense subcommittee of the House Appropriations Committee.

"There has been no program more frustrating than the program of naval shipbuilding over the years," said Rep. George Mahon of Texas, chairman of the Appropriations Committee at the opening today of three days of hearings.

One of the prime concerns of the subcommittee and the Navy during these hearings will be the problems between shipbuilders and the Navy which have lead to $2.4 billion in outstanding contract claims.

"We have been harrassed constantly by this problem of claims," Mahan said.

A claims settlement team, headed by Rear Adm. Frank Manganaro, was formed less than a year ago to settle shipyard claims promptly, Michaelis said The first to be settled, a $144 million claim from Newport News Shipbuilding, was settled by the team in February.

On March 1, two recent claims from Electric Boat were assigned to the team for settlement.

"With the Manganaro team, we are achieving a proper balance between accuracy and speed of settlement," Michaelis said.

The three-day hearings will probe the deteriorated relationship between the Navy and private shipbuilders, and the problems of the Navy's shipbuilding program—soaring costs, countless costly changes in orders, and late delivery of ships.

General Dynamics-Electric Boat, whose annual Groton payroll of $273 million depends upon its sole customer, the Navy, will be represented, along with EB's two chief competitors, Newport News Shipbuilding and Ingalls Nuclear Shipbuilding.

The three shipbuilders were invited to testify because they have filed the largest contract claims against the Navy. Totalling $2.4 billion, it may take years of hard negotiations before the claims are settled.

Today's testimony was being given by a group of naval officers led by Michaelis.

Meanwhile, cost overruns continue to mount. Pentagon officials expected last summer EB would file a claim of $300 million on its 688-class submarine contracts. By the December deadline for filing, the figure had jumped to $437 million. It's now at $544 million—cost overruns for which EB blames the Navy. General Dynamics chairman and chief executive David S. Lewis cites two reasons—30,000 changes ordered during construction of the 688-class subs, "very unrealistic escalation clauses" in the 688 contracts.

Prolonged contract disputes have led Newport News and Ingalls each to treaten to stop work on ships already under construction in their yards. When the parties have failed to settle their differences in negotiations, the issues have been forced into court.

"An acrimonious and adversarial environment now marks Navy-shipbuilder business relations," says the shipbuilders Council of America, composed of nearly all the builders of large Navy ships.

The deterioration of those relations became obvious last fall when Newport News told the Navy it would not bid on any more Navy ships and proceeded to amass a backlog of commercial ship construction. The Defense Department, in turn, began to give serious consideration to building new ships, including the 688-class subs so vital to EB, in its own Navy yards.

The situation has eased somewhat since then. Newport News and the Navy settled last month a $149-million claim ($742 million in claims remain in dispute) and the company is expected to bid on the next 688-class contract. The Defense Department proposal reportedly died because of the increased costs of building the subs in Navy yards.

But cost overruns and claims remain unresolved, and the House Defense Appropriations Subcommittee wants to know who the responsible parties are.

In addition, the subcommittee also is expected to analyze during these hearings the Fiscal 1978 and five-year shipbuilding programs.

Late this morning the subcommittee was hearing testimony on the Navy's plans to increase its active duty fleet from 475 ships to a long-range goal of 600 ships.

ITEM 3.—*Sept. 23, 1977—Norwich Bulletin article entitled "EB Boss Denies Rumor of Sub Plant Shutdown"*

(By Thomas C. Oat and Dennis Morin)

NORWICH.—Laying to rest rumors of an impending shutdown at the shipyard, Electric Boat General Manager Gordon E. MacDonald Thursday night sternly warned management officials the shipyard is "struggling" for survival.

Announcing several major changes at the shipyard, MacDonald said EB told the Navy they would no longer accept submarine overhaul contracts and would concentrate instead on new submarine construction.

MacDonald, who came to the Groton shipyard in April 1976, specifically to straighten out major submarine programs, told management they've lost a lot of construction contracts and jobs because of their own problems.

"We are struggling for our lives right now," MacDonald told the managers. He added the company is trying "to survive" as the best submarine construction facility in the world.

MacDonald gave the main address at the tenth annual meeting of the EB Management Club Thursday night at the Norwich Sheraton.

"We've done a lot, but it's not enough," MacDonald said of improvements at the shipyard. "We have to work together as a team.

"I am convinced without any question at all that we can turn it around," MacDonald said.

MacDonald told the group about his recent meetings with officials in Washington and said he would be in Washington several times in the next week to defend the shipyard's record.

"We have everything in our favor," MacDonald said.

MacDonald discounted several rumors which have been circulating around the shipyard and in Washington concerning a November shutdown of the shipyard and his own departure from what was originally forecast as a temporary job.

"We are not going to shut down the yard," MacDonald told the group. Although he admitted he received calls from Washington on the rumor and also feedback from local Navy officials, MacDonald said the shipyard had no such plans.

MacDonald recounted his job when he came to the Groton facility from General Dynamics main headquarters in St. Louis was to straighten out the 688 construction program and other problems at the shipyard, and, he said, he had not completed that task.

He said he was not leaving the Groton job "until I'm satisfied it (the 688 program) is right.

"We have made significant improvements, but it's not enough," MacDonald sternly told the more than 300 management officials. "Even with these significant improvements, you have to realize we have a long way to go.

"There is no reason in the world we shouldn't have had the whole thing," MacDonald told the managers about recent awards of submarine construction contracts to competitors. "We have lost a lot of jobs into the 1980's."

Electric Boat has been struggling under a mammoth backlog of submarine orders, both in the 688 and Trident classes, and recently lost out on bids for three 688 projects. Delivery dates on many EB contracts recently had to be extended.

"We have a real problem with our credibility," MacDonald told the managers, and noted recent meetings with Navy and government officials over future awards.

MacDonald told the group he personally told Navy officials EB did not want to do any submarine overhauls in the near future and wants to concentrate on new construction.

However, he warned the shipyard must maintain its capability to do such jobs in 1979–1980 or before if overhaul problems arise which no one else can handle.

MacDonald said he "met a lot of opposition" in his attempt to get the shipyard out of the overhaul business, "but I felt it was something that had to be done."

ITEM 4.—*Oct. 25, 1977—Daily Press article entitled "General Dynamics Threatens Navy With Shutdown"*

General Dynamics' Electric Boat Division has given the Navy an ultimatum on paying outstanding shipbuilding claims, according to an article in the current issue of Business Week.

According to the Oct. 31 issue, Electric Boat reportedly warned the Navy last week that it will close its gates for the month of December unless it gets an advance on $544 million in outstanding claims.

Both the Navy and Electric Boat deny there has been any ultimatum.

Newport News Shipbuilding in August 1976 and again in October 1976 said it would stop building Navy ships unless the Navy made progress in setting $893 million worth of claims that were outstanding at that time.

Electric Boat has $2 billion worth of contracts to build 18 high-speed nuclear attack submarines. However, of the eight submarines that were supposed to be delivered by now, only one has been built.

Newport News is currently building 11 such attack submarines. The yard has delivered the USS Baton Rouge and the lead sub of the class, the USS Los Angeles.

Besides Newport News and Electric Boat, Litton System's Ingalls shipyard in Mississippi has had a running conflict with the Navy over claims. Currently, it is building Navy ships under court order.

In addition to problems with the Navy, Electric Boat is undergoing some radical management changes, according to the Norwich, Conn. Bulletin. The Bulletin in today's issue also says that 15 to 30 percent of the labor force of over 20,000 will be laid off soon because of the worsening financial condition of the yard.

ITEM 5.—*Oct. 24, 1977—New London Day article entitled "Shipyard's Future Cloudy as Problems Multiply"* [1]

(By Joan Poro and Dan Stets)

GROTON.—Persistent labor and management problems appear to be pushing General Dynamics-Electric Boat toward a potential loss of hundreds of millions of dollars on the 688-class nuclear submarine program.

Even if EB obtains a substantial portion of its $544-million claim against the Navy on 688-class contracts, a major loss is in the offing, according to EB and government sources.

NEW GENERAL MANAGER

P. Takis Veliotis today becomes the third general manager in three years to try to get a handle on an overcrowded shipyard, unskilled labor force and two of the nation's major new weapons systems.

MacDonald: EB must be profitable to survive as a submarine builder.

Veliotis, 53, has come from General Dynamics Quincy shipbuilding Division where he managed a workforce a quarter the size of EB's.

He replaced Gordon E. MacDonald who returned to corporate headquarters and left Veliotis with major productivity problems affecting a $3 billion backlog of seventeen 688's and five Trident missile subs.

Veliotis today initiated a major reorganization of top management. He reportedly has sharply reduced the number of staff managers serving under the former general manager and brought in a management team from Quincy Shipbuilding.

The Day has learned the delivery dates in the 688 program have been pushed back again, resulting in an average 26-month delay from original contract delivery dates and a seven-month slip from EB's previous estimates.

Employees: EB has bitten off more than it can chew.

In addition, the Navy warned Congress last week EB's delivery estimates for the Tridents are unrealistic because of productivity problems. While EB projects delivery of the lead ship Ohio for October 1979, the Navy believes the ship will not be completed until April 1980—a full year behind the original contract schedule.

The estimated number of manhours to complete the Ohio already has increased from 14.5 million to 19.6 million—a 35 percent jump. *The Day* has learned.

The corresponding increase in projected construction costs was from $305 million to $430 million.

The lagging productivity is expected to continue to drive up cost overruns on the $1.4-billion 688 program and cut into anticipated profits from the Tridents.

Information from several sources suggests the potential loss on the 688s could be as high as $400 million—four times the earnings of General Dynamics in 1976 and twice Lockheed Aircraft's loss on the C5-A cargo plane in 1969.

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[1] Editor's Note: In a five-part series starting today, *The Day* analyzes labor and management problems of General Dynamics-Electric Boat.

The series is based on interviews with government, business and EB sources, including members of top management at EB.

Former General Manager Gordon E. MacDonald and Adm. Hyman G. Rickover, chief of the naval nuclear propulsion program, both refused to be interviewed.

Navy Secretary W. Graham Claytor Jr. personally intervened, at the request of EB concerning release of information sought by *The Day* from the Navy under the Freedom of Information Act. *The Day's* requests still are being analyzed by the Navy secretary.

Tuesday's story deals with the problems EB encountered in hiring unskilled new employees and the impact on submarine construction.

Signals of the potential loss can be gleaned from General Dynamics' quarterly and annual reports on the 688 program.

Auditors: General Dynamics' financial position hinges on EB's productivity.

The corporation said in its annual report it needs a substantial portion of the claim—coupled with projected productivity improvements—to avoid a loss.

But in its latest quarterly report the corporations now says a "very substantial" portion of the claim must be recovered—again, depending on productivity improvements which have not developed, according to several shipyard sources.

MacDonald, General Dynamics' financial vice president, disclosed recently the corporation is dumping $15 million a month into the ailing EB division on top of $200 million already involuntarily invested.

Not all of EB's wounds are self-inflicted. MacDonald has said bad 688-class designs by Newport News and unforeseen double-digit inflation in the early years of the program played a major role.

"I have watched with great concern in recent years as this highly successful submarine designer and builder has struggled against overwhelming odds to build the SSN-688 class submarines," MacDonald told a congressional subcommittee earlier this year. "Thousands of engineering changes and design modifications, delays and inflation have caused monumental difficulties for the company . . . We must find a way for this division to return to a reasonable level of profitability if Electric Boat is to suvive as a submariner builder."

These problems were compounded by poor productivity, inability to hire skilled labor, inadequate material control and ineffectiveness of frequent managerial reorganizations.

General Dynamics is banking EB's future profits on a significant upturn in productivity. In its 1976 annual report, the corporation concedes profits on Trident depend on "good performance by Electric Boat." And it says its hopes for avoiding a loss on the 688 program hinge on "projected productivity improvements."

Arthur Andersen & Co., the corporation's auditor, qualified its 1976 audit by warning shareholders that General Dynamics' financial position is dependent upon "achievement of the productivity improvements included in the (688) program cost estimates," as well as recovery of a substantial portion of the claim.

EB, which employs a total of about 28,000 men and women, has expanded its production workforce by 5,000 in just two years. About half of the present force is unskilled.

The result is a high rate of construction errors requiring time-consuming and costly rework.

There also is a high rate of turnover, especially among newly-hired trades workers, complicating the comany's urgent effort to build up its workforce.

And among the workers who stay, there is an average absentee rate of about 10 percent.

IDLE TIME A FACTOR

Shipyard sources say idle time also is a continuous problem, resulting from a combination of poor planning, lack of material control, strict separation of the trades, and laziness.

"Never have so many gotten so much for so little," one employee commented.

And management has failed to come to grips with the problems, several management and labor sources say.

What is the future for EB?

There are at least several possibilities:

General Dynamics reportedly has threatened to close the yard in December in a dispute with the Navy over its claims and cash flow. Top management has not denied the possibility. Managers have been told to reply to questions with a carefully worded statement. "EB" has no plans to close the yard."

MacDonald has told Congress EB would stop work on the 688s before its financial troubles seriously harmed General Dynamics.

General Dynamics might sell EB, either to another corporation or the Navy.

EB has yet to record any profits on the 688s, although it already has delivered the first of 18, the Philadelphia, to the Navy.

The corporation's marine group, composed of EB and Quincy Shipbuilding, had 1976 earnings of $15.5 million—a 1.5-percent return on sales of $1 billion. Sales at Quincy included several liquefied natural gas tankers—sold to General Dynamics. The company, though subsidiaries, has agreed to take equity ownership in seven of the LNG tankers now under firm contract.

By contrast to the marine division's earnings, the military aircraft division earned $20.1 million—or 6.6 percent—on sales of only $304.3 million in 1976.

Two shipbuilding companies have told the Defense Department either to straighten out their claims against the Navy or take over their shipyards, according to congressional testimony. The companies were not identified.

The Navy could take the 688s from EB and give them to Newport News Shipbuilding in Virginia or ingalls Shipbuilding in Mississippi. It probably would cost the Navy more money, including a penalty payment to EB, but it would free EB to get the Tridents built on schedule.

As the only yard building giant new subs, EB plays a vital role in the nation's nuclear deterrent strategy. The 560-foot Tridents will replace the aging 425-foot Polaris-Poseidon missile subs.

Veliotis, EB's new general manager, could usher in a new era of productivity. His reputation for cracking the whip has preceded him from Quincy, and labor officials at EB already are wary.

General manager at Quincy for the past five years, Veliotis is credited with salvaging the commercial yard which General Dynamics had considered closing in 1972.

When he took over Quincy, there were large layoffs and no new construction in the yard.

Veliotis' challenge at EB is reversed.

EB has bitten off more than it can chew, many say.

The new Trident and 688 programs have required massive increases in the workforce, the opening of a major manufacturing subdivision 50 miles away at Quonset Point, R.I., and start-up of an innovative new Trident construction facility in Groton.

"EB stumbles along without knowing what it's doing. It's too big," said one high-management observer. "They have incidents of using the wrong paint on ballast tanks, the wrong welding wire—it's a comedy of errors, it's the Keystone cops. EB's problem is that it has never addressed what it has to do with a multibillion business backlog."

ITEM 6.—*Oct. 25, 1977—New London Day article entitled "EB: Boom or Bust? Part II: Shortage of Skilled Labor Results in Errors, Delays."* [1]

(By Joan Poro and Dan Stets)

GROTON.—General Dynamics-Electric Boat has an ironic problem: a $3-billion backlog of contracts for the most sophisticated weapons systems in the world, and not enough skilled labor to handle it.

The result is a series of construction errors, rework and costly delays which threatens the company with a multi-million dollar loss on eighteen 688-class submarines and diminished profits on five Tridents.

"I would say 10 years ago we built submarines. Now I don't know what we're building."

About half of the 9,950 workers laboring directly on the submarines are not skilled, largely because EB has been unsuccessful in far-reaching recruitment efforts. The shortage of skilled manpower is significant because submarines are not produced on an easily trained assembly line. Each is a custom, hand-crafted product integrating the Navy's most advanced defense system.

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[1] Editor's Note: In this second of a five-part series, *The Day* analyzes the impact of one of EB's most serious productivity problems—the shortage of skilled labor.

The series was based on interviews and documents from about 60 business, government and EB sources, including members of top management at EB.

In Wednesday's story, *The Day* takes a look at what it's like to work at Electric Boat.

HALTS ALL HIRING

Among other dramatic moves on his first day on the job. EB's new General Manager P. Takis Veliotis abruptly halted all hiring in an apparent effort to assess the rapidly expanding workforce.

It needs assessment.

The Day has requested information from both EB and the Navy on errors inspectors have discovered during EB sub construction.

EB has not responded but the Navy has confirmed some errors. They are:

Repeated use of wrong welding wires on a variety of metal.

A multi-ton foundation support was fabricated backward by Thames Valley Steel Corp., nevertheless installed by EB in the Submarine La Jolla, then ripped out and replaced with a support from another sub.

The Submarine Omaha was launched, put back into dry dock and found to have a small portion of its pressure hull plating pitted by electrolytic action from a live welding cable.

The forward weapons loading hatch on the Submarine New York City was misaligned with the result that torpedos could not be loaded on the sub.

Here are other errors learned by *The Day:*

Torpedo tubes on the lead Trident sub Ohio were installed improperly and ripped out at least twice. The Navy denies the report.

About 1,000 hangers were "tack" or temporarily welded in a sub and apparently forgotten until Navy inspectors discovered they had not been permanently welded in place. Hangers are installed to carry overhead cables and pipes.

"The 690 was built twice. They had to tear out a lot. It's a good boat now. Even the crew has to agree."

All inspectors interviewed stressed that construction errors often are minor—and that they're discovered sooner or later in the multi-layered inspection process.

Largely responsible for the construction errors is the pressure put upon the supervisors and the trades to get a job done on schedule, several workers said.

"I say get this cost-and-time factor out of it and put the human factor into the equation," said a first-class inspector with 15 years in the yard. "We not only want to get the boats out. We want to get them back."

HIGH INCIDENCE OF ERROR

EB inspectors reported that the number of rejections of work performed by the trades has risen dramatically with the surge of "green labor." The percentage has risen as high as 30 to 50 per cent, according to some inspectors.

"There are a lot of people working without that much experience," commented another inspector. "You just hope you have enough good people in supervision and inspection to pick them up."

"The 690 was built twice," said an inspector, referring to the 688-class submarine Philadelphia, delivered to the Navy in June, two years late. "They had to tear a lot out. It's a good boat now. Even the crew has to agree."

"I say get this cost and time factor out of it and put the human factor into the equation."

Delays in the 688 program have been blamed largely by EB on bad drawings from Newport News Shipbuilding, the 688-class designer. Few shipyard workers will argue that there has been significant difficulty with the plans.

"There are all kinds of design changes and money wasted," commented a pipefitter union official. "One of our better pipefitters called me to his workbench and said, 'Look at this. This is what we have to work with.' There's no way you could read that blueprint. EB's claim on the 688s is valid."

"The plans are not compatible," said another inspector with 21 years in the yard. "We've got thousands (of plans) that we don't know what we're doing with and we're in trouble. I would say 10 years ago we built submarines. Now I don't know what we're building."

EB has filed a $544-million claim against the Navy for cost overruns on the 688-class sub program. The claims are based almost entirely on the Newport News designs.

Nevertheless, *The Day* has learned that even if EB obtains a substantial portion of its claim, it still stands to lose hundreds of millions of dollars on the

688 program because of construction delays attributable in part to lack of skilled labor.

According to *The Day's* calculations, using information from sources, every additional month of work spent on Trident and 688-class sub construction costs EB $28 million in direct labor and overhead.

WELDING MISTAKES COMMON

Besides the Newport News designs, welding mistakes appear to be among the most pervasive construction problems in the shipyard.

"The welder and the welding foremen—through their ignorance and lack of concern—use the wrong welding wires on the wrong metal and you end up with a weld that is not going to meet Navy specifications," explained a welder.

"It's a big problem. We're auditing the welders to certify they are using the right wire, right metal. We've never had to do that before," said an inspector. In 15 years at EB, he says he's never before seen a welding problem as large.

"Before, they always had plenty of experienced people," he said. "You're dealing with 2,000-some welders. They may have been through a course, but there are so many different types of wire it all looks the same."

Although welding with the wrong wire was raised in many interviews with shipyard workers, the Navy claims the amount of welding rework is not excessive.

"High quality standards are required for submarine welding," a spokesman said. "Thus, some welding rework is normally anticipated in submarine construction."

The Navy declined to answer questions about the total estimated cost or delays resulting from the welding problems at EB.

Many supervisors and experienced tradesmen complained that the unskilled "learners" were not receiving adequate on-the-job training.

"Used to be a man would walk in off the street and his boss would line him up with a mechanic (skilled tradesman)," an inspector reminisced.

" 'Okay,' the boss would say. 'You're gonna be like a pet chicken to this guy. You get alongside him and you do what he does and you learn.' That's how they made skilled mechanics."

That's not how it's done anymore, many old-timers told *The Day*. EB is too big. They paint a different picture:

EB's inability to recruit skilled trades workers forces it to hire inexperienced labor. As the workforce expanded during the past two years fom 9,000 to 14,000, skilled workers were made supervisors, further dropping the percentage of experienced "hands on tools."

A contest started last month at EB illustrates the lengths to which the company has gone to find skilled people. It challenges its employees to bring in a skilled shipfitter, pipefitter, welder or inside machinist and get in return a $100 savings bond and a chance to win a $500 color television.

The shortage of skilled manpower is not unique to EB.

"Both private and naval shipyards have traditionally found themselves seldom able to fulfill any but a small fraction of their skilled-labor needs from off-the-street hires," Vice Adm. Clarence R. Bryan, commander of Naval Sea Systems command, told a congressional subcommittee earlier this year.

At least temporarily, Veliotis has stopped hiring off the streets—and is widely expected to lay off a large number. Recently hired unskilled employees will be among the first to go.

ITEM 7.—*Oct. 26, 1977—New London Day article entitled "EB: Boom or Bust? Part III: Idle Time, Workers' Attitudes Are at Heart of EB's Problems"* [1]

(By Joan Poro and Dan Stets)

GROTON.—Many people don't like working in the General Dynamics-Electric Boat shipyard. But they do it.

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[1] Editor's Note: In the third of a five-part series, *The Day* takes a look at what it's like to work for the region's largest employer.

In preparing the story, *The Day* sought interviews with the division's general manager, then Gorden E. MacDonald; EB's chief of safety engineering, Harold J. Morgan; the chief of environmental control, Robert H. Secor; and the director of shipyard operations, then Harold F. Foley.

The formal requests were made Oct. 11 through S. Joseph Wornom, manager of public affairs. The company has not responded.

The second largest employer in Connecticut, "The Boat" provides jobs for more than 23,000 in Groton, and another 5,000 in Rhode Island. With at least 3,000 layoffs expected, many would agree with the union local leader who remarked. "Quite a few people appreciate their jobs at EB."

YARD DIRTY, AIR CLOUDED

But it's not a nice place to work. The shops are dirty and the offices are drab. The submarine tanks are hot and crowded, the staging sometimes hazardous and the air often clouded with smoke and dust.

"If it's a sunny day and you know you've got a rotten job facing you, you just don't go in," said a pipewelder.

'It is a fact that men stand idle, sometimes for hours, all through lack of supervision.'

That attitude, apparent in a 10-per-cent absenteeism rate among the men and women who physically build the subs, is part of EB's problem. Absenteeism and excessive idle time contribute largely to EB's poor productivity and looming financial losses, several sources say.

Absenteeism among the 10,000-some shipyard operations employees has ranged from 10 to 12 per cent in recent weeks, according to EB's own weekly analysis.

Much of the unexcused absenteeism plaguing the yard appears to be among young, single workers whose financial responsibilities are minimal.

A supervisor who asked his subordinate why he was averaging a four-day work week was told: "Because I can't get by on three days."

EB is a difficult place to get used to, commenced a 60-year-old shipyard worker. "It is a very confining thing. It is like a big jail. You walk in and the door slams behind you. You can't get out," he said.

Absenteeism is a sign of the times throughout industry, many observers noted.

"A lot can be talked about in terms of the younger generation. They love the sun and sand. They work when they want to, they quit when they want to," said a salaried employee.

Absenteeism is highest among the so-called hull trades—welders, shipfitters, grinders, burners, lead bonders, carpenters and painters. These are the workers who have to do their jobs before the installation and piping trades can go to work.

FAR BEHIND IN WORK

"The shipfitting and hull work is so far behind, I don't know how it will ever catch up," observed a manager.

The shipyard workers who do come to work often are idle—some because they can get away with it, others frustrated by a lack of materials or help from other trades when needed.

"The foreman doesn't have his schedule arranged and there frequently are times the guys are told to take a walk because there's nothing to do," said a welder.

"The problem with productivity is that they don't schedule," said a rigger who claims he has waited sometimes three or four hours for another trade. "There's no incentive to ask for another job if it's okay to hang around waiting."

MEN STAND IDLE

"A lot of people just stand around. It is a fact that men stand idle, sometimes for hours, all through lack of supervision," said an old-time shipyard worker.

Adm. Hyman G. Rickover, who heads the Navy's nuclear propulsion program, calls it loafing.

"For many years, there has been a large amount of loafing at Electric Boat. I have personally observed this problem in both shops and ships during my inspections, and recently I have received reports that loafing is so bad that some workers do not even make the effort to appear busy," Rickover told Congress.

One manager estimated that the average tradesman works "hands on tools" in the submarine about four hours a day.

"The bosses only expect six hours out of people a day, but what they get is three if they're lucky and four if they're real lucky," said a trades clerk.

Workers saunter through the gates to their jobs in the morning and after lunch and yet run out the gates when the quitting whistles blow.

The bars nearby are filled by shipyard workers before and after shifts and during the half-hour lunch breaks.

"I could never drink as much as they do and go back to work," commented a manager.

"Sure," counters a first-class sheetmetal worker, "but look at the other side of the coin—the working conditions those guys are returning to every day."

He cited conditions in the main shipyard and on the building ways. "You have two burners inside a cylinder, people welding and grinding in a relatively small space. There's very little escape from the smoke," he said. He recalled standing at the forward end of a sub and being unable to see the bulkhead 50 feet away because of the dust in the air.

"I was recently working in the 90 boat and the vent pipe wasn't working. The fiberglass was so bad you could see it floating in the air," said a pipewelder.

The fiberglass situation is a good example of company attitudes, claimed a lawyer familiar with Electric Boat.

"Asbestos has been replaced with fiberglass and they don't know yet if it has the same effect as asbestos," he said. "Management's positions is, 'We'll wait and see. If it is as bad as asbestos, then we'll do something about it,' " he said.

"In the meantime, how many people are affected by it? The attitude is not unique to EB, but it is one they will have to overcome if they want the respect of their employees," he said.

Conditions in the shipyard take their toll on the spirits of workers.

"When you work at a place that is not a nice place, when the conditions are not nice, where the prestige is lacking, where there's a lot of noise and a lot of smoke in the air, it's tough to have incentive to work hard," said a union local leader.

Lack of incentive is a pervasive problem at EB, according to many employees in a wide range of departments.

"The attitude among workers in the yard is, why should I push? He'll just hand me another job he wants done right away. It's like a disease," commented a first-class designer. "The company should reward the productive worker, make an example out of him rather than the guy who is messing up."

"In the old days, if a boss came to you with 'a hot job' you wouldn't go to the bathroom till lunchtime, you worked so hard on it. Now if you are approached with a hot job, you say, 'Stick it in your nose,' " said another designer.

That's the way he feels, after 15 years at EB. And, he observed, the attitude is creeping up into the ranks of old-timers. "Those who have been around here for 25 years, who were crackerjacks, now look around and ask, 'Why should I be busting my hump when these kids don't?' "

NO AMBITION LEFT

"I've given up my ambition. I never seem to get anywhere," said a first-class inspector with 20 years at EB. "You know you never can change anything. You haven't the power. There are too many people—supervisors, general foremen, superintendents, planners, expediters, analysts—all pile up on top of each other."

"It is a frustrating and discouraging place to work. You have no way that you can get to the point where you can say, 'I like the place, I like to work here,' " said another shipyard worker with 28 years in the yard.

Many shipyard workers said they felt Gordon E. MacDonald really tried to humanize the shipyard during his 17-month tenure as general manager.

"The people are the company and without them, you have nothing," MacDonald said in his first interview after taking over EB.

"MacDonald's program never had time to work," commented a union official. "The pessimists are winning him over. Those who believe you can't treat people like people and expect production in return, that you have to be tough, you have to crack the whip."

Ironically, that comment was made six weeks ago, long before it was learned that P. Takis Veliotis would take over the shipyard.

ITEM 8.—*Oct. 27, 1977—New London Day article entitled "EB: Boom or Bust? Part IV: Can management at EB ever be made effective?"* [1]

(By Joan Poro and Dan Stets)

GROTON.—P. Takis Veliotis has been in town four days and already has proved his reputation as a tough guy. He'll have to be tough.

General Dynamics-Electric Boat, with a $3-billion backlog of submarine contracts, has grown so large it seems unmanageable. How will the new general manager bring the drifting giant under control?

ACTED IMMEDIATELY

He took over Monday with 11 hand-picked lieutenants. He announced 3,000 layoffs Tuesday. He told the state's governor and congressmen Wednesday his decisions were irreversible. A management style very different from Gorden E. MacDonald's.

Veliotis is the third general manager in as many years. He came to solve the problems that faced his predecessors, MacDonald and Joseph D. Pierce.

He named a new director of shipyard operations—the fourth in three years.

In the last year, 180 of the top 300 managerial positions changed hands.

EB's answer to its own problems traditionally has been a shakeup, many EB managers told The Day.

Will this week's make a difference? Can Veliotis turn a profit at Electric Boat?

One of the most striking differences between Veliotis and MacDonald is that Veliotis brought eight men with him from Quincy Shipbuilding and immediately picked three from Groton to help him manage EB.

"A new leader can't do it by himself. He has to gear up for the effort. He needs a large management team," observed an EB manager.

"Reorganization is so frequent it's a joke. Everybody's worked for everybody."

MacDonald, who came to EB in May 1976 from General Dynamics corporate headquarters, did not bring a management team with him from St. Louis. He sifted through the existing EB management and surrounded himself with men upon whom he depended. And he took his time about it.

One of the men he settled on was Harold F. Foley of Lebanon, promoted from director of nuclear construction engineering to director of shipyard operations. In his new post under MacDonald, Foley presided over the shipyard trades which build the submarines.

POWERLESS DEPUTY

But as an equal among equals, he did not have authority to hire, fire or order other EB directors around. When MacDonald was on one of his frequent trips out of town, there was no deputy general manager to pull the staff together.

But neither did MacDonald pull his staff together very often. Staff meetings were infrequent.

"You didn't have regular communications from the top. That's the main problem. There was no direction," commented a manager who has worked for several directors. Getting shifted among departments is an occupational hazard at EB.

"Reorganization is so frequent, it's a joke. Everybody's worked for everybody," said a top manager.

The case of Ira Glass of Mystic was cited to *The Day* several times. A man who came up in engineering, Glass was shifted by MacDonald from director of nuclear engineering to a new post of director of production control—an area in which he had no experience, according to associates.

"MacDonald couldn't tell him what the problem was. He could only tell him he wanted the problem to go away," said an associate of Glass.

AFRAID FOR JOBS

Pressures at the top of EB are such that managers appear afraid for their jobs and reluctant to try innovations and compete with each other.

[1] Editor's Note: Interviews for today's story, the fourth in a week-long series about Electric Boat, were conducted during the last several weeks.

Comments and observations used in the analysis of EB management were made before there was any firm indication that another management shakeup was imminent.

"When you get there, you better get your résumé in order," commented a manager.

During MacDonald's tenure as general manager, seven staff managers left EB—some were fired—six were given different jobs, including demotions.

The turnover at the top traditionally has been so frequent that managers feel they don't have time for long-range planning, observers said.

"Any manager or director who gets a new job doesn't have much time to show he has control of the situation and can do things better," one manager said.

He complained that there is no management by objective at EB. "They don't sit down and reflect on what they are going to be doing in the next year. And if they do they then don't sit down at the end of the year and assess how well they did," he said.

Perhaps because of rapid turnover in the upper levels, competition among managers is strong, several told *The Day*.

"Each department at EB has its own budget, and each director is looking out for his own interests," said an engineer.

Managers often appear afraid to innovate.

"Most responsible people want improvement but don't want to innovate in their departments," said a first-class designer. "They don't want center stage. Once the spotlight's on you, you have to perform."

FLEXTIME FIRING

The case of George W. Roos hampered the zest for innovation, several observers feel.

Roos granted "flextime" this summer to the white-collar workers. Although the system of flexible summer hours worked flawlessly, according to union and management, Roos was fired over it by MacDonald, sources say. As director of industrial relations, Roos reportedly had granted the privilege with the misunderstanding that it would be okay with the boss.

As is customary for top managers who fall out of grace at EB, Roos found a position in another division of General Dynamics. Only two peers attended his going-away party.

"They feel no kinship to each other," a manager said.

There also are problems in lower levels of management. They often stem from the caliber of employee promoted into supervisory positions, workers say.

Politics often play a role. Favorites are promoted despite their lack of qualification, several workers said.

FAVORITES MOVE UP

"The criteria for advancement often is, 'Who has made it 20 years and hasn't offended Rickover?' " said a top manager.

With the rapid buildup of the shipyard force during the past year, many skilled mechanics were promoted.

"The supervisors often aren't qualified," said a shipyard worker with nine years in the yard. "Just because they know all the frames on the boat and the thicknesses of the steel, that's a small part. The biggest part is knowing how to handle men."

"They have a very poor training program, if any at all, for supervisory personnel," said another shipyard worker with almost 30 years at EB.

Many employees interviewed by *The Day* believe the key to productivity is in the hands of the supervisors and front-line foremen.

"EB has the image of a monster. We tie up the roads. The cops love it because they can set up radar checks. It's not that big . . ." said a designer.

"How many people, average, does a supervisor handle? If you can't work with say 20 people—if you can't recognize personality conflicts, get a team together, then you shouldn't be a supervisor," the designer said.

PRESSURES CITED

Others are more sympathetic. They cite the pressures the low-level supervisors feel from top and bottom.

"These young kids are trying to supervise kids, deadbeats, druggies and women," said one old-time manager. "We are not giving the average first-line foreman, enough support. He handles absenteeism, overtime, training, time sheets,

work sheets, log books . . . He maybe spends just three hours a day on the boats. So no wonder with all the semiskilled help, how do you get a day's work done?"

Others also were critical of middle level management.

"There are plenty of general foremen, because you see that on their hats. But there are no general foremen who come up to the men and say, 'Hey men, what can we do to get you guys busy? What's the problem?" a shipyard worker said.

A significant problem at EB is the adversary relationship between the 14,000 member Metal Trades Council (MTC) and management.

The friction was eased somewhat under MacDonald's open door policy. MTC President Anthony L. DeGregory frequently sidestepped EB's labor relations department to work out problems personally with MacDonald or Foley, the director of operations.

Veliotis, who has shown no signs of such openness has named Frank W. McNally as director of industrial relations—and overseer of labor-management issues. McNally was the management tough guy during negotiations and the five-month MTC strike in 1975.

"We're all there to make a living and a profit for the stockholder but we're just not hacking it" said a manager. "The union and the management have got to get it together. Each has to eat a little crow."

Misunderstanding and mistrust appear to be at the heart of union-management unrest. The union officials complain the supervisors don't know the terms of the contract and are continually violating it. The management complains that the unions grieve an unreasonable number of disciplinary actions.

Some union local officials concede that fellow local leaders sometimes go overboard in defending members who are obviously in the wrong.

MTC President Anthony L. DeGregory, however, said the unions are required legally to defend members who ask their representation. However, DeGregory said, the MTC often will drop a grievance in an early step of the grievance procedure if the union decides it has no case.

OVERTIME AND ABSENTEEISM

Two other problems with the MTC raised in interviews with management deal with overtime and absenteeism.

Managers complain that a contract requirement for equal distribution of overtime forces the company to allow "deadbeats" to work Saturdays and Sundays.

If a tradesman is qualified for the overtime assignment, he must be offered it if it's his turn, DeGregory said. But, he stressed, "There is no reason to give overtime to anyone who doesn't perform well. If these people are not doing their job, they should be fired."

The MTC offered in 1975 negotiations to help the company control unwarranted absenteeism. The union was told by McNally at the time that the MTC could not participate in management of the shipyard.

"So we aren't going to help them," said a union official.

Whether Vellotis can penetrate the many layers of shipyard employees to get at the heart of productivity remains to be seen. It's a challenge.

As one manager put it, "The Navy knows what kind of a submarine it wants, but it's a zig zag down to the welder who's building it."

ITEM 9.—*Oct. 31, 1977—Business Week article entitled "A Rescue Mission at Electric Boat"*

General Dynamics Corp.'s Electric Boat Div. in Groton, Conn., has become the latest shipyard to hand the Navy an ultimatum over unpaid shipbuilding claims. This week Electric Boat was reportedly warning the Navy that it will close its gates for the month of December unless it gets an advance on $544 million in outstanding claims. But Electric Boat's financial and management problems go far deeper than its hassle with the Navy.

The immediate reason for General Dynamics' reported ultimatum—which neither the shipyard nor the Navy would deny—is a serious cash-flow problem. By this spring GD had pumped $200 million in corporate funds into the yard to keep it going. That came on top of $140 million GD laid out over the last two years to modernize it.

Cleaning house.—Traditionally, Electric Boat was considered the nation's top submarine builder, but problems have beset it in recent years. The main problem is inflation. But corporate officials privately admit that Electric Boat has troubles across the board—from purchasing, inventory control, and scheduling to materials handling and personnel. All of these hamper productivity. As a result, Electric Boat is losing an estimated $15 million per month.

The situation became so bad in May, 1976, that GD sent in its corporate executive vice-president, Gordon E. MacDonald. to straighten out the yard. He quickly fired some 150 middle managers. Monday GD will announce that P. Takis Veliotis, general manager of its Quincy (Mass.) boatyard, will take over at Groton. MacDonald will return to corporate duties.

So far there have been no visible results from MacDonald's shakeup. The shipyard has Navy contracts worth $2 billion to build 18 high-speed, 688-class nuclear attack submarines, plus contracts to build the first five Trident missile submarines, which will replace the Polaris/Poseidon subs. But only one of the eight attack submarines that should have been delivered by now is finished, and that was two years late. (Whether related or not, last spring the 688 program manager, Henry Hyman, joined another shipyard.) The new Trident program is also running late.

Cutting back.—The combination of management difficulties and financial problems is so acute that it is receiving the full attention of GD's chairman and chief executive officer, David S. Lewis, Jr. Lewis and MacDonald have reportedly asked the Navy to reassign all maintenance and overhaul work on submarines to other shipyards, so Electric Boat can concentrate on new construction.

Normally, Electric Boat would begin overhauling two to three nuclear submarines a year. But each submarine takes about a year to be reworked, and that dilutes the skilled manpower available for new construction.

The shipyard also holds contracts with the Navy to do "mini-overhauls" of two months or so on the Polaris/Poseidon submarines at overseas bases in Rota in Spain and Holly Loch in Scotland. Each year, 200-man teams are sent over to work on these bases. MacDonald reportedly has asked to be relieved of this work, too.

Neither the company nor the Navy will comment on the Electric Boat situation. Officially, the Navy says it will be ready to make a settlement offer to the yard by the end of the year. Last week the Navy offered GD approximately $20 million as an advance payment against its claim. But that may not be enough for GD, even on a temporary basis. As yet the company has not accepted the offer.

Shipyard claims against the Navy now amount to $2.7 billion and have sparked a series of head-to-head confrontations between the Navy and the commercial yards on which it relies. Tenneco Inc.'s Newport News Shipbuilding & Dry Dock Co. last year temporarily refused to accept new orders, and Litton Industries Inc.'s Pascagoula (Miss.) shipyard is working only under court order.

ITEM 10.—*Mar. 6, 1978—New London Day article entitled "Cost Overruns at EB Could Hit $1 Billion*

(By Dan Stets)

GROTON.—General Dynamics-Electric Boat could end up with total cost overruns of close to $1 billion on its submarine construction contracts unless new General Manager P. Takis Veliotis succeeds in improving productivity in the shipyard.

The overruns—possible losses if not reimbursed by the Navy—include $200 million on the first four Trident submarines and at least $500 million on 18 attack subs now under contract, according to government sources and the General Accounting Office (GAO).

In addition, the GAO said in a report issued last week that EB could experience a cash deficit of $3.5 million a week this year because of productivity problems. If this trend continues, the company could hit total overruns of $1 billion by mid-1980.

EB's financial situation points out the importance of three things:

Projected productivity improvements under Veliotis.

Favorable settlement of $544 million in claims against the Navy.

EB's reliance on Trident contracts for financial stability.

The Navy estimated before Veliotis' arrival last Oct. 24 that EB could exceed the $1.3 billion ceiling price on the first group of four Tridents by $200 million, The Day has learned from government sources.

The possible overrun on the first Tridents was calculated by Navy officials in Groton and was based on poor productivity trends, sources say.

Both EB and the Navy have declined to comment on the projected overrun in Trident construction costs.

The Navy has previously said the total overrun on the first Trident would be $400 million, but this estimate is for the total cost of the ships including such things as research and development, missiles and government furnished equipment.

About $100 million was attributed to construction problems at EB.

In its report last week, the GAO said the expected overrun on the 688s would be at least $500 million and could go much higher. The current ceiling price on these 18 subs is $1.4 billion.

The GAO said Navy officials project the weekly deficit of $3.5 million this year and say that EB is recovering only 55 to 70 cents on each dollar spent.

The company has notified the Navy that by the end of 1977 its "unreimbursed expenditures"—possible losses on the 688 program—will total $350 million.

The continuing losses point out the need for productivity improvements since the last of the 688s is not expected to be delivered until sometime in 1983—according to shipyard sources—and the Navy is not expecting the first Trident until April 1980.

In its report to the Securities and Exchange Commission (SEC) for the third quarter of last year, the company indirectly indicated it is expecting to receive at least 70 percent of the claims.

The report shows that General Dynamics is counting about 70 percent of the claims money expended so far—$214 of a $300 million deficit as of Oct. 2, 1977—in its sales column. This is a practice the SEC, in an exchange of letters with The Day, said can be used for contracts such as EB's for which sales are totaled on a percent-of-work complete basis.

If this accounting pattern continues, it would indicate General Dynamics is looking for a total settlement of $380 million—about 70 percent of the $544 million claim.

But if the GAO estimate of a minimum $500 million overrun on the 688s holds true, the corporation could sustain losses running into the hundreds of millions of dollars, regardless of the outcome of the first claims.

EB has already announced its intention to file further claims on the 688s.

As for productivity improvements, they rest on Veliotis' shoulders

The question of productivity has been a sensitive one at EB. The company has repeatedly declined to describe the impact of changes such as a tough new absenteeism policy, efforts to improve the control of production materials and attempts to improve the skill mix of the work force.

Despite the initial projected losses on the Trident, the company's future appears to rest on this new missile submarine program.

EB already has contracts for seven of the new giant subs. The Navy is now planning a fleet of 14 Tridents and has said a fleet of 21 ships would be needed to replace the nation's aging Polaris-Poseidon fleet.

EB is now the only shipyard capable of building the new subs. A hefty profit on future construction could balance earlier overruns, but this is dependent on the effectiveness of the new general manager.

ITEM 11.—*Mar. 13, 1978—General Dynamics news release stating that the company had formally notified the Navy that it intends to stop all work on 12 April 1978 on the 16 SSN–688 submarines under construction at its Electric Boat Division*

ST. LOUIS, Mo., Mar. 13, 1978.—General Dynamics Corporation today formally notified the U.S. Navy that it intends to stop all work on April 12, 1978 on the remaining 16 SSN–688 submarines under construction at its Electric Boat Division because the contracts for these ships have been materially breached by Navy actions.

The Company is taking this action reluctantly and only as a last resort after making strenuous efforts over the past three years to negotiate a fair and

equitable financial settlement to cover the enormous impact of the Navy's unilaterally directed engineering and design changes. These changes have made it impossible for Electric Boat to build the submarines on an efficient and timely basis.

Since 1974 the Company has been spending increasingly larger amounts of its money to pay for significant portions of the wages of its workers and for material which rightfully should have been paid for by the Navy. To date, the Company's investment in this area alone is more than $370 million and has been increasing at a rate of approximately $15 million per month.

The SSN-688 submarines were not designed by Electric Boat. The engineering plans and specifications furnished to Electric Boat by the Navy and its design agent have been grossly defective and seriously late to schedule. The Navy has imposed more than 35,000 revisions to these plans and specifications, with the result that a production line operation planned for construction of the submarines of this class has been completely disrupted, the benefits of serial production have been lost and deliveries of the ships delayed two to three years. The Navy by its actions has frustrated Electric Boat's efforts to perform under the SSN-688 contracts in a professional manner as it had in the past.

In December 1976, the Company filed claims for price increases totaling $544 million to cover the impact of Navy changes imposed up to that time. The Company now has in preparation claims that should be significant to cover the cost of subsequent Navy action to increase the earlier claim amounts as the true effect of those changes has become evident.

The Company has been negotiating with Navy officials to develop a method of restructuring the contracts to recognize that the work now required by the Navy is radically different from that contemplated in the original contract and that heavy additional costs are incurred by schedule delays in periods of high inflation. Present schedules call for the last of the ships under contract to be delivered in about six years.

The Navy has been unwilling to agree to any settlement that would be fair and equitable to the Company and its shareholders.

At the present time there are nearly 14.00 General Dynamic employees working on the SSN-688 program who would be affected by the planned action. These people are located principally in Connecticut and Rhode Island.

Work on the new Trident ballistic missile submarines will continue.

ITEM 12.—*Mar. 19, 1978—Washington Star article entitled "A Fraud Probe on Ship Contracts"*

(By Gregory Gordon)

The Justice Department is investigating the possibility that three major shipbuilders committed criminal fraud in their filings of huge contract claims against the Navy, official sources report.

Justice Department officials are looking into a number of fraud allegations among the $2.7 billion in claims lodged by Litton Industries, Newport News Shipbuilding and Drydock Co. and the Electric Boat Division of General Dynamics, the sources said.

Electric Boat, which has pending claims of $544 million, has threatened to halt construction of 16 submarines April 12 if it is not paid. The Navy offered the comapny a settlement, but it was rejected.

Adm. Hyman Rickover testified before Congress that he believes the claims are "grossly exaggerated" and has alleged fraud.

One high Justice Department official indicated the investigation by the department's fraud section may extend beyond the three companies, but said the number of firms involved in the review "does not exceed six."

Joseph Wornom, spokesman at Electric Boat in Groton, Conn., said "We're not aware or have any knowledge at all of any such investigation."

The Navy's general counsel's office, which referred the cases to the Justice Department, and the FBI will assist in checking for possible fraudulent claims where a company:

Submitted bills for work never performed;

Falsely described the nature of the work and inflated the charges;

Or used cheaper parts than called for in the contract and charged for the prescribed parts.

An official explained the billing disputes between the government and defense contractors result mainly because most contracts are negotiated at a fixed price. He said the Navy often later alters its order when it learns of new technology, and there are disagreements over the cost of changing the specifications.

One source close to the investigation said there are "a whole host of suggestions or allegations" of fraudulent billing.

"But if they are true," he said, "how much money they amount to, I don't know."

ITEM 13.—*Apr. 7, 1978—New York Times article entitled "Navy Sets Provisional Payment of $66.5 Million to Electric Boat"*

WASHINGTON, April 6 (AP).—The Navy awarded the General Dynamics Corporation's Electric Boat division $66.5 million in provisional payments on the company's $544 million in claims for the construction of 18 nuclear-powered attack submarines at Groton, Conn.

Today's award of the provisional payments came about two weeks after it was announced that the Navy and General Dynamics had reached an "interim understanding" allowing the company to continue work on submarine construction.

General Dynamics had threatened to stop work on 16 of the submarines. Two others had been delivered to the Navy.

The Navy said the provisional payments "do not constitute a value of the company's claim," and that it expected no additional provisional payements before settlement of the dispute, which goes back to 1976.

The Navy faces $2.7 billion in claims from several shipbuilders who say that Government-ordered changes in design and specifications caused construction delays and cost increases. Senior defense officials have critized the Navy for failing to resolve these disputes and for poor handling of its ship-construction budget.

In an unrelated development, it was announced that General Dynamics and the American Telecommunications corporation had signed a letter of intent for General Dynamics to acquire the El Monte, Calif., telecommunications equipment maker for about $42 million.

The terms of the conditional agreement call for the exchange of each share of A.T.C. common stock for $21.75 in cash or for 0.435 share of a new General Dynamics convertible preferred stock with an annual cumulative dividend preference of $4.25 a share, convertible into General Dynamics at $70 a share and with a liquidation preference of $50 a share. The cash offer would cover about 45 percent (but less than 50 percent) of the outstanding A.T.C. shares, which closed yesterday on the over-the-counter market at 19⅜ bid, 19⅞ offered.

Involved are the Rock Island's railroad properties and operating rights over 1,966 miles of railroad line between Santa Rosa, N.M., and St. Louis, via Kansas City.

The purchase price will be $57 million, according to B. F. Biaggini, chairman and chief executive officer of Southern Pacific, and William M. Gibbons, trustee of the Rock Island properties, now being reorganized. The sum will be paid in cash at the closing of the transaction following approvals by the Interstate Commerce Commission and Rock Island's reorganization in Chicago, it was said.

Mr. Gibbons added that he had reported to the bankruptcy court in Chicago that the agreement in principle had been reached and that a definitive contract covering the transaction would be presented for approval as soon as possible.

ITEM 14.—*May 4, 1978—Statement of Vice Admiral Bryan, Commander, Naval Sea Systems Command on "Claims and Shipbuilding Management" before House Armed Services Seapower Subcommittee and reprinted in the NAVSEA Observer; and Admiral Bryan's "Point Paper on the Problem"*

Mr. Chairman, members of the Seapower Subcommittee—I appreciate the opportunity you have given me to appear before you. Secretary Hidaglo has asked me to provide you with clarifying and amplifying information about ship-design changes, or things that have been represented to the press and others as design changes. One press account has it that the Navy ordered 35,000 revisions for one shipbuilder after it had signed the contracts for building the ships and clearly

implied that the shipbuilder was expected to pay for an imputed massive change to the ships.

The Congress and the public are understandably shocked and concerned about such statements. I sincerely believe such allegations are not only inaccurate, but are very misleading.

First, let me recount some of the fundamentals of designing and building a complex, demanding product of high technology. They apply to many things, but in this instance I will address naval ships. After the conceptual and preliminary design is approved, the Navy, often in conjunction with shipbuilders, prepared the next stage of engineering called the contract design, which consists of certain general blueprints and the detailed specifications for construction. This package is the basis for the preparation of the detailed design, which includes all the engineering drawings for ship construction. These drawings, also called blueprints or plans, which will eventually total in the thousands for a modern warship, are prepared by a shipbuilder. He may use his own engineering staff, or he may employ the services of private ship-design agents. Where ships of a class are built by more than one shipbuilder, the Navy pays the lead shipbuilder to provide copies of his construction drawings to the fellow shipbuilders for their use. In recent years, the Navy has provided funds to the lead design shipyard to revise the details of his drawings to suit the particular facilities or procedures of the follow shipbuilders, if it will reduce their time or cost of construction.

One interesting ramification of this practice is that, even though the actual detailed construction drawings are actually prepared by the lead shipbuilder, since they are done under a Navy contract, they are viewed as "government furnished" drawings by the follow builders.

Those drawings serve a number of purposes. Primarily, they are the way the engineers and technicians tell the workmen how to make and install every bit of a ship, from its hull and frames, down to the precise details of how to make the millions of electrical connections in all the switchboards and weapons systems. Further, they form the living record of general technical instructions to all those who construct and inspect every part of that ultimate ship. They serve as the means to record every lesson learned throughout the design and construction process so that errors noted and problems encountered are corrected or avoided in subsequent ships. Every time a drawing is modified, whether for the correction of an early error, the improvement of a manufacturing process, the incorporation of an actual design change, or merely the addition of clarifying information to the construction workers, that particular drawing modification is carefully recorded and is issued with a revision coding so there can be traceability and accountability for the actual set of plans to which each ship is built.

This basis procedure of keeping track of the communication between the designer and the worker as each drawing may be completed, changed, clarified or up-dated is called a drawing revision. It is a system proven over the years for naval ships and commercial ships. The fundamental concept is used in the aircraft industry and, indeed, any complex design and manufacturing endeavor where the designers and the builders need a disciplined method to assure proper construction as well as a method for documenting the accurate configuration of the product as it is actually built.

As I touched on previously, the description of how to construct a ship and install evehything in it required many individual drawings. Obviously, large and complex ships require more drawings than smaller and simpler ships. Therefore, if one wants to assess drawing "revisions" in any reasonable manner, the statistic should, from a common sense standpoint, at least compare the average revisions per drawing. In 1969, before starting the detailed design effort for the SSN 688 Class, the lead shipbuilder estimated that an average of 6 revisions per drawing would eventually be required. After eight years, during which 31 ships have been awarded, the lead yard has issued an average of about five revisions per drawing. Since there are approximately 6,000 construction drawings for all those submarines, the result is something over 30,000 drawing revisions. I can only assume that this arithmetic is the basis for the "35,000 changes" allegation.

Let's look at that kind of comparable statistics for some other kinds of ships, Navy and private, new and old. Our last class of nuclear attack submarine (SSN 637) designed in the 1960's by the current follow-builder of the SSN 688 Class had an average of 5 revisions per drawing; the FFG 7, LHA and DD 963 average range was from 4 to 7 per drawing; two classes of tankers designed by a private builder for commercial customers has averages of 5.7 and 6.7 revisions per draw-

ing. The POLARIS submarine program of the 1960's was properly heralded as a magnificent example of great professionalism in design and construction; a follow-shipbuilder of the SSN 616 Class saw an average of 6 revisions per drawing.

I emphasize that most of these revisions are inherent in the normal and proven process of developing and refining the millions of details involved in carefully and accurately designing a complex, reliable ship, of providing clarifying information to the construction worker, and of updating the final configuration so that the men who will operate and maintain it for many years will start from an accurate-as-built baseline.

However, I do not intend to imply that none of these plan revisions are due to changes in the design. Indeed, there are those. They may be caused by a deliberate decision to incorporate a combat capability that was not known or was not available when the design was started. They may stem from increased knowledge of what will make some part of the ship more reliable or maintainable. They may correct errors in the original specifications. But these kinds of deliberate changes by the Navy are made known to and are the subject of prior negotiations with each shipbuilder. If they are mandatory for the safe operating and military capability of each ship, then they must be done. If they are judgmental, but mutually agreeable contract adjustments cannot be achieved, then they are not required on work already done by a shipbuilder, and the Navy will provide for that work after delivery of the ship at the most favorable opportunity.

A more meaningful measure of real changes is the effect on ship cost. As a general statistic, the cumulative effect of total construction costs of deliberate Navy changes to a ship design or specifications averages about 5 percent. Under the contract terms, a shipbuilder is not supposed to accept a revised drawing if he considers that it requires a change in the contract. The Navy has elaborate internal checks and balances to screen, evaluate, and justify changes to ships under construction. When it is concluded that a deliberate change is justified, the Navy's policies and procedures are to identify the potential impact, if any, on the shipbuilder's cost and schedule and mutually negotiate a contract modification for such effects. If mutual agreement cannot be reached, the Navy has the alternative to defer the change to some later place and time after the ship is completed. Or, if the change is essential to the safety, reliability, or performance of the military mission of the ship, the Navy can direct the shipbuilder to perform the work by issuing a change order. In this latter event the Navy seeks to arrive at a subsequent, mutually agreeable negotiation of the cost and schedule effects. Failing this agreement, the shipbuilder may submit a claim. The Navy uses such change orders sparingly as a matter of policy and strongly prefers to provide for necessary changes by means of mutually satisfactory negotiations with the shipbuilder.

Point Paper on the Problem

The purpose of this paper is to discuss the related but separate issues of unresolved shipbuilding claims and Navy management of its shipbuilding program. With the exception of one, all currently pending claims are against contracts signed in 1971 or before, and should not be confused with the second issue which is current Navy management of its shipbuilding program.

1. Our shipbuilders are building and delivering quality ships. Of the 30 destroyers at Ingalls, 21 have been launched and of those, 12 have already been delivered to the Navy; the last 9 are well into construction. Two of the LHA's have been delivered, two more have been launched and the fifth is well into construction. Last year Newport News delivered one aircraft carrier, one cruiser, and two attack submarines.

2. Virtually all the $2.7 billion in claims are from three shipbuilders, Newport News, Electric Boat and Ingalls, and involve only eight contracts. For the most part, these contracts were the same type as those used successfully for shipbuilding for many years previously. They were fixed priced incentive contracts with clauses that separately reimbursed the shipbuilder for the effects of inflation. These contracts compensated the shipbuilder for inflation providing he performed on schedule and within his original estimates of the effort required. The shipbuilder and the government agreed to a pre-determined schedule of inflation payments, the amount of which was to reflect actual changes in

a Bureau of Labor Statistics index. This schedule applied regardless of the shipbuilders actual rate of expenditures. Under this arrangement, the shipbuilders were compensated for the effects of inflation up to the ship's contract delivery date. Costs of inflation beyond that date occasioned by Government responsible causes, such as contract changes, were paid for as a part of an equitable adjustment to the contract. This arrangement provided shipbuilders a strong financial incentive to deliver ships on time.

3. During the period of contract performance covered by these claims, all three major shipbuilders—Ingalls, Newport News and Electric Boat—expanded their work force by thousands of new hires, in a relatively short period of time, in order to build the ships for which they had contracted. Building ships is demanding work, and requires a variety of skills and crafts that do not readily exist in hiring halls, on the street or elsewhere in the market place. It is now clear that the shipbuilders overestimated their ability to acquire and train sufficient skilled workers and obtain the productivity needed. As a result, productivity declined, rework increased, training costs rose; and overhead costs went up. All these contributed to higher costs than the shipbuilders estimated when they entered into the contracts. They were not able to get work done on schedule. To the extent delays beyond contract delivery dates were contractor-responsible, the shipbuilders were not protected from the effects of inflation. Moreover in such cases their problems were exacerbated by the double digit inflation of the early 1970's. During this same period the shipbuilding industry was also hit by the combined economic effects of the energy shortage and OSHA/EPA legislation. In addition, the period 1972–1974 was characterized by greatly lengthened manufacturing lead times for many items for which the shipbuilders subcontracted. This contributed to overall schedule delays and aggravated the financial effects of uncompensated inflation.

4. As a consequence of all these factors, costs have or will exceed the maximum value of many of the contracts. In order to recoup their cost overruns, shipbuilders have submitted large claims alleging Navy responsibility for all such costs. They do not recognize items of shipbuilder responsibility. Typically the face value of a claim exceeds the shipbuilder's actual cost overrun and exaggerates the magnitude of the problem. In some cases the shipbuilder could settle the claim for a fraction of the claimed amount and still recover all costs and a profit.

5. Shipbuilders have spent years preparing these claims. The majority of today's outstanding claims were initially filed in 1975 and 1976 which gives the appearance of management problems much more current than is the actual case. As these claims are reported by the press periodically or as the claim amount is adjusted, an appearance of continual problems of shipbuilding mismanagement is generated. Because these claims cannot be settled without lengthy analysis and negotiation, and are carried over from one year to the next year, they appear as a continuing part of shipyard/shipbuilding management problems. In some cases the shipbuilders generate additional claims on the same contracts as the shipbuilder encounters additional losses as the ships continue to be built. For example, the LHA contract was awarded in May 1969. The initial claim against the contract was for $246 million and was filed in March 1972. The shipbuilder has subsequently increased the claim 5 times in the past 5 years. The LHA claim now totals over one billion dollars. Detailed support for this claim was not received until October 1977.

6. Once a duly designated government contracting official enters into a contract with a supplier, then those things, at that price, are meant to be the property of the U.S. government. Consequently, the government contracting official cannot pay more, not accept less, unless the Government receives something of equal value in return. Otherwise, lacking such compensating considerations, he is giving away something that belongs to the Government. Many issues that arise during the course of a contract are routinely settled by the government contract administrator. The price of the contract can properly be adjusted upward if the contractor's costs were increased due to a specific Government action. For example, if an item of Government furnished equipment is late, the Navy contracting official is authorized to increase the contract price and extend the contract delivery date to compenaste the shipbuilder for his added costs and delay. Likewise, when the Navy orders changes in specifications, the contract gives the shipbuilder the right to an equitable adjustment in contract price to compensate for the cost of the changed work and its impact on the cost of other work. These

adjustments are a normal part of administering contracts and works so long as agreement can be reached between the shipbuilder and the Government regarding the extent of government responsibility and the amount of compensation involved.

7. Shipbuilding contracts, as well as all other Government contracts, permit the contractor to submit a claim wherein he describes how the alleged Government actions, increased his costs and by what amount. The Government contracting officer then has the claim analyzed by technical, legal, and financial personnel to aid him in determining how much of the claimed amount can be justified as being the responsibility of the government. Extensive effort and time are necessarily required to compensate the analysis of individual claims for hundreds of millions of dollars covering work performed over many years. The Comptroller General has generally commended the Navy for its claims analysis procedures and most claims are settled by negotiations using these procedures. However, for those that cannot be settled by mutual agreement, the contractor can appeal to the Armed Services Board of Contract Appeals. If he is not satisfied with the Board's decision, he can further carry it to the Court of Claims.

8. There is another method of settling contract disputes. Public Law 85–804 gives special authority to the President to modify defense contracts without regard to other provisions of law (under which the government contracting officials must operate) whenever he deems that such action would facilitate the national defense. This authority has, in turn, been delegated to the Secretaries of Defense, Army, Navy and Air Force. The Congress must be informed in advance of the intended use of this authority where it would involve an expenditure of more than $25 million. If during 60 days of continuous session after notification either the Senate or House passes a resolution against the action then the 85–804 authority can not be used. If, at the end of the period, no such resolution has been forthcoming, then the Secretary, assuming sufficient funds are available, can make the proposed "85–804" settlement, regardless of whether or not it can be justified by the specific provisions of the contract or was due to government actions. It was this procedure that Deputy Secretary of Defense Clements attempted to apply in 1976 to settle all outstanding claims with Newport News, Electric Boat, and Ingalls. This effort was abandoned when he was unable to reach agreement with some of the shipbuilders as to the amounts of money to be paid them.

9. It is unlikely that we will again see these same shipbuilders overestimate their ability to increase and train their work force. Newport News has already recovered from it manpower trauma of a few years ago. They have taken very strong measures, reducing the work force by eliminating thousands of marginal or untrained employees, slashing overhead and concentrating on proven production control and training methods. At Ingalls, the problem presently faced is how to manage a declining workforce. Of the three major shipbuilders only Electric Boat is still going through the growing pains of training and maturing a large work force hired over a short time. In October 1977, the company brought in a new General Manager with previous shipbuilding experience. He has initiated some of the type of strong actions already successful at Newport News: reduction of overhead and of non-productive work force, intensifying the training of both workers and supervisors, firmer control over material procurement and handling. Time will be required for these initiatives to prove their effectiveness.

10. In the area of contracts and contract administration, the Navy has made significant changes in connection with new shipbuilding contracts. Better understanding of claims have caused us to:

A. Modify our contract provisions in such areas as inflation, energy costs, incremental payments—all directed toward the government's assuming more of the cost risks;

B. Write kinds of contracts consistent with expected risks—cost type in lead ships of a new design—fixed price incentive for follow ships with a greater spread between target and ceiling price in order to partially protect the contractor from the effects of unanticipated cost growth while at the same time financially motivating good cost performance;

C. Improve communication between ship designer and shipbuilder by having both the lead and follow shipbuilders participate earlier in the ship design process;

D. Employ landbased test sites more broadly replicating critical areas of the ship;

E. Increase emphasis on the timely delivery of reliable government furnished equipment; and

F. Require shipbuilders to adopt more effective management systems to control costs and schedules.

11. Although the government has assumed more of the cost risk in recent shipbuilding contracts, the Navy cannot guarantee there will be no claims in the future. Contracts which contain financial incentives for performance automatically provide a financial incentive for claims whenever performance falls behind. In such cases, the Navy will rely on its well established claims evaluation procedure and endeavor to settle them promptly. But this will require both parties to be willing to deal with contract disputes on their merits.

12. The problem of unresolved claims on old contracts continues to cloud an understanding of current shipbuilding management. Today our shipbuilders can and are building quality ships; the question of shipbuilding capacity is one of underutilization vice lack of capacity; recent shipbuilding contracts recognize the lessons of claims and the government has assumed more of the cost risks such as inflation and energy. What is needed today is a stable long range shipbuilding program which will provide a rational basis on which contractors can bid for Navy ships.

Construction in Naval Shipyards

Following an address to the Current Strategy Forum at the Naval War College at Newport, R.I., Vice Admral C. R. Bryan, COMNAVSEA, answered the following question on shipbuilding:

Question. Admiral, in the course of all the difficulty with the private yards, there have been continued grumblings about the possibility of reinstating a construction program in public yards. Would you comment on that?

VICE ADMIRAL BRYAN. Yes. I was in the Naval Shipyards when we were building ships there. As you know we stopped doing that some years ago. . .

About two and one-half years ago or so Secretary Clements requested the Navy to make a study of the feasibility of reintroducing new construction in Naval Shipyards, nuclear submarines and surface ships. We did so.

We looked at building ships in Naval Shipyards, and the conclusion at that time was there would certainly be some benefits but that it was going to cost a significant amount of money: some amount of money for start-up costs and more money per copy if you didn't give them very many ships to build, which was one of the problems we had when we did build in Naval Shipyards.

Then, shortly after President Carter took over, he asked for a reassessment and we relooked at it. Our conclusion, which was concurred in by the Secretary of the Navy and by the Secretary of Defense, was that the same benefits were still there and the same premium was still there. It would cost you money to do it.

I concluded that I would not recommend it at this time for the basic reason that I could not see enough naval shipbuilding that would keep our existing private shipbuilding base adequately employed. And, therefore, it seemed to me imprudent to start up a Naval Shipyard and further erode our existing private shipbuilding base. However, if and when the time came that there was a sufficient naval shipbuilding program in volume to be authorized that would completely workload the existing capability, or, if that were the only way to build a ship, then and only then should we consider starting up again in Naval Shipyards.

ITEM 15.—*June 22, 1978—Letter from Secretary of the Navy Claytor to the Chairman, Senate Appropriation Committee submitting the Navy's proposed Public Law 85–804 settlement of General Dynamics' Electric Boat Division SSN 688 Class claim and contract cost overruns.*

DEPARTMENT OF THE NAVY,
OFFICE OF THE SECRETARY,
Washington, D.C., June 22, 1978.

HON. WARREN G. MAGNUSON,
Chairman, Senate Appropriations Committee, U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: Attached is a copy of a letter with accompanying documentation which 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 steps taken by the Navy to reform two SSN 688 contracts with General Dynamic Corporation (Electric Boat Division). This is the outcome of a long series of arduous and complex negotiations and is considered by the Navy to be decidedly in the national interest.

My staff and I are prepared to brief you and your Committee members and staff as you may desire.

Sincerely,

W. GRAHAM CLAYTOR, Jr.,
Secretary of the Navy.

Attachments.

MEMORANDUM OF DECISION
GENERAL DYNAMICS—ELECTRIC BOAT

June 19, 1978.

This decision memorandum is the outcome of strenuously contested and complex negotiations by the Navy Department and General Dynamics—Electric Boat (EB) Division since December 1977.

The General Dynamics position is that the anticipated costs to the completion of two SSN 688 contracts[1] in 1984, unreimbursed to General Dynamics without claims recovery, in the amount of $843 million, place an unacceptable burden on its corporate structure and stability; and that if the measure of relief described herein is not granted, it has no reasonable choice but to stop work on the remaining fifteen SSN 688 nuclear attack submarines and rely upon appropriate judicial action.

Independent financial verification confirms the magnitude of the anticipated unreimbursed costs.

A detailed analysis of the history of the two SSN 688 contracts and the controversy it has engendered, together with the risks and uncertainties of protracted, highly complex litigation, lead to the conclusion that it will "facilitate the National Defense" for the Navy to grant to General Dynamics the measure of relief described in this Memorandum and in Attachments 1 and 2, subject to the conditions described therein.

HISTORICAL BACKGROUND

The Navy entered the 1970s with an urgent demand for a new class of nuclear attack submarines that would embody significant advances in submarine technology. The SSN 637 Class nuclear attack submarine, dating back to the early 1960s, had been an extremely successful program due in large measure to excellent performance by Electric Boat, the designer and major producer of this Class.

On the basis of assumptions that history would later portray as overoptimistic, the SSN 688 program was considered to be merely an evolution from the SSN 637. In retrospect, significant misjudgments were made by both the Navy and industry. The attractiveness of the long term business base provided by the SSN 688 Class seemingly resulted in a willingness by the shipbuilders to accept contractual terms which would later prove unwise. The Navy elected to develop an alternate design capability for submarines after exclusive use of EB design talent for almost 20 years. With the SSN 688, Newport News Shipbuilding Division of Tenneco became a submarine design agent for the first time and was also awarded the lead ship construction in February 1970.

In January 1971 the first production contract was awarded after intense competition among three shipbuilders. EB was awarded seven SSN 688s and Newport News four. With the benefit of hindsight it can now be concluded that unwarranted optimism governed the competition and resulting contract. By basing the award on ceiling price competition, the fixed-price-incentive contracts allowed little cost growth flexibility. This approach for the first production contract of a new weapon system was thereafter quickly abandoned by the Navy.

In the early phases of construction it became evident that the Navy design agent was having difficulty in providing GFI (Government-Furnished Information) in a timely manner. Yet, optimism seemingly continued to prevail in all quarters. Neither Newport News nor Electric Boat appeared to recognize that major problems were imminent. From a national security standpoint, construction and deployment of more SSN 688s at a rapid pace were considered essential.

[1] N00024–71–C–0268 and N00024–74–C–0206.

In this environment Congress authorized eleven additional SSN 688s for the FY 73–74 program requirements. These represented the second flight of construction. Original Navy strategy was to split this unusually high quantity between EB and Newport News.

Second flight negotiations were significantly influenced by SSN 637 experience and early first flight experience, primarily estimates rather than actuals. In retrospect, the EB estimates to complete have proved to be grossly understated. For whatever reasons, Newport News' bid was essentially noncompetitive. On October 31, 1973, EB was awarded a contract for seven SSN 688s followed by an option for four more on December 10, 1973. This award was made despite Navy in-house concern over the ability of EB to meet schedule. Within a period of 35 months. EB as follow shipbuilder was awarded a total of 18 SSN 688s, or 78 percent of the total construction program authorized to that date.

The SSN 688 schedule and cost problems gradually surfaced as the danger signals became increasingly strong. EB was forced by its contractual commitments into a dramatically rapid growth in its labor force, aggravated by the award of the first TRIDENT contract in July 1974. Delays were experienced in the receipt of GFI. Materials were impacted by inflation, shortages of needed materials, and expanding leadtimes. Double digit inflation seriously dislocated the American economy precisely in 1974–1975.

In late 1974, EB finally avowed its serious difficulties. A February 1975 claim for $220 million was settled with the Navy for $97 million, and was followed by the filing of a December 1976 claim for $544 million. Its most recent assessment in the 1977 General Dynamics Annual Report acknowledges an anticipated loss of $843 million to the final construction of the eighteen SSN submarines. Coopers & Lybrand, a firm of independent public accountants retained by the Navy, has concluded, based on their comprehensive review, that General Dynamics employed reasonable procedures in arriving at this amount. This unprecedented loss has been a focal point in the complex negotiations leading to the settlement agreement.

CRITICAL ISSUES

The agreement which ultimately emerged from these negotiations culminates almost four years of contention and uncertainty. The conclusion reached is that the EB–SSN 688 problem is of paramount national interest that requires recognition of the financial consequences flowing from contractor and Government related causes, as well as other causes beyond the control of either party. The following critical issues were revealed in the negotiations:

EB management underestimated the complexity of the SSN 688 in its proposals and was unable to control manpower and productivity effectively during contract performance.

The competitive environment and respective bid strategies of EB and Newport News resulted in the award to EB of all eleven submarines of the second flight with all the risks inherent in that decision.

Choice of an alternative design source resulted in significant costs to EB despite efforts by the Navy to make this an effective process.

Lateness of GFI had a serious delaying and disruptive effect on EB.

Given the above factors the protection against inflation afforded by the first two SSM 688 contracts proved inadequate under conditions of schedule slippages and during the double digit era of 1974–1975.

Shipbuilding uniqueness and complexity connected with the new SSM 688 attack submarine were intensified by the severely restrictive contractual structure, the inadequate productivity of a rapidly multiplying work force, and the extraneous forces of unforeseen inflation.

The negotiations commenced actively in October 1977, broke off in mid-March 1978 when EB announced termination of construction and were resumed in late March when a 2-month moratorium of the contractor's stop-work order was agreed upon. The agreement of the parties (Attachment 2) was reached on 9 June, 2 days before expiration of the moratorium and after a further stop-work notice given on 5 June.

BASIC ELEMENTS OF AGREEMENT

The prolonged negotiations ultimately produced the following basic elements of agreement which are embodied in an Aide Memoire signed by the parties on 9 June 1978 and included herewith as Attachment 2.

1. Navy recognizes a $125 million price increase on the two contracts by reason of the claims filed by General Dynamics in December 1976 in the face amount of $544 million.[2] General Dynamics will absorb a loss of $359 million or half of the remaining $718 million loss; the Navy will pay the other half, or $359 million, under Public Law 85–804.

2. Cost underruns will be shared on a 50/50 basis, as will cost growth in an aggregate amount not to exceed $100 million, beyond which General Dynamics will assume sole responsibility.

3. Costs, if any, solely attributable to inflation rates based on BLS indices, above the 7% labor and 6% material annual inflation upon which the $843 million loss is projected, will be the responsibility of the Navy.

4. The contract prices of the two SSN 688 contracts are to be increased to $2668 million, $843 million (amount of the projected loss) above the current figure. Pursuant to such contract adjustments, the Navy will make an initial progress payment to General Dynamics of about $300 million, approximately $45 million less than the unreimbursed costs incurred to date by General Dynamics.[3] The balance of the $359 million loss assumed by General Dynamics—$314 million—will be withheld from progress payments during the construction period, with more than one-half of that amount (approximately $200 million) to be absorbed by General Dynamics by the end of 1980.

5. General Dynamics will fully release, in form satisfactory to the Navy, all claims on the SSN 688 contracts based on events to date, as well as any past impact of the SSN 688 contracts on the TRIDENT contract, an aspect of major importance.

6. The agreement is subject to appropriate Congressional review and the availability of appropriations.

By implementing the foregoing basic elements of the Agreement between the Navy and General Dynamics, the Navy will, by strict analysis, pay a competitive price for the 18 SSNs constructed by General Dynamics.

DECISION

Electric Boat and the Navy must get on with the business of building essential combatant ships. TRIDENT and the SSN 688 go to the very heart of the Nation's strategic and defense forces. Construction of these ships and the availability of Electric Boat as a strong and capable source of future work, are essential to our national defense. Not granting the relief set forth above will inevitably mean long years of litigation and a disruptive relationship that will unreasonably jeopardize the national defense.

Accordingly, in the exercise of my residual powers under Public Law 85–804, 50 U.S.C. No. 1431 *et seq.*, and in accordance with the agreement (Attachment 2) reached with the General Dynamics Corporation, an Agreement which is expressly made subject to the Congressional review provided in Public Law 85–804, it is my decision that it will "facilitate the National Defense" to reform the two SSN 688 contracts with General Dynamics in accordance with the provisions of such Agreement. The contracting officer will prepare and execute the required contractual terms and conditions in accordance with the stipulations of Attachment 2 which are an integral part of this decision.

W. GRAHAM CLAYTON, Jr.,
Secretary of the Navy.

ATTACHMENT 1

DETAILED ANALYSIS OF THE MEMORANDUM OF DECISION

Matters of utmost importance to the National Defense are at stake. The Trident program with seven ships currently awarded to EB and none yet delivered, is a vital element of the Nation's future strategic defense posture. The SSN 688 ships are an essential component of the attack submarine forces. Eighteen ships are involved, with only three delivered. The construction of these vital ships has

[2] General Dynamics has repeatedly and publicly stated that it was preparing additional substantial claims, based on events subsequent to 1 November 1976, cut-off date of the above claim. The estimated magnitude was privately (prior to 9 June) said to be an additional $750 million.

[3] It is estimated that the unreimbursed costs will increase to approximately $60 million by the effective date of the contract modifications.

been seriously affected by a long-standing controversy between the Navy and the Electric Boat Division of General Dynamics. The understandings reached by the Navy and General Dynamics on 9 June 1978 (Attachment 2) represent an equitable solution of that controversy, so seriously detrimental to the national defense.

Faced with enormous losses on the two contracts for the SSN 688 submarines, General Dynamics announced a stop-work order on 13 March 1978, originally effective on 12 April and later extended, by difficult negotiations, to 11 June 1978. Even as negotiations proceeded against this deadline, GD issued layoff notices to some 8,000 workers on 5 June. The settlement agreement memorialized in Attachment 2 was reached the afternoon of 9 June.

General Dynamics Financial Position

In the course of the prolonged negotiations, General Dynamics provided extensive financial and other data. Legal requirements concerning extraordinary contractual actions were met. In addition to the audit of historical costs by the Defense Contract Audit Agency, an independent accounting firm, Coopers and Lybrand, operating under a Navy contract, conducted extensive analysis of both past and prospective costs to complete. The GAO is currently conducting its own analysis.

The financial analysis confirmed that General Dynamics faced a loss of $843 million on the two SSN 688 contracts. This loss projection assumes what both parties believe to be realistic, an average labor inflation of 7 percent per annum and a material inflation of 6 percent per annum over the remaining six years necessary to complete the two contracts. Approximately $345 million of the $843 million loss has already been incurred by the Corporation.

At the Navy's request, the independent accounting firm evaluated the impact of the probable loss, verified that the financial data provided by General Dynamics was accurate and reached the conclusion that it would remain a viable corporate entity if it absorbed a fixed loss in the order of magnitude ultimately agreed to—$359 million. It was important to analyze such a loss from the viewpoint of its effect upon the corporation's loan structure and future working capital requirements. Of primary importance also was the possible impact of the unprecedented fixed loss on other defense work of General Dynamics including many high priority Defense programs such as the Tomahawk cruise missile and the F–16 aircraft. General Dynamics categorically refused to expose itself and its stockholders to further losses and announced that it would rely upon the courts to adjudicate its existing claims against the Navy ($644 million) plus additional substantial claims under preparation in the range, as stated by the Corporation, of $750 million.

Background of SSN 688 Program (1970–1971)

Electric Boat entered the 1970s as the premier submarine builder in the world. As a design agent it was responsible for designing Nautilus and 14 classes of individual nuclear submarines. Since 1955 nuclear construction experience included 17 SSBNs, 22 SSNs and 27 overhauls/conversions. The SSN 637 Class of nuclear submarine was the predecessor to the SSN 688 Class. Thirty-seven of these ships were built between November 1961 and August 1975. It was an extremely successful program for the Navy and for EB, which built a total of 12 SSN 637 submarines, more than any other shipbuilder. The last 8 SSNs delivered by EB during the period April 1970 to April 1973 averaged 3,320,000 manhours and were typically completed ahead of schedule. Electric Boat sales and gross profits during the 10-year period 1967–1976 totaled $3.5 billion and $125 million (or 3.5 percent), respectively. These results were largely due to SSBN and 637 construction experience, together with overhaul work.

SSN 688 construction came to life contractually in February 1970 with the award of the lead ship to the Newport News Shipbuilding and Dry Dock Division of Tenneco, Inc. In retrospect, the setting for the program was unrealistically optimistic on the part of the Navy as well as Electric Boat, Newport News and Ingalls Shipbuilding, the three competing contractors for the first flight of follow-on ships. The following extract from the Navy pre-award survey regarding construction of the first flight of SSN 688s reveals a basic fallacy:

"The requirements are generally *sufficiently similar to previous SSN 637 Class* and 671 construction requirements to merit the conclusion that EB Div, with proper management preplanning, etc., can meet the production requirements." (Emphasis added)

Competitive Environment for SSN 688 First Flight (1971)

Hindsight underscores five key aspects of the competition for the first 688 construction contract:

First, was the stated optimism which viewed the 688 as an evolutionary development, just as the 637 Class was an evolution from the Permit (SSN 594) Class.

Second, Newport News was designated design agent for the 688, whereas EB had served in this capacity for all previous nuclear submarines. This shift in policy represented a deliberate decision on the part of the Navy, motivated by a desire to have an alternate source of nuclear submarine design.

Third, there was a great deal of competitive pressure among the three competing shipbuilders. It was well known that only two would receive awards and for all practical purposes the losing contractor would drop out of the program and forego a substantial business base over a 10 to 15 year period.

Fourth, the primary award criteria were based on ceiling price. The result of this radical technique was inordinately to lower the spread between target and ceiling in a fixed-price-incentive contract and reduce virtually to the point of disappearance the flexibility for absorbing cost increases within the terms and conditions of the contract. This technique was used by the Naval Sea Systems Command only on the SSN 688 first flight contract and, as a matter of Naval policy, has not and will not be used again.

Fifth, the first SSN 688 contract contained an escalation clause that had proved adequate for economic protection during the stable 1960s but would prove to be woefully inadequate during a period of double digit inflation and under conditions where schedules were radically altered through Navy and contractor related causes, as well as factors beyond the control of either party.

On 8 January 1971 EB was awarded a fixed-price-incentive contract with escalation, for construction of 7 SSN 688s. Newport News was awarded a similar contract for 4 SSN 688s. The total dollar value at ceiling price was $428.1M for EB and $249.5M for Newport News. As a result of the ceiling price competition the EB contract was incentivized to cover a minimal 5.7 percent cost growth over target while the Newport News contract would cover only 1 percent. These data are in sharp contrast with a typical range of 20 to 25 percent in most fixed-price-incentive shipbuilding contracts, or indeed 35% in the Trident program.

Competitive Environment for SSN 688 Second Flight (1973)

From a national security standpoint, the attitude in the early 1970s was that rapid construction and deployment of the SSN 688 was vitally important. In step with the aforementioned early optimism that prevailed, the Congress authorized a total of 11 SSN 688s to cover FY 73–74 requirements. It was original Navy desire to award these second flight SSN 688 requirements to two contractors. This was a logical approach considering the stage of the program and the way in which the first flight was awarded. However, due to numerous factors affecting the competitive environment in 1973, the situation changed radically. On 31 October 1973 EB was awarded a fixed-price-incentive contract, with escalation, for 7 SSN 688s with an option for an additional 4 that was exercised by the Navy almost immediately on 10 December 1973. The total dollar value of this contract at ceiling price was $846.8M.

Government and contractor optimism still ran high. EB cost reports and the first flight manhour estimates were the primary basis for second flight pricing. First flight manhour estimates to complete showed little change from those proposed and accepted in January 1971 when that flight was awarded. Only 11 percent of actual estimated manhours had been booked at the time of second flight negotiations so there was little hard evidence to refute EB manhour and cost estimates.

Newport News turned out to be essentially noncompetitive in the second flight bidding. Proposed prices were high and many exceptions were taken to the terms and conditions of the request for proposal. This was a period of deteriorating relations between the Navy and Newport News. In effect, the Navy was in a sole source position with Electric Boat.

There seems to have been a significant in-house concern over the ability of EB to meet schedule if it was awarded 11 second flight ships. The Navy recognized a potential facilities problem and other negative impacts if EB assumed the total procurement role for the second flight. Nevertheless, the decision was made to award all 11 SSNs to EB on a wave of what history would later portray as unrealistic optimism both on the part of the Navy and EB.

28-844—78——35

The Emerging Problem: Assessment and Magnitude (1974–1978)

Several factors made it difficult to quantitatively assess SSN 688 production problems. The Navy was experiencing obstacles in providing timely Government-Furnished Information (GFI). This was a primary factor. Until mid-1974 the major impact of late GFI was considered to be with Newport News because EB cost reports and proposed schedules continued to be optimistic. For example, the June 1974 report estimated that both the 688 I and 688 II contracts would deliver at the contractor estimate of manhours. Return costs were only 32 percent of the SSN 688 I contract and negligible on the SSN 688 II contract. The SSN 690 (first hull constructed by EB) estimate to complete was projected to exceed the contract estimate by 37 percent. However, EB furnished the Navy plans to recover on the downstream ships. Indeed, in the 1971–1973 time frame, EB was reluctant to admit the difficulty in recovering lost schedule on some of the early SSNs. It was not until late 1974 that Electric Boat finally acknowledged that they were facing serious difficulty with the SSN 688 contracts.

On 2 February 1975 EB submitted a claim for approximately $220M on the first flight contract, based primarily on the fact that GFI was not timely nor suitable for the intended use. This claim was settled on 7 April 1976 for $97M. Other disagreements aside, Navy did acknowledge that delay had resulted from design agent problems encountered by Newport News and that this delay did impact on the timeliness of 688 class construction. A year's extension was accordingly added to the delivery dates of all Electric Boat SSN 688s. At the time of this settlement EB agreed to submit additional claims by 1 December 1976.

A May 1976 proposal by then Deputy Secretary of Defense would have substituted a revised escalation clause in exchange for a waiver of delay and disruption claims under both SSN 688 contracts. Even though EB indicated its willingness to go along with this proposal, with a value then estimated to be in the order of $170M, it was never consummated.

On 1 December 1976 EB submitted additional SSN 688 claims on both contracts totaling $544M. Again these claims were based primarily on the impact of late and unsuitable GFI.

In February 1978 EB reported that the projected program loss for both SSN contracts could be as high as $981M. At the same time EB issued a revised delivery schedule which contained substantial slippages. Also included were schedule slippages on Trident. In its April 1978 public financial statements for its fiscal year 1977, GD revised the projected loss to $843M on the basis of a lower and what both parties believe to be a more realistic estimate of labor and material inflation.

Responsibility for Cost Growth

The Navy has been analyzing the EB problems since late 1974. Throughout much of this period, discussions bordered on acrimonious, with adamant positions taken by both sides. This resulted in one side or the other reaching a singleminded conclusion regarding the cause of the problem which often was publicly stated and hence only served to crystallize the position of the other side. To state that there is a single overridding cause of the EB SSN 688 problem is misleading oversimplification. The truth is that there are many significant causes which contributed to the EB problem, as we have earlier indicated. There is a mix of contractor and Government interrelated causes, plus a series of extraneous causes beyond the control of both parties. Nothing resembling an exact quantification of blame and responsibility, on one side and the other, can be achieved. Nevertheless, conclusions may be drawn from the ensuing discussion.

Electric Boat Management

EB encountered serious and unforeseen obstacles with the steep manpower buildup demanded by the new programs and the startup of its facility at Quonset Point, Rhode Island. The problem was compounded by the award of the first TRIDENT contract in July 1974. Manpower rose from 12,000 in January 1971 to 18,800 in January 1975 and 26,000 in January 1977. There is evidence that serious productivity problems were associated with this manpower buildup. In fact, a new management team reduced personnel by more than 5,000 after assuming control in October 1977. Beyond doubt, manhours and associated labor productivity have been among the numerous pivotal elements in the cost growth of the 688 program. Problems were complicated by an inadequate cost and schedule

control system which the new management is in the process of revamping. As a consequence of all contributing causes, whatever their source or nature, projected manhour growth over original contract estimate equals about $55.5 million manhours at an increased cost of about $800 million in 1978 dollars.

Competitive Environment and Bid Strategies

The second flight (11 ships) bidding posture by EB is a key to an understanding of the critical situation which later developed. A basic premise for the bid was the very favorable SSN 637 experience, together with more reliance on the then meager first flight experience than was warranted. Only marginal cost data were available from first flight experience and the seemingly entrenched view, shared explicitly or tacitly by both the Navy and EB, that the SSN 688 was a normal evolution from the SSN 637. Overly optimistic cost reports and an inadequate cost/schedule control system which gave inadequate visibility of emerging problems to both the Navy and the contractor, were further elements of self-deception.

Another major element of the second flight contract derived from the respective bidding strategies of the two competing contractors— Electric Boat and Newport News. As stated, the Navy had desired to award two contracts to accommodate the large quantity of authorized submarines. However, Newport News, the design agent for the Navy and builders of the lead ship (SSN 688), proved to be essentially noncompetitive, leaving the Navy no choice but to award all 11 SSNs to Electric Boat. In retrospect, this proved to be a costly decision. Technical judgments which should have aroused concern over the ability of EB to meet schedules, were not reflected in the contract. Escalation provisions were keyed to a tight delivery schedule. By themselves, the second flight contractual features, except for the crucial escalation coverage, might not have proved chaotic but when combined with the smoldering problems of the first flight contract, the potential for a domino effect of disastrous proportions was present. By hindsight, the seeds for the current critical situation were unquestionably sown in October 1973 when the second flight contract was signed.

Acquisition Policy

It gradually became apparent that the SSN 688 was considerably more than just a larger SSN 637. Overoptimism clearly prevailed on both sides of the table in lieu of the hard-headed hindsight analysis of actual experience which now establishes that the manhour basis of EB's bids was gravely unrealistic.

Contractually the SSN 688 was a transition phase in defense procurement policies. The first 23 ships (18 under 2 EB contracts and 5 under 2 Newport News contracts) were governed by contracts which provided inadequate flexibility to cope with abnormal inflation, or other cost increases. Two subsequent contracts for 8 ships, both with Newport News, contains more flexible contractual terms which reflect some of the lessons learned from experience.

Design Agent Role

The decision to develop an alternate design agent was made by the Navy. Broadening of the submarine design base had obvious appeal. However, in going from design to construction there is an essential communication link between design personnel and ship construction personnel. EB had been the submarine design agent for all nuclear submarines from the early 1950s until the SSN 688 program came along in 1970. There can be no question that a close relationship was built up over those many years that was an important asset in the high level performance achieved by EB.

This changed with the SSN 688 because EB suddenly was just a builder rather than a designer/builder. It is true that the Navy instituted controls in an attempt to make the Newport News/EB interface work. However, there can be no question that there were serious problems associated with this new arrangement. To an unmeasured extent, the lateness of the GFI package can be attributed to the learning process of a new design agent. Fully quantifying this impact is virtually impossible but there is no question that it significantly existed in the early stages of the SSN 688 program.

An obvious question arises from the fact that other submarine builders had previously adapted to EB as the design agent, and they were relatively successful, particularly in the case of the SSN 637 class. While this is true, the SSN 637 data has to be kept in perspective. EB delivered SSN 637 ships an average of 2.4 months ahead of schedule while the other shipbuilders delivered on an

average of 5.3 months late. Also, as the designer/builder, EB built 32 percent of the 637 class ships. This was a higher percentage than that of any other builder. In contrast, in its role merely as builder of follow ships, TB is currently constructing 58 percent of the SSN 688s. If only the first and second flights are considered, when a vast percentage of the design learning process would occur, EB was building 78 percent of the authorized SSN 688s. Newport News, as the design agent/lead shipbuilder, delivered the first SSN 688 27 months beyond the original contract delivery date. In all its surrounding circumstances, the SSN 688 class complexity posed infinitely greater problems than the SSN 637 class.

Navy Caused Delay

Electric Boat was impacted by Government caused delay primarily associated with lateness of Government-Furnished Information provided by Newport News, the Navy's design agent. As stated, the Navy allowed the contractor 12 months delay in the analysis associated with the first claim. Analysis of the current claim ($544M) allows an additional 5 months of Government caused delay, supported by a detailed review of the causes of delay on the first ship (SSN 690) and their impact on the remaining 17 ships.

The conclusion is clear from this strict claims analysis that Government caused delay of 17 months on first flight SSN construction had a negative impact on the second flight proposal which was submitted 27 months after the signing of the first flight contract.

Shipbuilding Industry Uniqueness

There is a unique complexity in shipbuilding that must be recognized. Few industries have to cope with the length of production leadtime that must be brought under the shipbuilding contractual umbrella. Based on current schedules the SSN 688 first flight contract will run 109 months and the second flight contract 127 months. Managing untold risks over this length of time under one fixed-price contractual instrument is an unparalleled management and technological challenge. GFI, especially when combined with the required technical and quality requirements of nuclear propulsion plants, is another significant management problem both from the Government's and the contractors' standpoints. A shipbuilding contractor is controlled by some 6,000 to 10,000 drawings and a vastly larger number of revisions which, because of the realities of combatant ship construction, encompass infinite detailed data which must be phased in during the construction process. The SSN 688 construction was certainly not exempt from this complexity. EB would ultimately receive 5368 detailed design drawings to construct the first flight of SSNs. At the time of contract award EB had less than 500 of these drawings. In January of 1973, 2 years after award, EB had received only about 50 percent of the required detailed design drawings. Completion of the initial issue of detailed design drawings to EB by the Navy's design agent, was made in March 1976 or a little more than 5 years after the award of the first flight contract. In this environment the timing of GFI is a crucial element. While these rigorous requirements are familiar to Navy program managers and shipbuilders, the task remains uniquely demanding, fraught with uncertainties.

The winning or losing of a shipbuilding contract goes to the heart of a builder's stability and, at times, survival. The current economic destiny of Electric Boat depends on four contracts, 2 SSN and 2 Trident. At current projections, the $843 million loss on the two SSN 688 contracts would be about seven times the total gross profit earned by EB during the 10-year period 1967–1976. All the gross profits earned by Electric Boat since the design and construction of Nautilus in 1955 will be wiped out by the $359 million fixed loss which GD has agreed to absorb on these two contracts. Electric Boat was responsible for the design and construction of a major portion of the Polaris/Poseidon fleet, a program which is not only the Nation's first line of strategic defense but also a considerable source of pride to the Government-contractor team that brought it all about. Electric Boat is now entrusted with the design and construction of Trident which will be an important part of the Nation's strategic forces into the Twenty-First Century.

The foregoing recital is intended to highlight certain essential realities of the SSN 688 program in its historical context. It is important to recognize the challenge presented to all concerned in the ship acquisition process, from the birth of a concept through deployment and operation, viz., that it is the responsibility of all the players to insure that the system works and that it works equitably.

In other requests for extraordinary relief from major Defense contractors the quality of the product has at times been a relevant issue. Not so with the SSN 688 ships. As with previous submarines, Electric Boat is producing the ultimate in defense capabilities to ensure that in submarine technology the United States is without peer.

The Decision Rationale

The existence of a serious problem at EB, with origins at the turn of the last decade, is indisputable. Its solution, balancing the equities on the side of the shipbuilder, the military needs of the Navy and above all the national interest in its multiple aspects, has been extremely difficult to define. The basic challenge in the negotiations which commenced in October 1977 was to draw the lines of each side's responsibility. The solution emerged after long, tedious and at times contentious months of analysis and negotiation. The breakdown of negotiations on 13 March 1978 when EB announced termination of SSN 688 construction, suggests the extent to which the Navy's tenacious defense of the Government's interest conflicted severely with General Dynamics' defense of its corporate interests.

The Navy's basic strategy for the solution of the EB-SSN 688 problem was developed in January 1978 after completion of the analysis of the $544 million claim by the Navy Claims Settlement Board, together with a mass of other information relevant to the determination of a strategy consistent with the national interest.

One essential element, but only one, of the solution ultimately reached, was the Board's evaluation of the $544 million claim according to the norms that prevail in this highly technical and legal sphere of analysis known as "entitlement." Beginning in March 1977 this claim was subjected to extensive study by a Navy team of technical and legal personnel of the Board, headed by Rear Admiral F. Manganaro. This analysis yielded a figure of $125 million.

If General Dynamics had accepted this amount as full and final settlement (which it categorically refused), it would still stand to lose $718 million on the two SSN 688 contracts. It was uncompromisingly unwilling to accept a loss of this magnitude. Moreover, General Dynamics unequivocally stated that it was preparing additional claims based on events subsequent to 1 November 1976 (cut off date of the $544 million claim) which it estimated in the range of $750 million, plus further unmeasured claims for the cross impact of the SSN 688 contracts upon the Trident submarine construction. Failure to reach the settlement embodied in Attachment 2 would have unmistakably involved protracted litigation (7–10 years), of unpredictable outcome, but at a predictably high price in the intensified disruption of the Navy's relationship with an essential shipbuilder. Absent the settlement of 9 June, General Dynamics indicated that it would build only under a court order, obtained by the Navy, forcing it to continue construction of the SSN 688 submarines, conditioned—the Corporation seemed confident this would occur—upon the Navy's obligation to reimburse an adequate percentage of its actual costs [4] while the courts slowly ground out the infinite complexities of charges and countercharges.

In the face of the only two realistic alternatives—settle or litigate—the Navy's negotiating strategy from the outset of discussions in December 1977 was that there was full need and justification for going well beyond the entitlement "value" of the claim ($125 million) but only to a limit consistent with the national interest. Stated differently, the Navy strategy announced to General Dynamics, as early as October 1977, was that an essential element of any settlement was that the Corporation would have to absorb a very substantial fixed loss. This has occurred.

To recapitulate the reasons that motivated the Navy's strategy to seek a settlement not merely of claims but of a complex controversy driven by the mounting losses incurred by the shipbuilder ($345 million to date) and yet to be incurred ($498 million) to the completion of ship construction in 1984:

The costs associated with the overoptimism which prevailed during the program planning and early construction phases resulted in severe economic consequences The Navy is justified in assuming a reasonable share of these consequences.

The delay and disruption caused by late GFI furnished by the Navy design agent warrant recognition beyond that obtained through strict claims analysis.

[4] Litton's threat to stop building the LHAs led to an order by a Federal District Court forcing the Navy to pay actual costs defined as 91 percent of the shipbuilder's invoiced costs, a level of payment dramatically higher than the pertinent contract required.

The inherent difficulties of documenting and analyzing disruption are well understood in Government and in the shipbuilding industry. The lateness of GFI early in the program, particularly as it impacted EB as the follow-on shipbuilder, undoubtedly created a disruption problem that is real despite an inability to quantify this with desired precision.

The SSN 688 program has been a costly and traumatic experience for General Dynamics/Electric Boat and a systematic concern to the Navy. It has caused the Corporation to conduct a thorough review of its managerial approach to ship construction. A new shipbuilding oriented management team was installed at EB in October 1977. It has taken aggressive action to reduce overhead and improve productivity controls. Numerous Navy military and civilian officials have discussed the planned improvements with EB management. There is reason to believe that the right kind of action is being taken, although time is needed to measure ultimate results.

An essential and stubborn premise of all Navy discussions with officials of General Dynamics was that a severe fixed loss would have to be the centerpiece of any settlement. This was the crucial issue which led to a breakdown of negotiations on 13 March 1978 and the announced termination of SSN 688 construction, with its potential impact on the EB workforce (8,000 to 14,000 dismissals) and the Defense posture of our Nation. Despite these threats, the Navy persisted in its view that EB's shared responsibility for past misjudgments, inefficiencies in its management of the EB labor force and its associated buildup, had to be unmistakably severe and visible.

General Dynamics, with extreme reluctance, agreed to take the unprecedented fixed loss of $359 million on the two SSN–688 contracts. Throughout the negotiations, the Navy stressed this essential element of the final settlement. Such a settlement, however, would not have occurred had the Navy not been willing to compromise on the issue, which became particularly critical in the closing stages of the negotiations, of making a substantial initial progress payment to General Dynamics to relieve the heavy amount of unreimbursed costs which had been accumulated under the existing contracts. At the date of settlement these amounted to approximately $345 million, a figure which it is anticipated will grow to $360 million by the effective date of the settlement agreement.

It was in this context, of the hard give-and-take of complex negotiations, that the $300 million initial progress payment was ultimately agreed upon by the Navy, thus leaving General Dynamics with $45–$60 million of unreimbursed costs in 1978 plus an additional amount of approximately $47 million which will be withheld from progress payments later this year—or a total of approximately $100 million which General Dynamics will absorb in 1978 out of the agreed fixed loss of $359 million. By Navy withholdings from progess payments to be due in 1979–80, General Dynamics will have absorbed more than $200 million of the $359 million fixed loss by the end of 1980. The balance of approximately $159 million will be proportionately withheld in the ensuing years until 1984.

It is paramount that Electric Boat get on with the business of building ships and that Navy officials get on with the business of administering contracts to acquire ships, free from acrimonious controversy. An inordinate amount of Navy and contractor resources has been diverted from these central tasks. The Trident is certainly important to the Nation's strategic posture and the SSN 688 is an essential component of our naval forces. The Nation needs these ships. We repeat again that not granting the relief to General Dynamics defined in Attachment 2 would inevitably have led to litigation, lasting prolonged years with all the waste of staggering financial and human resources which this would entail. Neither side can sanely afford these consequences if, as we believe, a reasonable settlement, consonant with the national interest, has been achieved.

Under the terms of the settlement, the Navy will be paying a competitive price for the 18 SSNs that Electric Boat is constructing.

Long Term Perspective

An esential goal of the long months of negotiations was to achieve a permanent solution of the SSN 688 claims and, more importantly, of their underlying problems, as described in this Memorandum. Aside from the highly important, albeit often intangible, element of the harmonious relationship between the parties which the settlement is certain to produce, the following points provide reasonable assurance of the permanent nature of the settlement:

The $2,668 million estimate to complete is considered realistic and has been reviewed by the previously mentioned accounting firm, Coopers and Lybrand, as

well as by the independent auditors of General Dynamics (Arthur Andersen & Company). This included the estimate of the manhours required to finalize construction of the SSN 688 submarines.

The manpower buildup, with its associated problems and costs, is now largely behind Electric Boat. The new management team at Groton and Quonset Point, headed by Mr. Takis Veliotis, an experienced shipbuilder, has instituted a wide variety of controls and training programs designed to improve the productivity of the workforce. A comprehensive material inventory conducted in January 1978, together with other related measures, inspires confidence that the right kinds of action are being taken to ensure stability and efficiency.

Problems associated with the GFI package have virtually been resolved. The initial issue of detailed design drawings was completed in March 1976 and the volume of revisions has decreased considerably. The parties have agreed to take all steps necessary to process and negotiate changes, unresloved at the date of settlement and occurring subsequent thereto, promptly and on a fully priced basis (Attachment 2, para. 8). Navy's and Electric Boat's top management is committed to monitoring this process to make sure that it works.

The risks of inflation, inadequately covered in the two SSN 688 contracts, are fully anticipated by the terms of the contract reformation the settlement provides for (Attachment 2, para. 7).

The settlement agreement of 9 June specifies significant incentives for cost reductions by General Dynamics below the $2,668 million EAC (estimate at completion) dividing these on a 50/50% basis with the Navy. On the other hand, unforeseen cost growth above $2,668 million (at 7%–6% inflation) is to be shared on a 50/50 basis up to $100 million (viz. $2,768 million) but above that amount General Dynamics assumes full responsibility. The Navy, on the other hand, assumes the risks of labor and material inflation above a 7–6% per annum, on the premise that cost growth originating from this cause is attributable to causes beyond the control of General Dynamics. There is thus in the settlement agreement a flexible and clearly defined method for covering unforeseen costs, should these occur (Attachment 2, pars. 5, 6, 7).

Any Public Law 85–804 action must also address the question of precedent and inferences that other Defense contractors might draw from a particular decision. General Dynamics will lose $359 million on the two SSN 683 contracts, without considering the interest on capital and the profit traditionally expected from and associated with a business venture. This is the highest loss ever absorbed by a business enterprise in its dealings with the Navy, and exceeds the gross profit made by Electric Boat on the construction of nuclear submarines since the program began in 1955. The total dispute has taken long, hard years to resolve. No person, however unreasonable, could conclude that another contractor would in its right mind venture down a similar road merely to obtain the kind of relief that this decision authorizes.

ATTACHMENT 2

AIDE MEMOIRE

Prolonged negotiations by the parties have produced the following basic elements of agreement concerning changes in the existing two contracts for the construction of SSN 688 submarines.

1. Analysis of the $544 million dollar claim by the Navy Claims Settlement Board yielded a recommended figure of $125 million. This has been partially recognized by a previous provisional price increase of $65.5 million, and the remainder is hereby confirmed.

2. General Dynamics agrees to absorb, without reimbursement, otherwise reimbursable costs in the amount of $359 million, as provided below.

3. It is presently anticipated by General-Dynamics that the total allowable costs of the two contracts (at 7% labor and 6% material inflation rates) will be $2,668 million or $843 million in excess of reimbursements the company can receive under the two contracts. The Navy agrees to adjust the contract prices to a total figure (aggregate ceiling prices) of $2,668 million. The Navy will pay General Dynamics upon the effective date of the implementing contract modifications progress payment amounts under the current contract terms and conditions totalling $300 million. Payments subsequent to the effective date of the contract modifications shall be made through the adoption of a revised progress

payment schedule over the remaining work to be performed to the final delivery of all ships, with the customary provision for retentions not to exceed 5% of the total contract price.

4. General Dynamics will absorb any unreimbursed costs remaining after the payment of $300 million referred to in paragraph 3, (presently anticipated to be about $45 million) and will bear the remainder of the $359 million, referred to in paragraph 2, by amortization of otherwise reimburseable costs through proportionate reductions in progress payments over the remaining construction period.

5. Should the allowable costs at tcompletion prove less than currently estimated (at a 7% labor and 6% material inflation rate), the Navy and General Dynamics shall benefit from such reduction 50–50%.

6. Should the allowable costs at completion prove greater than the current estimate (at the aforesaid 7%–6% inflation rates), the Navy and General Dynamics will share such cost growth 50–50% up to a $100 million cost growth, but above that figure General Dynamics will assume exclusive responsibility.

7. Additional costs for the construction of the SSN 688 submarines, solely attributable to inflation rates, based on BLS indices, above the 7% labor and 6% material, shall be the responsibility of the Navy. The BLS index for the month of December 1977 shall be the base.

8. Equitable adjustment for all unadjudicated changes ordered by the Navy since 1 January 1978 shall promptly be negotiated by the parties. Furthermore, and to contribute to the orderly management of the contracts, General Dynamics and Navy will take all steps necessary promptly to process and negotiate contract change proposals, subsequent to the effective date of this document, on a fully priced basis.

9. General Dynamics will fully release, in a form satisfactory to the Navy, all claims under the two SSN 688 contracts, as well as for impact of those contracts on the Trident contract, based upon events prior to the date of this document, and will not contest in any forum the validity and enforceability of the SSN 688 or Trident contracts based upon events prior to the date of this document.

10. The Government's obligations hereunder are subject to the availability of appropriations.

11. General Dynamics and Navy will promptly execute contract modifications and such other documents as are necessary to implement this Aide Memoire and Navy shall submit these documents to Congress for the review required by Public Law 85–804. The effective date of the implementing documents shall be the date of the favorable conclusion of the Congressional review period. In the event the implementing documents do not become effective or the appropriations do not become available, the Navy and General Dynamics shall be released from the understandings set forth herein, and neither the Navy nor General Dynamics shall be deemed to have waived or be in any manner prejudiced with respect to any rights existing prior to the negotiations conducted by the parties which led to the execution of the Aide Memoire.

APPENDIX G

Miscellaneous statutes, regulations, and documents

CONTENTS

ITEM 1.—*Public Law 85–804 (50 U.S.C. 1431–1435)*

JULY 1, 1976.

17–501 Act of August 28, 1958, as amended, (Public Law 85–804) ; 72 Stat. 972, as amended by 87 Stat. 605 (1973) ; 50 U.S.C. 1431–1435, as amended:

"Be it enacted by the Senate and Hous of Representatives of the United States of America in Congress assembled, That the President may authorize any department or agency of the Government which exercises functions in connection with the national defense, acting in accordance with regulations prescribed by the President for the protection of the Government, to enter into contracts or into amendments or modifications of contracts heretofore or hereafter made and to make advance payments thereon, without regard to other provisions of law relating to the making, performance, amendment, or modification of contracts,

whenever he deems that such action would facilitate the national defense. The authority conferred by this Section shall not be utilized to obligate the United States in an amount in excess of $50,000 without approval by an official at or above the level of an Assistant Secretary or his Deputy, or an assistant head or his deputy, of such department or agency, or by a Contract Adjustment Board established therein. The authority conferred by this Section may not be utilized to obligate the United States in any amount in excess of $25,000,000 unless the Committees on Armed Services of the Senate and the House of Representatives have been notified in writing of such proposd obligation and 60 days of continuous session of Congress have expired following the date on which such notice was transmitted to such Committees and neither House of Congress has adopted, within such 60 day period, a resolution disapproving such obligation. For purposes of this Section, th continuity of a session of Congress is broken only by an adjournment of the Congress sine die, and the days on which either House is not in session because of an adjournment of more than 3 days ot a day certain are excluded in the computation of such 60 day period.

SEC. 2. Nothing in this Act shall be construed to constitute authorization hereunder for—

(a) the use of the cost-plus-a-percentage-of-cost system of contracting;

(b) any contract in violation of existing law relating to limitation of profits;

(c) the negotiation of purchases of or contracts for property or services required by law to be procured by formal advertising and competitive bidding;

(d) the waiver of any bid, payment, performance, or other bond required by law;

(e) the amendment of a contract negotiated under section 2304(a)(15), title 10, United States Code, or under section 302(c)(13) of the Federal Property and Administrative Services Act of 1949, as amended (63 Stat. 377, 394), to increase the contract price to an amount higher than the lowest rejected bid of any responsible bidder; or

(f) the formalization of an informal commitment, unless it is found that at the time the commitment was made it was impracticable to use normal procurement procedures.

SEC. 3(a) All actions under the authority of this Act shall be made a matter of public record under regulations prescribed by the President and when deemed by him not to be detrimental to the national security.

(b) All contracts entered into, amended, or modified pursuant to authority contained in this Act shall include a clause to the effect that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of three years after final payment, have access to and the right to examine any directly pertinent books, documents, papers, and records of the contractor or any of his subcontractors engaged in the performance of and involving transactions related to such contracts or subcontracts.

SEC. 4(a) Every department and agency acting under authority of this Act shall, by March 15 of each year, report to Congress all such actions taken by that department or agency during the preceding calendar year. With respect to actions which involve actual or potential cost to the United States in excess of $50,000, the report shall—

(1) name the contractor;

(2) state the actual cost or estimated potential cost involved;

(3) describe the property or services involved; and

(4) state further the circumstances justifying the action taken.

EXTRAORDINARY CONTRACTUAL ACTIONS

With respect to (1), (2), (3), and (4), above, and under regulations prescribed by the President, there may be omitted any information the disclosure of which would be detrimental to the national security.

(b) The Clerk of the House and the Secretary of the Senate shall cause to be published in the Congressional Record all reports submitted pursuant to this section.

SEC. 5. This Act shall be effective only during a national emergency declared by Congress or the President and for six months after the termination thereof or until such earlier time as Congress, by concurrent resolution, may designate."

ITEM 2.—*Federal statutes relating to false claims*

STATUTES AND COMMON ACTIONS RELEVANT TO FALSE CLAIMS

286. Conspiracy to defraud the government with respect to claims.—Whoever enters into any agreement, combination, or conspiracy to defraud the United States, or any department or agency thereof, by obtaining or aiding to obtain the payment or allowance of any false, fictitious or fraudulent claim, shall be fined not more than $10,000 or imprisoned not more than ten years, or both. (June 25, 1948, c. 645, § 1, 62 Stat. 698.)

287. False, fictitious or fraudulent claims.—Whoever makes or presents to any person or officer in the civil, military, or naval service of the United States, or to any department or agency thereof, any claim upon or against the United States, or any department or agency thereof, knowing such claim to be false, fictitious, or fraudulent, shall be fined not more than $10,000 or imprisoned not more than five years, or both. (June 25, 1948, c. 645, § 1, 62 Stat. 698.)

Section 371. Conspiracy to commit offense or to defraud United States.—If two or more persons conspire either to commit any offense against the United States or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than $10,000 or imprisoned not more than five years, or both.

If, however, the offense, the commission of which is the object of the conspiracy, is a misdemeanor only, the punishment for such conspiracy shall not exceed the maximum punishment provided for such misdemeanor. (June 25, 1948, c. 645, § 1, 62 Stat. 701.)

Section 1001. Statement or entries generally.—Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry, shall be fined not more than $10,000 or imprisoned not more than five years, or both. (June 25, 1948, c. 645, § 1, 62 Stat. 749.)

1002. Possession of false papers to defraud United States.—Whoever, knowingly and with intent to defraud the United States, or any agency thereof, possesses any false, altered, forged, or counterfeited writing or doucment for the purpose of enabling another to obtain from the United States, or from any agency, officer or agent thereof, any sum of money, shall be fined not more than $10,000 or imprisoned not more than five years, or both. (June 25, 1948, c. 645, § 1, 62 Stat. 749.)

1003. Demands against the United States.—Whoever knowingly and fraudulently demands or endeavors to obtain any share or sum in the public stocks of the United States, or to have any part thereof transferred, assigned, sold, or conveyed, or to have any gratuity, or other debt due from the Uniter States, or any part thereof, received, or paid by virtue of any false, forged, or counterfeited power of attorney, authority, or instrument, shall be fined not more than $10,000 or imprisoned not more than five years, or both; but if the sum or value so obtained or attempted to be obtained does not exceed $100, he shall be fined not more than $1,000 or imprisoned not more than one year, or both. (June 25, 1948, c. 645, § 1, 62 Stat. 749.)

2514. Forfeiture of fraudulent claims.—A claim against the United States shall be forfeited to the United States by any person who corruptly practices or attempts to practice any fraud against the United States in the proof, statement, establishment, or allowance thereof.

In such cases the Court of Claims shall specifically find such fraud or attempt and render judgment of forfeiture. (June 25, 1948, c. 646, § 1, 62 Stat. 976.)

§ 231. Liability of persons making false claims.

Any person not in the military or naval forces of the United States, or in the militia called into or actually employed in the service of the United States, who shall make or cause to be made, or present or cause to be presented, for payment or approval, to or by any person or officer in the civil, military, or naval service of the United States, any claim upon or against the Government of the United States, or any department or officer thereof, knowing such claim to be false, ficti-

tious, or fraudulent, or who, for the purpose of obtaining or aiding to obtain the payment or approval of such claim, makes, uses, or causes to be made or used, any false bill, receipt, voucher, roll, account, claim, certificate, affidavit, or deposition, knowing the same to contain any fraudulent or fictitious statement or entry, or who enters into any agreement, combination, or conspiracy to defraud the Government of the United States, or any department or officer thereof, by obtaining or aiding to obtain the payment or allowance of any false or fraudulent claim, or who, having charge, possession, custody, or control of any money or other public property used or to be used in the military or naval service, who, with intent to defraud the United States or willfully to conceal such money or other property, delivers or causes to be delivered, to any other person having authority to receive the same, any amount of such money or other property less than that for which he received a certificate or took a receipt, and every person authorized to make or deliver any certificate, voucher, receipt, or other paper certifying the receipt of arms, ammunition, provisions, clothing, or other property so used or to be used, who makes or delivers the same to any other person without a full knowledge of the truth of the facts stated therein, and with intent to defraud the United States, and every person who knowingly purchases or receives in pledge for any obligation or indebtedness from any soldier, officer, sailor, or other person called into or employed in the military or naval service any arms, equipments, ammunition, clothes, military stores, or other public property, such soldier, sailor, officer or other person not having the lawful right to pledge or sell the same, shall forfeit and pay to the United States the sum of $2,000, and, in addition, double the amount of damages which the United States may have sustained by reason of the doing or committing such act, together with the costs of suit; and such forfeiture and damages shall be sued for in the same suit.

ITEM 3.—*Naval Sea Systems Command Instruction 4365.1A. This document sets forth the requirements for legal, technical and audit review of claims prior to payment*

DEPARTMENT OF THE NAVY,
NAVAL SEA SYSTEMS COMMAND,
Washington, D.C., January 13, 1976.

From: Commander, Naval Sea Systems Command.
To: All Offices, Reporting Directly to CAMNAVSEA Commander, Naval Sea Engineering Center Distribution List.
Subject: NAVSEA Contractor Claims Settlement Program.
Ref: (a) NPD 1-401.55; (b) NPD 1-401.57; (c) SACAM; (d) ASPR 3-807.3; (e) ASPR Manual for Contract Pricing, Appendix A; (f) NAVSHIPSINST 5510.2B of 17 July 1968, Sub: Naval Ship Systems Command Security Manual; (g) NAVSHIPSINST 5500.11A of 18 February 1972, Subj: Dissemination Control of Official Information; policy and procedures for.
Encl: (1) Claim Processing Schedule, form NAVSEA 4365/2. (2) NAVSEA Claims Board. (3) NAVSEA Contractor Claim Report, form NAVSEA 4365/1.

1. *Purpose.*—To establish a program, in furtherance of the policies and procedures set forth in references (a) and (b), for processing, controlling, and disposing of by agreement or final contracting officer decision all claims involving NAVSEA contracts, and to assign responsibilities for the performance of required functions within such a program.

2. *Cancellation.*—This instruction cancels NAVSEAINST 4365.1 of 10 April 1975.

3. *Scope.*—

a. All claims, as defined in reference (a), which are submitted by a contractor to this Command or to any office reporting directly to this Command, and all NAVSEA claims against contractors, are within the scope of this instruction except as excluded below.

b. Exclusions:

(1) Field changes described by paragraph 12-4.3.9 of reference (c).

(2) The pricing or settlement of formal change orders; normal price adjustments under escalation provisions and redetermination provisions; and actions under ASPR Section XVII (Public Law 85-804).

(3) Matters before the Armed Services Board of Contract Appeals (ASBCA), the General Accounting Office (GAO), or the courts.

(4) Any claim whose value as submitted by the contractor, or to the contractor, is less than $100,000. (However, this will not preclude processing of such claims in accordance with this instruction of the cognizant Contract Administration Office or Headquarters buying division so desires.)

4. *Responsibilities.*—This section specifies responsibilities of various organizations and individuals within NAVSEA Headquarters or shore activities for processing of claims.

a. *Contracts Directorate (SEA 028):*

(1) SEA 028 shall have overall responsibility for the NAVSEA Claim Settlement Program, and is authorized to communicate directly with Claim Team Managers on all matters pertaining to claims. Specific responsibilities include:

(a) Initial receipt and analysis of contractor claims.

(b) Assignment of contract claims to appropriate shore activity for processing. (Claims arising under NAVSEA contracts that are not administered by a NAVSEA Field activity will be processed within SEA 02. For these claims, the cognizant purchase division or SEA 028 will assume the responsibilities listed in paragraph 4d. below).

(c) Technical assistance and direction to claim settlement teams during processing.

(d) Review of claim settlement team work to ensure adequacy.

(e) Coordination of all aspects of claim processing at the Headquarters level, including required reports.

(f) Review of individual claim histories and publication of "lessons learned" to concerned personnel throughout NAVSEA Headquarters and shore activities.

(g) Budgeting for, control of, and allocation of the required resources to the appropriate processing activity designated pursuant to 4a (1) (b) above. These resources include (1) dollars for issuance of support contracts to cover necessary expenses and personnel costs, and (2) ceiling points for hiring required Government personnel for claims analysis and processing.

(2) Contracts Directorate personnel other than SEA 028 shall provide claim settlement assistance as required.

b. *Counsel (SEA OOL).* The Office of Counsel, (SEA OOL) shall participate in all aspects of claims analysis, evaluation, and settlement, including designation of the legal members of claims teams, i.e., Team Counsel; furnishing legal advice; participation with the team members in obtaining and identifying factual information needed to evaluate the merits of the claim; preparation of a legal memorandum with respect to each claim, indicating therein whether, and the extent to which there is a legal basis for any payment, and if so, whether the facts upon which payment depends are supported by substantial evidence; and legal review of proposed contract modifications or final Contracting Officer's Decisions.

c. *Other Headquarters Organizations.* Deputy Commanders, Project Managers, Staff Offices of NAVSEA and NAVSEC are responsible for providing assistance and analysis is support of the claims effort within their areas of responsibility and/or cognizance as requested by SEA 028.

d. *Supervisors of Shipbuilding Conversion and Repair and Naval Plant Representatives.* Supervisors of Shipbuilding (SUPSHIPs) and Naval Plant Representatives (NAVPROs) will report pending or anticipated claims to SEA 028 in accordance with paragraph 7 below. After receipt of a contractor claim, and determination by SEA 028 that the claim will be accepted and processed, or after issuance of a claim against a contractor, the cognizant SUPSHIP or NAVPRO will be responsible for establishing a claim settlement team and assigning to the team a contracting officer, an engineer, and additional personnel as necessary for effective processing of the claim. These personnel assignments will be made on a full-time basis whenever necessary to insure prompt processing of the claim. The SUPSHIP/NAVPRO will not be responsible for technical direction and management of the claim settlement team efforts; this responsibility is assigned to SEA 028. However, the SUPSHIP/NAVPRO will be responsible for providing all required administration support, including the control and allocation of resources. To the extent feasible, the claim settlement team will be physically separate from the rest of the SUPSHIP/NAVPRO operations.

e. *Claim Settlement Team.* The claim settlement team, under the direction of the contracting officer (claim team manager), will analyze the claim, research all available data, develop and document a recommended Government position, and conduct negotiations with the contractor. The Contracting Officer, assisted by other team members as he deems necessary, will present the team's recommended pre- and post-negotiation positions to cognizant review and approval authorities described in paragraph 5f and 5h below. The Contracting Officer will prepare and submit claims reports as required by paragraph 7 below.

f. *Headquarters Boards:*

(1) The membership and responsibilities of the NAVSEA Claims Board are set forth in enclosure (2).

(2) The responsibilities of the NMC Claims Board and the NMC General Board are set forth in reference (a).

5. *Procedure.*—A sequential procedure as outlined in the following paragraphs will be used in the processing and disposition of claims.

a. *Claim Receipt.* Any addressee upon receipt of a contractor claim shall promptly refer the matter to SEA 028 and the cognizant acquisition manager for consideration and action.

b. *Preliminary Review:*

(1) A SEA 028 designated headquarters group will make a preliminary review of the claim to determine its completeness and acceptability, considering not only the criteria established by reference (a) but also "Truth in Negotions Act" requirements as set forth in references (d) and (e). The outcome of the preliminary review will be a recommendation/decision to:

(a) Reject the claim in accordance with reference (a), or

(b) Accept the claim and process it

(2) If it is determined that the claim will be processed, a claim settlement team will be established. The team will at a minimum consist of a contracting officer (claim team manager), engineer, counsel and auditor (DCAA). The contracting officer and engineer will be appointed by the cognizant SUPSHIP or NAVPRO in consultation with SEA 028. Counsel will be appointed by SEA 00L and the auditor by the cognizant DCAA office. This minimal team will be augmented as necessary by technical analysts, negotiators and other field or headquarters personnel. The claim settlement team will review the claim, prepare a claim settlement plan, and provide SEA 028 with information required for submission of claims reports to higher headquarters.

(3) The claim settlement plan, all pages of which will be stamped "Attorney-Client Privileged," will be submitted to SEA 02 via the cognizant SUPSHIP or NAVPRO and SEA 028, with a copy to SEA 00L, the cognizant acquisition manager, and the cognizant SEA 02 Purchase Division Director, and will include:

(a) A brief summary of each claim item and how the claim item can be classified (lead-yard/follow-yard drawings, delay, defective specifications, disruption, etc.).

(b) The elements of proof required to support entitlement for each claim item.

(c) An opinion as to the data necessary to support legal entitlement and quantum, and the extent to which the contractor has presented this data.

(d) A claim processing schedule showing the estimated completion date for each major event as illustrated by enclosure (1), form NAVSEA 4365/2.

(e) An outline of the proposed data filing system to be used during claim analysis and evaluation. The system must be designed to meet the needs of claim analysis, evaluation and negotiation, but also should be structured to support the needs of litigation should a contracting officer's decision be issued with a subsequent appeal by the claimant.

c. *Factual Investigation:*

(1) The claim settlement team will investigate the claim and develop the relevant facts. Pertinent legal issues will be outlined by counsel so that the factual inquiry can proceed in the most productive manner. This factual inquiry is the most essential part of the claim settlement effort. It must be thorough and comprehensive, and shall extend to all sources (contractor, Government and other) where relevant data may be available. The burden of proof rests with the contractor:

(a) To establish that his asserted additional costs were caused by a compensable act or a failure to act by the Government, and

(b) To establish and support through adequate documentation the amount, if any, of additional costs for which the Government is responsible.

(2) The Government has the right to request, receive, and inspect any and all relevant data and records of the contractor. The claim settlement team has the duty to, and shall request the contractor to make available all such documents and other data. In assessing the merits of the claim the team shall take into account all facts available from any source whether or not furnished by the contractor. All documents and oral statements obtained during fact finding will be completely identified. Affidavits will be obtained if it appears that individuals from whom statements were obtained may not be available at a later date. An assessment should be made of the first hand knowledge, reliability and expertise of both Government and contractor personnel known to have knowledge of the events cited in the claim or who may be potential witnesses.

d. *Preliminary Documentation.* The preliminary documentation consists of two distinct phases: the team efforts, and the Headquarters review.

(1) Claim settlement team efforts:

(a) Preliminary Technical Analysis Report (TAR). The preliminary TAR is prepared by the team engineer and/or technical analysts with the advice of the claim team negotiator, counsel and other team members. The TAR is a factual recitation of the claim, the facts as they exist, and the engineering evaluation and analysis of the validity of the claim on technical grounds. It includes the team recommendation on quantum, supported by analysis. Where the TAR refers to laboratory or other test reports, copies of such reports should be attached and personnel who conducted the test should be identified. The TAR should identify questions or issues on which expert testimony may be submitted to the experts. The name(s) of the expert(s) will also be provided.

(b) *Preliminary Legal Memorandum.* The team counsel will prepare a preliminary legal memorandum, based on the preliminary TAR, pointing out areas requiring further clarification and furnishing guidance on the validity of the claim issues. The preliminary legal memorandum may be informal in nature and is advisory information for the team.

(c) *Audit Assistance.* The team will consult with the auditors as necessary to obtain assistance in evaluation of the facts and to verify costs.

(2) NAVSEA Headquarters Review. SEA 028, SEA 00L, and the cognizant acquisition manager will review the preliminary TAR and the preliminary legal memorandum. Comments will be provided to the claim team manager for use in preparing the final TAR. This review of preliminary documentation will be conducted on-site wherever possible; in all cases, direct discussions between Headquarters personnel and team members during the fact finding phases and TAR preparation will be encouraged to expedite the processing procedure and avoid excessive typing and reproduction.

e. *Final Documentation:*

(1) Final Technical Analysis Report (TAR). The team engineer shall prepare the final TAR taking into consideration the comments of all members of the team and comments received as the result of the Headquarters review of the preliminary TAR. He shall endeavor to resolve any questions on factual issues. Where the team has determined that documentation is inadequate, the team engineer will obtain from the contractor or otherwise generate the necessary documentation or explain in the TAR why it is not available. The TAR and all comments thereon shall be available for use in the legal and audit evaluation of the claims.

(2) Advisory Audit Report. The DCAA auditor will be furnished a copy of the final TAR for use in the preparation of the audit report. If the TAR is not yet available, the preliminary TAR and other pertinent information may be furnished. However, in such cases the resulting advisory audit report will also be considered preliminary and subject to further revision as necessary upon completion of the TAR.

(3) Final Legal Memorandum. The team counsel will be responsible for the preparation of the final legal memorandum. This memorandum will be furnished other team members for reference purposes in arriving at a pre-negotiation position. The legal memorandum will meet all the requirements of reference (a) and become a part of the business clearance package.

f. *Pre-Negotiation Position.* Based upon the TAR, advisory audit report, legal memorandum and other facts developed by the claim settlement team, the claim

team manager in consultation with the team negotiator will develop for each claim a pre-negotiation position range to form the basis for negotiations. The pre-negotiation position will be presented to appropriate levels for review and approval as authorized below.

(1) *Claims with a proposed settlement value of less than $1 million:* The pre-negotiation position will be reviewed and approved in accordance with established field activity or Headquarters business clearance procedures.

(2) *Claims with a proposed settlement value of over $1 million:* The pre-negotiation position will be reviewed by SEA 028 and the NAVSEA Claims Board which will recommend disposition to SEA 02. Final approval must be given by SEA 02.

g. *Conduct Negotiations.* As soon as practicable after establishing an approved negotiation position, negotiations with respect to settlement of the claim shall be conducted with the contractor. Unless otherwise directed by SEA 02, the negotiations will be conducted by the claim team manager or claim team negotiator with other team members present and participating as appropriate.

h. *Post-Negotiation Position.* No settlement commitment will be made nor will a contracting officer's decision be issued until appropriate approval has been received. The settlement proposal (Post-Negotiation Business Clearance) will be prepared by the claim team manager in accordance with reference (a) and presented for review and approval as outlined below.

(1) *Claims with a proposed settlement value of less than $1 million:* The proposal will be reviewed and approved in accordance with established field activity or Headquarters business clearance procedures.

(2) *Claims with a proposed settlement value of $1 million or over, but no more than $10 million.* The proposal will be reviewed by SEA 028 and the NAVSEA Claims Board, which will recommend disposition to SEA 02. Additionally, any proposed settlement in excess of $5 million will be summarized and informally reviewed with CNM and ASN (I&L) before the final approval by SEA 02.

(3) *Claims with a proposed settlement value of over $10 million:* The proposal will be reviewed by SEA 028 and the NAVSEA Claims Board. The Board will forward the proposal, together with suitable recommendation, via SEA 02 and SEA 00 to the Chairman, Naval Material Command Claims Board, for further review as appropriate. The Chief of Naval Material (with ASN(I&L) concurrence) is the approval authority for final disposition.

i. *Disposition.* Final disposition of the claim will be made by issuance of an approved contract modification or contracting officer's final decision. In no case will a final contracting officer's decision be issued without prior approval of SEA 02. If a final contracting officer's decision is issued, it is most important that all files and back-up date be preserved, since they will be essential to the defense of the Government position in the event the contractor appeals the decision.

6. *Classification of Data.*—All documents requiring classification will be marked and handled in accordance with the provisions of reference (f) or superseding instructions. In addition, all unclassified reports and documents generated as a result of this instruction and any folders, records, and files containing such reports or documents shall be marked "FOR OFFICIAL USE ONLY" in accordance with reference (g) or superseding instructions. All legal memoranda and written advice will be labeled "Attorney-Client Privileged-Attorney Work Product" as well.

7. *Contractors Claim Settlement Reports and Forms.*—a. *Contractor Claim Settlement Report:*

(1) *Pending or anticipated claims.* Each SUPSHIP or NAVPRO, as soon as he becomes aware of a pending or anticipated claim, will forward an initial report of such claim to SEA 028, with a copy to the cognizant acquisition manager. Subsequent update reports will be submitted not later than the last day of each calendar quarter, until such time as the claim no longer is anticipated or the claim has actually been submitted and assigned to a claim settlement team. The foregoing reports will be submitted on form NAVSEA 4365/1, enclosure (3), "Item 1 through 7 only," and marked "Pending" or "Anticipated." Where the precise data is unknown, estimates will be reported to the extent possible.

(2) *Actual claims.* Within 30 days after assignment of a claim to claim settlement team, the claim team manager will forward to SEA 028 an initial claim report on form NAVSEA 4365/1, enclosure (3) and a Claim Processing Schedule

form NAVSEA 4365/2, enclosure (1). An updated claim report and Claim Processing Schedule will thereafter be forwarded to SEA 028 not later than the last day of each calendar quarter.

(3) *Settled claims.* Within 90 days after settlement of a claim, the claim team manager will forward to SEA 028 a memorandum report discussing lessons learned from the claim analysis and suggested actions to avoid future similar claims.

(4) *Distribution of reports.* Claim managers will furnish to the cognizant SUPSHIP or NAVPRO a copy of all reports sent to SEA 028. SEA 028 will distribute copies of claims reports to concerned codes and offices within NAVSEA and to other Headquarters offices as required.

(5) Report Symbol NAVSEA 4365–2 is assigned to the Contractor Claims Settlement Report.

b. *Form.* Copies of forms NAVSEA 4365/2 (Claim Processing Schedule) and NAVSEA 4365/1 (Claims Status Report) can be obtained from SEA 0281.

R. C. GOODING.

NAVSEA CLAIMS BOARD

The NAVSEA Claims Board is established to provide for more thorough review of the medium and large size claims and to advise on other claim related matters. The Board is basically concerned with claims involving a proposed settlement value of $1 million or more. Its membership and duties are given below.

a. Membership and rules of procedure:

(1) The regular voting membership of the Board shall consist of:

Chairman: Executive Director, Contracts Directorate, (SEA 02B).

Member and Alternate Chairman: Director, NAVSEA Contract Administration Division, (SEA 028).

Member: Executive Director for SUPSHIP Management, (SEA 074) or Field Management Assistant, (SEA 06L).

Member: Director of Cognizant 02 Purchase Division, (SEA 022, 024, 025, 026, or 027).

Member: Cognizant Acquisition Manager.

(2) For Advice:

Counsel: NAVSEA Counsel (00L) or Deputy NAVSEA Counsel, Claims (00L2).

Secretary of the Board: Contract Administrator, (SEA 0281).

(3) When necessary, the Chairman of the Board may call upon other NAVSEA, NAVSEC, or SUPSHIP personnel as he deems appropriate.

(4) Four voting members, plus counsel, shall constitute a quorum of the Board.

(5) The Board shall meet at the call of the Chairman.

(6) Records of deliberations, findings and recommendations shall be maintained by the Secretary of the Board.

Enclosures.

NAVSEA 4365/2 (1-75)

CLAIM PROCESSING SCHEDULE

CONTRACT ACT NO.	CONTRACTOR	DATE

PHASE	STEP	MILESTONE	ACTUAL OR (TARGETED) COMPLETION DATE
FACT FINDING	1.	CLAIM RECEIVED	
	2.	CLAIM SETTLEMENT TEAM ESTABLISHED	
	3.	CLAIM PROCESSING PLAN PREPARED	
	4.	FACTUAL INVESTIGATION & LEGAL REVIEW	
	a.	PRELIMINARY TAR COMPLETED	
	b.	PRELIMINARY LEGAL MEMO COMPLETED	
	c.	HEADQUARTER'S REVIEW OF 4a & 4b	
FACT REVIEW	5.	FINAL DOCUMENTATION	
	a.	FINAL TAR COMPLETED	
	b.	ADVISORY AUDIT REPORT COMPLETED	
	c.	FINAL LEGAL MEMO COMPLETED	
DECISION AND SETTLEMENT	6.	PRE-NEGOTIATION POSTION APPROVAL	
	7.	CONDUCT NEGOTIATIONS	
	8.	POST NEGOTIATIONS POSITION APPROVAL	
	9.	CONTRACT MODIFICATION	

REMARKS:

(USE BACKSIDE IF MORE SPACE IS REQUIRED.

CLAIMS STATUS REPORT
NAVSEA 4365/1 (1-75) PAGE 1

DATE:

1. CONTRACTOR:

2a. CONTRACT NO.: _____ b. CONTRACT WORK: _____

c. ORIGINAL CONTRACT PRICE: _____ d. TYPE: _____ e. _____ DATE OF AWARD

f. CURRENT CONTRACT PRICE: _____

3a. ORIGINAL CLAIM AMOUNT: _____ b. DATE CLAIM SUBMITTED: _____

c. CURRENT CLAIM AMOUNT: _____

4. BASIS OF CLAIM: _____

5. PARTICIPATING ACTIVITIES: _____

6. CLAIM VALIDITY ASSESSMENT: _____

7. PLANNED DISPOSITION: _____

NAVSEAINST 4365.1A
13 January 1976
CLAIMS STATUS REPORT
NAVSEA 4365/1 (1-75) PAGE 2

RCS NAVSEA 4365-2

8a. LATEST REVISED CONTRACT PRICE	
DATE	AMOUNT
	$

8b. LATEST REVISED CLAIM AMOUNT			
DATE	REVISED AMOUNT	AMOUNT OF CHANGE ±	REASON
	$	$	

8c. PROVISIONAL PAYMENT AGAINST CLAIM	
DATE	AMOUNT
	$

9. CLAIM TEAM:
CONTRACTING OFFICER:

ENGINEER:

NEGOTIATOR:

LAWYER:

AUDITOR:

10. FINAL DISPOSITION:
a. MOD. NO.:

DATE:

FINAL SETTLEMENT AMOUNT:

ITEM 4a.—*June 14, 1973—Contracting Officer's decision in the Lockheed case involving DE 1052 and Amphibious Transport Dock (LPD) shipbuilding contracts*

DEPARTMENT OF THE NAVY
NAVAL SHIP SYSTEMS COMMAND
WASHINGTON, D. C. 20360

IN REPLY REFER TO
02XC1:WES:jon
Ser: 92-02X

AIR MAIL - REGISTERED
RETURN RECEIPT REQUESTED

14 June 1973

Lockheed Shipbuilding & Construction Company
2929 - 16th Avenue, S.W.
Seattle, Washington 98134

Gentlemen:

1. In November 1968 and in January and February 1969 Lockheed Shipbuilding and Construction Company (hereafter LSCC), formerly the Puget Sound Bridge and Drydock Company, initially submitted consolidated claims for equitable adjustments under four Bureau of Ships (currently Naval Ship Systems Command, or NAVSHIPS) contracts, NObs-4785, NObs-4660, NObs-4765 and NObs-4902. The amounts claimed have been revised several times; the most recent revision being that accompanied by DD Forms 633-5 dated May 5, 1971, for a cumulative amount of $139,572,006. Other LSCC correspondence at various times stated these claims in an amount totaling as much as $158,012,440.

2. The DE 1052 Contract and Claim. Contract NObs-4785 is for the construction of five DE 1052 class ocean escort vessels. It was awarded to LSCC on July 22, 1964 as a result of formal advertising. The solicitation provided for a split award. LSCC was fourth low bidder; the three lower bidders received contracts for seven other DE 1052 class vessels each, with a balance of five vessels awarded to LSCC. Contract NObs-4785 had an initial fixed price of $60,285,000 and also provided for escalation; its specified original and amended delivery dates are as follows:

Vessel	Orig Delivery Date	Amended Delivery Date[1/]	Actual Delivery Date
DE 1057	Sep 1968	May 1970	8 May 1970
DE 1063	Dec 1968	Jun 1971	22 Jun 1971
DE 1065	Mar 1969	Dec 1971	30 Dec 1971
DE 1069	Jun 1969	Apr 1972	28 Apr 1972
DE 1073	Sep 1969	Aug 1972	11 Aug 1972

1/ Bureau Modification No. 3 of February 8, 1965, extended these five vessels' delivery dates each for five months because of late delivery of Government-furnished equipments, viz: AN/SQS-26 sonars. Subsequent Modification Nos. A-239 of July 3, 1967 and A-566 of February 27, 1970, made further extensions resulting in the final amended delivery dates enumerated above, but reserved the parties' rights as to respective responsibilities for that balance of the vessel delays.

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Ser: 92-02X

3. Since the DE 1052 class vessels constituted a new vessel class for which previous DE working plans were inapplicable, NAVSHIPS, on December 6, 1963, awarded Contract NObs-4715 to Gibbs & Cox, Inc., to prepare DE 1052 class working plans and other data. The DE 1052 vessel construction solicitation (which resulted in the split award to four shipyards) advised bidders of the Gibbs & Cox working plans contract, and provided that promptly upon execution of the lead ship (DE 1052) construction contract, the lead ship builder -- which turned out to be Todd Shipyards Corporation, Seattle -- was to subcontract to Gibbs & Cox for the NObs-4715 work, whereafter NObs-4715 was to be nullified. The DE 1052 vessel construction solicitation also informed bidders that on lots excluding vessel DE 1052 the standard NAVSHIPS working plan practice would be followed, namely, that such other construction contractors could either purchase working plans at the cost of reproduction from the lead ship builder or they themselves could prepare their own working plans.

4. On November 19, 1968, LSCC submitted a claim for a $30,783,460 equitable adjustment under Contract NObs-4785; by May 5, 1971, that amount had been revised to $45,181,080.

5. The LPD Contracts and Claims. The last three contracts enumerated in paragraph 1 are for the construction of amphibious transport dock (LPD) vessels, and were awarded as follows:

Contract No.	Vessels	Date Awarded	Price	Method
NObs-4660	LPD 9 & 10	5-23-63	$50,445,000	Negotiated 1/
NObs-4765	LPD 11, 12 & 13	5-15-64	$69,774,000	Formal Adv.
NObs-4902	LPD 14 & 15	5-17-65	$48,395,000	Formal Adv.

NOTE: 1/ Awarded without discussion on basis of initial price.

All three contracts are fixed price with escalation.

6. The original and amended contract delivery dates, and the actual delivery dates, for these LPDs are:

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Contract No.	Vessel	Orig Contract Date	Amended Contract Date	Actual Delivery Date
NObs-4660	LPD-9	09-30-66	10-18-68 1/	10-18-68
NObs-4660	LPD-10	12-31-66	07-07-69 1/	07-07-69
NObs-4765	LPD-11	04-15-67	05-70 2/	05-15-70
NObs-4765	LPD-12	07-15-67	12-70 2/	12-04-70
NObs-4765	LPD-13	10-15-67	12-26-69 2/	12-26-69
NObs-4902	LPD-14	06-17-68	02-71 3/	02-12-71
NObs-4902	LPD-15	09-17-68	06-71 3/	06-25-71

NOTES: 1/By NObs-4660 Modification No. A-738 of March 9, 1970
2/By NObs-4765 Modification No. A-737 of March 16, 1970
3/By NObs-4902 Modification No. A-499 of March 9, 1970

In none of the three foregoing modifications did the parties agree upon an apportionment of respective responsibilities for these delays in deliveries.

7. a. On January 20, 1969, LSCC submitted a claim for $24,151,451 under Contract NObs-4660; this amount was subsequently revised to $35,067,992 on May 5, 1971 on a DD Form 633-5 price proposal.

b. On February 6, 1969, LSCC submitted a claim for $24,991,341 under Contract NObs-4765; the May 5, 1971 revision increased this amount to $31,137,308.

c. On February 7, 1969, LSCC submitted a claim for $20,198,260 under Contract NObs-4902; the May 5, 1971 revision increased this amount to $28,185,626.

8. The Course of Claim Investigation and Aborted Settlement Negotiations. In February 1969, NAVSHIPS established a nucleus Special Task Force to investigate the three LPD claims. A different nucleus team was established to investigate the DE-1052 claim. Numerous visits to LSCC's Seattle facility were made in the course of these investigations. Commencing in December 1970 the parties sought to negotiate a settlement of these four claims. The following subparagraphs describe the events relating to the abortive settlement negotiations:

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a. By Revision No. 7, of January 30, 1970, to the Navy Procurement Directives, a new paragraph 1-401.55 was added. It established requirements that NAVSHIPS (among other Navy activities) report major claims and obtain the approval of the Assistant Secretary of the Navy (Installations and Logistics) before making any commitment to a claimant on a settlement exceeding $5,000,000.

b. On December 30, 1970, then Deputy Defense Secretary Packard wrote to Senator John Stennis that,

> "...the remaining claims (referring to Lockheed's LPD and DE 1052 claims), totaling $159.8 million, have been the subject of intensive negotiations between the Navy and Lockheed. To settle these claims, the Navy has offered Lockheed $58 million. I am hopeful that a settlement of these claims can be reached. Generally speaking, all negotiations regarding this program have also been concluded. The single remaining issue is Lockheed's acceptance of this offer."

c. On January 5, 1971, Lockheed wrote to Mr. Packard:

> "With reference to the ship construction claims, we are not prepared to accept the Navy offer of $58 million. It is our belief, however, that if both parties continue to pursue negotiations diligently a mutually acceptable solution can be achieved within a reasonable period of time."

d. Negotiations continued and on January 29, 1971 a final negotiating meeting was held with RADM N. Sonenshein, CAPT A. Holfield and Mr. R. Bates representing NAVSHIPS and Mr. R. Osborn and Mr. A Folden representing LSCC. A tentative settlement agreement of $62 million was reached with the understanding that it was subject to required approval of higher authority. For reasons detailed below such approvals were never received.

e. On February 1, 1971, Lockheed President D. J. Houghton wrote to Lockheed shareholders: "...last week we reached tentative agreement with the Navy to settle our ship construction claims for $62 million..." (emphasis added).

f. In a NAVSHIPS memorandum to the Assistant Secretary of the Navy (Financial Management) dated February 12, 1971, the Acting Commander, NAVSHIPS, stated:

"b. Tentative settlement - $62 million

"c. Provisional price increases made to date against these claims total $28.4 million

"d. Additional provisional price increases of $21 million are in process. Provisional increases require documentation in the form of technical analysis, audit verification and legal determinations to safeguard the Government's interests, and NAVMAT approval in accordance with NPD 1-401.55(e). Hence, the authorization of provisional increases involves essentially all the steps required in final settlement.

"e. Final Settlement Date - 15 March 1971. This date is largely theoretical. It is based upon completion of the extensive documentation required for each of the four contracts involved (including finalization of the Technical Advisory Reports (TAR's), DCAA final audit reports and formal legal memoranda) and submission of the post-negotiation business clearance by 10 March 1971 to NAVMAT and ASN (I&L) for approval in accordance with NPD 1-401.55. ..."

g. On February 24, 1971, NAVSHIPS and Lockheed executed a modification to the four contracts involved in these claims for the LPDs and DE 1052s, to provide Lockheed provisional price increases on account of the claims. The modification states unequivocally that the settlement agreement of $62,000,000 was subject to approval by "...higher Government authorities in accordance with applicable regulations..." and continued:

"The parties agree that neither the above provisional increases in the contract price nor the above mentioned tentative settlement of $62 million shall be construed as an acknowledgement of the validity of any of the specific claims included in the Contractor's claims submissions under these contracts nor does the Government admit the correctness of any of the facts alleged in these submissions. Furthermore, these provisional increases in the contract prices and the proposed settlement of $62 million shall not be considered to represent the value of the Contractor's claims if the Contracting Officer shall find, in the event the supplemental agreements incorporating the proposed settlement are not executed, that the Contractor is entitled to equitable adjustments in the contract prices totaling less than the provisional increases in contract prices made to date or less than the proposed settlement of $62 million on account of the facts alleged in his claims submissions."

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h. On May 20, 1971, then Defense Secretary Laird reported to Chairman Hebert of the House Armed Services Committee:

> "Claims under on-going contracts for DE 1052's and LPD's totaling $159.8 million have been tentatively settled for $62 million. The LPD settlement has been approved and paid; the DE 1052 agreement is still in the process of review by the Navy." (emphasis added).

i. Secretary Laird's confusion about the status of review of the LPD claims by the Navy -- which, incidentally, were not handled separately from the DE 1052 claim -- was corrected by then Deputy Defense Secretary Packard's statement to the Secretaries of the Army and Air Force in a memorandum dated June 4, 1971:

> "In June 1970, Lockheed's claims totaling $46 million for work under the five completed ship contracts were settled for $17.9 million. The settlement was reached through the Department of the Navy's established procedures for negotiating ship claims. Likewise, claims under four on-going contracts for DE 1052's and LPD's totaling $159.8 million have been tentatively settled for $62 million. The LPD and the DE 1052 agreement is still in process of review by the Navy. However, if it is assumed that a settlement of the $159.8 million claim will be for $62 million on these four contracts, the total Lockheed loss before taxes on all nine contracts will be approximately $89.6 million." (emphasis added).

j. On January 2, 1973, Lockheed prepared a four-page briefing paper on these claims, stating on page 2:

> "...LSCC and NAVSHIPS renewed and increased negotiation efforts on the remaining claims, and on January 29, 1971 Lockheed Aircraft Corporation Group Vice President R. J. Osborn, LSCC's President A. M. Folden and the Commander, Naval Ship Systems Command N. A. Sonenshein arrived at a settlement figure of $62 million. Subsequently, supplemental agreements were executed which committed LSCC to that settlement amount as of that date, and committed the Navy likewise upon approval "by higher Government authorities in accordance with the applicable regulations."
>
> Since the date of the "hand-shake" agreement on January 29, 1971, made in the spirit and within the parameters of Secretary Packard's plan, there has been virtually no progress by the Navy in finalizing the settlement agreement..."

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9. Navy Review Actions. With respect to the LSCC consolidated LPD and DE 1052 claims, the Navy took the following review actions:

a. On March 25, 1971, NAVSHIPS submitted the proposed $62 million settlement sum for the consolidated Lockheed claims for review and hopefully for approval by the duly constituted reviewers in the Naval Material Command; that group was named the "Contract Claims Control and Surveillance Group" (or CCCSG). The CCCSG, after several weeks of review and deliberation, concluded that the proposed LSCC claims tentative settlement could not be approved because of factual inadequacies in LSCC provided information in the area of legal entitlement for certain claim elements and for lack of substantiation of quantum with respect to the entire claim. Accordingly, on August 3, 1971, NAVSHIPS withdrew the proposed settlement from CCCSG consideration.

b. Thereafter, in August 1971 NAVSHIPS requested the Supervisor of Shipbuilding, Conversion and Repair, 13th Naval District (SUPSHIP-13), whose office is the cognizant contract administration office with respect to the four LSCC contracts, to assemble a team to obtain improved substantiation of the proposed settlement in certain areas. For the most part, as described in greater specificity in paragraphs below, LSCC declined to disclose cost or pricing data to support its DD Form 633-5 price proposals for these claims, and other contract performance and production information relevant to the support and substantiation of these claims.

c. Notwithstanding the foregoing lack of cooperation from LSCC, on June 9, 1972, NAVSHIPS once again submitted the proposed LSCC claims settlement to the Naval Material Command for review and approval. On this occasion the NAVMAT reviewers were designated the NAVMAT Claims Board. On June 20, 1972, the DE 1052 portion of the submission was supplemented with the LPD portion of the submission. After six months review and consideration of these submissions, the NAVMAT Claims Board determined that the settlement was unsupported and not susceptible of approval. Accordingly, on January 24, 1973, NAVSHIPS once again withdrew the submission from NAVMAT consideration.

10. The foregoing recapitulation of events in paragraphs 8 and 9, surrounding the tentative claims settlement agreement of January 29, 1971, and the submission and resubmission of the proposed settlement to higher authority for review and approval, and the two determinations not to grant approval by NAVMAT, lead to the unavoidable conclusion that in fact both LSCC and the Navy understood that the $62 million

claims settlement was not unconditional. It required review by higher authorities and approval by the Chief of Naval Material and by the Assistant Secretary of the Navy (Installations and Logistics), in accordance with Navy Procurement Directives, paragraph 1-401.55. Such approvals were never received because the NAVMAT Claims Board perceived certain general and specific inadequacies in LSCC's claims support and substantiation. Three major claim items were identified as inadequately documented in the SUPSHIP 13 letter serial 130-2904 of October 17, 1972, to LSCC. Further, in NAVSHIPS letter serial 90-02 of 26 December 1972 to LSCC the Navy stated:

> "We have completed a preliminary review of this additional data submitted by your company, which, though responsive in some respects, still fails to present a clearly discernible 'cause and effect' relationship between alleged Government-responsible actions, on the one hand, and the claimed resulting increased costs to LSCC, on the other. The paucity of data showing such relationship applies also to the other elements of the LPD claims, as well as to the DE 1052 Class claim.
>
> "To ensure consideration in this Command's final consideration of your claims, you are invited to submit to this Command, via the Supervisor, any material establishing the above-noted relationship, including any incisive rationale, supported by historical cost data."

For the foregoing reasons the tentative January 29, 1971, NAVSHIPS settlement did not receive the higher level approvals required by applicable Navy directives. Similarly, the provisional payments NAVSHIPS made to LSCC on account of these claims -- for details, see paragraphs 14-15 below -- were premised upon an exposition of a portion of the claim facts, specifically, LSCC's claim assertions and representations taken at their face value, without regard for a full and complete evaluation of other contemporaneous events in the performances of these contracts, many of which were later found to be attributable to non-government responsible causes. Those provisional payments were also influenced by anticipated LSCC cost overruns projected from costs incurred and to be incurred to complete contract performances as of January 1971. Accordingly, the provisional payments were found to be subject to the same deficiencies in support and substantiation as was the tentative $62 million settlement of January 1971.

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11. LSCC Claim Itemization. LSCC has broken down its claims into subject areas of alleged Government-responsible causes of additional costs which are said to constitute entitlement to equitable adjustments in the contracts' prices. Enclosure (1) sets forth the Contracting Officer's determinations and findings related to these various allegations. For convenience only, some allegations common to all contracts have been treated in the same section of the determinations and findings. Each contract, however, has been treated as a separate entity. Enclosure (2) lists and classifies alleged improper rejections of LSCC work discussed in enclosure (1). Enclosure (3) lists the change orders included in the consolidated claims; determinations and findings relative to them are included in enclosure (1).

12. In support of its allegations, LSCC has submitted little or no historical cost, production and management data to substantiate its estimates. The Contracting Officer and his authorized representatives have requested relevant historical cost, production and management information but, with rare exceptions, such information has not been provided. The last such request was made on 20 March 1973, at which time the Navy stated its preliminary position in writing to LSCC on each of the claim allegation issues and requested any additional comments or available supporting data LSCC might have. LSCC has not responded to the Navy position or request.

13. All ships procured under the instant contracts have been delivered; cost, performance and management data is now historical and should have been used to price the requested equitable adjustments. LSCC has effectively refused to use all of the available data, and in fact, has denied authorized representatives of the Contracting Officer access to much directly relevant cost and pricing data.

Since LSCC has been unable to support adequately many elements of its claims, it appears that an impasse has been reached. Accordingly, the Contracting Officer deems it necessary to make a unilateral determination of the amount due LSCC by way of equitable adjustment in the prices of the four contracts. In considering the claims as originally asserted, the Contracting Officer finds in some subject areas that there is no data to support a determination of entitlement; in other areas, when entitlement has been established, the equitable adjustments must be based on Navy-developed estimates. The Navy-developed manhour estimates have been priced using Defense Contract Audit Agency-developed composite historical contract labor rates.

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14. The Contractor has previously received provisional price increases on each contract on account of these consolidated claims as follows:

NObs	Mod.[1/]	Payment
4660	8	$14,435,000
4765	7	$13,128,000
4785	12	$10,081,158
4902	7	$11,387,000

[1/] These modifications were embodied in a single supplemental agreement, executed on February 24, 1971, effective January 29, 1971; this modification incorporated the provisional payments made by earlier modifications and set forth the cumulative provisional payments for each LPD contract. The cumulative DE 1052 contract provisional payment of $10,081,158 was not stated in Mod. 12 to Contract NObs-4785 but rather in field Mod. No. A-742 issued February 5, 1971.

15. Paragraph 4 of each of the foregoing modifications provides that upon final resolution of the claim, if the equitable adjustment resulting from such resolution is less than the provisional increase, the contract price as provisionally adjusted shall be reduced by the amount of the equitable adjustment, and the balance shall immediately be refunded to the Government, or credited to the Government against existing unpaid invoices. The equitable adjustments resulting from the Contracting Officer's determinations and findings in enclosure (1) are summarized by contract in enclosure (4) and totals brought forward below. Accordingly, inasmuch as the total adjustment in the prices of contracts NObs-4660, 4675, 4902 and 4785 as determined herein do not exceed the provisional payments previously made, pursuant to paragraph 4 of the modifications cited above, the contracts' prices are hereby adjusted as follows and demand is made for the balance due:

NObs	Provisional Payment	Equitable Adjustment	Balance Due U.S. Government
4660	$14,435,000	$1,796,805	$12,638,195
4765	$13,128,000	$1,832,191	$11,295,809
4785	$10,081,158	$ 821,892	$ 9,259,266
4902	$11,387,000	$2,334,661	$ 9,052,339
Totals	$49,031,158	$6,785,549	$42,245,609

Notice is hereby given that, in accordance with General Provision No. 42 of each contract "Interest", commencing thirty (30) days from receipt of this Final Decision, an interest charge at the rate of six percent (6%) per annum will be assessed on any unpaid balance.

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16. LSCC's Premature May 24, 1973 "Appeal" Letter. On May 24, 1973, Mr. F. Trowbridge vom Baur, counsel for LSCC, wrote a letter to the Secretary of the Navy, with a copy to the Armed Services Board of Contract Appeals, purporting to "appeal" the LSCC claims on the DE 1052 and LPD contracts. Two bases were presented: that the Navy has not honored the January 29, 1971 contract modification settling these claims for $62 million, and that Navy failure to issue a final decision of the Contracting Officer constitutes an appealable action. The factual misconceptions inherent in the first basis are rebutted in paragraphs 8, 9 and 10. With respect to the second basis, on March 20, 1973, NAVSHIPS sent LSCC a detailed 71 page explanation of the Navy's position on each element of the consolidated LPD and DE 1052 claims. That March 20th letter stated:

> "You are requested to carefully review the Navy's position and to provide any comments or additional data you may have prior to April 20, 1973. Your comments will be carefully considered, and any new factual data will be carefully weighed and considered prior to formalization of any further settlement offer or any final decision of the Contracting Officer. Should you desire, a meeting can be arranged to allow further discussion of these matters."

By letter of April 13, 1973, LSCC requested that "...no further action be taken with regard to..." the Navy's March 20, 1973 letter. Thus although LSCC specifically requested that a final decision on this matter be held in abeyance, NAVSHIPS received no further communication from LSCC until receipt of the foregoing May 24, 1973 "appeal" letter from Mr. Vom Baur. These facts clearly indicate that the "appeal" by Mr. Vom Baur is premature.

17. This is the final decision of the Contracting Officer. Decisions on disputed questions of fact and on other questions that are subject to the procedure of the Disputes clause may be appealed in accordance with the provisions of the Disputes clause. If you decide to make such an appeal from this decision, written notice thereof (in triplicate) must be mailed or otherwise furnished to the Contracting Officer within thirty days from the date you receive this decision. Such notice should indicate that an appeal is intended and should reference this decision and identify the contract by number. The Armed Services Board of Contract Appeals is the authorized representative of the Secretary for hearing and determining such disputes. The Rules of the Armed Services Board of Contract Appeals are set forth in the Armed Services Procurement Regulation, Appendix A, Part 2.

signed
W. E. SHULTZ
CDR, SC, USN
Contracting Officer

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Copy to:
SUPSHIP-13
Armed Services Board of Contract Appeals

Encls:
(1) Contracting Officer's Determinations and Findings re Certain Claims Against Contracts NObs-4660, 4765, 4902 and 4785
(2) Classification of Alleged Improper Rejections of Work
(3) Listing of Change Orders Being Adjudicated
(4) Summary of Contracting Officer's Final Decision by Claim Subject and Contract

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SHIPS 02
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SHIPS 022 (4)
SHIPS 02XC1 (5)
SHIPS 00J
SHIPS 00J2
PMS 380
PMS 383 (3)
SUPSHIP-13 (Claim Team File) (10)
DCAA, Seattle
PLA SUPSHIP-13
PLA NAVSHIPS
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Enclosure (1)

CONTRACTING OFFICER'S DETERMINATIONS AND FINDINGS RE CERTAIN CLAIMS AGAINST CONTRACTS Nobs-4660, 4765, 4902, and 4785

I. NObs-4785

A. ALLEGED INACCURATE AND MISLEADING CONTRACT SPECIFICATIONS CONTRACT PLANS AND GUIDANCE DRAWINGS

1. Statement of the Contractor's claim:

LSCC claims entitlement to an equitable adjustment covering the expense of purchasing, fabricating and installing quantities of steel, aluminum, cable and piping components in excess of alleged bid estimates therefor. The Contractor claims entitlement to $9,067,859 as follows: 20,000 engineering manhours, 653,856 production manhours, and $1,528,164 for material. Entitlement is claimed on the basis of either or both of the following theories:

a. The Contract specifications and drawings defectively failed to indicate the true quantities of the various materials which would be actually required.

b. The working plans (detail construction plans) drawn by Gibbs & Cox, Inc., and supplied by Todd Shipyards Corporation, Seattle Division, generally incorporated unnecessarily complex, therefore more expensive, construction details, for which the Government is responsible.

2. Findings of Relevant Facts:

a. With respect to the first theory of recovery, the Contracting Officer finds that the Contract specifications, plans and guidance drawings (bidding package) were not defective in the manner alleged by LSCC. On the contrary, that they were equivalent to and in some areas better than other shipbuilding specifications.

b. With respect to the second theory of recovery, the Contracting Officer finds that LSCC, prior to its bid on the DE 1052 Class ships, had built destroyer types utilizing Gibbs & Cox working plans; i.e., the DDG 20, 21 and 22. Accordingly, the Contracting Officer finds LSCC should reasonably have bid based on utilization of Gibbs & Cox working plans incorporating Gibbs & Cox design techniques. In addition, any alleged entitlement based on Todd supplied working plans is barred pursuant to Article 3 of Contract NObs-4785 entitled "Working Plans and Other Data."

3. Contracting Officer's Decision:

Based on the foregoing findings, the Contracting Officer determines that LSCC is not entitled to any equitable adjustment reflecting alleged additional expense incurred for the causes set forth above, as the result of the alleged requirement to purchase, fabricate and install quantities of steel, aluminum, cable and piping in excess of those amounts LSCC alleges were included in its bid.

B. ALLEGED EXCESSIVE DESIGN FEATURES INCORPORATED IN LEAD YARD PLANS BY GOVERNMENT SELECTED DESIGN AGENTS

1. Statement of the Contractor's Claim:

LSCC claims entitlement to an equitable adjustment of $2,048,144 based on five specific allegedly excessive design features incorporated in the Gibbs & Cox prepared working plans. The specific allegations, and corresponding amounts claimed are:

a. Excessive number of spring hangers and sway braces for piping system: 1,340 engineering manhours, 17,349 production manhours, and $56,915 for material;

b. Requirement for chrome-molybdenum alloy steel piping and fittings where contract specifications permit cheaper carbon steel: 24,080 production manhours, and $34,525 for material;

c. Requirement for significantly more expensive lower rudder bearing lube oil system than permitted by the specifications: 370 engineering manhours, 18,122 production manhours, and $5,631 for material;

d. Requirement for a more complex structural collar plate design than permitted by the specifications: 80 engineering manhours, and 106,406 production manhours; and

e. Requirement for a more complex fire hose storage rack than permitted by the specifications: 8,342 production manhours, and $4,124 for material.

The theory for recovery is, again, alleged Government responsibility for Todd supplied, Gibbs & Cox drawn, working plans that incorporate requirements allegedly excessive to the specifications.

2. Findings of Relevant Facts:

The Contracting Officer finds that Contract NObs-4785, General Provisions, Article 3, entitled, "Working Plans and Other Data" provides, in pertinent part, that:

> "Should plans contain requirements beyond those set out in the specifications listed in Article 2 hereof, the Government will not be responsible for the cost of meeting such additional requirements."

In addition, LSCC, in selected instances, exercised its option to redesign Gibbs & Cox drawn features it considered excessive. In addition, any alleged entitlement based on Todd supplied working plans containing "requirements beyond those set out in the specifications" is barred pursuant to Article 3.

3. Contracting Officer's Decision:

Based on the foregoing findings, the Contracting Officer determines that LSCC is not entitled to any equitable adjustment reflecting alleged additional expense incurred as the result of the alleged excessive working plan requirements for spring hangers and sway braces, chrome-molybdenum alloy steel piping and fittings, lower rudder bearing lube oil system, structural collar plate design and firehose storage racks.

II. NObs-4785 - ALLEGED DEFECTIVE DYNAMIC ANALYSIS AND SHOCK SPECIFICATIONS

LSCC claims equitable adjustment entitlement to an additional $12,130,495 on account of additional work, in seven separate categories set forth below, caused by alleged defective shock specifications, including MIL-S-901C but, in particular, the dynamic analysis requirement of NObs-4785.

A. AUXILIARY MACHINERY FOUNDATIONS:

1. Statement of the Contractor's Claim:

LSCC claims that as the result of ambiguous dynamic analysis design requirements; i.e., defective specifications, it could not reasonably anticipate the final design of equipment foundations. Further, that such final design produced unreasonably large, complex and expensive foundations. LSCC claims entitlement based on the foregoing, to an additional 6,881 engineering manhours, 288,057 production manhours, and $123,185 for material.

2. Findings of Relevant Fact:

The Contracting Officer finds that the dynamic analysis specifications were defective in that a bidder could not, in all cases, reasonably determine the foundations' size and complexity that would finally be required; that attempting to perform to the ambiguous dynamic analysis requirements as finally interpreted after award resulted in unreasonably large, complex, and expensive foundations; that a portion of such additional expense was due to the Gibbs & Cox standard use of plate rather than shaped forms; that LSCC knew at bid of such Gibbs & Cox practice; that additional expense was due to vendor and LSCC errors; that LSCC has been requested to identify and segregate such costs but that this has not been satisfactorily accomplished; that, accordingly, the Contracting Officer does not have sufficient information to make a determination of the additional cost incurred.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is entitled to an equitable adjustment but that unless and until more detailed relevant information is provided, the amount of such adjustment cannot be determined and must be, for these purposes, established as zero.

B. PIPE HANGERS:

1. Statement of the Contractor's Claim:

LSCC alleges that as the result of the ambiguities in the dynamic analysis requirement, it could not foresee, for bidding purposes, the complexity and therefore the extent of work that would be required in fabricating and installing pipe hangers. LSCC alleges entitlement to an additional 18,984 engineering manhours, 279,190 production manhours and $104,101 for material.

2. Findings of Relevant Facts:

The Contracting Officer finds that the dynamic analysis specifications were defective in that a bidder could not in all cases reasonably determine actual construction requirements, that however, there is no evidence that dynamic analysis caused the complexity in pipe hanger design, that LSCC had the option to redesign pipe hangers to a simpler design; that the Government is not liable for excesses in the Gibbs & Cox design; that LSCC in fact exercised its option on the DEs following the DE 1057; that these were shock tested, not dynamically analyzed; and that neither the dynamic analysis specification or the shock specification were defective with respect to pipe hanger requirements.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is not entitled to an equitable adjustment on the basis of alleged defects in dynamic analysis and shock specifications as they apply to pipe hangers.

C. ELECTRICAL JUNCTION BOX FOUNDATIONS:

1. Statement of the Contractor's Claim:

LSCC claims that as a result of the ambiguous dynamic analysis requirement it could not anticipate, for bid purposes, the complexity and lack of standardization that would result in electrical junction box foundations designed in accordance with the dynamic analysis specification. Further, that such lack of standardization and increased complexity substantially increased the cost to fabricate and install such foundations and that such increased cost amounted to 60,627 production manhours.

2. Findings of Relevant Fact:

The Contracting Officer finds that the dynamic analysis specification did not result in more complex junction box foundations than could reasonably have been anticipated at bid; that the junction box foundation design was a function of the Gibbs & Cox plans; that LSCC had the option to design its own system if it desired; that the Government is not liable for any excesses in the Gibbs & Cox design; and that neither the dynamic analysis specification or the shock specification is defective with respect to electrical junction box requirements.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is not entitled to an equitable adjustment on the basis of alleged defects in the dynamic analysis specification as it applies to electrical junction box foundations.

D. SHAFT STRUT SUPPORTS:

1. Statement of the Contractor's Claim:

LSCC claims that due to use of dynamic design, the shaft strut supports increased in size by 33-1/3% over that shown on the contract guidance plan. LSCC alleges that it could not reasonably anticipate the required size of the shaft strut because of the ambiguous nature of the dynamic analysis specification and requests an equitable adjustment for an alleged additional 370 engineering manhours, 640 production manhours, and $14,590 for material.

2. Findings of Relevant Fact:

The Contracting Officer finds that the size of the shaft strut did not result from dynamic design; that it was sized in accordance with an original specification requirement, i.e., design data sheet DDS 4301; and that such sheet took precedence over the contract guidance plan.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that there is no equitable adjustment entitlement for any costs involved in providing a shaft strut sized in accordance with original specification requirements.

E. VENDOR MATERIAL COST INCREASES:

1. Statement of the Contractor's Claim:

LSCC alleges that it incurred substantial additional expense as the result of a decreased competitive environment caused by vendors' reluctance to provide equipments in accordance with the Class "A" shock requirements of NObs-4785. As the result of such decreased competition, LSCC alleges that it was required to expend an additional $3,585,037 beyond what it reasonably could have anticipated. Further, LSCC has requested an additional $444,716 for vendor claims related to shock and dynamic analysis (the total of $4,029,753 is reduced, by LSCC, by $59,679 to remove its shock documentation claim from this portion of its consolidated claim).

2. Findings of Relevant Facts:

The Contracting Officer finds that LSCC could and should have bid the contract based on providing equipments in accordance with the specification; that such specifications clearly indicated which equipments had to meet Class "A" shock requirements; that LSCC requested or should have requested vendor quotes for bidding purposes on the basis of the shock specifications; and that LSCC did or should have included all cost of providing vendor equipment to the shock requirement in its bid. The Contracting Officer finds that there has been no showing by LSCC that the Government is responsible for increased costs allegedly incurred by Unicure, Co., Eastern Cold Storage Co., Meva Corporation, or Canadian Vickers.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that there is no entitlement to an equitable adjustment reflecting the alleged cost increases in vendor material.

F. LATE EQUIPMENT DELIVERY:

1. Statement of the Contractor's Claim:

The Contractor requests an equitable adjustment reflecting 30,902 production manhours on the basis that vendor attempts to comply with shock requirements, etc., delayed delivery of Contractor-furnished equipment.

2. Findings of Relevant Fact:

The Contracting Officer finds that the DE-1057 was delayed approximately 13 months for other than Government cause; that there is no showing that delay in vendor equipments resulted from shock requirements or, in fact, that such delays were beyond LSCC's actual need dates for the equipments; and that there is showing that many equipments were delayed as the result of such circumstances as vendor strikes, etc.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is not entitled to any equitable adjustment based on the allegation that shock requirements delayed delivery of Contractor-furnished equipment.

G. MAIN CIRCULATION SYSTEM SUPPORT:

1. Statement of the Contractor's Claim:

LSCC alleges that it could not determine for bidding purposes the shock requirements for the main circulating system in that it was not clear from the specifications whether the system should be treated more like a foundation than a pipe system for shock purposes. Accordingly, when it was determined that the system was to be designed for shock purposes, like a foundation, significant additional work was required. It is alleged that the additional work amounted to 6,550 engineering manhours, 18,492 production manhours plus $2,555 for material.

2. Findings of Relevant Fact:

The Contracting Officer finds that a main circulating system is unique in that it is basically a piping system but also must satisfy requirements of a foundation as heavy valves and pumps are mounted thereon; that the ship specifications were not clear as to how the system should be treated for shock purposes; that the problem does not derive from any alleged defect in either the dynamic analysis requirement or MIL-S-901C but from the ship specification; that the ambiguity in this regard is the responsibility of the Government; and that the additional work required as a result of the ambiguity was 1,260 engineering manhours, 16,894 production manhours and $2,555 for material.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is entitled to an equitable adjustment of $193,227, reflecting an additional 1,260 engineering manhours, 16,894 production manhours, and $2,555 for material, which is determined to be the additional work beyond that LSCC could reasonably have anticipated from the specification for shock proofing (providing supports) the main circulating system.

III. NObs-4785 - ALLEGED MISCELLANEOUS CONSTRUCTIVE CHANGES

LSCC claims entitlement to an equitable adjustment of $189,464 based on the existence of three alleged constructive change orders which will be discussed separately below. Claim Volume V discusses two additional alleged constructive changes; i.e., habitability and microfilm, but bases no equitable adjustment request thereon. Accordingly, no consideration has been given to these two items.

A. AIRBORNE NOISE AND UNDERWATER NOISE SPECIFICATION:

1. Statement of the Contractor's Claim:

LSCC alleges entitlement to an equitable adjustment covering 9,462 engineering manhours allegedly expended in attempts to obtain "background" information on prior Navy experience with minimization of airborne and underwater noise.

2. Findings of Relevant Facts:

The Contracting Officer finds that the requested information was not needed to perform any contract requirement and was not required by the Contract to be furnished by the Government. In addition, the Contracting Officer finds that the Government, in a spirit of cooperation, made a reasonable attempt to provide as much of the requested information as possible.

3. Contracting Officer's Decision:

On the basis of the foregoing findings, the Contracting Officer determines that LSCC is not entitled to an equitable adjustment as compensation for engineering hours allegedly incurred requesting background data on airborne and underwater noise.

B. SURFACE HARDNESS SPECIFICATIONS:

1. Statement of the Contractor's Claim:

LSCC alleges entitlement to an equitable adjustment reflecting 656 engineering manhours, 712 production manhours, 13 disruption manhours, and $1,367 of material for an alleged requirement to perform "research and development" in achieving the specification requirement for 300 Brinell hardness on bolster bearing surfaces.

2. Findings of Relevant Facts:

The Contracting Officer finds that achievement of the specification requirement for 300 Brinell hardness was not beyond the existing state of the art.

3. Contracting Officer's Decision:

Based on the foregoing, the Contracting Officer determines that LSCC is not entitled to an equitable adjustment as compensation for costs incurred in performing a requirement to provide a 300 Brinell hardness on bolster bearing surfaces.

C. 400 CYCLE MOTOR GENERATOR SET:

1. Statement of the Contractor's Claim:

LSCC claims entitlement to an equitable adjustment, reflecting 40 engineering manhours, 2021 production manhours, 2166 disruption manhours, and $49,293 for material, based on alleged Government responsible "out-of-sequence" installation of a Contractor-furnished 400 cycle motor generator set. LSCC claims that the 400 cycle motor generator specification was defective with respect to airborne noise limitation and method of frequency regulation. Resolution of such defects allegedly delayed motor generator purchase order placement for 7 months which "in turn delayed delivery of the equipment and consequently disrupted the normal outfitting and installation sequence."

2. Findings of Relevant Facts:

The Contracting Officer finds that there was no airborne noise limitation requirement that delayed vendor delivery of the 400 cycle motor generator set beyond LSCC's actual need date for the equipment; that the frequency regulation difficulties arose from LSCC's choice of equipment, not from the specifications; that there were no unilateral changes affecting the motor generator set that delayed it beyond LSCC's actual need therefor; and that identical equipment, built to the same specifications by the same vendor had been delivered to another shipbuilder in the same geographical area months before LSCC's actual need date.

3. Contracting Officer's Decision:

Based on the above findings of fact, the Contracting Officer determines that LSCC is not entitled to any equitable adjustment reflecting alleged increased cost resulting from "out-of-sequence" installation or other difficulties it may have experienced with the Contractor-furnished 400 cycle motor generator set.

IV. NObs-4785 - ALLEGED CONSTRUCTIVE CHANGE ORDERS ON VENTILATION, SONAR CABLING AND SEA CHEST REQUIREMENTS

LSCC has requested an equitable adjustment of $665,747 as compensation for three alleged constructive change orders concerning ventilation, sonar cabling and sea chest requirements.

A. VENTILATION:

1. Statement of the Contractor's Claim:

LSCC alleges that it was required to provide a significantly more complicated and expensive ventilation system for Auxiliary Machinery Room #2 than originally required by the specifications. On the basis of such additional requirement LSCC alleges entitlement to an equitable adjustment reflecting 350 engineering manhours, 12,727 production manhours plus $33,543 for material.

2. Findings of Relevant Fact:

The Contracting Officer finds that the specifications in section 9380-1-C require LSCC to prepare detailed line diagrams and calculations in sizing the ventilation system for the Auxiliary Machinery Room #2; that the Contract Guidance Plan DE1052-800-227704 did not show the ventilation system as required by the calculations; that the intent of the contract guidance plan was to illustrate principles and methods of system design; that pursuant to specications section 5000-0-d, the specification requirements take precedence over the guidance drawing; that the size of the ventilation system is based on the heat load generated by the equipments in a space; that the equipments in the Auxiliary Machinery Room were Contractor furnished equipments; that LSCC requested a formal change order covering the increased ventilation requirements; that the Government denied the request stating that the increased system was "within the requirements of the specifications"; and that LSCC provided the larger ventilation system which met the requirements of the specifications.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that the increase in the ventilation was required by the specifications in sizing the system for a space containing Contractor furnished equipment and that the increase in the system did not constitute a constructive change. Accordingly, LSCC is not entitled to an equiptable adjustment for the increased ventilation system.

B. SONAR CABLES:

1. Statement of the Contractor's Claim:

LSCC claims equitable adjustment entitlement covering the cost of intercompartment sonar cabling as well as installation of Government-furnished connectors thereon. Additional work alleged amounts to 26,317 production manhours and $83,660 for material. LSCC contends that Note 19 on Contract Guidance Plan DE 1052-800-2111855(B), stating in part that "All intercabinet cabling will be supplied with connectors . . .", constituted a Government representation that all sonar cabling would be Government furnished and would have connectors installed thereon.

2. Findings of Relevant Fact:

The Contracting Officer finds that Article 4 of Contract NObs-4785, entitled "Government Furnished Property" provides that the Government is responsible for providing only the property listed on Schedule "A" to the Contract and that:

> "Any such requirements for the furnishing of material by the Government appearing in the plans, specifications or other data shall be of no force and effect and are hereby superseded by the list set forth in Schedule "A"."

Accordingly, no matter how Note 19 is construed, the Contracting Officer finds that it can have no force and effect with respect to the Government's obligation to furnish material. The Contracting Officer finds that cable for sonar installations have customarily not been included on Schedule "A" but that customarily, for all past LSCC SQS-26 installations, the Government has furnished cables, with connectors installed, for intracompartment cabinets, but not for intercompartment cabinet connections. Accordingly, the Contracting Officer finds that the parties entered into Contract NObs-4785 with the understanding that the Schedule "A" listing of AN SQS-26 sonar included intracompartment cables but excluded intercompartment cabling. Finally, the Contracting Officer finds that Note 19 could not reasonably be construed to apply to intercompartment cable because such cable had to be pulled through bulkheads, etc., and therefore could not possibly have been pre-cut by the Government and furnished with connectors installed as LSCC contends. Further, that LSCC was required to install Government-furnished connectors on Contractor-furnished cable pursuant to Article 1, entitled "General Scope of Work" which states, in pertinent part, as follows:

> "The Contractor . . . shall construct . . . Ocean Escort Vessels . . ., and will deliver the vessels, complete in all respects, including the installation of materials to be furnished by the Government . . ."

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that the provision by LSCC of intercompartment sonar cabling and the installation of connectors thereon was wholely within the original contract requirements. Accordingly, there is no equitable adjustment entitlement for such provision or installation.

C. SEA CHEST:

1. Statement of Contractor's Claim :

LSCC claims equitable adjustment entitlement, reflecting 240 engineering manhours, 7,636 production manhours and $134,353 for material, on the basis that the Government refused to approve installation of a sea chest as shown on a Contract Guidance Plan. LSCC claims that such refusal in effect required LSCC to comply with the Todd-supplied working plan arrangement which LSCC contends violated section 9480-0, page 381, lines 50-57, of the specifications stating that "piping shall not be led through the following spaces, except as necessary to serve the space: JP-5 tanks."

2. Findings of Relevant Fact:

The Contracting Officer finds that the sea chest location shown on the applicable guidance plan violated the specification requirement of section 9480-0 that "chests for pump suctions shall be located to minimize their becoming airbound under the conditions of roll and pitch specified in 9020-0."; that pursuant to specifications section 5000-0-d, the specifications requirement takes precedence over the guidance drawing; that the Todd solution did not violate section 9480-0 because the pipe was not run through a JP-5 tank, but through a jacket installed in the tank; that the Government did not direct conformance with the working plan solution but only disapproved a proposal that was in violation of the specifications; and that there were alternative solutions to either the guidance plan arrangement or the working plan arrangement which would have complied with specification requirements.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that disapproval of the proposed sea chest location did not constitute a constructive change. Accordingly, LSCC is not entitled to an equitable adjustment on the basis of such disapproval.

V. NObs-4785 - ALLEGED LATE AND DEFECTIVE GOVERNMENT-FURNISHED INFORMATION AND MATERIAL

LSCC claims entitlement to an equitable adjustment of $2,493,110 for alleged late and defective Government-furnished information and material in five separate categories addressed separately below:

A. LATE AND DEFECTIVE GFI (WORKING PLANS):

1. Statement of the Contractor's Claim:

LSCC claims that Todd supplied working plans were received later than scheduled and in an "unstable" condition, i.e., subject to major reservation, hold-ups and revisions. An equitable adjustment is requested to cover the additional costs caused thereby. LSCC cites alleged Government delinquencies in providing design information to Gibbs & Cox as the basis for Government liability. The claimed additional effort is 88,064 engineering manhours and $79,605 for material.

2. Findings of Relevant Facts:

The Contracting Officer finds that working drawings were received by LSCC in adequate time to meet the actual construction schedule of the DE 1057; that such construction schedule as more fully set forth below, was delayed some 13 months for other than Government responsible cause; that contractually required Government-furnished information was generally furnished in a timely manner; that "working plans" are not Government furnished information under the terms of the Contract; and in any and all events, that Article 3, entitled, "Working Plans and Other Data" of Contract NObs-4785 disclaims any liability for late or defective Todd supplied working plans.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is not entitled to an equitable adjustment based on the alleged receipt of late or defective working plans.

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B. SCHEDULE "A" NON-CONFORMING MATERIAL:

1. Statement of the Contractor's Claim:

LSCC has requested an equitable adjustment to cover additional expense allegedly caused by: (1) 31% of Government-furnished property failing to conform to the Schedule "A" listing thereof; (2) failure of the Government to timely authorize use of such non-conforming equipment, and, in some instances, to timely provide technical data therefor; and (3) provision of the latest equipment model of an open parenthesis designated equipment rather than that model existing at time of bid. LSCC claims the foregoing has resulted in 400 additional engineering manhours and 2,345 additional production manhours.

2. Findings of Relevant Facts:

The Contracting Officer finds that certain items of Government-furnished equipment with designations different from those listed on Schedule "A" were furnished pursuant to the Government's right under Clause 12, entitled, "Additional Provisions Relating to Government-furnished Property" of the General Provisions of NObs-4785; that contract modifications have been issued covering all such items save four; that the additional expense reasonably incurred by LSCC because of these "Non-conforming" equipments totaled 60 engineering manhours; and that no adjustment is required under the terms of the contract for equipments that were designated, on Schedule "A", by an open parenthesis.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC, pursuant to General Provisions Clause 12, entitled "Additional Provisions Relating to Government-furnished Property" is entitled to an equitable adjustment of 60 engineering manhours, or $488., reflecting the added cost to install the following Government-furnished items:

Schedule "A" Item	44.1
	210
	252
	271

The Contracting Officer determines that no additional entitlement exists for any other alleged "non-conforming" equipments included within LSCC's claim as covered by its formal proposal; i.e., DD Form 633-5 of 5 May 1971.

C. LATE AND DEFECTIVE GFI (EQUIPMENT DOCUMENTS):

1. Statement of the Contractor's Claim:

LSCC claims entitlement to an equitable adjustment based on the delivery of GFM technical manuals that were allegedly either incorrect or late. The amounts claimed are 580 engineering manhours and 2,900 production manhours.

2. Findings of Relevant Facts:

The Contracting Officer finds that technical manuals on four items of GFM were furnished late and were "related data and information . . . as may reasonably be required for the intended use" of Government-furnished equipment under the terms of General Provisions Clause 11, entitled, "Government Furnished Property" of Contract NObs-4785; that the reasonable cost impact on LSCC of such technical manuals amounted to 216 engineering manhours and 430 production manhours; and that all other allegedly late or incorrect manuals were either timely received with respect to actual need or not needed in light of other information available to LSCC.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC, pursuant to General Provisions Clause 11, entitled "Government-furnished Property" of Contract NObs-4785, is entitled to an equitable adjustment of 216 engineering manhours and 430 production manhours or $6348. covering all increased cost resulting from late or incorrect technical manuals on the following equipment:

Schedule "A" Item	52
	145
	61
	163

The Contracting Officer determines that no additional entitlement exists for any other alleged late or incorrect technical manuals included within LSCC's claim as covered by its formal proposal; i.e., DD Form 633-5 of 5 May 1971.

D. LATE AND DEFECTIVE GFE:

1. Statement of the Contractor's Claim:

LSCC alleges it incurred additional work on account of Government-furnished equipment that was late, defective or both as follows:

(a) Defective GFE (especially electronic and electrical) allegedly increased LSCC's costs by 9,395 production manhours;

(b) Late GFE (12 items) allegedly increased LSCC's costs by 1105 production manhours; and

(c) Late GFE components and untimely equipment mods allegedly increased LSCC's costs by 7,600 production manhours.

2. Findings of Relevant Facts:

The Contracting Officer finds as follows:

a. Defective GFE - that all defective GFE identified in the LSCC's claim covered by its DD Form 633-5 of 5 May 1971 has been covered by contract modification pursuant to General Provisions Clause 11, entitled, "Government-Furnished Property", of Contract NObs-4785; that the adjustment to contract price or performance time or both resulting from, to result from or already incorporated in such modifications, reflects or will reflect full and complete agreement by the parties, as of the execution date thereof, with respect to all adjustment entitlement, including any cost of delay and disruption for such defective GFE.

b. Late GFE - that LSCC, as set forth below, was delayed in its construction schedule as the result of other than Government cause; that of all the alleged late GFE there were 12 items of Government-furnished equipment as follows that were late to LSCC's actual need therefor:

Schedule "A" Item	18
	19.1
	50
	6.1
	73
	85
	140
	141
	163
	286
	66
	255.05

That all additional cost incurred, including that of delay and disruption, as the result of such late GFE items, totals 265 additional manhours.

c. Late GFE components and Untimely Equipment Mods - that all additional costs, including those associated with delay and disruption, were considered in pricing the modifications associated with the alleged untimely furnishing of field change kits and ORDALT kits (equipment mods); that there were some 98 parts, for otherwise timely GFE, that were not timely furnished and have not been otherwise covered by contract modification; that the additional cost incurred as the result of such late GFE components totaled 196 production manhours.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is entitled, pursuant to General Provisions Clause 11 entitled, "Government-furnished Property", to an equitable adjustment of $4,923, reflecting the additional 461 production manhours as set forth above. Such amount constitutes the total price adjustment to which LSCC is entitled for Government-furnished Equipment allegedly furnished late, defective or both and included in its claim as covered by its formal proposal; i.e., DD Form 633-5 of 5 May 1971.

E. SQS-26 SONAR - HMR 127:

1. Statement of the Contractor's Claim:

LSCC alleges entitlement to an equitable adjustment reflecting an additional 2,942 engineering manhours, 103,713 production manhours, and $309,624 for material, based on the alleged requirement to install a significantly more complex bow sonar than originally required by the contract; i.e., an AN/SQS-26(C)x sonar rather than an AN/SQS-26(B)X. Notwithstanding that Schedule "A" designated the SQS-26 with open parenthesis, LSCC has based its entitlement request on the Government's statement at the "Bidders Conference" that "For bid purposes, sonar should be comparable to AN/SQS-26(B)X.", and the unpriced contract modification known as HMR 127 which allegedly deleted guidance plans showing a "BX" arrangement and replaced them with guidance plans showing a "CX" arrangement.

2. Findings of Relevant Facts:

The Contracting Officer finds that a statement at a "Bidders Conference" is not binding contractually on the Government pursuant to the express understanding of all attendees at such conferences; that, however, the only bid information available was a guidance plan (DE 1052-800-2277038) showing, in effect, a BX sonar arrangement; that the specifications, in Section 9020-0-1, page 13, lines 3-5, require that "The Contractor shall install at his expense the items provided by the Government in accordance with approved plans", that HMR 127, deleting the BX arrangement guidance plan and substituting a CX arrangement guidance plan in effect changed the requirement on which LSCC bid based not on Schedule "A", but on the deleted guidance plan; that the additional expense incurred by LSCC in installing the larger, more complex CX system amounted to 2,942 engineering manhours, 86,049 production manhours plus $180,354 material which such amount includes all costs on account of delay, disruption or both.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is entitled, pursuant to General Provisions Clause 3, entitled "Changes", of Contract NObs-4785, in the pricing of HMR 127, to an equitable adjustment of $1,123,275, reflecting the added cost to LSCC to install an AN/SQS-26(C)X sonar rather than the AN/SQS-26(B)X: i.e., 2,942 engineering manhours, 86,049 production manhours plus $180,354 for material.

VI. NObs-4785 - ALLEGED FAULTY GOVERNMENT CONTRACT ADMINISTRATION

LSCC has requested an equitable adjustment of $623,698 based on alleged faulty Government contract administration in four separate categories as set forth below. A fifth claim category, the DE 1052 trial deficiency list, was not made the subject of an equitable adjustment request and accordingly is not considered further herein.

A. LATE AUTHORIZATION OF CHANGE ORDERS:

1. Statement of the Contractor's Claim:

LSCC claims it was forced to expend an additional 12,000 engineering manhours because changes shown on Todd supplied working drawings were not immediately authorized for NObs-4785. This, LSCC asserts, resulted in additional engineering to determine the extent of applicability of each plan, and delay and disruption (although no production manhours are claimed) because of plan hold-ups, reservations and revisions. LSCC claims entitlement to an equitable adjustment on the basis that information of such changes was "Contrary to the contractual follow yard arrangement" and that the Government, by failing to "timely" authorize such changes, breached its implied duty not to delay or interfere with the Contractor's performance thereby creating a "constructive suspension of work."

2. Findings of Relevant Facts:

The Contracting Officer finds that there was no understanding, express, implied or otherwise, that Todd supplied working plans would only include change orders also authorized to LSCC; that in fact, just the opposite understanding existed in accordance with LSCC's past experience with working plans supplied by another yard at the cost of reproduction and from the following exchange at the "Bidders Conference":

> "Question: - How will change orders, which may not be authorized to all builders, be incorporated by G & C? This should be done in such a manner that yards which do not have authority to accomplish the change are not forced to make plan revisions when later new change order revisions are made.
>
> "Answer: - Gibbs & Cox will provide applicable design services for change orders only for builder of DE 1052.";

In any event, Special Provisions, Article 3, entitled, "Working Plans and Other Data", bars any recovery based on Todd supplied working plans. Further, the Contracting Officer finds that issuance of change orders under General Provisions Clause 3, entitled, "Changes", is at the discretion of the Government; that failure to proceed with unchanged work is the responsibility of the contractor; and that all relevant changes eventually issued and priced have been priced per bilateral modification including the following language:

> "The change in delivery dates and price described above is considered to be fair and reasonable and has been mutually agreed upon in full and final settlement of all claims arising out of this modification and any other modifications or change orders indicated above, including all claims for delay and disruption resulting from, caused by, or incident to, such modifications or change orders."

Specifically, with respect to alleged delay in issuing formally proposed change orders pursuant to modification No. 6 to NObs 4785, the Contracting Officer finds that LSCC was under a contractual duty to proceed "diligently" with the unchanged work pursuant to the following language of modification No. 6:

> "Pending the execution of a bilateral agreement or the direction of the Contracting Officer pursuant to the "Changes" clause, the Contractor shall proceed diligently with the planning and construction of the vessel without regard to the effect of any such proposed change. If supplemental agreements are negotiated covering such changes, the Contractor shall be entitled to compensation for work done, as required by the Government, under this paragraph."

and that proposed changes which became formal changes and which have been priced by the parties were so priced pursuant to bilateral contract modifications including the release/accord and satisfaction language quoted above.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is not entitled to an equitable adjustment based on the various alleged delays in authorizing changes.

B. CORRESPONDENCE RESPONSE:

1. Statement of the Contractor's Claim:

LSCC alleges 103 instances of delinquent Government response to LSCC information inquiries. LSCC proposes equitable adjustment entitlement because "these delays or failures on the part of the Navy to take prompt action are classified as Constructive Suspensions of Work." LSCC requests compensation for 5,002 engineering manhours and 26,724 production manhours.

2. Findings of Relevant Fact:

The Contracting Officer finds that LSCC has provided detail information with respect to only 12 of 103 alleged acts; that LSCC has been requested to detail the remainder but has refused; that the 12 examples evidence LSCC's ability to provide detail when it desires; that of the 12 examples, four are covered elsewhere (main condensate pipe support, feed discharge pipe support, auxiliary exhaust pipe support and welding procedure approval); that of the remaining eight only one, electrical central arrangement, resulted in additional expenditure; and that the additional expenditure resulting from untimely approval of LSCC drawing No. 345-9767, amounted to 240 engineering manhours.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is entitled to an equitable adjustment, under the General Provisions clause entitled "Suspension", for the delay in approving drawing 345-9767 of $1,951., reflecting 240 additional engineering manhours.

C. SHOCK RESISTANCE CERTIFICATION:

1. Statement of the Contractor's Claim:

LSCC alleges that NObs-4785 had "no requirement for administration of a shock certification program." Further, that "as a follow yard, the shipbuilder was entitled to rely on the fact that shock resistance certification for equipment would be obtained by the "lead" yard." LSCC claims that the Supervisor (SUPSHIP 13) required LSCC to "develop and administer a control system to certify all shock resistant equipment." LSCC characterizes this alleged SUPSHIP 13 requirement as a constructive change supporting entitlement to an equitable adjustment covering 12,980 additional engineering manhours plus $59,674 for material.

2. Findings of Relevant Fact:

The Contracting Officer finds that LSCC was required by the contract specifications to shock test the ships basically in accordance with Military Specification MIL-S-901C of 15 January 1963; that such military specification together with the ship specification established the requirement to assure the shock resistance of specified equipments and to report such assurance to the Government; that such contractual requirement specifically included either (1) shock testing the equipment and reporting the results to the Navy (MIL-S-901C, section 4.2.7) or (2) obtaining an extension from the Government of a prior shock test in accordance with MIL-S-901C, section 3.2.2; and that the Government never required any performance with respect to shock certification beyond the foregoing which are the requirements LSCC originally agreed to perform under the terms of the contract.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is not entitled to an equitable adjustment reflecting any of the costs allegedly incurred in obtaining shock resistance certification.

D. ASSIGNMENT OF NAVSHIPS DRAWING NUMBERS:

1. Statement of the Contractor's Claim:

LSCC claims that on previous contracts with identical contract language, the Government acquiesced in use of the "key letter" system; i.e., purchased working plans could retain their original number, although revised by the purchaser, as long as revisions were indicated by a "key letter." LSCC alleges, however, that on NObs-4785, the Government prohibited use of the "key letter" and required that a new number be assigned to each revised drawing.

LSCC categorized the prohibition as a constructive change and requests an equitable adjustment reflecting 2000 additional engineering manhours.

2. Findings of Relevant Fact:

The Contracting Officer finds that on previous shipbuilding contracts with language identical or substantially similar to specification Section 9020-1-e of Contract NObs-4785, the Navy permitted use of the key letter system; that on NObs-4785, based specifically on Section 9020-1-e, the Navy prohibited the "key letter" system and required that new numbers be applied to any revised working drawings; that, however, the additional work required to add such number was negligible and in fact so small as to be indistinguishable from the normal plan preparation effort.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that the requirement to assign a new number to each revised plan was beyond the requirement of Section 9020-1-e as such section had been interpreted by the parties on past contracts. Accordingly equitable adjustment entitlement exists. However, the Contracting Officer determines that no significant additional work was performed as the result of such requirement and establishes the amount of the equitable adjustment as zero.

VII. NObs-4660, 4765, 4902, and 4785:

A. ALLEGED INSPECTION REQUIREMENT CONSTRUCTIVE CHANGES

1. Statement of the Contractor's Claim:

LSCC's contentions are basically the same for all four contracts under consideration herein. LSCC claims that, during the contract performance periods, the Navy, through quality assurance audits and other actions, directed LSCC to comply with specification and inspection requirements which exceeded the workmanship standards and acceptance criteria established prior to the award of these contracts in the day-to-day contact between the Navy inspection forces and LSCC's craftsmen and management in each of the individual areas concerned. This includes alleged "approval" of LSCC's Quality Assurance Manual in 1963. LSCC specifically refers to such areas as the fitting and welding of steel; fabrication and erection of piping; installation of foundations, machinery and equipment; installation of furniture; non-destructive testing acceptance standards and control of piping materials; and normal testing and trial procedures. In addition, LSCC claims that it had to considerably expand and augment its staff for inspection and quality assurance. LSCC has requested a price adjustment

of $18,611.040 for the four contracts. The amount is broken down between contracts as follows:

Contract NObs	Amt Claimed	Engineering Manhours	Production Manhours	Material Dollars
4660(LPD 9-10)	$3,909,417	10,493	390,344	$285,023
4765(LPD 11, 12, 13)	5,810,448	12,100	539,000	500,000
4785(DE-1052 Cl)	5,143,620	10,379	412,572	404,596
4902(LPD 14-15)	3,747,555	14,853	328,386	278,897

2. Findings of Relevant Fact:

The Contracting Officer finds that there is no evidence that the Navy has ever acquiesced in LSCC's inspection systems; that beginning circa 1959 the Navy started upgrading inspection requirements by making changes in contract specifications and incorporating such upgraded specifications in new contracts; that such upgrading was profound and included a basic change in concept; i.e., prior to October 1961, the Government was responsible for the bulk of contract inspection, subsequent to that date the contractors, in accordance with new language set forth in the detail ship specifications, became responsible; that LSCC was fully apprised of the policy to upgrade inspection requirements through correspondence and meetings; that LSCC resisted compliance with the upgraded requirement; that LSCC did not submit its "preliminary inspection manual" until 17 July 1963; that this manual was not approved, as alleged, but was stated, by letter, to be insufficient in certain areas; that the Navy continually attempted to get specification compliance with only slow progress achieved; that because of such unsatisfactory progress the Navy ran formal audits of LSCC's performance; that these audits, subject to exceptions set forth below, only identified areas where LSCC was failing to meet contract requirements; that LSCC consistently promised to upgrade its system when being considered for award of the next contract and consistently failed to meet requirements after award, and that LSCC bid or reasonably should have bid each contract on the basis of the new requirements including, if LSCC considered it to their advantage, applying such requirements to other existing Government work.

The Contracting Officer finds that the following specific Government acts did result in extra work:

a. Contract NObs-4660 - Five (5) "unsat chits" were issued which, in effect, required work beyond specification requirements. This work totaled 78 engineering manhours, 156 production manhours plus $65 for material;

b. Contract NObs-4660 - Eighty-five (85) "unsat chits" that should not have been issued, for which work was not done, but which required administrative effort amounting to 1,360 engineering manhours; and

c. Two (2) audit findingsin fact required work in excess of specification requirements as follows:

(1) Audit finding 13-13.7 which affected all four contracts and resulted in the expenditure of 320 production manhours and $600.00 for material; and

(2) Audit finding 9.f., applicable only to NObs-4660 and 4765 which resulted in an expenditure of 1,432 engineering manhours.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is entitled to an equitable adjustment in contract price as follows:

NObs 4660	$17,107
NObs 4765	6,376
NObs 4902	936
NObs 4785	1,004

reflecting the increased cost resulting from the "unsat chits" and audit findings detailed above. The Contracting Officer rejects all other inspection (quality assurance) allegations of LSCC as valid basis for equitable adjustment entitlement under contracts NObs-4660, 4765, 4785 and 4902.

VIII. NObs-4660, 4765 and 4902

A. LATE AND DEFECTIVE LEAD YARD PLANS:

1. Statement of Contractor's Claim:

a. LSCC claims entitlement to an equitable adjustment for the effects of alleged "Late and Defective Lead Yard Plans" under contracts NObs-4660, Nobs-4765, and NObs-4902, of $7,055,294, $4,350,829, and $4,960,091 respectively.

b. In brief, LSCC claims that it purchased working drawings from Ingalls Shipbuilding Corporation in accordance with his contractual option; and that the working drawings so purchased were late, causing delay and disruption, and so defective that they caused additional costs for rip-out, engineering, delay and disruption.

2. Findings of Relevant Facts:

a. The Contracting Officer has considered Article 1.(b) of the Special Provisions of NObs-4660; Article 4.(a) of the Special Provisions of NObs 4765; and Article 3.(a) of the Special Provisions of NObs 4902. Footnote #6 to the Invitation for Sealed Bids for the construction of LPD-9 and LPD-10 was also considered.

b. Article 1.(b) of the Special Provisions of NObs-4660 is quoted in pertinent part as follows:

> "(b) The Contractor may, at its expense and election, obtain from the Ingalls Shipbuilding Corporation, Pascagoula, Mississippi, at the cost of reproduction, for use hereunder to the extent applicable, copies of working plans and other design data as have or will be prepared by said Company for the construction of the LPD-7. The Government does not guarantee, nor does the Government make any representations with respect to the timeliness of the preparation and availability of such plans and data, the correctness and accuracy of any details, dimensions, or any other information appearing therein, nor does the Government guarantee that such plans and other data include all data necessary for the construction of the vessels under this contract.".

The above article is a bar to compensation based on working plans.

c. Article 4.(a) of the Special Provisions for NObs-4765 is quoted in pertinent part as follows:

> "(a) The Contractor may, at its own expense and election obtain from the Ingalls Shipbuilding Corporation, Pascagoula, Mississippi, at the cost of reproduction, for use hereunder to the extent applicable, copies of working plans, booklets, material schedules, purchase specifications, and other data as have been or will be prepared by said Shipbuilder for the construction of the LPD-7. The Government does not guarantee nor does the Government make any representations with respect to the timeliness of the preparation and availability of such plans and other data, the correctness and accuracy of any details, dimensions, or any other information appearing therein, nor does the Government guarantee that such plans and other data include all data necessary for the construction of the vessels under this contract.".

The above article is a bar to compensation based on working plans.

d. Article 3.(a) of the Special Provisions of NObs-4902 is quoted in pertinent part as follows:

> "(a) The Contractor may, at its own expense and election, obtain from the Commander, New York Naval Shipyard, Ingalls Shipbuilding Corporation and Puget Sound Bridge and Dry Dock Company at the cost of reproduction, for use hereunder to the extent applicable, copies of working plans, booklets, material schedules, purchase specifications, and other data as have been or will be prepared by those shipbuilders for the construction of LPD-4 (New York Naval Shipyard), LPD-7 (Ingalls) and LPD-11 (Puget Sound). The LPD-7 and LPD-11 are flag ship versions and have an additional level in the superstructure for flag facilities. The Government does not guarantee nor does the Government make any representations with respect to the timeliness of the preparation and availability of such plans and other data, the correctness and accuracy of any details, dimensions, or any other information appearing therein, nor does the Government guarantee that such plans and other data include all data necessary for the construction of the vessels under this contract.".

The above Article is a bar to compensation based on working plans.

e. Footnote #6 of Invitation No. IFB-600-545-63-S for quotations on LPD-9 and 10, as amended by Bureau of Ships letter P.R. 529-31430, Serial 1712-882 of 2 April 1963 to all Prospective Officers is quoted as follows:

> "The LPD-7 is presently under construction by the Ingalls Shipbuilding Corporation, Pascagoula, Mississippi. The specifications at the time of issuance of this Invitation for the vessel(s) to be constructed under this contract are the same specifications governing the construction of the LPD-7 at said Company. As the working plans prepared for the LPD-7 are based upon the electrical, mechanical and other materials used by the Ingalls Shipbuilding Corporation, it is emphasized that in these and other important respects including the possibility that changes may be made to the LPD-7 which would not be applicable to the vessel(s) under this contract, the working plans may not be suitable for the construction of the vessel(s) under this contract. The working plans and other data, and the construction of the vessel(s) hereunder, must of course, be in accordance with the specifications and other requirements of this contract."

3. Contracting Officer's Decision:

In view of the above quoted contractual and advisory language found in all three contracts and the request for quotations for LPD's 9 and 10, the Contracting Officer has determined that LSCC is not entitled to an equitable adjustment for delays and defects in working plans which LSCC at their option, purchased from Ingalls Shipbuilding Corporation. In consequence, this segment of LSCC's claim is denied.

IX. NObs-4660 and 4765

A. MULTIPLE APPROVAL OF LEAD YARD PLANS:

1. Statement of the Contractor's Claim:

LSCC claims entitlement to an equitable adjustment in the prices of contracts NObs-4660 and 4765 as compensation for costs incurred as a result of additional work required because of SUPSHIP 13's refusal to accept design data for these contracts which had been previously approved by other Governmental activities. This procedure of requiring changes in previously approved design data before approval by SUPSHIP 13 is alleged to have caused LSCC to revise the design data, and change completed work on the ships to conform with the revised design data. Alleged costs for which equitable adjustments

are claimed are as follows:

	NObs-4660	NObs-4765
Engineering M/H (Total)	37,440	8,475
Production M/H (Total)	203,671	58,386
Total Costs Claimed	$2,081,730	$621,666

2. Findings of Relevant Facts:

The Contracting Officer finds that 233 plans under contract NObs-4660 and 96 plans under contract NObs-4765 were improperly subjected to multiple approvals by SUPSHIP 13. LSCC has not furnished factual support for the estimated engineering and production hours expended as a result of the multiple plan approvals. This data was sought by oral request and by memo's Ser 431.3-50 of 7 Dec 1971 and 20 December 1971, but no reply was made by LSCC. Based upon a detailed analysis of 77 plans which were subjected to improper multiple approvals, the Contracting Officer finds that an average of six (6) engineering hours (hardcore) might reasonably have been incurred as a result of each improper multiple approval. The Contracting Officer also finds that an average of 15 production hours (hardcore) might reasonably have been expended for each hour of engineering (hardcore) effort expended. In the absence of production data from the Contractor, it is not reasonably possible to estimate the number of engineering and production hours expended as a result of the alleged disruptions.

3. Contracting Officer's Decision

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is entitled to equitable adjustments under the Changes clause of the contracts reflecting increased costs incurred as a result of the Government's multiple approval of lead yard plans. The equitable adjustments are determined to be:

	NObs-4660	NObs-4765
Engineering M/H (Hardcore)	1,398	576
Engineering M/H (Disruption)	-0-	-0-
Production M/H (Hardcore)	20,970	8,640
Production M/H (Disruption)	-0-	-0-
Total	$197,481	$86,821

X. NObs-4660 and 4765

A. DELAY AND DISRUPTION-ADJUDICATED CHANGES:

1. Statement of Contractor's Claim:

LSCC claims entitlement to an equitable adjustment in contract prices on two independent proposals. LSCC by letter Serial 2875 of 1 March 1971 for NObs-4660 and letter Serial 3902 of 1 March 1971 for NObs-4765, originally claimed a total of $5,071,966.56 for overall delay and disruption arising out of the issuance and adjudication of approximately 548 change orders which number is alleged to be excessive. This amount was included in the DD 633-5 forms submitted with the claim for each contract. Subsequently, by LSCC letter Serial 2882 of 17 May 1971, supplemented by LSCC memorandum of 18 January 1972, LSCC claimed an additional $3,681,055.76 for work performed over and above the work scope contained in 14 change orders to NObs-4660 and nine change orders to NObs-4765. The original DD-633-5 forms have not been augmented to reflect the additional work claimed as added work scope on the 23 identified change orders.

2. Findings of Relevant Fact:

The Government did issue and adjudicate approximately 548 change orders as claimed. Each change order, including the 23 for which added work scope is claimed, was implemented by a supplemental agreement which included, among other things, the following agreement,

> "The change in delivery dates and price described above is considered to be fair and reasonable and has been mutually agreed upon in full and final settlement of all claims arising out of this modification and any other modifications or change orders indicated above, including all claims for delays and disruptions resulting from, caused by, or incident to such modifications or change orders."

The supplemental agreements were each considered and executed by both LSCC and the Government. Except for change order HMR No. 128 to NObs-4660 and change order HMR No. 74 to NObs-4765, there is no indication on the face of the agreements or in the negotiation records that LSCC made any reservations as to delay, disruption or work scope or that the change order did not contemplate all of the work required to cover the changed work. The negotiation files for HMR No. 128 and HMR No. 74, which increased the number of dial telephones, indicates that the Government negotiator and LSCC negotiator agreed not to include additional wiring and new circuits but to make these elements the subject of a subsequent change order should additional wiring and circuits be required. Additional wiring and circuits were necessary in order to install

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the additional dial telephones and have them in an operable condition. No subsequent change order was issued to cover the wiring and additional circuits.

3. Contracting Officer's Decision:

Although as presently submitted this segment of the claim is divided into two distinct parts with two different theories, both can be decided as one. The supplemental agreements bilaterally accepted and executed by LSCC and the Government implementing the change orders have taken into consideration all elements of the changed work including, but not limited to, work scope, delay and disruption. In consequence, the agreement included in the supplemental agreements quoted above is governing and precludes payment of the additional compensation claimed except for the extra wire and circuits required to install the dial telephones added by HMR No. 128 and HMR No. 74 referenced above. The additional work over and above the work scope negotiated for HMR No. 128 and HMR No. 74 has been evaluated and the equitable adjustment due is determined by the Contracting Officer to be:

a. NObs-4660 (LPD 9 & 10) HMR No. 128

(1) 1,607 Production M/H	$14,399
(2) Material costs	825
(3) Total	$15,224

b. NObs-4765 (LPD 11-13) HMR No. 74

(1) 2,411 Production M/H	$23,001
(2) Material costs	1,238
(3) Total	$24,239

XI. NObs-4660 and 4765

A. LATE/DEFECTIVE GOVERNMENT FURNISHED MATERIAL:

1. Statement of Contractor's Claim:

a. LSCC claims entitlement to an equitable adjustment in contract prices for the following:

It alleges that the Government failed to deliver, by the required dates, in excess of one thousand items of Government Furnished Material (GFM);

It is alleged that over one hundred technical documents to be furnished by the Government were never delivered, and a significant portion of the Government furnished equipment was

defective. The alleged result of these Government failures to comply with contractual requirements was increased costs of performance because of costs incurred, (1) to repair the defective GFM and (2) delay and disruption to the overall production effort under contracts NObs-4660 and NObs-4765.

b. The requested equitable adjustment to the contracts' prices as compensation for the alleged late and defective GFM are:

	NObs-4660	NObs-4765
Engr. M/H	8,988	120
Prod. M/H	47,850	4,000
Material	$159,898	-0-
Totals	$650,291.68	$39,641.60

2. Findings of Relevant Fact:

a. The Contracting Officer finds that those aspects of this claim dealing with defective GFM are duplicates of items resolved under the "Unadjudicated Change Orders" and "Delay and Disruption-Adjudicated Changes" sections hereof and are, therefore, not reconsidered here.

b. The Contracting Officer finds that several items of GFM were delivered to LSCC at later dates than the delivery dates in the Master Material Erection and Component Percentage Ship Schedule (MMES/CPSS). However, the Contracting Officer also finds that delays in performance of the contracts were being concurrently experienced because of factors which were not the responsibility of the Government, e. g., strikes, labor shortages. See, for example, LSCC letter Ser. 1 of October 10, 1968. In some instances LSCC requested postponement of delivery of GFM because it was not prepared to use the items at the scheduled delivery date.

c. As a result of these concurrent delays and disruptions, and LSCC's failure to provide factual data establishing a cause/effect relationship between alleged late GFM and increased costs of performance, the Contracting Officer finds that, except for the items enumerated below, that late deliveries of GFM did not have an adverse effect on the performance efforts of the Contractor.

d. The following items of GFM are found to have been delivered later than the date when the material was needed by LSCC. It is also found that the late deliveries were the direct cause of identifiable increased costs of performance.

NObs	Schedule "A" No.	Nomenclature	Quantity
4660	46	AN/SRC-20 Transceiver	9
4660	47	AN/SRC-21 Transceiver	5
4660	59	AN/URA-17 Converter	8
4660	93	R-1051/URR Radio Receiver	27
4660	106	C-3868/SRC Control Unit	8
4765	213	Dental Chair	1

3. Contracting Officer's Decision:

a. Based upon the foregoing findings of fact, the Contracting Officer determines that LSCC is entitled to equitable adjustments under the Changes clauses as compensation for increased costs of performance caused by the late delivery of the items of GFM cited above.

b. The equitable adjustments are:

	NObs-4660	NObs-4765
Engr. M/H	-0-	60
Prod. M/H	31	172
Material	-0-	-0-
Total adjustments	$278	$2099

XII. NObs-4660 and 4765

A. AIR CONDITIONING AND VENTILATION:

1. Statement of Contractor's Claim:

a. LSCC claims entitlement to and equitable adjustment in contract prices because heating, ventilating, and air conditioning specification requirements of Contracts NObs-4660 and NObs-4765 were allegedly modified or enlarged with a resultant increase in its costs.

b. LSCC requests an equitable adjustment to increase the price of contract NObs-4660 by $541,340.36 and Contract NObs-4765 by $189,761.52.

2. Findings of Relevant Facts:

a. LSCC's allegations are considered in four separate parts.

(1) Change Order No. 25 - This Change Order, Contract Modification No. F-51, issued in accordance with the Changes Clause of Contract NObs-4660, is unadjudicated. The Contractor has submitted a work scope and pricing proposal which has been evaluated by Government technical and pricing personnel.

(2) Increased air conditioning capacity requirements for LPD's 9-13 - LSCC alleges that the cumulative effect of several Change Orders which added to or revised the total amount of electronics equipment requiring air conditioning caused LSCC to increase the size of the cooling units from seventy-five tons each to eighty tons each. These contentions, including LSCC's proposed work scope and pricing proposals, have been analyzed. The Contracting Officer finds that increased air conditioning capacity was required.

(3) Increased air conditioning for MK 56 and 63 compartments - LSCC alleges that the MK 56 and 63 weapons systems provided by the Government and installed aboard the LPD's 9-13 had greater cooling requirements than were stated in the data provided to LSCC. In support of this contention, LSCC has supplied a work scope and pricing proposal for the effort required to provide the necessary air conditioning. The Contracting Officer finds that erroneous data regarding the air conditioning requirements were supplied to LSCC and that this defective data caused LSCC to perform additional work not within the requirements of the contract.

(4) Increased air conditiong for eleven electronics compartments - LSCC alleges that additional air conditioning was required to meet the cooling requirements for eleven electronics compartments. The Contracting Officer finds that for this additional effort LSCC has already been fully compensated by adjudicated Change Order FMR No. 298, NObs-4660, Supplemental Agreement A-719. This Supplemental Agreement contains a complete disclaimer of any further claims for the effort required in the performance of the Change Order.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is entitled to an equitable adjustment under the Changes Clause of the contracts for additional efforts described in Sections (1), (2) and (3) above. As a result thereof, the contracts' prices increased as follows:

	NObs-4660	NObs-4765
Engineering M/H	2240	328
Production M/H	11,454	5943
Material	$78,416	$56,803
	$196,410	$116,004

XIII. NObs-4660 and 4765

A. BUTTERFLY VALVES:

1. Statement of the Contractor's Claim:

LSCC requests an equitable adjustment to increase the prices of contracts NObs-4660 and 4765 as compensation for alleged increased costs incurred because the Government prevented the use of "butterfly"valves, in approximately twenty piping systems, requiring instead the use of "globe", "gate", and "horizontal disc" valves. The Contractor contends that the "butterfly"valves would have met the specification requirements. The Government's insistance upon use of the allegedly more expensive valve types constitutes a constructive change order, entitling LSCC to additional compensation for the resultant increased costs in accordance with the provisions of the "Changes" Clause of the Contracts.

	NObs-4660	NObs-4765
Engr M/H	3044	1250
Prod M/H	46,682	42,498
Material	$89,410	$128,288
	$528,562.56	$549,268.64

2. Findings of Relevant Facts:

a. The Contracting Officer finds that the contracts' specifications authorized, with exceptions, the use of "butterfly" valves in lieu of other valve types. Those specifications for both contracts primarily dealing with valves are found in Section 9480-0, "General Requirements for Piping Systems". The specification allowing the use of "butterfly" valves is Section 9480, lines 89 through 91: "butterfly type valves in accordance with MIL SPEC MIL-V-22133 may be used in lieu of gate valves where applicable".

b. MIL SPEC MIL-V-22133B(SHIPS) of 20 March 1961, entitled "Valves, Resilient Seated, Butterfly, Working Pressures up to 200 PSI, 180 Degrees F. Maximum" forbids the use of "butterfly" valves when the working pressure or temperature to which the valve would be exposed exceeds 200 PSI or 180 degrees F, respectively.

c. Section 9480-0, lines 92 through 95, provides: "Butterfly type valves shall not be used as bulkhead damage control cutout valves, tank cutout valves or sea chest valves over 12 inches in size".

d. Section 9480-0, states, lines 75, 76, "Gate valves shall not be installed for throttling service." Because "butterfly" valves could be used only in lieu of "gate valves, this Section precludes the use of "butterfly" valves.

e. In addition, although not prevented by the terms of the specifications, in certain applications the use of "butterfly" valves is unsatisfactory because of practical technical or cost considerations. The Contracting Officer finds that two items of Government-initiated correspondence restricted the Contractor's use of "butterfly" valves from those applications permitted by the specifications:

(1) UNSAT CHIT P-19 of 14 May 1965 (Damage Control Cut-Outs in Firemain System) and

(2) SUPSHIP-13 letter LPD/9480 Ser 552Q-3249 of 15 April 1965

f. The first item, the UNSAT CHIT, improperly rejected "butterfly" valves installed as Damage Control Cut-Outs at points in the firemains where such valves were permitted. The second item, the SUPSHIP-13 letter, informed the Contractor that BUSHIPS Instruction 9480.50B of 12 March 1965, an enclosure to the letter, could not be followed unless authorized by change order. The provisions of the Instruction permitting the use of "butterfly" valves in certain piping systems were already incorporated into the contract specifications. By preventing the use of "butterfly" valves without prior approval, the Navy restricted the option allowed the Contractor by the specifications.

The Contracting Officer finds that the following number of valve locations were affected by the Government's refusal to permit the use of "butterfly" valves at LSCC's option:

Contract	Claimed Valves affected	Finding Valves affected
NObs-4660 (2 ships)	658	336
NObs-4765 (3 ships)	879	486

3. Contracting Officer's Decision:

Based upon the foregoing findings of fact, the Contracting Officer determines that LSCC is entitled to an equitable adjustment

under the Changes Clauses of the contracts as compensation for increased costs of performance resulting from the Government's refusal to permit the use of "butterfly" valves. The equitable adjustments are:

	NObs-4660	NObs-4765
Engr M/H	(304)	-0-
Prod. M/H	3125	3267
Material	$30,484	$45,612
Totals	$56,399	$76,779

XIV NObs-4660

A. ANCHOR WINDLASS PIPING:

1. Statement of Contractor's Claim:

LSCC alleges that he was required by a Navy inspector to remove piping for the anchor windlass on LPD-9, previously installed in accordance with lead yard drawings, and reinstall the piping in accordance with the inspector's directions. The anchor windlass piping for LPD-10 was also originally installed in accordance with the inspector's directions. This additional work resulted in increased costs of performance for which LSCC claims entitlement to an equitable adjustment to the contract price, as follows:

	NObs-4660,
Engineering M/H	132
Production M/H	2648
Material	$3,930
Total Adjustment sought	$28,561

2. Findings of Relevant Facts:

a. The Contracting Officer finds that on LPD-9, LSCC installed the anchor windlass piping in accordance with the appropriate lead yard drawing. The Inspector, after conferring with the SUPSHIP 13 piping engineer, determined that the installation would have to be removed and reinstalled because it was not in conformance with the LPD-7 Class specifications Section 9480-0, lines 55 through 91. LSCC thereupon issued Engineering Revision Notice (ERN) No. M-2084 directing the work be accomplished. The work was done. Also, the anchor windlass piping for LPD-10 was installed in accordance with the ERN. The anchor windlass piping for subsequent LPD's 11-15 was installed and accepted by the Navy although built

in conformance to the lead yard plans instead of the ERN incorporating the inspector's instructions.

b. The Contracting Officer finds that the inspector improperly interpreted the LPD-7 Class specification, and that the initial piping installation was in conformance with the contract requirements.

c. In the absence of factual data from the LSCC, estimates of the cost of the performance of this work have been prepared by the Government.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that the actions of the Navy inspector constituted a constructive change order, and that the work performed in accordance with the said instructions is compensable in accordance with the provisions of the "Changes" Clause.

Therefore, the contract price is increased as follows:

	NObs-4660
Engineering M/H	56
Production M/H	989
Material	$2,486
Total adjustment	$11,731

XV. NObs-4660

A. SEA TRIALS - LPD-9:

1. Statement of Contractor's Claim:

LSCC claims entitlement to an equitable adjustment in the price of contract NObs-4660 as compensation for costs incurred during the performance of a second Builder's Trial for LPD-9. It is alleged that this second sea trial was required by Government representatives, but was not required by the contract specifications.

Engineering Manhours	Production M/H	Material	Adjustment Sought
636	5169	$20,913	$71,590.20

The Contractor has also requested an increase of $8,506 to the contract price as compensation for other services provided during sea trials.

2. Findings of Relevant Facts:

The Contracting Officer finds that LSCC was directed to conduct a second Builder's Trial by Navy letters Serial 120-4833 of 21 August 1968 and Serial 102.2-4949 of 30 August 1968. The additional Builder's Trial was ordered because of machinery and equipment problems encountered during the first Builder's Trial. Subsequent to the first and prior to the second Builder's Trial, LSCC disclaimed liability for expenses to be incurred on a second Builder's Trial (LSCC ltr Ser 2101 of 5 September 1968). The second Builder's Trial was conducted in September 1968.

The Contracting Officer finds that the problems experienced during the first Builder's Trial which resulted in the requirement for the second Builder's Trial were not the responsibility of LSCC.

3. Contracting Officer's Decision:

a. The Contractor has withdrawn his claim for other services during sea trials (LSCC Memo of 8 November 1971), and the Contracting Officer determines that no change in the contract price will result from this claim.

Based on the foregoing findings of fact, the Contracting Officer determines that because the reasons cited for the second Builder's Trial were not the responsibility of LSCC, the Navy was acting beyond its contractual authority to order the performance of the second Builder's Trial. LSCC is entitled to an equitable adjustment to the contract price in accordance with the Changes Clause as compensation for this work which was not within the requirements of the contract.

b. The Contracting Officer determines that the equitable adjustment is as follows:

Engineering M/H	Production M/H	Material	Total Adjustment
64	4494	$20,913	$61,618

XVI. NObs-4660 and 4765

A. TANK STRENGTH TESTING:

1. Statement of the Contractor's Claim:

LSCC claims entitlement to an equitable adjustment to the contracts' prices as compensation for costs incurred as a result of performing strength tests for certain designated tanks aboard LPD's 10-13. LSCC contends that because all the tanks here involved are identical to tanks which had been successfully tested on LPD-9, the Government should have granted a waiver on tank strength testing of the follow-on ships, as permitted in the specifications. In addition, LSCC has requested an equitable adjustment in the contracts' prices as compensation for costs incurred in obtaining water used for the performance of the tests (LSCC letters LPD/4365 Ser 2875 of 1 March 1971 and LPD/4365 Ser 3902 of 1 March 1971).

The alleged manhours expended and costs incurred in this testing are:

NObs-4660

Engineering M/H	60
Production M/H	11,040
Material	$200.00
Water	$15,509.00
Total	$115,045.86

NObs-4765

Engineering M/H	120
Production M/H	9612
Material	$400.00
Water	$16,973.00
Total	$111,338.76

2. Findings of Relevant Fact:

The Contracting Officer finds that specification 9290-8-c, "Strength Tests", is applicable to the ships/tanks in question and is quoted here in pertinent part:

> "If the results of these [strength] tests offer conclusive proof of the adequacy of the design and workmanship, the strength test for the remaining ships of the Class being constructed at the plant may be waived at the discretion of the Supervisor." (Emphasis added.)

LSCC's requests for waivers of the subject strength tests were rejected by the Supervisor's letters LPD/9290 Ser 552E-3242 of 16 April 1965 and LPD/9290 Ser 205-3187 of 8 June 1966. LSCC performed the tank strength testing, as directed. The Contracting Officer finds that during the construction of LPD-9, 10, and 11, numerous discrepancies were discovered in LSCC's fabrication and welding efforts, resulting in the issuance of UNSAT CHITS. LSCC attempted to conduct tank strength tests prior to completion of the tanks. In addition, the tests, even when conducted on supposedly completed tanks, were often unsuccessful.

3. Contracting Officer's Decision:

Based upon the foregoing findings of fact relative to the construction of the subject tanks, the Contracting Officer determines that the Supervisor was acting reasonably and responsibly when he refused to grant waivers for the tank strength tests because of the lack of conclusive proof of the adequacy of LSCC's workmanship. Therefore, LSCC is not entitled to an equitable adjustment to the contracts' prices as compensation for costs incurred as a result of performing the tank strength tests. Because the tank strength tests were within the scope of the contracts' requirements, and the water used during the tests was not designated in the contracts as Government furnished, the Contracting Officer determines that LSCC is responsible for its provision, and is not entitled to an equitable adjustment to the contracts' prices as compensation for costs incurred as a result.

XVII. NObs-4660

A. SECURITY SERVICES:

1. Statement of the Contractor's Claim:

LSCC claims entitlement to an equitable adjustment to the price of contract NObs-4660 as compensation for increased costs resulting from (1) alleged Navy directions to provide additional guard services for LPD 9-10, and (2) costs of guard services incurred because Government-responsible delays extended the delivery of the ships beyond the originally scheduled date. The adjustment sought is $40,986.

2. Findings of Relevant Fact:

LSCC has furnished no evidence to support the assertion that the Government's representative(s) directed the increase in the number of guard personnel assigned to LPD's 9-10. In addition,

as is determined elsewhere herein, the Government is not solely responsible for delays and disruptions which resulted in the delivery of the ships on dates later than the original contract delivery dates.

3. Contracting Officer's Decision:

The Contracting Officer determines that (1) LSCC is not entitled to an equitable adjustment to increase the contract price as compensation for increased security services allegedly required because of Government order and (2) LSCC is not entitled to an equitable adjustment to increase the contract price as compensation for providing security services beyond the original contract delivery date for the ships.

XVIII. NObs-4660, 4765, and 4902

A. IMPROPER REJECTION OF WORK:

1. Statement of the Contractor's Claim:

LSCC claims entitlement to equitable adjustments under the Changes Clause as compensation for increased costs resulting from the improper rejection by Navy Inspectors of conforming work performed on LPD's 9-15.

Contract	Adjustment Sought
NObs-4660	$106,850
NObs-4765	93,905
NObs-4902	53,019

2. Findings of Relevant Fact:

a. Written notices of work rejection are known as "UNSAT CHITS". The Contracting Officer finds that the UNSAT CHITS cited by LSCC are classified as follows:

(1) Not examined because withdrawn by Contractor	3
(2) Examined, but found to be valid	220
(3) Examined, with sufficient data to support a determination that the UNSAT CHIT was invalid	164
(4) Duplicate of previously issued UNSAT CHIT	13
	400

A list of the classified UNSAT CHITS is attached as enclosure (1). Navy inspectors are authorized representatives of the Contracting Officer for the purpose of performing inspection. Improper rejections of work by the Navy inspectors may constitute compensable actions under the "Changes" Clause when a contractor is required to re-perform work which originally met the contract requirements.

The Contracting Officer finds that only the UNSAT CHITS in classifications "(3)" and "(4)" above, were improperly issued.

b. LSCC has furnished only estimates of both work performed and costs incurred to support the requested equitable adjustment in contract price. Dispite written requests, LSCC has not furnished factual data to prove a cause/effect relationship between the invalid UNSAT CHITS and the alleged resulting costs of corrective action taken. Therefore, an estimate was made of the effort that should have been required by LSCC to make the necessary corrections.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is entitled to an equitable adjustment under the Changes Clause as compensation for increased costs of performance resulting from the Government's improper rejection of conforming work.

The equitable adjustments are determined to be as follows:

	NObs-4660	NObs-4765	NObs-4902
Engr M/H	704	156	-0-
Prod. M/H	1432	1036	-0-
Material	$5600	$7800	$700
Totals	$23,261	$18,873	$700

XIX NObs 4660, 4765 and 4902

A. ADMINISTRATIVE FAULT: (see footnote*)

1. Statement of Contractor's Claim:

a. LSCC claims entitlement to an equitable increase in the contracts' prices because it alleges that the costs of performance were increased because of the Government's failure to properly administer the contracts. Three separate types of improper administration are cited as a basis for equitable adjustments of the contracts' prices, which are:

(1) Delays in administration.
(2) Delays in plan approval.
(3) Delays in answering correspondence.

b. The increased work and costs attributed to these delays are alleged to be,

NObs	Engr M/H	Prod M/H	Total
4660	1350	14,000	$ 90,494
4765	4252	30,524	323,642
4902	1561	15,280	162,566

2. Findings of Relevant Fact:

a. Delays in Administration.

(1) NObs-4765 - The contract specifications require LSCC to revise the LPD-7 Operational Stations Booklet (OSB) to reflect conditions aboard the LPD-11. The Government was required to furnish the LPD-7 OSB: LSCC was to deliver the revision approximately one year prior to completion of the ship. The LPD-7 OSB was delivered to Lockheed in March 1968; the LPD-11 was delivered in May 1970, twenty-six months later and providing the Contractor fourteen months to revise the OSB. The Contracting Officer finds that LSCC was not injured by the alleged late delivery of the LPD-7 OSB because concurrent delays in delivery of LPD-11 allowed adequate time for revision of the Booklet.

(2) NObs-4902 - LSCC requested a waiver of performance testing of main feed pumps in February 1967. The waiver was not granted until August 1967. LSCC alleges this delayed procurement of the pumps. The Contracting Officer finds that because the pumps were delivered to LSCC prior to the filing of the request for waiver, no injury occurred.

b. Delays in Plan Approval.

NObs-4660,4765,4902. The Contracting Officer finds that LSCC was required to submit to the Government for approval plans which had not been previously approved and plans previously approved but changed by LSCC. LSCC alleges that Government delays in responding to requests for plan approvals caused increased costs of performance of the contracts. LSCC cited one thousand thirty-seven NObs-4660, eighty NObs-4765 and sixty-seven NObs-4902 plans alleged to have been subjected to excessive approval time; he has not submitted documentation to establish the dates that each of these approved plans were required. The Contracting Officer finds that without information as to the dates the plans were needed, any alleged injury suffered by LSCC cannot be established.

c. Delays in Answering Correspondence.

NObs-4765 and 4902 - LSCC cites fifty-nine pieces of correspondence for NObs-4902 which the Navy is alleged to have excessively delayed in answering, thus causing increased costs in the performance of the contracts. The Contracting Officer finds that LSCC has not provided documentation to establish the dates the responses to the items of correspondence were required, and without information as to the dates the responses were needed, any alleged injury suffered by LSCC cannot be established.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is not entitled to an equitable adjustment in the contracts' prices under the Changes Clauses for alleged increased costs incurred as a result of the administrative fault of the Government.

* The Contractor's claim contained a category entitled "Excessive Approval Time". This category was written for Contract NObs 4660 only. However, the subject matter of this category appears in the Consolidated Claim under the title "Administrative Fault" for contracts NObs 4765 & NObs 4902. Since the subject matter is the same they are combined in this document.

4660 Excessive Approval Time
4765 Administrative Fault
4902 Administrative Fault

XX. NObs 4660, 4765, 4902, and 4785

A. UNADJUDICATED CHANGE ORDERS:

1. Statement of the Contractor's Claim:

LSCC claims entitlement to an equitable adjustment in the contracts' prices in three parts. Each part requests compensation for items of work performed by LSCC which were not required by the contracts' original specifications (LSCC letters LPD/DE/RNW/c/4365 Ser 2878 of March 24, 1971 and LPD/CO/REN/gs Ser 2201 of 10 Dec 1971). Part I of the claim concerns formal Change Orders based upon Headquarters Modification Requisitions (HMR). These were Naval Ship Systems Command (NAVSHIPS) originated change orders. Part II of the claim concerns Change Orders originated by SUPSHIP 13, a NAVSHIPS field organization, and based upon Field Modification Requisitions (FMR). Part III of the claim includes work performed by LSCC for which no formal Change Order was issued. These items of work are defined in two types of documents: (1) LSCC Proposed Change Orders (CPCO), initiated by LSCC to claim compensation for work defined therein considered by him to be beyond the specification requirements of the contract and (2) Unresolved Work Modifications (UWM), a bilateral modification to a contract defining a particular item of work to be performed for which the parties are in disagreement as to its inclusion within the specification requirements of the contract, but in agreement to resolve the question of inclusion at a later time after completion of the work. LSCC seeks compensation for these three part of the claim as follows:

NObs-4660	$ 491,755
NObs-4765	1,709,134
NObs-4902	3,070,236
NObs-4785	1,504,563

2. Findings of Relevant Fact:

a. For the formally issued Change Orders, HMR's and FMR's, LSCC has submitted the appropriate work scope and pricing proposals in accordance with the "Changes" Clause of the contracts. For each proposal, the Contracting Officer finds that the normal price and technical analysis have been made for each Change Order.

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b. The CPCO's and UWM's both address items of work performed for which there was disagreement as to their inclusion in the contract specification requirements. During the initial performance period of the contracts, when a disagreement developed, LSCC performed the alleged unrequired work, and submitted a CPCO, seeking reimbursement. Subsequently, LSCC revised his procedures, and required the execution of a UWM before the work in question would be performed. For each CPCO and UWM, the Contracting Officer finds that a technical evaluation has determined whether the item of work was included in the specification requirements. For those work items found to be beyond the specification requirement a technical and price/cost analysis has been made.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is entitled to an equitable adjustment under the Changes clause of the contracts for the Change Orders, CPCO's and UWM's listed on enclosure (3) attached hereto, in the amounts shown thereon. As shown on enclosure (4) the equitable adjustments determined by contract are as follows:

	NObs-4660	NObs-4765	NObs-4902	NObs-4785
Engineering M/H	6,035	10,642	23,700	8953
Production M/H	16,745	34,232	85,869	(81,017)
Material	$391,374	$316,945	$568,338	(13,512)
Total	$582,809	$724,717	$1,600,134	(805,986)

XXI. NObs 4660, 4765, and 4902

A. HABITABILITY:

1. Statement of the Contractor's Claim:

LSCC claims entitlement to an equitable adjustment in the contracts' prices because it alleges that the Navy provided and approved lead yard plans and guidance drawings were in conflict with the habitability specifications contained in the contract. As a result, LSCC was required to accomplish a composite drawing program to resolve the conflicts by re-designing the spatial allocation of furniture and equipment to meet the habitability requirements of the specifications. In addition, extensive rework and scrappage occurred because the

conflicts were not discovered until after installation of much of the furniture and equipment. LSCC's alleged costs associated with this additional effort are:

Contract	Engr. M/H	Prod. M/H	Mat'l	Total
NObs-4660	15,000	71,980	$74,611	$1,037,044
NObs-4765	20,000	71,732	$82,424	$1,226,644
NObs-4902	20,000	31,772	$52,120	$ 719,653

2. Findings of Relevant Fact:

a. The Contracting Officer finds that there was a conflict between the contract plans and the habitability specifications in each contract. To resolve the conflicts, LSCC developed composite drawings. In addition, the Government relaxed several habitability specification requirements. The parties executed a Supplemental Agreement for each contract which, among other things, allowed LSCC to deviate from the contract plans to determine the individual compartment complements, and provided that the work required by the Supplemental Agreement would be accomplished at no change to the contract price or delivery schedule and that all future claims, including delay and disruption, associated with the Supplemental Agreement were waived.

b. The Contracting Officer finds that LSCC reasonably expended efforts in attempting to resolve the conflicts between the contract drawings and the habitability specifications, said work not required by the entire contract requirements as waived or modified.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is entitled to an equitable adjustment under the Changes Clause of the contracts as compensation for increased costs in attempting to meet the habitability specifications requirements of the contracts. The contracts prices are adjusted as follows:

Contract	Engr. M/H	Prod. M/H	Mat'l	Total
NObs-4660	11,680	30,566	$25,234	$379,230
NObs-4765	8,690	24,789	$20,465	$323,257
NObs-4902	8,711	15,130	$12,500	$230,219

XXII NObs 4765 and 4902

A. SHOCK AND DYNAMIC ANALYSIS:

LSCC claims entitlement to equitable adjustments of $1,707,384 to Contract NObs-4765 and $6,969,450 to Contract NObs-4902 as compensation for additional costs of performance in meeting the shock and dynamic analysis specification requirements. LSCC alleges that these efforts were not required or anticipated under the terms and conditions of the contracts, but were imposed on LSCC by Government actions. The detailed LSCC allegations and the Contracting Officer's findings of fact and determinations will be set forth herein separately for each contract.

1. Statement of Contractor's Claim for NObs-4765 (LPD 11-13):

a. LSCC alleges the following actions or events are the responsibility of the Government, the causes of the increased costs of performance, and constitute entitlement for the equitable adjustment sought.

(1) Failure of the "Lead Yard", Ingalls Shipbuilding Corporation, to provide adequate shock and dynamic analysis data.

(2) Misinterpretations of the shock specifications by SUPSHIP 13 which increased the amount of work required.

(3) Defective contract shock specifications required unanticipated effort to prepare adequate specifications for subcontracts/purchase orders.

(4) LSCC did not anticipate that it would be required to shock test equipment made to Bureau Standard Drawings which did not contain shock test qualification legends.

(5) Improper rejection by SUPSHIP 13 of LSCC Shock Qualification Reports.

(6) Navy imposed requirement that LSCC witness certain shock tests of equipment.

(7) Navy improperly refused to grant shock qualification extension for the ship's service turbo-generators (SSTG).

(8) Increased equipment costs resulting from increased shock requirements imposed by the Government subsequent to execution of the contract.

(9) Delay and disruption costs resulting from the above Government responsible acts and events.

b. Because of the above actions, LSCC alleges he expended an additional 12,488 engineering manhours, 44,944 production manhours, and $1,176,418 for material.

2. Findings of Relevant Fact for NObs 4765 (LPD 11-13):

a. The Contracting Officer finds that:

(1) Contract Special Provision, Article 4, "Working Plans and Other Data", contained in the Invitation for Bids, clearly informed the Contractor that the Government did not guarantee the timeliness, availability, correctness, accuracy, or completeness of any data LSCC might, at its option, acquire from Ingalls Shipbuilding Corporation. In addition, the shock testing, qualification, and data requirements for the "lead yard" were in certain respects different than the requirements for the instant contract, and therefore inapplicable.

(2) (a) SUPSHIP 13 memo of 2 December 1966 to LSCC properly interpreted the shock specifications applicable to Change Order No. 49. This Change Order, increasing the load carrying capacity of the "Upper Vehicle Stowage Area" and the "Lower Vehicle Ramp" has been adjudicated by the parties, including full compensation for all work required.

(b) SUPSHIP 13 letter LPD/9400 Ser 252-7901 of 7 December 1964 to LSCC properly interpreted shock specifications applicable to the "Stern Gates" and the "Transverse Water Barrier". Also, FMR No. 401 revising the shock specification requirements for the "Stern Gates" and "Transverse Water Barrier" is contained as an element in the section herein entitled "Unadjudicated Change Orders", and shall not be determined in this section.

(3) Specification MIL-S-901B, paragraph 6.1 provides the requirements for "Ordering Data" for Navy Class H1 shockproof which were adequate for the preparation of purchase order specifications. The "lead yard" shock specifications could not be relied upon because the instant shock specifications were revised by Modification 2, contained the IFB and resultant contract.

(4) The applicable Bureau Standard Drawings were available for review during the period LSCC was preparing its bid. The Contractor knew or should have known the contents of the legends contained on the drawings, and the number of equipments shown that had not been previously shock tested and qualified.

(5) LSCC has presented no evidence nor has the Contracting Officer discovered any information to show that SUPSHIP 13 improperly rejected LSCC Shock Qualification Reports.

(6) LSCC has presented no evidence nor has the Contracting Officer discovered any information to show that the Government directed LSCC to witness certain shock tests of equipment.

(7) The SSTG's selected by LSCC and installed in the ships had not previously been shock tested. The specifications provide that these units were required to be shock tested. Without a prior successful shock qualification, there was no basis for granting a waiver of the test equipment.

(8) The Contractor has furnished no evidence to support the allegation that Government actions increased the shock specification requirements after the execution of the contract.

(9) The Contracting Officer has found that the alleged Government responsibility for the above actions and events is not factually supported by LSCC. Therefore, the Government is not responsible for the alleged costs resulting from the alleged production delay and disruption caused thereby.

3. Contracting Officer's Decision for (LPD 11-13):

Based on the foregoing findings of fact, the Contracting Officer determines that the Contractor is not entitled to an equitable adjustment in the contract price.

4. Statement of Contractor's Claim for NObs-4902 (LPD 14-15):

a. The Contractor alleges the following actions or events are the responsibility of the Government, the causes of increased costs of performance, and constitute entitlement for the equitable adjustment sought.

(1) The Navy misinterpreted the shock specifications by requiring Dynamic Design-Analysis Method (DDAM) for foundations and certain equipments.

(2) The Contractor was required to review and revise drawings to include shock data, this effort not required by the contract.

(3) Contract required, but the "lead yard" failed to furnish, satisfactory shock data for use in procurement documents and test procedures, and as guidelines for shock qualification reports. Acting beyond contractual authority, the Government required the Contractor to witness shock testing.

(4) LSCC installed LPD 11-13 design foundations and other items in the LPD 14-15, and was then required to perform extensive re-work because of DDAM.

(5) Misinterpretation of the specification by the Government increased the shock resistance requirements, causing upgrading of piping, ducting, and wiring systems.

(6) Increased shock requirements caused late delivery of certain equipments, e.g., main boilers, main condensers, etc., and disruption in the construction of the ships.

(7) Government shock specification interpretations subsequent to contract execution upgraded the requirements, resulting in increased material costs.

(8) All of the above actions and events caused additional delay and disruption in the construction of the ships.

b. Because of the above actions, Lockheed alleges he expended an additional 29,500 engineering manhours, 294,280 production manhours, and $2,593,905 for material.

5. Findings of Relevant Fact for NObs-4902 (LPD 14-15):

a. The IFB and contract contained revisions to the shock specifications for the LPD 14-15 as compared to the LPD 11-13; e.g. MIL-S901C vice MIL-S901B. LSCC by letter Ser 10-12, AMP/sl of 21 April 1965, written prior to contract award, confirmed that he had given full consideration in his bid to the specification requirements for Dynamic Shock Analysis. The specifications were not changed following award of the contract. LSCC has presented no evidence which establishes his allegation of Navy upgrading of specification requirements because of misinterpretation.

b. LSCC has provided no evidence to establish any instances where the Government exceeded the contract requirements for the revision of drawings to contain shock data.

c. As found in finding of fact No. 1, LPD 11-13, the Government is not responsible for data expected from or provided by the "lead yard". In addition, the shock specifications for this contract are different in several respects from those in the "lead yard" and for LPD 9-10 and 11-13. Data based on those specifications would be inapplicable to this contract. There is no evidence that the Government required the Contractor to witness shock tests.

d. LSCC began fabrication and installation of foundations and other items before the LSCC DDAM procedures had been accomplished. The Contractor was required to modify the foundations and other items to meet the shock specifications. The Government did not direct LSCC to fabricate or install these components prior to the DDAM analysis.

e. The shock specifications were neither defective nor misinterpreted by the Government. The shock requirements for the piping, ducting, and wiring systems were not increased by the Government beyond that established by the contract specifications.

f. The shock requirements for equipment on LPD 14-15 were different than those for LPD 11-13. These differences were known or should have been known by LSCC prior to award of the contract. Following contract award, the Government did not revise the shock specifications or take any other action that caused delay in deliveries or increased costs of performance by the LSCC vendors.

g. The Contracting Officer has found that the alleged Government responsibility for the actions and events cited above is not factually supported by LSCC. Therefore, the Government is not responsible for the alleged costs resulting from the production delay and disruption caused thereby.

6. Contracting Officer's Decision for NObs-4902 (LPD 14-15:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is not entitled to an equitable adjustment in the contract price.

XXIII NObs-4765 and 4902

A. DEFECTIVE SPECIFICATIONS:

1. Statement of the Contractor's Claim.

a. LSCC alleges that on numerous specified occasions the Government provided LSCC with defective specifications which caused increased costs in the performance of the contracts for which it claims entitlement to an equitable adjustment to the contracts' prices. Under contract NObs-4765, a total of twenty-two separate claims are made, and under contract NObs-4902 a total of eleven separate claims are made. Of the 33 claims, six are identical in both contracts. By the following correspondence LSCC has provided additional information regarding these claims: Contract NObs-4765: LSCC IDC dated January 21, 1972, IDC dated December 22, 1971, IDC dated February 29, 1971. Contract NObs-4902: LSCC IDC dated January 28, 1973 and IDC dated March 7, 1972.

b. LSCC's alleged total estimated costs for each contract are as follows:

	NObs-4765	NObs-4902
Engr M/H	18,200	2,000
Prod M/H	34,300	4,500
Material	$25,000	$18,000
Total costs	$495,264	$79,940

2. Findings of Relevant Facts:

a. LSCC's various claims are numerically identified by LSCC IDC dated January 21, 1972 for NObs-4765, and LSCC IDC dated January 28, 1972 for Contract NObs-4902.

b. The Contracting Officer finds that in certain instances the Contract specifications were defective, as alleged by LSCC. For continuity, the claim numerical identification system used by LSCC will be utilized here to designate those specific claim items found to be based upon defective Government specifications.

c. Contract NObs-4765. Of the 22 basic items comprising the claim under this contract, the Contracting Officer finds that four items are based upon defective Government specifications. These are, Item No. 8 (JP-4 Solenoids), Item 11 (UNSAT CHITS resulting from defective specifications), Item 12 (miscellaneous specifications problems), and Item 20 (meat slicers). Items 11 and 12 contain 66 and 52 sub-items respectively. In Item 11, only the following twenty-two sub-items are found to be based upon defective Government specifications: L (dk 76), 3 (op 21, op 60), 8 (mp 11, 12, and 1), 13 (ax 19), 18 (dk 25), 19 (dk 40), 25 (el 94), 27 (wp 9), 3 (br 2), 31 (ax 9), 33 (ax 16), 34 (bp 480), 35 (mp 983), 37 (op 153), 38 (sp 20), 41 (op 43), 42 (el 104), 48 (el 87), 58 (ax 13), 62 (el 23), 64 (ax 9), and 65 (ax 26, 22, 12, etc.). In item 12, only the following five sub-items are found to be based upon defective Government specifications: 8 (testing of weapons cargo elevator), 17 (manholes for tanks), 24 (secure processing space deck flight), 34 (accommodation ladders), and 36 (motors for horizontal pallet conveyors).

d. Contract Nobs-4902. Of the eleven items claimed under this contract only one item, No. 11 (UNSAT CHITS) is found to be based upon defective Government specifications. This item No. 11 is comprised of seven UNSAT CHITS, only two of which are considered valid: No. 3 (QDRR-12) and No. 4 (QDRR-16).

3. Contracting Officer's Decision:

Based upon the foregoing findings of fact, the Contracting Officer determines that LSCC is entitled to an equitable adjustment to the contracts' prices in accordance with the provisions of the Changes clause as compensation for additional costs incurred as a result of defective Government specifications.

	NObs-4765	NObs-4902
Engr M/H	195	9
Prod M/H	100	0
Material	$692	None
Total adjustment	$3,134.	$71

XXIV NObs-4660, 4765, 4902 and 4785

A. STORAGE AND WAREHOUSING:

1. Statement of the Contractor's Claim:

a. LSCC claims entitlement to an equitable adjustment to increase the contracts' prices as compensation for unanticipated

increases in storage and warehousing costs incurred because of delays in the production of the vessels, said delays occurring because of alleged Government actions. The additional warehousing space was required by LSCC for security and protection of material necessary for the construction of the ships, but which could not be used because of the continuing stretch-out of the construction schedule.

b. LSCC acknowledges that the Government is not responsible for the storage and warehousing costs incurred as a direct result of the machinist strike of 1965, the electrical workers strike of 1966 - 1967, and the overall manpower shortage in the Seattle metropolitan area during this period, but he does allege that the Government-responsible delays occurring prior to the machinist strike greatly accentuated the storage and warehousing difficulties resulting from the strikes and labor shortage.

c. As a result of the increased warehousing and storage costs incurred, LSCC seeks equitable adjustments to increase the contracts' prices by the following amounts:

Contracts	Adjustment Sought
NObs-4660	$ 36,116.00
NObs-4765	378,371.00
NObs-4902	55,096.00
NObs-4785	100,091.00

2. Findings of Relevant Fact:

LSCC has submitted in one package a consolidated claim for storage and warehousing costs incurred in the performance of six contracts. In the claim the Contractor has by his own formula apportioned the alleged total incurred costs to each of six contracts, including the four contracts cited above. The Contracting Officer has determined elsewhere herein that the delay in the performance of these contracts was neither caused by nor is the responsibility of the Government.

3. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer determines that LSCC is not entitled to an equitable adjustment in the contracts' prices because of storage and warehousing costs incurred because of delays in the production of the ships.

XXV. NObs 4660, 4765, 4902, and 4785

A. NUCLEUS CREW:

1. Statement of Contractor's Claim:

LSCC claims entitlement to an equitable adjustment in the Contracts' prices in that it alleges that LSCC was directed by the Government to provide office and training space, at LSCC's expense, for Navy "nucleus crews" assigned to the ships constructed under these contracts. The Contractor asserted that these contracts, as all previous contracts, did not require that space be provided for "nucleus crews".

CONTRACT	ADJUSTMENT SOUGHT
NObs-4660	$ 587
NObs-4765	2,406
NObs-4902	234
NObs-4785	3,903

2. Findings of Relevant Fact:

a. The "nucleus crew" moves to LSCC's shipyard about six (6) months prior to the completion of the ship for the purpose of providing the crew with an opportunity to become familar with the vessel's operational characteristics. The Contracting Officer finds that the usual facilities were provided for the "nucleus crew" of each ship despite the absence of a specification requirement.

b. It was traditional in the shipbuilding industry to provide facilities for "nucleus crews" of US Navy ships although the contracts had not required this service to be provided. As a result of this established practice, shipbuilding firms were aware of this requirement when preparing their price proposals or bids for Navy shipbuilding contracts, and so took into account the estimated cost of this service when preparing the total estimated price for performance. LSCC includes such costs in overhead.

c. The Government did not inform LSCC, prior to award of the contracts, that services for "nucleus crews" would not be required.

3. Contracting Officer's Decision:

The Contracting Officer determines that prior to the award of the contracts LSCC was fully aware that services for the "nucleus crews" would be required. Because LSCC included or should have included in his bids or price proposal an element of cost for these services, the Contracting Officer determines that LSCC has been fully compensated for this work effort, and is therefore not entitled to an equitable adjustment to the contracts' prices.

XXVI NObs 4660, 4765, 4902, and 4785

A. INTEREST

1. Statement of the Contractor's Claim:

LSCC has requested an equitable adjustment to increase the contracts' prices as compensation for interest paid on borrowed money required to finance the alleged additional work described in this Consolidated Claim.

Contract	Adjustment Sought
NObs-4660	$5,793,573
NObs-4765	4,670,213
NObs-4902	2,702,645
NObs-4785	2,099,412

2. Finding Of Relevant Fact:

a. The Contracting Officer finds that during the performance periods of these contracts, that LSCC borrowed sums of money which were used in the operation of the shipyard and acquisition and expansion of permanent facilities at the shipyard. During this period, LSCC was performing contracts for both private customers and the Government. Government contracts, other than the subject contracts, were being performed by LSCC. The alleged interest expense arising from these borrowings has been apportioned to the subject contracts by LSCC.

b. The Contracting Officer finds that LSCC has not provided sufficient documentation to establish the separate amounts of money borrowed to finance each of the elements of alleged Government-responsible additional work required in the performance of the contracts. LSCC has not identified the separate amounts of money borrowed to finance the alleged Government-responsible additional work required for each of the subject ships or contracts. Thus, LSCC cannot identify the interest expense incurred as a result of borrowings required to finance alleged Government-responsible additional work required in the performance of the contracts.

3. Contracting Officer's Decision:

The Contracting Officer, based on the foregoing findings of fact, determines that LSCC is not entitled to an equitable adjustment in the contracts' prices as compensation for the alleged interest expenses as claimed by LSCC.

XXVII NObs 4660

A. MICROFILM:

1. Statement of the Contractor's Claim:

LSCC included "microfilm" as a cost element on the Contract Pricing Proposal (DD-633-5) for the Consolidated Claim submitted by LSCC letter LPD/4365 Ser 2875 of 1 March 1971. The amount claimed for microfilm, $36,000, was attributed to Contract NObs-4660 (LPD 9-10). LSCC did not provide explanatory or support information for this claim item.

2. Findings of Relevant Facts:

LSCC was requested to furnish a cost element breakdown of this claim item by memorandum of 2 November 1971, stating that this claim item was included in the unadjudicated Change Order section of the Consolidated Claim. The contracting Officer finds that the alleged additional costs for microfilm were submitted by Contractor Proposed Change Orders C-1537, D-1538, and E-1539.

3. Contracting Officer's Decision:

The Contracting Officer determines that the "microfilm" cost element set forth separately on the DD-633-5 identified above is included in a portion of claimed costs alleged in the Unadjudicated Change Order section of the Consolidated Claim. Because the Contracting Officer has made findings of fact and determinations relevant to this claim item "Unadjudicated Change Orders" section herein, it shall not be considered here as a separate claim item.

XXVIII NObs-4660, 4765, 4902 and 4785:

A. FICA TAX INCREASE

1. Statement of the Contractor's Claim:

LSCC claims entitlement to an increase in the contracts' prices under the provisions of the "Federal, State and Local Taxes" clauses (ASPR 11-401.1 (1961) as reimbursement for additional costs incurred which were the result of increases in in Federal Social Security taxes made effective during the performance of the contracts.

Contract	CLAIM	AMOUNT
NObs-4660	ltr Ser 2853 of 8-25-70	$ 263,876
NObs-4765	ltr Ser 3466 of 8-25-70	592,175
NObs 4785	ltr Ser 1938 of 8-24-70	834,700
NObs 4902	ltr Ser 1475 of 8-25-70	439,922

2. Findings of Relevant Facts:

The Contracting Officer finds that the FICA tax rates were increased in 1966 and 1968 and that LSCC's costs increased as a result. The increased FICA costs are included in the DCAA - computed composite labor rates being used for other price adjustments hereby being made. The DCAA auditor computed an increase in FICA costs only on the original bid hours as originally time-phased by LSCC because, as elsewhere stated herein no periods of sole or non-concurrent Government responsible delay have been found. An increase may be made to the contracts' prices to cover increased FICA costs under the provisions of the "Federal, State and Local Taxes" clause.

3. Contracting Officer's Decision:

The Contracting Officer determines that, provided the Contractor warrants in writing that no amount for increases in Federal Social Security Taxes was included in the contract price as a contingency reserve or otherwise, the prices of the contracts are increased as follows:

CONTRACT	PRICE INCREASE
NObs-4660	$ 97,781
NObs-4765	306,332
NObs-4785	240,958
NObs-4902	310,624

XXIX NObs 4660, 4765, 4902, and 4785:

A. DECELERATION AND STRETCH-OUT OF THE ORIGINAL CONTRACT WORK

1. Statement of the Contractor's Claim:

LSCC alleges that the totality of the claimed compensable Government acts required LSCC to decelerate, stretchout, and delay performance of work required by the original contracts beyond the specified building periods for each contract as formally amended; and that the escalation provision of the contracts cover only such formal contract period. Accordingly, as the Government acts allegedly forced performance of original contract work in a later, more expensive timeframe, LSCC alleges entitlement to payment therefore as follows:

NOBS 4660	$3,887,131
NObs 4765	3,971,279
NObs 4785	2,357,946
NObs 4902	3,101,222

2. Findings of Relevant Fact.

The Contracting Officer finds that certain compensable acts, as determined elsewhere herein could have caused some delay in delivery of vessels under the four contracts; that such delay caused by the Government, however, was negligible, and in all events, concurrent with non-Government-responsible delay caused primarily by the following all pervasive problems:

a. A tremendous expansion of workload from six ships under contract in 1962 to 18 ships under contract by the end of 1964;

b. A yard expansion program in excess of $20 million between 1962 and 1968 which LSCC admits caused an adverse impact on yard productivity;

c. A situation whereby almost every ship built by LSCC during the relevant period, not just the ships covered by the four contracts involved herein, required up to 80% more man hours to build than LSCC had originally estimated;

d. The fact that a high percentage of such additional manhour expenditure, as documented by LSCC itself in numerous letters, QPPC reports, etc., was caused by labor inefficiency resulting from the chronic labor problems, such as:

(1) Strikes - Two major strikes by LSCC;s own admission caused at least 20 months delay;

(2) Slowdowns - labor negotiations, by LSCC's own admission, caused significant loss of efficiency through slowdowns, even when no strike resulted.

(3) Turn-over - in one year LSCC experienced a turn-over rate of shop personnel, in excess of 100%. Lockheed's turnover rate for the entire 10 year period was abnormally high.

(4) Lack of skilled manpower - during one period, in excess of 60% of the work force had less than three years experience in the yard.

(5) Training - in Feb of 1966, by the Contractor's own admission 20% of the yard work force were trainees. Productivity was appreciably reduced.

(6) Inability to obtain labor as originally contemplated - During the bid period unemployment in the area was as high as 8%. During the performance period, because of overall economic improvement, unemployment dropped to as low as 2%.

e. Contracting Officer's Decision:

Based on the foregoing findings of fact, the Contracting Officer

determines that no delay occurred during the performance of Contracts NObs 4660, 4765, 4785, and 4902 that was solely the responsibility of the Government. Accordingly, LSCC is not entitled to an equitable adjustment in the contracts' prices reflecting the cost of any delay in performing those contracts.

XXX. NObs 4660, 4765, 4785, and 4902

A. CLAIM PREPARATION COSTS:

1. Statement of the Contractor's Claim:

LSCC requests an equitable adjustment in the prices of the four contracts as reimbursement for costs of claim preparation. These costs include legal, accounting, estimating, technical and administrative expense incurred. The equitable adjustments sought for each contract are as follows:

CONTRACT	ADJUSTMENT SOUGHT
NObs-4660	$ 347,236
NObs-4765	348,126
NObs-4785	627,597
NObs-4902	309,050

2. Findings of Relevant Fact:

The Contracting Officer has determined that there is no legal entitlement for all costs arising from services provided by outside accounting consultants and outside lawyers. The Contracting Officer has determined from audits of LSCC actual incurred costs of claim preparation, less outside consultants, allocable to the four contracts, that the costs are $958,409. These costs, when allocated to the total claimed manhours, result in a rate per allowed manhour of $0.125.

CONTRACT	ALLOWED M/H	RATE	FINAL ALLOCATED COSTS
NObs-4660	114,689	$0.125	$14,336
NObs-4765	99,631	0.125	12,454
NObs-4785	34,691	0.125	4,336
NObs-4902	131,004	0.125	16,376

3. Contracting Officer's Decision:

Based upon the foregoing findings of fact, the Contracting Officer determines that LSCC is entitled to equitable adjustments as compensation for claim preparation costs. These equitable adjustments are determined to be:

NObs-4660	$14,336
NObs-4765	12,454
NObs-4785	4,336
NObs-4902	16,376

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XXXI. NObs-4660, 4765, 4902 and 4785:

A. PROFIT

1. Statement of Contractor's Claims:

LSCC claims entitlement to an equitable adjustment in the contracts' prices for profit on performance of changed work. Profit is claimed in the various claim subjects' pricing.

2. Findings of Relevant Facts:

The Contracting Officer finds that LSCC is entitled to equitable adjustment in the contracts' prices as a result of various compensable acts of the Government as previously determined herein under the clauses entitled "CHANGES" and "SUSPENSION"; that such equitable adjustments have not, but should include amounts for profit; that the adjustment under the clauses "FEDERAL, STATE, AND LOCAL TAXES" does not, and should not include an allowance for profit; that the allowances for profit computed in accordance with the "Weighted Guidelines" method described in the ASPR 3-808 are as follows:

NObs-4660	$143,141
NObs-4765	131,107
NObs-4902	175,601
NObs-4785	51,368

3. Contracting Officer's Decision:

The Contracting Officer, based on the foregoing findings of relevant facts has determined that the contracts' prices shall be adjusted for profit as follows:

NObs-4660	$143,141
NObs-4765	131,107
NObs-4902	175,601
NObs-4785	51,368

CLASSIFICATION OF ALLEGED IMPROPER REJECTION OF WORK

NObs S/B NObs 4660

(1) Withdrawn by contractor

1. SP-372-1P 2. TX-25-1P 3. MP-151-1P

(2) Valid Chits

1.	TH-10-11P	2.	SP-296-13P	3.	DK-42	4.	DK-49	5.	SP-296-14P
6.	SP-382-8P	7.	DK-28	8.	DK-22	9.	DK-9	10.	DK-6
11.	MP-29	12.	MP-25	13.	AX-34	14.	EL-123	15.	BR-16
16.	MP-16	17.	MP-27	18.	MP-23	19.	L-40	20.	L-39
21.	L-27	22.	L-10	23.	DK-129	24.	EL-140	25.	EL-15
26.	EL-79-1P	27.	EL-11	28.	EL-5	29.	SP-25-8P	30.	SP-105-2P
31.	MP-44	32.	PI-35	33.	MP-77-8P	34.	TC-4-10P	35.	SP-201-3P
36.	SP-215-1P	37.	PI-43-5P	38.	SP-196-3P	39.	DK-4	40.	C-8
41.	C-10	42.	C-15	43.	C-27	44.	C-31	45.	C 22
46.	MP-44-2P	47.	SP-295-5P	48.	SP-310-8P	49.	EL-37	50.	TH-10-15P
51.	TH-23-9P	52.	DK-55	53.	AX-26	54.	SP-1	55.	MD-8-5P
56.	MP-10	57.	MP-3A	58.	MP-8	59.	MD-23-4P	60.	WP-5
61.	SP-267-4P	62.	DK-8	63.	Mp-81-2P	64.	TH-5-1P	65.	TE-11-1P
66.	BR-24	67.	BR-17	68.	SP-370-3P	69.	DK-20	70.	DK-16
71.	SP-187-12P	72.	AX-54	73.	AX-53	74.	BR-44	75.	DC 61
76.	BR-47	77.	TH-20-3P	78.	DK-152	79.	PI-1-11P	80.	PI-34-2P
81.	Pi-30-8P	82.	AV-9	83.	WP-4	84.	OP-144	85.	Op-166
86.	DC-200	87.	DC-199	88.	DC-79	89.	DC-193	90.	DC-192
91.	BR-6,2	92.	MP-30	93.	DC-28	94.	MP-13	95.	Op-45
96.	OP-41	97.	OP-37-8P	98.	OP-32-29P	99.	OP-19-9P	100.	OP-21-8P
101.	OP-30-3P	102.	OP-26-2P	103.	OP-23-9P	104.	OP-31-17P	105.	Op-18E
106.	OP-32-3P	107.	OP-32-10P	108.	OP-74	109.	AX-11	110.	DC-60
111.	MP-13	112.	DC-54	113.	DC-53	114.	MD-15	115.	DC-43
116.	DC-40	117.	DC-2	118.	DC-4	119.	MP-32	120.	AV-1
121.	AV-3	122.	AV-1	123.	OP-4	124.	DC-70	125.	DC-69
126.	DC-127	127.	DC-121	128.	MP-24-23-22	129.	OP-140	130.	AX-36
131.	EL-10	132.	BR-61	133.	EL59	134.	SP-207-4P	135.	SP-259-13E
136.	SP-315-8P	137.	EL-43	138.	SP-370-10P	139.	TC-8-2P	140	SP-336
141.	OP-38-4P	142.	OP23-13P	143.	OP-14C	144.	TC-16-11P	145.	OP-23-1P
146.	BR-22	147.	EL-108	148.	DK-175	149.	WP-18	150.	OP-9
151.	MP-30	152.	DK-218	153.	MP-40	154.	TH-31-10P	155.	SP-235-1P
156.	SP-233-5P	157.	TH-22-14P	158.	TH-32-27P	159.	TH-32-28P	160.	S-11
161.	TH-45-10	162.	TX-3-4P	163.	TX-10-1P	164.	TX-14-4P	165.	TX-18-2P
166.	TH-45-12P	167.	TH-45-17P	168.	TH-45-21P	169.	TH.45-22P	170.	TE 2-18P
171.	SP371-6P	172.	TE 19-11P	173.	TE-19-12P	174.	SP-255-2P	175.	TE-5-2P
176.	TE-22-16P	177.	TE-19-37P	178.	TE-22-17P	179.	TE-22-18P	180.	TE-8-9P
181.	TE-8-10P	182.	TE-7-1P	183.	DK-260	184.	TE-6-5P	185.	TE-6-2P
186.	TE-6-4P	187.	WP-12	188.	WP-13	189.	WNP-27	190.	TC 37-5P

Encl (2)

191.	WPS-105	192.	DK-261	193	DK-264	194.	DK-283	195.	DK-308-8P
196.	SP-256-7P	197.	MP-161	198.	WP-7	199.	TE-2-29P	200.	TH-45-25P
201.	SP-265-12P	202.	SP-339	203.	SP-94-1P	204.	EL-77-2P	205.	DK 82
206.	TH-38-1P	207.	TH-30-1P	208.	TH-21-3P	209.	SP-125-2P	210.	SP-263-40P
211.	SP-292-6P	212.	SP-369-7P	213.	SP-366-14P	214.	EL-32	215.	DK-112
216.	BR-504	217.	AX-513	218.	BR-509	219.	DK-95	220.	MP-13

(3) Invalid Chits

1.	TH-10P	2.	P-21	3.	PI-19	4.	EL-23	5.	EL-165
6.	EL-14	7.	SP-24-10P	8.	MP-54	9.	OP-15	10.	SP-201-1P
11.	SP-207-3P	12.	SP-208-1P	13.	EL-111	14.	SP-320-1P	15.	PI-45
16.	TC-19-5P	17.	TH-10-18P	18.	TH-10-19P	19.	TH-23-8P	20.	TH-26-1P
21.	DK-37	22.	MP-24	23.	MP-11	24.	MD-1	25.	MD-12-13P
26.	MD-12-11P	27.	MD-12-10P	28.	MD-12-8P	29.	EL-83-2P	30.	EL-84-3P
31.	EL-82-5P	32.	EL-79-3P	33.	EL-86	34.	EL-85-2P	35	EL-83-6P
36.	BR-23	37.	DK-18	38.	DK-30	39.	DK-31	40.	PI-8
41.	SP-6-8P	42.	MP-44-1P	43.	TM-48-9P	44.	TM-48-9P	45.	TM-26-4P
46.	DK-40	47.	BR-19	48.	DC-208	49.	SP-229-13P	50.	SP-295-9P
51.	DC-196	52.	MD-31	53.	HB-35	54.	Dc-11	55.	SP-265-12P
56.	OP-11	57	OP-38-9P	58.	OP-31-8P	59.	OP-25-2P	60	OP-34-2P
61.	OP-34-1P	62.	OP-32-11P	63.	OP-11E	64.	OP-54-4P	65.	AX-1
66.	HB-2	67.	Dc-57	68.	EL-99	69.	OP-17-3P	70.	MD-68
71.	DC-172	72.	EL-11	73.	SP-187-14P	74.	SP-189-12P	75.	EL 129
76.	SP-282-4P	77.	EL-96-9P	78.	OP-12A	79.	OP-11F	80.	SP-264-7OP
81.	TC-16-21P	82.	MP-52-3P	83.	TW-2-7P	84.	TW-1-1P	85.	DK-202
86.	AX-44	87.	DK-289	88.	TH-32-8P	89.	TH-32-10P	90.	SP-224-4P
91.	TH-21-5P	92.	TH-20-4P	93.	TH-40-11P	94.	TX-47-3P	95.	TX-45-2P
96.	TX-35-1P	97.	TX-26-2P	98.	TX-25-2P	99.	TX-26-3P	100.	TX-44-1P
101.	TE-19-13P	102.	WP-130-2P	103.	DK-315	104.	WP-125	105.	WP-161
106.	WP-40	107.	WP-150	108.	WP-143	109.	WP-20	110.	TE-1-7P
111.	WP-139-4P	112.	WPS-27	113.	WPS-28	114.	WPS-63	115.	WPS-81
116.	WPS-85	117.	WPS 82	118.	DK-317	119.	DK-308-9P	120.	SP-261-15P
121.	MP-162	122	DK=284	123.	SP-4	124.	TE-2-12P	125.	SP-374-2P
126.	TH-30-2P	127.	OP-54-3P	128.	SP-261-16P	129.	SP-114-7P	130.	SP-114-14P
131.	SP-120-8P	132.	SP-152-6P	133.	SP-33-9P	134.	SP-163-1P	135.	SP-237-24P
136.	SP-238-18P	137.	SP-251-16P	138.	SP-252-1P	139.	SP-290-16P	140.	SP-322-31P
141.	EL-598	142.	EL-596-10P	143.	EL-662	144.	SP343-8P	145.	SP-341-1P
146.	SP-338-4P	147.	EL-606	148	EL-82	149.	WP-41-3P	150.	MP-514
151.	BR-503	152.	DK-111	153.	DK-123	154.	DK-178	155.	DK-134
156.	AX-523	157.	BR-507	158.	DC-530	159.	EL-73	160.	Mp-15

(4) Duplicate Chits

1.	EL-150	2.	EL-112	3.	PI-50	4.	MP-49	5.	MP-7
6.	Br-57	7.	OP-11K	8.	DC-51	9.	TH-32-29P	10.	TC-38-1P
11.	TM-49-35-P	12.	SP-378-4P						

Nobs. 4765

(1)	WITHDRAWN BY CONTRACTOR	NONE
(2)	VALID CHITS	NONE
(3)	INVALID CHITS: DK-26, DK-40, MP-4 & EL-49.	
(4)	DUPLICATE CHITS	NONE

Nobs. 4902

(1)	WITHDRAWN BY CONTRACTOR	NONE
(2)	VALID CHITS	DK -5
(3)	INVALID CHITS	EL-49
(4)	DUPLICATE CHITS	NONE

(RS-10) CHANGE ORDERS BEING ADJUDICATED

LPD 9 and 10, NObs-4660

HMR 153	MOD A-376	FMR 228	MOD A-641
HMR 162	MOD A-683	FMR 228.1	MOD A-758
HMR 162.1	MOD A-682	FMR 228.2	MOD A-759
HMR 183	MOD A-562	FMR 228.3	MOD A-760
FMR 191.1	MOD A-723	FMR 228.4	MOD A-756
FMR 191.2	MOD A-728	FMR 228.5	MOD A-755
FMR 191.3	MOD A-743	FMR 228.6	MOD A-757
FMR 191.4	MOD A-744	FMR 228.7	MOD A-762
FMR 191.5	MOD A-745	FMR 228.8	MOD A-763
FMR 191.6	MOD A-746	FMR 228.9	MOD A-771
FMR 201	MOD A-640	FMR 229	MOD A-642
FMR 212.1	MOD (Cancelled)	FMR 230	MOD A-643

LPD 9 and 10, NObs-4660

FMR 231	MOD A-644	FMR 365.3	MOD A-665	FMR 433	No MOD
FMR 232	MOD A-645	FMR 365.4	MOD A-684	FMR 434	No MOD
FMR 239	No MOD	FMR 365.5	MOD A-748	FMR 435.1	No MOD
FMR 241	MOD A-774	FMR 365.6	MOD A-729	FMR 435.2	No MOD
FMR 243	MOD A-472	FMR 365.7	MOD A-730	FMR 435.4	No MOD
FMR 257	MOD A-478	FMR 365.8	MOD A-731	FMR 435.5	No MOD
FMR 272	MOD A-501	FMR 365.9	MOD A-766	FMR 437	No MOD
FMR 286	MOD A-511	FMR 366	No MOD	FMR 442	MOD A-753
FMR 303.1	MOD A-603	FMR 410	MOD A-685	FMR 443	MOD A-754
FMR 304	MOD A-646	FMR 410.1	MOD A-657	FMR 444	MOD A-747
FMR 306	MOD A-647	FMR 410.2	MOD A-658	FMR 444.1	MOD A-773
FMR 306.1	MOD A-772	FMR 410.3	MOD A-659	FMR 448	MOD A-776
FMR 306.2	MOD A-775	FMR 410.4	MOD A-660	FMR 450	No MOD
FMR 311	MOD A-648	FMR 410.5	MOD A-686	FMR 451	No MOD
FMR 312	MOD A-649	FMR 410.6	MOD A-747	FMR 452	No MOD
FMR 313	MOD A-650	FMR 410.7	MOD A-687	FMR 444.2	MOD A-782
FMR 314	No MOD	FMR 410.8	MOD A-688	FMR 455	MOD A-786
FMR 339.3	No MOD	FMR 410.9	MOD A-724	FMR 454	MOD A-787
FMR 348	MOD A-651	FMR 411	MOD A-666		
FMR 349	MOD A-652	FMR 412	MOD A-661	CPCO	
FMR 350	MOD A-653	FMR 417	No MOD	C-1398	
FMR 363	MOD A-654	FMR 420.1	MOD A-678	C-1537	
FMR 364	MOD A-656	FMR 420.3	MOD A-761	C-1544	
FMR 365	MOD A-662	FMR 427.2	MOD A-711	C-1561	
FMR 365.1	MOD A-663	FMR 427.3	MOD A-717	C-1567	
FMR 365.2	MOD A-664	FMR 427.4	MOD A-726	C-1571	
		FMR 432	No MOD	C-1671	

LPD 11, 12, 13, NObs-4765

HMR 119	MOD A-747	FMR 202	MOD A-366	FMR 240.8	MOD A-548
HMR 125	MOD A-583	FMR 203	MOD A-350	FMR 240.9	MOD A-526
HMR 128	MOD A-584	FMR 207	MOD A-356	FMR 256.5	MOD A-555
HMR 129	MOD A-585	FMR 210	MOD A-382	FMR 256.6	MOD A-556
HMR 130	MOD A-586	FMR 211	MOD A-383	FMR 256.7	MOD A-557
FMR 59.2	MOD A-549	FMR 216	MOD A-367	FMR 259.2	MOD A-558
FMR 128	MOD A-375	FMR 173	MOD A-614	FMR 267	MOD A-559
FMR 144	MOD A-365	FMR 222.1	MOD A-545	FMR 268	MOD A-560
FMR 146.1	MOD A-550	FMR 222.2	MOD A-546	FMR 276	MOD A-561
FMR 147	MOD A-457	FMR 240	MOD A-455	FMR 302	MOD A-562
FMR 162.1	MOD A-609	FMR 240.1	MOD A-463	FMR 305	MOD A-563
FMR 171.2	MOD A-501	FMR 240.2	MOD A-464	FMR 306	MOD A-477
FMR 171.3	MOD A-511	FMR 240.3	MOD A-493	FMR 306.2	MOD A-485
FMR 185	MOD A-333	FMR 240.4	MOD A-500	FMR 306.4	MOD A-488
FMR 189.1	MOD A-551	FMR 240.6	MOD A-532	FMR 306.5	MOD A-496
FMR 196	MOD A-552	FMR 240.7	MOD A-533	FMR 306.6	MOD A-504

LPD 11, 12, 13, NObs-4765

FMR 306.7	MOD A-505	FMR 235.3	MOD A-682	FMR 536	MOD A-921
FMR 306.8	MOD A-508	FMR 235.4	MOD A-683	FMR 569	MOD A-928
FMR 306.9	MOD A-514	FMR 356.8	MOD A-686	FMR 448.1	MOD A-929
FMR 308	MOD A-564	FMR 356.9	MOD A-687	FMR 594	MOD A-930
FMR 311	MOD A-565	FMR 235.5	MOD A-694	FMR 581	MOD A-932
FMR 312	MOD A-566	FMR 443	MOD A-703	FMR 582	MOD A-933
FMR 313	MOD A-567	FMR 269.2	MOD A-963	FMR 579	MOD A-934
FMR 314	MOD A-562	FMR 408.3	MOD A-704	FMR 533	MOD A-936
FMR 315	MOD A-582	FMR 408	MOD A-706	FMR 578	MOD A-941
FMR 316	MOD A-503	FMR 411.1	MOD A-707	FMR 531	MOD A-942
FMR 318	MOD A-569	FMR 411.2	MOD A-708	FMR 532	MOD A-948
FMR 321	MOD A-570	FMR 408.1	MOD A-712	FMR 540	MOD A-954
FMR 323	MOD A-571	FMR 411.3	MOD A-719	FMR 546	MOD A-959
FMR 324	MOD A-572	FMR 411.4	MOD A-723	FMR 480.2	MOD A-960
FMR 325	MOD A-573	FMR 411.5	MOD A-724	FMR 544	MOD A-962
FMR 326	MOD A-574	FMR 411.6	MOD A-725	FMR 269.2	MOD A-963
FMR 327	MOD A-575	FMR 411.7	MOD A-726	FMR 589	MOD A-964
FMR 328	MOD A-576	FMR 411.8	MOD A-727	FMR 543	MOD A-965
FMR 329	MOD A-577	FMR 480.1	MOD A-758	FMR 592	MOD A-972
FMR 330	MOD A-513	FMR 480	MOD A-775	FMR 598	MOD A-973
FMR 331	MOD A-578	FMR 241.1	MOD A-795	FMR 596	MOD A-974
FMR 332	MOD A-524	FMR 406	MOD A-796	FMR 600	MOD A-975
FMR 332.1	MOD A-537	FMR 406.2	MOD A-797	FMR 595	MOD A-976
FMR 332.2	MOD A-530	FMR 512	MOD A-799	FMR 427.1	MOD A-977
FMR 332.3	MOD A-534	FMR 515	MOD A-802	FMR 594.1	MOD A-979
FMR 333	MOD A-579	FMR 406.3	MOD A-818	FMR 594.2	MOD A-983
FMR 335	MOD A-580	FMR 545	MOD A-825	FMR 601	MOD A-984
FMR 337	MOD A-581	FMR 241.2	MOD A-828	FMR 550	MOD A-990
FMR 339	MOD A-607	FMR 241.4	MOD A-842	FMR 551	MOD A-991
FMR 340	No MOD	FMR 406.6	MOD A-843	FMR 553	MOD A-992
FMR 355	No MOD	FMR 241.3	MOD A-844	FMR 585	MOD A-993
FMR 355.1	No MOD	FMR 406.5	MOD A-850	FMR 586	MOD A-994
FMR 355.2	No MOD	FMR 406.4	MOD A-852	FMR 605	MOD A-995
FMR 377	MOD A-610	FMR 538	MOD A-855	FMR 524	MOD A-996
FMR 378	No MOD	FMR 554	MOD A-863	FMR 541	MOD A-997
FMR 383	MOD A-624	FMR 512.1	MOD A-875	FMR 602	MOD A-998
FMR 401	MOD A-659	FMR 560	MOD A-906	FMR 604	MOD A-999
FMR 433	No MOD	FMR 501	MOD A-907	FMR 606	MOD AA-01
FMR 356.1	MOD A-594	FMR 501.1	MOD A-908	FMR 547	MOD AA-02
FMR 356	MOD A-621	FMR 501.2	MOD A-909	FMR 548	MOD AA-03
FMR 356.2	MOD A-632	FMR 501.3	MOD A-910	FMR 549	MOD AA-04
FMR 356.2	MOD A-632	FMR 501.4	MOD A-911	FMR 608	MOD AA-06
FMR 356.4	MOD A-654	FMR 501.5	MOD A-912	FMR 594.3	MOD AA-07
FMR 356.3	MOD A-656	FMR 501.6	MOD A-913	FMR 609	MOD AA-08
FMR 356.6	MOD A-668	FMR 566	MOD A-914	FMR 552	MOD AA-09
FMR 356.7	MOD A-674	FMR 567	MOD A-915	FMR 584	MOD AA-10
FMR 235	MOD A-679	FMR 571	MOD A-917	FMR 610	MOD AA-11
FMR 235.1	MOD A-680	FMR 573	MOD A-919	FMR 612	MOD AA-13
FMR 235.2	MOD A-681	FMR 591	MOD A-920	FMR 614	MOD AA-15

LPD 11, 12, 13, NObs-4765

FMR 355.3	No MOD
FMR 476	No MOD
FMR 568	No MOD
FMR 572	No MOD
FMR 575	No MOD
FMR 597	No MOD
FMR 613	Canceled
FMR 615	No MOD
FMR 616	MOD AA-30
FMR 617	No MOD

CPCO	D-1538
CPCO	D-1545
CPCO	D-1568

MOD A-869
MOD A-882
MOD A-898
MOD A-951
MOD A-952

LPD 14, 15, NObs-4902

HMR 42	MOD F-53
HMR 42.1	MOD A-426
HMR 70	MOD A-427
HMR 72	MOD A-428
HMR 79	MOD A-429
HMR 81	MOD A-430
HMR 82	MOD A-431
HMR 84	MOD A-432
FMR 11.3	MOD A-378
FMR 107	MOD A-188
FMR 107.1	MOD A-379
FMR 112.1	MOD A-380
FMR 133	MOD A-363
FMR 133.2	MOD A-381
FMR 133.4	MOD A-500
FMR 133.5	MOD A-559
FMR 141	MOD A-191
FMR 152	MOD A-207
FMR 155	MOD A-220
FMR 155.1	MOD A-382
FMR 157	MOD A-383
FMR 163	MOD A-384
FMR 168	MOD A-235
FMR 168.1	MOD A-257
FMR 168.2	MOD A-275
FMR 169	MOD A-226
FMR 170	MOD A-243
FMR 172	MOD A-229
FMR 174	MOD A-247
FMR 176	MOD A-248
FMR 182	MOD A-241
FMR 186.1	MOD A-385
FMR 188.1	MOD A-386
FMR 205	MOD A-274
FMR 218	MOD A-388
FMR 218.1	MOD A-469
FMR 219.2	MOD A-389
FMR 228	MOD A-390
FMR 229	MOD A-391
FMR 233.1	MOD A-392
FMR 235	MOD A-393
FMR 236	MOD A-377
FMR 245	MOD A-394
FMR 251	MOD A-395
FMR 257	MOD A-396
FMR 260	MOD A-397
FMR 261	MOD A-398
FMR 263	No MOD
FMR 264	MOD A-399
FMR 265	MOD A-400
FMR 266	MOD A-401
FMR 266.1	MOD A-402
FMR 266.2	MOD A-403
FMR 266.3	MOD A-404
FMR 266.4	MOD A-366
FMR 267	MOD A-405
FMR 268	MOD A-406
FMR 270	MOD A-407
FMR 272	MOD A-408
FMR 275	MOD A-409
FMR 276	MOD A-410
FMR 277	MOD A-411
FMR 278	MOD A-412
FMR 279	MOD A-413
FMR 282	MOD A-414
FMR 283	MOD A-415
FMR 284	MOD A-416
FMR 285	MOD A-417
FMR 286	MOD A-418
FMR 287	MOD A-419
FMR 288	MOD A-420
FMR 289	MOD A-421
FMR 291	No MOD
FMR 291.1	No MOD
FMR 292	MOD A-422
FMR 294	MOD A-423
FMR 312	MOD A-441
FMR 402	MOD A-532
FMR 401	MOD A-533
FMR 482	MOD A-542
FMR 289.1	MOD A-580
FMR 437	MOD A-596
FMR 439	MOD A-597
FMR 440	MOD A-598
FMR 443	MOD A-602
FMR 448	MOD A-607
FMR 133.7	MOD A-610
FMR 401.2	MOD A-613
FMR 230.1	MOD A-627
FMR 431	MOD A-629
FMR 467	MOD A-642
FMR 444	MOD A-643
FMR 450	MOD A-644
FMR 301.1	MOD A-645
FMR 452	MOD A-646
FMR 401.1	MOD A-647

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FMR 413.1	MOD A-648	FMR 490	MOD A-679	FMR 478	MOD A-717
FMR 449	MOD A-649	FMR 474	MOD A-686	FMR 500	MOD A-719
FMR 343	MOD A-652	FMR 133.8	MOD A-687	FMR 399.1	MOD A-720
FMR 406	MOD A-653	FMR 440.1	MOD A-688	FMR 488.1	MOD A-725
FMR 453	MOD A-656	FMR 487	MOD A-690	FMR 514	MOD A-726
FMR 372.1	MOD A-657	FMR 454	MOD A-691	FMR 512	MOD A-727
FMR 425	MOD A-658	FMR 488	MOD A-694	FMR 485	MOD A-728
FMR 455	MOD A-663	FMR 494	MOD A-696	FMR 514.1	MOD A-732
FMR 491	MOD A-664	FMR 493	MOD A-697	FMR 489	MOD A-733
FMR 460	MOD A-665	FMR 475	MOD A-698	FMR 525	MOD A-738
FMR 461	MOD A-666	FMR 496	MOD A-700	FMR 480	
FMR 462	MOD A-667	FMR 495	MOD A-701		
FMR 463	MOD A-668	FMR 188.2	MOD A-705	CPCO	E-1569
FMR 355.1	MOD A-669	FMR 503	MOD A-708	CPCO	E-1539
FMR 218.4	MOD A-670	FMR 432	MOD A-709	CPCO	E-2143I
FMR 466	MOD A-671	FMR 476	MOD A-710	CPCO	E-2154I
FMR 294.4	MOD A-672	FMR 497	MOD A-711		
FMR 468	MOD A-673	FMR 501	MOD A-712	MODS	
FMR 133.9	MOD A-674	FMR 502	MOD A-713		
FMR 446	MOD A-675	FMR 505	MOD A-714	MOD A-611	
FMR 441	MOD A-677	FMR 506	MOD A-715	MOD A-613	
FMR 473	MOD A-678	FMR 407	MOD A-716	MOD A-640	

NObs 4785

HMR	44	MOD F-41	FMR	119	MOD A-425
HMR	52	MOD F-131	FMR	157	MOD A-295
HMR	127	MOD A-118	FMR	178	MOD A-426
HMR	142	MOD F-168	FMR	187	MOD A-427
HMR	144	MOD A-420	FMR	188	MOD A-428
HMR	146	MOD F-162	FMR	190	MOD A-390
HMR	147	MOD F-163	FMR	191	MOD A-429
HMR	149	MOD F-171	FMR	198	MOD A-430
HMR	154	MOD A-281	FMR	201	MOD A-379
HMR	159	MOD F-181	FMR	204	MOD A-431
HMR	164	MOD A-237	FMR	208	MOD A-391
HMR	167	MOD No	FMR	218	MOD A-402
HMR	169	MOD A-410	FMR	223	MOD A-392
HMR	173	MOD A-274	FMR	223.2	MOD A-442
HMR	183	MOD A-397	FMR	224	MOD A-432
HMR	184	MOD No	FMR	225	MOD A-437
HMR	190	MOD A-423	FMR	227	MOD A-433
HMR	193	MOD A-355	FMR	228	MOD A-434
HMR	195	MOD A-411	FMR	229	MOD A-473
HMR	197	MOD A-387	FMR	231	MOD A-435
HMR	200	MOD A-412	FMR	233	MOD A-438
HMR	201	MOD A-413	FMR	236	MOD A-445
HMR	202	MOD A-414	FMR	238	MOD A-446
HMR	204	MOD cancel	FMR	240	MOD A-441
HMR	206	MOD A-415	FMR	242	MOD A-448
HMR	208	MOD A-4191(c)	FMR	248	MOD A-474
HMR	209	MOD A-417	FMR	258	MOD A-471
HMR	210	MOD A-424			

Enclosure (4)

SUMMARY OF CONTRACTING OFFICER'S FINAL DECISION
BY CLAIM SUBJECT AND AMOUNT

C.O. Decision, Encl (1)

Section	Page	Short Title	Contract NObs 4785	4660	4765	4902
IA	2	Inaccurate & Misleading Specs, Plans & Guidance Drawings	$ -0-	$	$	$
IB	3	Excessive Design Features in Lead Yard Plans	-0-			
II		Defective Dynamic Analysis & Shock Requirements				
IIA	4	Auxiliary Machinery Foundations	* -0-			
IIB	5	Pipe Hangers	-0-			
IIC	6	Electrical Junction Box Foundations	-0-			
IID	7	Shaft Strut Supports	-0-			
IIE	7	Vendor Material Cost Increases	-0-			
IIF	8	Late Equipment Delivery	-0-			
IIG	9	Main Circulation System Support	193,227			

Section	Page	Short Title	Contract NObs 4785	4660	4765	4902
III		Misc. Constructive Changes	$	$	$	$
IIIA	10	Airborne & Underwater Noise Specifications	-0-			
IIIB	10	Surface Hardness Specifications	-0-			
IIIC	11	400 Cycle Motor Generator Set	-0-			
IV		Constructive Changes				
IVA	12	Ventilation	-0-			
IVB	13	Sonar Cables	-0-			
IVC	14	Sea Chest	-0-			
V		Late and Defective GFE/GFE				
VA	15	Late & Defective Working Plans	-0-			
VB	16	Schedule "A" Non-Conforming Material	488			
VC	17	Late & Defective GFI-Equipment Documents	6348			
VD	18	Late & Defective GFE	4923			
VE	19	SQS-26 Sonar - HMR 127	1,123,275			

Section	Page	Short Title	Contract NObs 4785	4660	4765	4902
VI		Contract Administration	$	$	$	$
VIA	20	Late Authorization of Change Orders	-0-			
VIB	22	Correspondence Response	1951			
VIC	23	Shock Resistance Certification	-0-			
VID	23	Assignment of NAVSHIPS Drawing Numbers	* -0-			
VIIA	24	Inspection Requirement Changes - "Quality Assurance"	1004	17,107	6376	936
VIIIA	27	Late & Defective Lead Yard Plans		-0-	-0-	-0-
IXA	29	Multiple Approval of Lead Yard Plans		197,481	86,821	
XA	31	Delay & Disruption Adjudicated Changes		15,224	24,239	
XIA	32	Late and Defective GFM		278	2,099	
XIIA	34	Air Conditioning and Ventilation		196,410	116,004	
XIIIA	36	Butterfly Valves		56,399	76,779	

Section	Page	Short Title	Contract NObs 4785	4660	4765	4902
XIVA	38	Anchor Windlass Piping	$	$ 11,731	$	$
XVA	39	Sea Trials - LPD-9		61,618		
XVIA	41	Tank Strength Testing		-0-	-0-	
XVIIA	42	Security Services		-0-		
XVIIIA	43	Improper Rejection of Work		23,261	18,873	700
XIXA	45	Administrative Fault		-0-	-0-	-0-
XXA	47	Unadjudicated Change Orders	(805,986)	582,809	724,717	1,600,134
XXIA	48	Habitability		379,230	323,257	230,219
XXIIA	50	Shock and Dynamic Analysis			-0-	-0-
XXIIIA	54	Defective Specifications			3134	71
XXIVA	55	Storage and Warehousing	-0-	-0-	-0-	-0-
XXVA	57	Nucleus Crew	-0-	-0-	-0-	-0-
XXVIA	58	Interest	-0-	-0-	-0-	-0-
XXVIIA	59	Microfilm		-0-		
XXVIIIA	59	FICA Tax Increase	240,958	97,781	306,332	310,624

Section	Page	Short Title	Contract NObs 4785 $	4660 $	4765 $	4902 $
XXIX	60	Deceleration and Stretchout	-0-	-0-	-0-	-0-
XXX	63	Claim Preparation Costs	4336	14,336	12,454	16,376
XXXI	64	Profit	51,368	143,141	131,107	175,601
		TOTALS	$ 821,892	$1,796,805	$1,832,191	$2,334,661

NOTE:
* Items where entitlement exists but data available is insufficient for quantification.

ITEM 4b.—*May 13, 1975—Armed Services Board of Contract Appeals decision Number 18460 concerning Lockheed Shipbuilding and Construction Company. The Board rules that the Navy must pay Lockheed $62 million because of the conduct of Secretary Packard when he was Deputy Secretary of Defense. The Board made no review of the merits of the claim itself relying instead on a theory of estoppel. Board Member John Lane dissents*

ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --	)	
	)	
Lockheed Shipbuilding & Construction Co.	)	ASBCA No. 18460
	)	
Under Contracts Nos. NObs-4660 et al.	)	

APPEARANCES FOR THE APPELLANT: vom Baur, Coburn, Simmons and Turtle
By: F. Trowbridge vom Baur, Esq.
George M. Coburn, Esq.
Richard C. Johnson, Esq.
Robert Allen Evers, Esq.
Washington, D. C.

Robert S. Gusman, Esq.
Corporate Counsel
Lockheed Aircraft Corporation

APPEARANCES FOR THE GOVERNMENT: Vincent A. Cinquina, Esq.
Counsel, Navy Contract Appeals Division

Trial Counsel:
Morris Amchan, Esq.

OPINION BY ADMINISTRATIVE JUDGE BIRD

Background. The disputes that give rise to this appeal arose under four shipbuilding contracts which called for the construction of twelve warships for the Navy. Appellant's claims, totalling approximately $160,000,000, were the subject of an extended investigation by the Naval Ships Systems Command (NAVSHIPS), which culminated in a tentative settlement of $62,000,000 in February 1971. The tentative settlement was expressly made subject to approval by higher Government authorities in accordance with applicable regulations. Provisional payments totalling approximately $49,000,000 were made under the tentative settlement.

The shipbuilding contracts, just described, comprised one of four military programs in which Lockheed Aircraft Corporation */ had massive claims against the Government in 1970 and 1971. In addition, Lockheed had a major commercial program involving the L-1011 airplane, in which it had an investment of about $700,000,000 in work-in-process at the end of 1970. When the Rolls Royce Company, which supplied engines for the L-1011, announced its insolvency in February 1971, this program was suddenly in deep trouble. In the face of these nearly overwhelming circumstances, Lockheed sought financial assistance from the Department of Defense (DOD), the several banks with which it had a line of credit, the airlines which were the purchasers of the L-1011 aircraft, and ultimately from the Congress of the United States. Appellant's ship claims, then, were merely a part of a much larger and much more complex whole.

After the tentative settlement of $62,000,000 was added to the contracts here by modification dated 24 February 1971, NAVSHIPS attempted to obtain the approval of higher authorities within the Navy. The parties are at issue whether such approval was ever given, actually or constructively. After several submissions by NAVSHIPS to the appropriate higher authorities had proved unavailing, the contracting officer, on 14 June 1973, issued his final decision which allowed slightly less than $7,000,000 for the ship claims and demanded repayment of approximately $42,000,000, the balance of the provisional payments theretofore made. Meanwhile, appellant had taken its appeal to this Board on 24 May 1973 (which was docketed as ASBCA No. 18460), citing (i) the Government's failure to honor the $62,000,000 settlement, and (ii) the contracting officer's failure to issue a timely final decision.

On 22 June 1973, appellant appealed the final decision of the contracting officer of 14 June (docketed as ASBCA No. 18571). It did so as a formality and to protect its position in the matter. On 27 August 1973, the Board dismissed the appeal of 22 June 1973 (ASBCA No. 18571) and made the subject matter a part of the earlier appeal.

The first ground of the complaint was that the tentative settlement of $62,000,000 had become legally enforceable against the Government. This was titled "Appeal No. 1." On 17 September 1973, the Government moved to dismiss Appeal No. 1. On 12 October 1973, the Board ruled that its decision on the motion would be deferred pending

*/ Lockheed Shipbuilding and Construction Co. is a subsidiary of Lockheed Aircraft Corporation. To avoid confusion, the former will be referred to as "appellant," the latter as "Lockheed."

a hearing on both the merits and the motion regarding Appeal No. 1. Subsequently, the parties agreed, with the Board's approval, to limit the scope of the hearing to Appeal No. 1, leaving the Trial of "Appeal No. 2", that is, the merits of appellant's ship claims, for later proceedings if appellant should not prevail in Appeal No. 1. If appellant prevails in Appeal No. 1, and the $62,000,000 settlement is adjudged to be legally enforceable against the Government, no further proceedings on the merits of the claims will be necessary, since by the terms of the tentative settlement, as expressed in the modification of 24 February 1971, appellant released the Government from further liability on account of its claims when the settlement became final.

At the hearing, appellant put in evidence its proof of approximately $3,500,000 of interest-on-borrowings cost through 30 September 1973, in relation to the $12,581,000 unpaid balance of the $62,000,000 settlement. (Tr. Exh. A-25; Tr. 782 ff., 918-9). With the agreement of the parties, the interest question was reserved for subsequent proceedings if appellant is successful in "Appeal No. 1." (App. Br. p. 1).

The only issue now before us, then, is whether the tentative settlement of $62,000,000 ever became final and legally enforceable against the Government. In this inquiry, we do not reach the merits of appellant's claims. Limited though this issue is, the record of this "Appeal No. 1" is massive. The transcript of the hearing totals 2,467 pages; four series of Rule 4 documents comprise 19 volumes; and finally, 16 volumes of trial exhibits were received at the hearing.

FINDINGS OF FACT

The Origins of Appellant's Financial Problems - January 1969 to March 1970.

1. In the spring of 1969, shortly after he had entered the Office of Deputy Secretary of Defense, Secretary Packard undertook a review of the Department of Defense (DOD) budget for the fiscal year 1970, and in the preparation of the DOD budget for the fiscal year 1971. In the course of this review, he considered virtually all of the major programs of the military services, and discovered that Lockheed had four major programs that were causing serious financial problems. These programs included the following: the C-5A transport aircraft, under a total package procurement contract with the Air Force; the Cheyenne fixed-rotor helicopter, under total package development and production contracts with the Army; a rocket motor for the short-

range attack missile (SRAM), for which Lockheed had a subcontract under Boeing Aircraft Company's total package prime contract with the Air Force; and finally, the shipbuilding contracts entered into with the Navy, with which we are concerned here. (Tr. pp. 5-8).

2. On 15 October 1969, Mr. Haughton, Chairman of Lockheed's Board of Directors, addressed a letter to the Secretary of the Navy in which he detailed the salient facts of appellant's claims against the Government under nine contracts with the Navy, calling for the construction of 22 ships for a total contract price of approximately $348,000,000. As of the date of the letter, six contracts had been completed and the remaining three were continuing. During its performance of the contracts, appellant had experienced significant cost increases which it claimed were due to acts of the Government, such as issuance of defective specifications, late delivery of and defective Government-furnished equipment and information, changes to inspection procedures, delayed approval of drawings, and other constructive changes. The total unreimbursed expenditures on account of these claims was approximately $95,000,000 at that time. The letter closed with a request that the Secretary give his personal attention to expediting a final resolution of the claims and provide approximately $50,000,000 in provisional payments. (R4, Tab A-1).

3. On 7 January 1970, the Under Secretary of the Navy replied to Mr. Haughton's letter, to the effect that he and the Secretary were very much aware of appellant's claims and that their final disposition was a matter of the highest priority. He recalled that prior to May 1969 appellant's claims had been reviewed in headquarters, NAVSHIPS, against the contract files and records of the project managers. In May, the letter continued, a full time claim review team was assigned to each of the claims, and since that date the personnel involved had spent most of their time in Seattle, where appellant was located, reviewing the claims to determine their validity and the amounts due appellant. The letter concluded with a discussion of further provisional payments against the claims. (R4, Tab A-4). In the meantime, the record shows that representatives of Lockheed discussed all four DOD programs, including the ship claims, with Secretary Packard on 11 November 1969. (R4, Tab A-2).

4. As time passed, Lockheed's financial difficulties caused increasing concern. On 2 March 1970, Mr. Haughton said, in a letter to Secretary Packard:

> "It has become abundantly clear to us that the unprecedented dollar magnitude of the differences to be resolved between Lockheed and the military services make it financially impossible for Lockheed to complete performance of these programs if we must await the outcome of litigation before receiving further financing from the Department of Defense." (R4, Tab A-7).

The letter contained a recapitulation of all four DOD programs and concluded:

> " . . . in the absence of prompt negotiated settlements there is a critical need for interim financing to avert impairment of continued performance. We urgently solicit the assistance of the Department of Defense in providing such financing." (Ibid.).

5. Lockheed reported its financial difficulties to its stockholders on 6 March 1970. The report noted that Lockheed had written off total losses of $290,000,000 before taxes on the four DOD programs, and in addition called attention to the financial impact of the L-1011 commercial aircraft program, which caused the company to experience increased absorption of G&A expense in 1969. The report concluded by summarizing what the magnitude of Lockheed's financial problems would be under the DOD programs, on the assumption that the Government prevailed on all of the issues involved, as follows: total losses of up to $500,000,000 on the C-5A before taxes, a loss in the range of $135 - $170,000,000 before income taxes on the Cheyenne helicopter, and a loss of approximately $270,000,000 under the shipbuilding contracts and the SRAM motor subcontract. Finally, the report discussed the impact of Lockheed's financial difficulties in terms of its cash requirements. (R4, Tab A-8).

The Deputy Secretary of Defense Begins to Develop A Plan for Dealing with Lockheed's Financial Problems - March to May 1970.

6. Shortly after becoming aware of Lockheed's financial problems, Secretary Packard assumed responsibility within DOD for developing a solution for them that would meet DOD needs.

a. He met with Lockheed representatives to ascertain whether the company had adequate resources to continue its defense work through 1969 and into 1970, while he tried to work out a satisfactory resolution to Lockheed's problems. (Tr. 8).

b. Given the magnitude of Lockheed's problems and the losses which it had already incurred, he determined that the problems could not be resolved in isolation; rather, they had to be dealt with on a company-wide basis (Tr. 9).

c. A task force or "Monitoring Committee," headed by Mr. McCullough and reporting directly to Secretary Packard, was appointed in March 1970 to work with the three services involved in the four troubled DOD programs, to monitor Lockheed's financial position and to keep close tab on its cash flow, until a solution to its problems could be worked out (Tr. 9, 36-38).

d. The principal function of the Monitoring Committee was to keep Secretary Packard informed on a current basis with respect to Lockheed's critical cash flow position, while the three services were entrusted with the active management of their respective programs. (Tr. 39). On this point, Secretary Packard was explicit in testifying that negotiation of a settlement of the ship claims was to be the responsibility of the Navy (Tr. 50, 529-30), that he did not investigate the merits of the ship claims, or ask any of his staff to do so (Tr. 540). From the start, appellant was aware that its ship claims were to be handled by the Navy rather than by the Office of the Secretary of Defense (OSD), and that they were not to be treated as merely a part of the total Lockheed problem. (Exh. G-31, p. 9).

7. On 9 March 1970, Secretary Packard and members of his staff appeared before the Armed Services Committee of the House of Representatives to testify on Lockheed's problems in relation to that Committee's consideration of the Military Procurement Authorization Bill for the fiscal year 1971. (R4, Tab A-9). After summarizing the four DOD programs which were causing Lockheed's financial difficulties, Secretary Packard outlined several alternative courses of action, including reorganization, merger, and bankruptcy. However, in their discussion of the problem both Secretary Packard and the Chairman of the Committee recognized the need to keep Lockheed in business, in order to preserve its capability of completing not only the four programs in question but also other programs such as Polaris which were not causing financial problems. On the assumption that Lockheed had sufficient cash to get through the fiscal year 1970 without further assistance, Secretary Packard proposed to request a contingency fund of $200,000,000 in the fiscal year 1971 budget over and above the

funding required for the Air Force's interpretation of the C-5A contract. Since his analysis was based on a preliminary study of Lockheed's cash needs, he testified that the $200,000,000 might not be enough, and that whether it would be enough would depend on the settlement worked out on the other issues. He continued as follows:

> "For example, if the Navy approved all the claims on shipbuilding, that would represent a difference of $100 million or more.
>
> "Or if the Army made a settlement on the Cheyenne, the funds needed would change. Each one of these issues represents a substantial increment of the total problem, so that the final outcome is going to be determined by how they add up. The $200 million for the C-5A probably may not be enough, but it will depend on how these other matters develop." (Id., at p. 7037).

8. On the following day, 10 March 1970, Secretary Packard appeared before the Senate Armed Services Committee, which with Senator Stennis presiding, was considering the Military Procurement Authorization Bill for the fiscal year 1971. Secretary Packard repeated much of the testimony that he gave the previous day to the House Committee. In the questioning that followed it appeared that the total of Lockheed's claims under the four DOD programs in question was slightly in excess of $1,000,000,000 (R4, Tab A-10, p. 845). In addition he noted that he had met the previous week with a group of bankers representing banks which had extended a large line of credit to Lockheed in 1969 (Id., at p. 828; for an account of this meeting, see Tr. 1854-7). There were 24 independent banks in the group, individually extending lines of credit up to a maximum of $30,000,000. Secretary Packard asked the banks to form a committee that he could deal with in working out a resolution of Lockheed's financial problems. The banks responded by appointing such a committee with Mr. Fred J. Leary, Jr., Senior Vice President, Bankers Trust Company, as Chairman. (R4, Tab A-10, pp. 839-40; Tr. 1857-8).

9. On 27 May 1970 Secretary Packard again appeared before the Senate Armed Services Committee to testify on the progress he had made with the Lockheed financial problems since first alerting the committee to them in March. (R4, Tab A-17).

a. He recounted how his Monitoring Committee had visited the Lockheed corporate headquarters in order to perform a cash-flow analysis, which included Lockheed's potential sales, cash receipts and disbursements, work-in-process inventory, capital investments in machinery and structures, depreciation, cash flow, and tax liabilities. The analysis confirmed the earlier determination that Lockheed had sufficient resources to enable it to continue its then current DOD work through calendar year 1970. (Id., p. 2419).

b. He noted an uncertainty, whether the 24 banks would honor their $400,000,000 total commitment under the then current credit agreement. At that time, Lockheed had drawn down only $320,000,000 of the $400,000,000 total. (Id., pp. 2419, 2436).

c. Regarding the ship claims, Secretary Packard testified that on 12 May 1970 claims totaling approximately $46,000,000 under five contracts had been settled for $17.9 million, a ratio, he observed, that was typical of shipbuilding claim settlements. He also observed that these claims had been processed through established Navy procedures, and had not been treated in an unusual manner because of Lockheed's financial difficulties. (Id., at 2424).

10. Throughout the spring of 1970, Secretary Packard either directly or through his staff kept in close touch with Lockheed's financial problems. (Exh. G-3, Atch. dtd. 15 Dec. 1970). At one of his meetings with the bankers, on 20 April 1970, he was advised by Mr. Leary that the banks would be unable to make additional funds available to Lockheed, beyond the $320,000,000 already advanced under the 1969 credit agreement, until DOD could reach some decisions on the four programs then in dispute. In reaching this judgment, the banks were merely following normal banking principles, under which the future viability of Lockheed, including all its DOD and commercial programs, was the decisive factor. In short, until a new comprehensive financing plan was developed for Lockheed, the banks could not be sure of Lockheed's ability to repay new loans, and hence they would be unable to make further credit available. (Tr. 1864-1872; Tr. Exh. A-11). Throughout the period, Lockheed's cash balances sometimes became very low and at one point were down to about $10,000,000 (Tr. 10).

The Evolution of Secretary Packard's Plan for Settling Lockheed's Claims Under the Four DOD Programs in Question - May to November 1970.

11. With regard to Lockheed's ship claims, it will be recalled that in early May claims under five completed contracts were settled at $17.9 million. (Finding 9c). There remained the claims under three

LPD contracts and one DE 1052 contract, which totalled approximately $160,000,000. With respect to these claims, Admiral Sonenshein, Commander NAVSHIPS, reported to the Chief of Naval Material on 15 May 1970 that settlement negotiations were to begin on schedule in mid-August in accordance with an accelerated plan. Admiral Sonenshein also noted that settlement of the five claims would give Lockheed $13,000,000 additional cash as soon as the contract modifications were executed. (R4, Tab B-12).

12. Pending payment of claims that had been settled, Lockheed's cash position was still critical during the summer of 1970. On 31 August 1970, a memorandum prepared for a meeting of Lockheed's Board of Directors announced that arrangements had been made with the banks for an additional loan of $30,000,000, secured by a pledge of collateral, as an interim step toward a revised overall financing program. With the additional $30,000,000, the borrowings under Lockheed's credit agreement of 1 May 1969 were increased to $350,000,000, the entire amount of which was to be secured by collateral. A proposed new "1970 Credit Agreement", which was to replace the 1969 Credit Agreement in its entirety, was to provide for bank credit in a total amount of $500,000,000, including the $350,000,000 previously advanced, $100,000,000 under a V-loan, and $50,000,000 additional credit. The obligation to make the V-loan was conditioned upon Lockheed's airline customers' making additional advance payments of $100,000,000 under their L-1011 purchase contracts. (R4, Tab A-21A). The interim drawdown of $30,000,000, coupled with the $600,000,000 financial plan, was announced by Lockheed in a press release dated 11 September 1970. The announcement stated that "While the proposed financing arrangement has not as yet been concluded, this additional financing will be contingent on, among other things, resolution of major defense contract differences with the Department of Defense." (R4, Tab A-22).

13. On 25 August 1970, the settlement team and all of the principals in NAVSHIPS headquarters staff involved in negotiating appellant's remaining ship claims met with Admiral Sonenshein and concluded that the amount supportable on the basis of the preliminary work on technical, audit and legal reviews of the claims was $59.9 million. The group also concluded that the NAVSHIPS "Command position" at the start of the settlement negotiations should be less than that to give room for negotiation. Accordingly, the Command position was fixed at $53.6 million. (Tr. Exh. A-32, pp. 92, 93). When asked what he meant by "a supportable figure of $59.9 million", Admiral Sonenshein replied that that meant that all the key members of his staff were in a position to prepare documentation of the ship claims based on facts that they had acquired through several years of investigation and analysis that would support $59.9 million. (Id., p. 95).

On 10 September 1970, Admiral Sonenshein and his staff briefed the Under Secretary of the Navy and two Assistant Secretaries, the Chief of Naval Operations, and the Chief of Naval Material on the status of the ship claims negotiation, including the Command position that had been agreed upon. (Id., p. 97).

14. On 3 November 1970, Admiral Sonenshein advised the Assistant Secretary of the Navy (I&L) and the Chief of Naval Material that he had made offers of settlement to both Avondale Shipyards, Inc. and to appellant. The offer to appellant was made on 27 October in the amount of $58,000,000, on claims, under four contracts, that totaled $159,000,000. The $58,000,000 offer thus covered all of appellant's claims that remained after the settlement arrived at on 12 May 1970 (for which see Findings 9c, 11). Admiral Sonenshein also advised that he understood that Mr. Haughton intended to discuss the $58,000,000 offer with Secretary Packard in relation to the corporation's overall financial problems. (R4, Tab A-25). At the hearing, there was a difference of opinion whether Admiral Sonenshein had personally informed Secretary Packard of the $58,000,000 offer or whether that information came to Secretary Packard from another source. Since it is plain that Secretary Packard was correctly informed of the matter (Finding 17d, infra), it is unnecessary for us to resolve the conflict in the testimony.

15. In October 1970, Lockheed's Board of Directors was notified that agreement had been reached with the Boeing Company, settling Lockheed's claim under the SRAM program for the sum of $20,000,000. At the same time, Lockheed's negotiations with DOD on its Cheyenne and C-5A claims were nearing conclusion. In both of these programs, the Board of Directors was advised that restructuring the contracts under the extraordinary procedures of Public Law 85-804 would be required. (R4, Tabs A-24, A-27).

16. At a special meeting of Lockheed's Board of Directors on 18 December 1970, the status of Lockheed's negotiations with DOD on the four programs in question was again reviewed. Mr. Haughton had just communicated on the subject with Secretary Packard, who in turn had been in close touch with the bankers in the light of the pending new 1970 Credit Agreement (Finding 12). Although one of the four programs had been completely settled, the remaining three, including the ship claims, were still in negotiation. The C-5A negotiations were a source of particular concern in that they had reached a point where Lockheed would have to choose, among other things, between accepting a fixed loss of $200,000,000 or litigating its disputes with the Government. Because of the magnitude of the matters still

awaiting settlement, a V-loan guarantee did not appear to be possible. However, the bankers undertook to do what they could to work out a new credit agreement regardless of the decision made by Lockheed. (R4, Tab A-29 Rev.).

Secretary Packard Presents His Plan of Action to the Congress - 30 December 1970.

17. On 30 December 1970, Secretary Packard addressed a lengthy letter to Senator Stennis, Chairman of the Senate Armed Services Committee, with copies to the Chairman of the House Armed Services Committee and to Mr. Haughton, in which he proposed a plan of action for resolving the contractual difficulties between the Government and Lockheed. (R4, Tab A-30). The plan was submitted by Secretary Packard in response to Mr. Haughton's letter of 2 March 1970 "citing his company's contractual and financial problems on four major defense programs" (Finding 4), and in recognition of his responsibility as Deputy Secretary of Defense to seek and to find a solution for Lockheed's problems that would preserve its capability to produce weapons systems urgently needed for the nation's defense, "at minimum cost to the U.S. Government and with minimum impact on third parties such as Lockheed employees, suppliers, subcontractors and their employees." (R4, Tab A-30, p. 1). The letter made the following points:

a. After briefly reviewing the four programs, including the nine Navy ship contracts out of which Lockheed's ship claims arose, Secretary Packard described the nature of the review that had taken place since receipt of Mr. Haughton's 2 March 1970 letter. The review included an evaluation of DOD operational requirements in relation to the four programs and a study of the impact which bankruptcy or corporate reorganization of Lockheed under the Bankruptcy Act would have on many other companies involved with Lockheed as suppliers or subcontractors in its national defense effort and upon credit agreements which the banking community had with many other companies so involved. (Id., pp. 2, 3).

b. The review also established that normal procedures for resolving Lockheed's disputes would require an extended period of time for which Lockheed had insufficient cash and inadequate commercial credit to finance its continued performance of vital defense programs. (Id., p. 2).

c. In the plan that the letter presented, Secretary Packard concluded that "our normal, established procedures are adequate to resolve two of the four issues." One of the two, involving the SRAM motor for which Lockheed was a subcontractor, had by then been settled for $20,000,000 and the problem concerning it resolved. (Id., p. 3).

d. The other program to be settled through normal, established procedures was the ship claims. On this subject Secretary Packard reported as follows:

> "Ship claims of $46 million for work under five completed contracts were settled for $17.9 million in June of 1970. This settlement was reached through the established procedures for negotiating ship claims. The remaining claims, totalling $159.8 million have been the subject of intensive negotiations between the Navy and Lockheed. To settle these claims, the Navy has offered Lockheed $58 million. I am hopeful that a settlement of these claims can be reached. Generally speaking, all negotiations regarding this program have also been concluded. The single remaining issue is Lockheed's acceptance of this offer." (Ibid.).

e. The two remaining issues, involving the Cheyenne program for the Army and the C-5A for the Air Force, required action under the extraordinary authority provided by Public Law 85-804. A settlement of the two Cheyenne contracts was described in some detail, including the conversion of the R&D contract to a cost reimbursement form effective as of 29 December 1969. (Id., pp. 3, 4).

f. The proposed plan for resolving the C-5A program difficulties was the most lengthy and detailed of all, because of the magnitude and intractability of the problems presented. After thorough consideration of all relevant factors, Secretary Packard narrowed the range for resolution to two alternatives: the first, to narrow the peripheral issues by negotiation and to litigate the remainder; and second, to settle all issues and impose a fixed loss of $200,000,000 on Lockheed. Under either alternative, the existing contract was to be restructured.

g. Secretary Packard concluded the letter by stating:

"Our actions in settling the disputes on the four defense programs will resolve contingent liabilities of Lockheed and, we hope, thereby provide a degree of certainty to the overall financial affairs of Lockheed that will permit the banks to continue to finance the commercial programs, and avoid bankruptcy.

"This summarizes the alternatives and the action we intend to take to resolve these very difficult contractual matters. The final details of the settlement and the documents necessary to implement this plan are now being prepared, and will be completed by the end of January 1971." (Id., pp. 5-6).

The "Tentative" Ship Claims Settlement - January and February 1971.

18. The reaction to Secretary Packard's letter of 30 December 1970 was immediate.

a. In a letter dated 5 January 1971, Mr. Haughton commented on Secretary Packard's plan for settlement of all four DOD program disputes. (R4, Tab A-32). With regard to the SRAM motor program and the Cheyenne development and production contracts, he expressed agreement with the plan. With reference to the ship construction claims, he responded as follows:

" . . . We are not prepared to accept the Navy offer of $58 million. It is our belief, however, that if both parties continue to pursue negotiations diligently a mutually acceptable solution can be achieved within a reasonable period of time." (Id., p. 2).

The balance of the rather lengthy letter dealt with the intricacies of the C-5A program, and, after discussing the two alternatives presented by Secretary Packard, elected the first, that is, to litigate the core of the disagreements rather than to accept a fixed loss of $200,000,000.

b. On 6 January 1971, representatives of the lending banks met with Secretary Packard and members of his staff to discuss the new financing plan for Lockheed (Finding 12). Mr. Leary indicated that the banks would not proceed with the financing plan if the C-5A

program were litigated or if a deferred payment arrangement were not provided under the fixed-loss settlement alternative. In addition, he told Secretary Packard that the total financing package envisioned resolution of all four of the DOD disputes. (Tr. 1886-90).

c. On 20 January 1971, the 1971 Credit Agreement between Lockheed and the 24 lending banks was published, although for reasons to be detailed below it never became fully executed. The agreement provided for the banks to extend credit to Lockheed in the amount of $500,000,000, with an additional amount of $100,000,000 to be provided by certain air carriers who had contracted for the purchase of L-1011 aircraft. The $50,000,000 credit to be provided by the banks in addition to the $350,000,000 rolled over from the existing 1969 credit agreement, was subject to several conditions, including one relating to satisfactory progress in the negotiations between Lockheed and DOD for the settlement of its claims. (R4, Tab A-34, at p. 14).

d. On 7 January 1971, Mr. Rule, Chairman of the Navy's Contract Claims Control and Surveillance Group (CCCSG) addressed a memorandum to the Chief of Naval Material stating in part as follows:

> "2. The press has recently described an overall proposal made by Mr. Packard to Lockheed to settle that company's financial problems with the DOD. Part of the proposal apparently is a $58 million settlement of the remaining shipbuilding claims approximating $150 million." (R4, Tab B-12-41).

Noting that Lockheed had rejected the $58,000,000 settlement of its shipbuilding claims and that the CCCSG had not performed the review required by existing regulation, Mr. Rule concluded as follows:

> "5. Obviously, Mr. Packard, et al, can exempt any Lockheed claim settlement from that review procedure and equally obvious is the fact that someone could be embarrassed if a commitment were made to Lockheed and then have the special review group vote negative on a clearance submitted for approval." (Ibid.).

19. On 27 January 1971, Secretary Packard responded to Mr. Haughton's letter of 5 January relating to the method of resolving the disputes between Lockheed and DOD on the ship procurements, the Cheyenne and the C-5A programs. (R4, Tab A-35). The bulk of the letter dealt with the resolution of the C-5A program dispute, in view of Lockheed's announced intention to elect the litigation alternative. On this point, Secretary Packard announced that, while litigation was pending,

DOD would not make any payments in excess of the contract ceiling nor could it restructure the existing contract. He then gave some further details of the fixed loss alternative for Lockheed's consideration and concluded as follows:

> "This proposal is based on the assumption, of course, that the banks and Lockheed proceed to execute and carry out the latest financing plan which Lockheed and the banks have under discussion.
>
> "Should Lockheed elect to reconsider and accept this fixed loss settlement offer on the C-5A program, we would then be prepared to proceed with the resolution of the CHEYENNE program as outlined in my letter of December 30, 1970 to the Chairmen of the Armed Services Committees, of which you have a copy. Resolution of the dispute on the ship procurements would be left to normal procedures for resolution." (Emphasis supplied). (Id., p. 2).

20. From 12 to 29 January 1971, Lockheed and representatives of NAVSHIPS conducted further negotiations relating to the earlier NAVSHIPS offer of $58,000,000. On 29 January, Mr. Osborn, Lockheed Corporate Vice President for Shipbuilding and Construction, accepted the NAVSHIPS offer of $62,000,000 in tentative settlement of the remaining ship claims. In reporting the settlement to the Assistant Secretary of the Navy (I&L), Admiral Sonenshein stated:

> "Lockheed understands that this settlement is subject to approval of CNM and ASN(I&L)." (R4, Tab B-13; see also Tr. 1439).

21. On 1 February 1971, Lockheed's Board of Directors met to consider, among other things, the status of negotiations with DOD, and the proposed credit agreement with the banks, and matters relating thereto. (R4, Tab A-37).

a. So far as the negotiations with DOD were concerned, the principal topic was the fixed-loss settlement of the C-5A program. The other settlements were also discussed, including the tentative settlement of $62,000,000 on the ship claims.

b. The Controller presented a summary of the financial impact of the settlements. On a tentative basis, he reported that, assuming the C-5A settlement were accepted and the ship claims were settled for the amount tentatively agreed upon, there would be an after-tax loss for 1970 of approximately $80,000,000 and a decrease in the net worth of the corporation from $331,000,000 at the end of September 1970 to about $240,000,000 at the 1970 year end.

c. The Board of Directors approved the recommendation of Management that Lockheed accept the DOD proposal set forth in Secretary Packard's letter of 27 January 1971.

d. After discussion, the Board of Directors also approved the 20 January 1971 Credit Agreement and related agreements with certain purchasers of the L-1011 aircraft, the cumulative effect of which would be to make $600,000,000 of credit available to Lockheed.

22. On 1 February 1971, Mr. Haughton responded to Mr. Packard's letter of 27 January 1971 and, as authorized by the Board of Directors, accepted the latter's proposal regarding the fixed loss of $200,000,000 on the C-5A program. Mr. Haughton recited the compelling considerations that necessitated the decision to accept the proposal, and also announced Lockheed's acceptance of the basis for settling the Cheyenne helicopter dispute. With regard to the ship claims, he stated:

> "Last week, as you know, we reached a tentative agreement with the Navy to resolve ship construction claims we have submitted." (R4, Tab A-38, p. 2).

Looking ahead to matters still awaiting final resolution, Mr. Haughton stated:

> "Our progress in implementing the financing plan that we and the banks now are discussing is quite satisfactory. We expect to finalize the agreement this month. However, you recognize that our ability to avail ourselves of the total credit is contingent upon our resolving our defense contract disputes.
>
> "We are prepared to meet with your representatives at your earliest convenience to negotiate final details of the restructured C-5A contract and to complete all other remaining details in regard to the Cheyenne and ship programs." (Ibid.).

23. On 2 February 1971, Mr. Haughton addressed a letter to Lockheed stockholders in which he announced the corporate decision to accept Secretary Packard's proposals regarding the Cheyenne and C-5A programs. He also announced the tentative agreement reached with the Navy to settle appellant's ship construction claims for $62,000,000. He concluded this part of the letter as follows:

> "Altogether the settlements will bring the losses we have written off on our four defense contract disputes to a total of $480 million before taxes. These disputes are the C-5A, Cheyenne helicopter, ship claims, and SRAM motor. We had advised you in our 1969 annual report that we had written off in 1969 and prior years a total of $290,000,000 on these programs, and we are writing off another $190 million before taxes for 1970.
>
> * * *
>
> "In the meantime we are proceeding satisfactorily in negotiations with our lending banks and expect to conclude successfully in the next few weeks a restructured credit arrangement providing additional financing for our L-1011 TriStar passenger transport and other programs.
>
> "We will now move quickly to formalize the C-5A, Cheyenne, and ship construction settlements so as to assure uninterrupted progress on these and our other programs." (R4, Tab A-39).

24. Having made its decision to accept Secretary Packard's proposal, and having reported the matter to its stockholders, Lockheed forwarded to the banks the full text of both the 1 February letter of Mr. Haughton to Secretary Packard and the 2 February letter of Mr. Haughton to the stockholders. Thus advised, Mr. Leary testified that it was his understanding of the matter that "the Department of Defense and Lockheed had settled their disputes, subject to finalization of documents." (Tr. 1894).

25. At the hearing, both Mr. Haughton and Secretary Packard testified as to their understanding of the status of negotiations with the Department of Defense as of 2 February 1971.

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a. Mr. Haughton testified as follows:

"Well, in the over-all settlement that I took to our Board of Directors on February the 1st, 1971 and as stated in my letter to Mr. Packard on that day I thought that we had an overall settlement and had reached agreement on disputes in principle with some more necessary contractual documents negotiation and clean-up to be done and then move on." (Tr. 220).

b. In his testimony, Secretary Packard referred to his initial proposal of 30 December 1970 in the following terms:

"And what I was recommending was what I considered to be a package deal." (Tr. 14).

c. With further reference to the 30 December 1970 letter, he continued:

"And it was then after presenting this matter to these two Congressional committees, and essentially in enclosing a copy of this to Mr. Haughton this constituted a proposal for Lockheed to consider whether they would accept it or not." (Tr. 16).

d. So far as the $58,000,000 offer (which Lockheed rejected) was concerned, Secretary Packard testified that he considered that the Navy and Lockheed were free to continue negotiations

"which . . . obviously could have been directed at nothing other than a higher figure than $58 million, and I was satisfied that we could accept the agreement that it would work out at $58 million, and that's what my letter of December 30th sent to the Armed Services Committee and Haughton said.

"But, obviously, if those procedures came up with a higher figure, that was something the company was entitled to do.

* * *

"I assumed that the Navy settlement would be at least $58 million, and if it were $58 million the rest of my proposal was a viable proposal for the company." (Tr. 121-2).

e. With reference to the $62,000,000 tentative settlement he testified:

"I expected the Navy to implement the agreement that they assured me they had worked out, and I considered that in my discussions with the company and with the bank, I certainly intended to convey to them my conviction that this whole claim would be settled for the $62 million." (Tr. 22).

"I intended to imply by my statement to the company, to the lawyers and to the Congress that a commitment was made to several Lockheed claims . . . It was my understanding that the Navy was going to settle the claim at that figure, at $62 million, and I intended to convey that impression to the people that I dealt with on this matter." (Tr. 528).

f. Finally, referring to the entire proposal he had made, he testified:

"I was speaking of the fixed loss of /sic, should read "on"/ the C-5A, which was what we asked them to accept, and I think that statement is quite correct that I expected this to be - them to accept this in return for our getting all of the other issues agreed to, and I would add even on the basis that I had proposed in my original letter to Mr. - Senator Stennis earlier.

" . . . I would say categorically if any of those other matters were not honored we certainly couldn't ask Lockheed to accept that $200 million loss. That's what this thing was all about was to try to get this thing resolved on an overall basis that would keep the company going and get the important work done for the Department of Defense." (Tr. 32).

The Insolvency of Rolls Royce, Supplier of Engines for the L-1011 Aircraft, and its Aftermath - 2 February to 9 June 1971.

26. With the settlements of the four DOD programs agreed to in principle as a result of Mr. Haughton's 1 February 1971 letter to Secretary Packard, the way seemed clear for the banks to complete the execution of the 1971 Credit Agreement, dated 20 January 1971. On this point Mr. Leary, representing the banks, testified that he told Secretary Packard:

> " . . . in putting together a total financing package, we envisioned that to mean support by all parties, namely resolution of the Department of Defense disputes, all of them, a new bank agreement to lend so as to give the world assurances that Lockheed's banks were prepared to go forward, and assurances on the part of the airlines that they also were prepared to go forward so that the total package contained, in effect, an additional $100 million within the $600 million of so-called airline financing." (Tr. 1889-1890).

The Credit Agreement of 20 January 1971, which was the vehicle for the total financing package referred to by Mr. Leary, never became effective. It was in the process of being executed in counterpart by the 24 banks when the Rolls Royce bankruptcy was announced on 2 February 1971. (Tr. 1893-4).

27. Immediately after the Lockheed Board meeting at which the settlement with the Department of Defense had been approved, Mr. Haughton flew to London, arriving there on the morning of 2 February. Within an hour or two, he was advised by the Rolls Royce officials that they intended to announce receivership the next day. He forthwith phoned Secretary Packard of this new development, and at about the same time the British Government advised Secretary Packard through the "British Ministry."

a. Mr. Leary was at once summoned from New York, and in the discussion in Secretary Packard's office after his arrival, Secretary Packard told him in effect that "we must keep Lockheed alive." (Tr. 1896-7).

b. In further discussions on 6 February 1971, Secretary Packard advised Mr. Leary that he was prepared to pursue the settlements as agreed upon if the banks, together with Lockheed, could come up with

a financial plan that was adjusted to reflect the substantial change brought about by the Rolls Royce bankruptcy. (Id., p. 1898).

c. On 8 February 1971, Secretary Packard notified Senator Ellender, Chairman of the Senate Committee on Appropriations, of the Rolls Royce receivership and its impact on Lockheed's financial difficulties. His letter stated, among other things:

> "It will take a week or two to determine whether the Lockheed L-1011 program can be held together. If it can be held together and bankruptcy is avoided, my recommendation for resolving the Department of Defense problems with Lockheed will not change." (Tr. Exh. A-15).

On the other hand, the letter continued, if a Lockheed bankruptcy should result, a receiver might elect not to continue performance of the C-5A contract, and as a result, completion of the program could cost the Government at least $200,000,000 more than the settlement to which Lockheed had agreed. Although he expressed uncertainty as to the financial impact on the other DOD-Lockheed programs, Secretary Packard stated his firm belief that it would be in the best interest of the national security if a Lockheed bankruptcy were avoided. (Ibid.).

28. The Rolls Royce insolvency lent urgency to the ship claims settlement. In view of the strong possibility of a Lockheed bankruptcy, a staff paper prepared for Secretary Packard proposed that $21,000,000 additional provisional payment be added to the $29,000,000 theretofore authorized. (R4, Tab R-89, pp. 132-136).

29. The Rolls Royce insolvency put Lockheed in a critical cash position, since approximately $700,000,000 of its assets were tied up in work-in-process in its L-1011 program as of 27 December 1970 (R4, Tab A-51, Note 3). Accordingly, contract modifications each with an effective date of 29 January 1971 were entered into on 24 February 1971, which had the effect of formalizing the tentative $62,000,000 settlement of the ship claims and providing $20,000,000 of additional provisional payments under the LPD contracts. The contract modifications were expressly conditioned upon the settlement being "approved by higher Government authorities in accordance with applicable regulations." (R4, Tab B-14-1). By this action, the total of provisional payments made against the $62,000,000 tentative settlement was increased to approximately $49,400,000, leaving a balance due of approximately $12,600,000. (Tr. Exh. A-25, p. 11; Tr. 784). In

its financial forecast of March 1971, Lockheed anticipated collection of the bulk of the $12,600,000 balance during the second quarter of 1971. (Tr. Exh. A-28, p. 8).

30. The applicable regulations upon which the tentative $62,000,000 settlement had been conditioned in the contract modification of 24 February 1971 was NPD1-401.55. This reference required cognizant procuring activities such as NAVSHIPS to report all contractor claims in excess of $5,000,000 to the Assistant Secretary of the Navy (I&L). With regard to settlement approval, the regulation provided as follows:

> "Prior to the settlement of any claim where the proposed settlement is $5,000,000 or more, the cognizant procuring activity shall present an oral briefing to the Assistant Secretary of the Navy (I&L) . . . The procuring activity shall present at the ASN(I&L) briefing all pertinent technical, legal and cost information, and a NAVMAT representative will present the comments of the Chief of Naval Material. Final settlement of the claim will be contingent on secretarial approval. No commitment shall be made to the contractor prior to such approval by the Assistant Secretary of the Navy (I&L)." (Emphasis supplied). (R4, Tab B-4).

NPD1-401.55 was issued by the Chief of Naval Material on 7 November 1969. On 30 October 1969, the same officer established a charter for the contract claims control and surveillance group (CCCSG) to perform, as a staff function within his command, the review of major claims submitted by Navy procuring activities such as NAVSHIPS. Mr. Rule was designated chairman of this group. (R4, Tab B-3).

31. Before the contract modification of 24 February 1971 was executed, Mr. Rule took pains to advise NAVSHIPS that the additional provisional payments provided for therein were authorized without prejudice to a full and complete review of the merits of the $62,000,000 tentative settlement by the CCCSG. The same advice was given to the Assistant Secretary of the Navy (I&L), as well as to Mr. McCullough, Chairman of Secretary Packard's Lockheed Monitoring Committee. (Exh. G-29; Tr. 1649-50).

32. On 25 March 1971, NAVSHIPS submitted to the Chief of Naval Material the justification, or so-called business clearance memorandum, relating to the $62,000,000 settlement that was required by applicable regulations, as discussed above. (R4, Tab R-55). Mr. Rule, Chairman of the CCCSG within the Naval Material Command, performed a preliminary review of the business clearance and rejected it on 2 April 1971 as "entirely unsatisfactory". (R4, Tab B-14-7). On 19 April 1971, after noting that the business clearance was incomplete, Mr. Rule requested NAVSHIPS to submit certain additional data. (R4, Tab B-14-12). On 9 June 1971, NAVSHIPS submitted seven supplementary documents in response to Mr. Rule's request. (R4, Tab B-15-1).

33. Subsequent to the Rolls Royce insolvency, the bankers busied themselves with a reassessment of Lockheed's financial position. The result was an interim measure intended to provide Lockheed with additional funds for the L-1011 program pending execution of a new credit agreement. */ The interim measure took the form of a Second Supplemental Agreement, dated 19 April 1971, to the Credit Agreement of 1 May 1969, under which Lockheed was at that time operating. (R4, Tab A-48). The interim measure accomplished the following:

a. It permitted Lockheed to borrow an additional $50,000,000 under the existing credit agreement, bringing the total authorization to $400,000,000.

b. Recognizing that the $600,000,000 financing contemplated by the aborted Credit Agreement of 20 January 1971, would be insufficient, it recited that the parties were continuing negotiations with a view to executing a new credit agreement constituting part of a $750,000,000 financing plan for Lockheed consisting of $650,000,000 of credit to be extended by the banks (of which $400,000,000 was to refinance credit extended under the 1969 agreement) and $100,000,000 of additional financing by the airlines for the production of the L-1011 aircraft.

c. It required Lockheed to maintain a consolidated net worth of not less than $225,000,000, whereas the then existing agreement had required a consolidated net worth of $340,000,000. The reduction in the net worth requirement was, as Mr. Leary testified, intended to reflect the agreed upon settlement of the DOD disputes. (Tr. 1901-02).

*/ The $200,000,000 contingency fund authorized by P.L. 91-441, as requested by Secretary Packard (Finding 7), was intended to enable Lockheed to complete the C-5A program. By letter of 2 February 1971 to Senator Stennis, Secretary Packard presented his plan for limiting expenditures of the $200,000,000 to the C-5A program (Tr. Exh. A-38).

d. Finally, it fixed a deadline of 30 September 1971 for the execution of the new credit agreement, in recognition of the fact that the interim measure was to be refinanced under a permanent plan (Tr. 1903).

34. In explaining the rationale of the $750,000,000 financing package, Mr. Leary testified that it was understood that of the $650,000,000 to be provided, if necessary, by the banks, the amount over $400,000,000 was to be secured by a $250,000,000 Government loan guarantee. In addition, he noted that this guarantee contemplated a margin of about $100,000,000. Lockheed's forecast, as reviewed by the banks and the Department of the Treasury, showed a maximum requirement of about $550,000,000 (Tr. 1907).

35. At a meeting of the Lockheed Board of Directors on 3 May 1971 (R4, Tab A-48-B), the following matters were discussed:

a. The Second Supplemental Agreement to the then current Credit Agreement of 1 May 1969 had been agreed to by the banks and Lockheed, and there had been a closing thereunder on 26 April 1971, at which time an additional $50,000,000 was borrowed. (Id., p. 12).

b. The Chairman of the Board of Directors reported on a meeting convened on 20 April 1971 in Washington, D. C. by Mr. Connally, Secretary of the Treasury, and attended by representatives of Lockheed, certain airlines, and the agent banks under the existing credit agreement. The meeting was concerned with (i) the reaffirmation of agreements between Lockheed and its L-1011 customers, (ii) negotiation of a contract between Rolls Royce and Lockheed, (iii) the importance of payment to Lockheed by the Government and execution of reformed agreements pursuant to Lockheed's 1 February 1971 acceptance of the Government's proposal for settling the disputes concerning the C-5A, Cheyenne and shipbuilding claims, and (iv) the need for a guarantee by the Government of additional bank loans in the amount of $250,000,000. (Id., pp. 14, 15).

36. On 7 May 1971, Secretary Packard and members of his staff appeared before the Senate Armed Services Committee to testify in connection with the Military Authorizations for fiscal year 1972. (R4, Tab A-49). The Lockheed financial problems were the topic under consideration. Secretary Packard first turned his attention to the losses under the four DOD programs which Lockheed would realize through 1970, in the total amount of $432.3 million. The shipbuilding losses totalled $89.6 million. Next, he testified regarding the impact of these losses on Lockheed, which was, in summary, to reduce shareholders' equity from $370.7 million in 1968 to $240 million through the end of the programs. With regard to the shipbuilding claims, Secretary Packard testified as follows:

". . . I again point out that these were handled in negotiations with the Navy in the same manner that they have been handling ship building claims with other contractors. These matters have been generally resolved now at this time. Some of them have been paid. We still have a few matters to clean up, but they will continue to be handled by the same procedures we use otherwise. I think there is no special action of any kind needed on that." (Id., pp. 2026-2028).

Finally, in his prepared statement, Secretary Packard observed that the settlement of shipbuilding claims under the five ship contracts in June 1970 had represented about 40% of the face value of the claims. Similarly, he noted, the ship claims under the remaining four contracts, totalling $159.8 million, "have been tentatively settled for $62 million. The LPD settlement has been approved and paid; the DE 1052 agreement is still in the process of review by the Navy." (Id., pp. 2036-37). */ The tentative settlement also represents approximately 40% of the face value of the claims.

37. During April and May 1971, there occurred a number of events which caused the Navy to reexamine the methods and standards by which it settled ship claims.

a. In a report to the Congress entitled "Evaluation Of Information From Contractors In Support Of Claims And Other Pricing Changes On Ship Construction Contracts" by the Comptroller General (B171096), the conclusion was expressed that the three contractors involved in the study did not provide tangible evidence by which the amounts claimed were related to the additional costs attributed to the Government. The report also concluded that, although historical data and standards were available, the Navy relied instead on the personal judgment and experience of its negotiators and analysts, which was, under the circumstances, an inadequate basis for evaluating the proposals and establishing the reasonableness of the prices negotiated. (R4, Tab C-01).

b. Criticism of Navy claims settlement procedures was also expressed during the period by Senator Proxmire, Chairman of the Subcommittee on Priorities and Economy in Government of the Joint Economic

*/ The LPD and DE 1052 claims were never separated. It was the DE 1052 claim settlement proposal which Mr. Rule found to be fully substantiated, rather than the LPD proposal. (Tr. 1615-16).

Committee (R4, Tab C-3), Vice Admiral H. G. Rickover, Deputy Commander for Nuclear Propulsion, Naval Ships Systems Command (R4, Tabs C-02, C-2-1), and Mr. Gordon W. Rule, Chairman of the CCCSG, Naval Material Command Headquarters (R4, Tab C-2-3, at 1115 ff.).

c. The Secretary of the Navy responded by letter dated 28 May 1971 to questions put by Senator Proxmire concerning the Navy's claims settlement procedures. In doing so, he emphasized that tentative settlements such as that reached in the Lockheed ship claims case can not be consummated before they have been approved by the CCCSG and the Assistant Secretary of the Navy (I&L), and that such approval will not be given "without exhaustive evaluation and documentation of facts and an in depth legal review." (R4, Tab C-4).

38. The Auditors' Report on Lockheed's financial statement for 1970 was issued by Arthur Young and Co. on 24 May 1971. The Report notes that the company had been faced with problems of extraordinary magnitude. (R4, Tab A-51).

a. Regarding the four DOD programs in which the company was involved in disputes with and claims against the U.S. Government, the report observed:

> "Some of these matters have been finally settled and as to the remainder, understandings have been reached for settlement. The necessary contractual documents are being prepared and it is expected that these will be signed by the end of June, 1971 . . . .
>
> "Pending the expected contractual documentation, these understandings are not legally binding on the parties. If, for any reason, they are not implemented, there will be far reaching effects on the Company's financial position, operations and ability to obtain financing." (Id., Note 2).

b. The Report also observed that Lockheed's problems were interrelated and their satisfactory resolution depended upon the accomplishment in 1971 of the following five matters, together with substantial new orders for the L-1011 aircraft.

(1) A guarantee by the U.S. Government of additional bank borrowings of $250,000,000 under the proposed new credit agreement (i.e. the 1971 Credit Agreement). (See Findings 33b and 52).

(2) Execution of a contract between Rolls Royce and the U.K. Government covering the funding of the L-1011 engine program.

(3) The coming into effect of the purchase agreement for the L-1011 engines with Rolls Royce.

(4) Execution of firm agreements with present L-1011 customers to absorb a price increase and continue with the program.

(5) Execution of restructured contracts for the C-5A and Cheyenne programs, and collection of amounts due from the U.S. Government under the Cheyenne development contract and from the negotiated settlement of claims under ship construction contracts. (R4, Tab A-51, Note 3).

39. On 26 May 1971, Secretary Packard and members of his staff appeared before the House Appropriations Committee to discuss the various problems involving Lockheed. The subject matter that was discussed was in general similar to the testimony given to the Senate Armed Services Committee on 7 May (Finding 36), but with regard to the ship claims Secretary Packard had the following to say:

"The claims on on-going ship contracts amounted to $159.8 million. We have a tentative settlement of $62 million part of which has been paid. The final payment will be made after we do the doublechecking to be sure the claims can be appropriately verified." (Emphasis supplied) (R4, Tab A-52A, p. 1343).

40. On 4 June 1971, Secretary Packard directed the Secretaries of the Army and Air Force to restructure the Cheyenne and C-5A contracts, respectively, in accordance with the tentative agreement of the parties. In doing so, he relied upon the authority contained in Public Law 85-804 and the tentative agreement. (R4, Tab A-54).

Events Leading to the Adoption of the 1971 Credit Agreement - 9 June to 14 September 1971.

41. From 7 - 18 June 1971, and from 13 - 20 July 1971, the Senate and House Banking Committees, respectively, heard a number of witnesses testifying on a bill to authorize emergency loan guarantees to major

business enterprises, subsequently enacted as Public Law 92-70, the Emergency Loan Guarantee Act of 9 August 1971. (R4, Tab A-67). This legislation was necessary to authorize the Government to guarantee the $250,000,000 additional credit to be made available by the banks to Lockheed, over and above the $400,000,000 advanced under the 1 May 1969 Credit Agreement. In view of the condition in the interim financing arrangement adopted in April 1971, to the effect that this guarantee be available before 30 September 1971 (Finding 33d), the proponents of the legislation evidenced a sense of urgency in the matter. The principal witnesses who testified at these hearings included the following: Secretary Packard and members of his staff in OSD; Secretary Connally and members of his staff in the Department of the Treasury; Mr. Haughton, Chairman of the Lockheed Board; representatives of the participating banks; Mr. Casey, Chairman of the Securities and Exchange Commission, and members of his staff; and Mr. Mayhugh, partner of Arthur Young and Company, which audited the financial statements of Lockheed for the year ended 27 December 1970. (See R4, Tabs A-55, 56, 57, 58, 59, 61, 62, 63 and 64).

42. The testimony given by the various witnesses noted in the preceding paragraph in support of the emergency loan guarantee legislation need not be summarized here, since it was essentially a restatement and summing up of events which have already been discussed. Several points throw light on Lockheed's financial problems as they were understood by the participants at that time.

a. In his testimony before the Senate Committee, Secretary Connally, who had been designated by the President to deal with the various parties concerned, including the U.K. Government, testified that Lockheed and the Defense Department had worked out an agreement "Approximately in December," by which Lockheed assumed $480,000,000 in losses on the various DOD programs. (R4, Tab A-55, at p. 41).

b. Again, testifying in answer to a question relating to the possible bankruptcy of Lockheed, Secretary Connally said:

> "There is another factor, as part of the settlement agreement with respect to the C-5A, the Cheyenne helicopter, SRAM and shipbuilding program between the Defense Department and Lockheed, there is a contingent liability of $100 million by /sic, should read "which"/ Lockheed has yet to pay to the Defense Department. As a result of that settlement agreement, and if indeed they go into bankruptcy, I think you can assume that that $100 million will be lost to the Government." (Id., p. 48).

c. On 15 July 1971, Mr. Moore, Chairman of the Board of Bankers Trust Company, testified in support of the legislation, making the point that the Government guarantee was the key to activating not only the credit agreement but also the other interrelated conditional agreements with Rolls Royce and with the airlines. In explanation, his prepared statement argued as follows:

> "You may quite appropriately ask whether we consider it essential that legislation authorizing such a guarantee be enacted before the August adjournment. We do. We seriously doubt that all of the necessary parties can or will hold the line during the August recess and until it can be determined thereafter whether or not appropriate legislation will be enacted. All must be sufficiently confident of the viability of Lockheed. Each of the airlines that have contracted to purchase L-1011's must refrain from cancelling, and scheduled progress payments must be made. The British Government must continue its support of Rolls-Royce. The sub-contractors must continue to work on their sub-contracts notwithstanding their doubts as to their ultimate payment. And Lockheed's projections indicate that it will run out of cash some time before Congress reconvenes.
>
> " . . . we understand that one of the airlines has publicly stated that it would have to make a decision to protect itself on equipment in the very near future. The airlines, the suppliers and Rolls-Royce are continuing to incur out-of-pocket costs . . . . The loss of any airline or major supplier could, and very probably would, spell the end of the L-1011 program." (R4, Tab A-62, pp. 152-153).

To characterize the Lockheed financial problem in all its complexity, and with all of the interrelated interests involved, Mr. Moore resorted to a figure of speech which had been used by Secretary Connally. That is, he said, "we doubt that all the possums can be kept up in the tree." (Id., p. 153).

43. On 22 July 1971, Secretary Packard wrote Senator Stennis requesting the latter's support on the reprogramming actions necessary to complete the Cheyenne helicopter settlement. He wrote:

> "I have testified before your committee and others on the complex nature of the entire Lockheed settlement. The many components of the settlement bear close relationship with one another and it is our hope to settle all of them within a similar time period. As you know, the settlements have been completed on the shipbuilding claims, C-5A, and the SRAM motor. I feel that it is important that the Cheyenne settlement be completed as soon as possible. . . . " (Emphasis supplied).(R4, Tab A-63A).

44. In the spring and summer of 1971, Lockheed presented its financial forecasts to the Department of Defense and to the Department of the Treasury in connection with the pending emergency loan guarantee legislation. The forecast of 27 May 1971 indicated that the LPD and DE ship claims had been settled for $62,000,000 in January 1971 and forecast collection of the balance due during the second quarter of 1971. (R4, Tab A-53, Sched. 2, p. 10). A similar forecast, adjusted to reflect events to 30 July 1971, also showed the LPD and DE ship claims as having been settled for $62,000,000 in January 1971 but predicted collection of the balance due under the settlement in the third quarter of 1971. (R4, Tab A-65, Sched. 2, p. 8). There is nothing in the record to show that anyone in the Government objected to either of these forecasts. Mr. Waters, Executive Vice President of Lockheed in charge of its cost recovery organization, supplied the data to the corporate controller for the ship claims portions of these forecasts. He testified that he had been instructed by his superior as early as 15 February 1971 to discontinue the bi-weekly "outstanding ship claims" report and to limit his future reports to "how much you collect" (Exh. G-45). Based on information he received from Navy officials, he testified that he assumed the $62,000,000 settlement was final, and his prediction of when the balance due under that settlement would be collected was also based on information obtained from Navy officials. (Tr. 884-885).

45. The notion that the ship claims had been settled for $62,000,000 subject only to finalization, was widely shared, not only by Secretary Packard and members of his staff in the Office of the Secretary of Defense (OSD), but also by Mr. Haughton and others representing Lockheed, the banks, and Secretary Connally and his staff in the Department of the Treasury. (Evidence supporting this finding of fact is spread at large in the record. See, for example, the testimony of Secretary Packard, Tr. 22, 528; Mr. McCullough, Tr. 1697; Mr. Haughton, R4, Tab A-57, pp. 235, 250-2; Mr. Anderson, Tr. 427-8; Mr. Waters, Tr. 884-5: Mr. Leary, Tr. 1894; Mr. Moore, Chairman of the Board of Bankers Trust Co., R4, Tab A-62; Mr. Greene, Secretary to the Emergency Loan Guaranty Board, Tr. 1304-8, 152-3; and 1314-7). The widespread nature of this notion was undoubtedly the result of the magnitude and complexity of Lockheed's financial problems, which in turn caused a broad interrelation of interest, both inside and outside the Government. The record as a whole indicates that all parties concerned kept in close touch with one another during the entire period, through meetings, briefings, and sharing reports.

46. The view that the approval function of Mr. Rule and the CCCSG was a mere formality was not shared by him and his committee. This was made manifest on 23 July 1971, when he rejected the $73.5 million settlement of the Avondale claims which NAVSHIPS had submitted to the CCCSG for approval. His rejection was based primarily on the lack "of evidential documentation", and the matter was returned to NAVSHIPS with a recommendation "that a contracting officer's decision be made which will require the contractor to prove to the satisfaction of the ASBCA or GAO every dollar of entitlement for action or inaction resulting in increased costs, alleged to be the responsibility of the government . . . " (R4, Tab C-5, para. 10). On 30 July 1971, Mr. Rule sent a copy of the Avondale claim rejection, together with detailed guidance on claims settlement, to all systems commanders within the Navy. (R4, Tab C-5-1).

47. On 3 August 1971, NAVSHIPS withdrew the $62,000,000 claims settlement proposal for Lockheed's ship claims from the CCCSG, because of Admiral Sonenshein's conclusion that to do so would afford an opportunity for NAVSHIPS to obtain the necessary evidential support by way of overcoming the kind of objections which the CCCSG had expressed in regard to the Avondale settlement proposal. (Tr. 1471). When queried as to the reason for the CCCSG's rejection of that proposal, Admiral Sonenshein testified as follows:

> " . . . there was a requirement for so-called cause and effect correlation and a direct and almost precise quantification of each element of the claim through so-called traceability from the accounting records. These criteria or requirements which have not been the practice or were not even in many cases practical to produce as compared to previous claims. . . ." (Tr. Exh. A-32, p. 141).

In further regard to the practicability of documenting claims in the manner desired by the CCCSG, Admiral Sonenshein testified:

> "I think I alluded to that earlier this morning when we were talking about the ability to determine the effects, the financial impacts, the fiscal impacts of delay and disruption. I said there is no accounting system in use in either Government shipyards or in private shipyards that I know of by which one can accurately identify the impact of a change to a contract or the true cost of delay and disruption costs for whatever reason other than very simple cases." (Id., p. 142).

48. Shortly after the Lockheed claims settlement proposal was withdrawn from the CCCSG by NAVSHIPS, Admiral Woodfin, Deputy Commander of NAVSHIPS for Contracts, met with Mr. Osborn of Lockheed to explain the action that had been taken. In addition to the evidentiary deficiencies of the NAVSHIPS submission discussed in the preceding paragraphs, Admiral Woodfin advised that Mr. Rule had considered the non-participation of the Supervisor of Shipbuilding, who was closest to the facts, an omission that required correction. Accordingly, Admiral Woodfin advised Mr. Osborn that the Navy, in the person of the Supervisor of Shipbuilding, would be back to do some more fact finding. (Tr. 2164-65). On 9 August 1971, Admiral Woodfin met with Lockheed's Mr. Waters, who wanted to know what Lockheed could do to bolster the justification of the proposed settlement. Admiral Woodfin advised that what the Navy needed from Lockheed was an analysis of the return costs on the LPD contracts, and Mr. Waters indicated that he could probably provide the additional information in 30-45 days. (Tr. 757-60, 910-11).

49. On 13 August 1971, Mr. Osborn met with Mr. Ill, who was then Assistant Secretary of the Navy (I&L), to discuss the withdrawal by NAVSHIPS of the Lockheed claims submission. With regard to the subject matter of the discussion, Secretary Ill testified as follows:

> "My best recollection is that I did talk to a senior representative of Lockheed; and that I did state at that time that it was better that we not try to force a decision out of the Gordon Rule Committee that we retract it. And I thought we would get the claim settled faster if we did it that way." (Tr. 2087).

When giving this testimony, Mr. Ill was unable to recollect the date of the meeting or the identity of the Lockheed representative. He supplied the missing information after checking his records. (Tr. 2212-13). Mr. Osborn's reaction to the discussions he had had with Admiral Woodfin and Mr. Ill was to rewrite the LPD claims as recommended by Admiral Woodfin so as to obtain the necessary approval from the CCCSG, a procedure that was estimated to require about 90 days. In so advising the corporate officials to whom he reported, by memorandum dated 8 September 1971, Mr. Osborn concluded:

> "I don't think there is a problem of the claims being approved. It is a matter of how the claims are written for presentation for final approval." (R4, Tab B-19).

50. A staff paper prepared for weekly briefings of Secretary Packard, known as the "Friday highlights," shows the following entry for 20 August 1971:

> "Shipbuilding Claims: Navy recommended settlement of the Lockheed ship claims ($155 million) to be settled for $62 million. The settlement was subject to review by the ships claims committee. $49½ million provisional payments have been paid to Lockheed. After the committee had rejected the Avondale settlement, the Naval Ships Command withdrew the Lockheed claims and is now obtaining additional documentation to satisfy that committee.
>
> "Airline Agreements: Lockheed's agreements with three airlines (Eastern, Delta, TWA) have as one condition that all outstanding claims owed to Lockheed as the result of DOD settlements shall be paid prior

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> to reaffirmation by the airlines of their L-1011 orders. Also, the loan guarantee board . . . requires that the airlines reaffirm the orders before any of the $250 million loan guarantee may be passed on to Lockheed. Delta has made inquiries regarding the status of payments to Lockheed. The only remaining claim is a $12½ million balance against the ship claims.
>
> "Dan Haughton, after meeting with Delta management on 18 August, called me. He does not believe that that small amount of unresolved payments will affect the reaffirmation of the airline orders . . . ." (R4, Tab R-89, pp. 202-203).

Mr. McCullough, Chairman of the Lockheed Monitoring Committee, prepared the Friday Highlight item quoted above. (Tr. 1642-44; Exh. G-79). When asked for his view of the effect that the withdrawal of the Lockheed claims settlement proposal from the CCCSG would have on the final approval of the settlement, he testified as follows:

> "As a matter of fact in my opinion, rereading it now and putting myself back in that time I thought all they were doing was going back to the drawing board to get some more details to satisfy higher review buys /sic, should read "guys"/ in the Navy." (Tr. 1708-09).

51. On 9 August 1971, the Emergency Loan Guarantee Act was signed by the President and became effective as Public Law 92-70 (R4, Tab A-67), pursuant to which an Emergency Loan Guaranty Board was created, composed of the Secretary of the Treasury as Chairman, the Chairman of the Board of Governors of the Federal Reserve System, and the Chairman of the Securities and Exchange Commission. On 18 August, Lockheed filed its application with the Board for a guarantee of up to $250,000,000 of the additional credit to be extended to Lockheed pursuant to the new 1971 Credit Agreement. This Agreement provided for a $750,000,000 financing package for Lockheed, which the bankers had planned the preceding April. (Finding 33b). Lockheed's application (R4, Tab A-69), which was voluminous, contained the following significant items, among other things:

a. The basic agreement between Lockheed and Rolls Royce, dated 10 May 1971, was summarized to show that the agreement would become effective when certain enumerated conditions were met. As of the date of the application, all of the conditions were either satisfied or about to be satisfied. (Id., Part V).

b. The disputed DOD programs were discussed. The C-5A contract had been restructured effective 7 June 1971 and the fixed loss of $200,000,000 had been accepted by Lockheed. */ The Cheyenne development contract was to be restructured effective 17 August 1971 and the loss thereunder fixed at $72.3 million for performance prior to 29 December 1969. **/ The SRAM contract had been settled in 1970, as previously noted. (Finding 15). Finally, regarding the outstanding ships claims, the application stated:

> "The claims relating to the other four contracts have been tentatively settled in the amount of $62 million; of that amount, $49,419,000 has been provided by execution of provisional contract modifications and the difference remains to be finalized and executed." (Id., Part VII, p. 4).

c. A copy of Lockheed's financial forecast of May 1971, adjusted to 30 July 1971 showed the LPD and DE ship claims as having been settled for $62,000,000 in January 1971. The same report forecast collection of the remaining $12.6 million in the third quarter of 1971. (Id., Sec. 4(a)(1)(C), p. 14).

52. On 25 August and 9 September 1971, the Emergency Loan Guarantee Board met to consider Lockheed's guaranteed loan application. (Tr. Exh. A-30). The minutes of the two meetings show that the Board considered all of the various and interrelated conditions that had to be satisfied as provided by the Emergency Loan Guarantee Act. It was agreed that the airline contracts with the four major airline customers would be executed in New York on 14 September 1971, at the same time the Credit Agreement, the Security and Pledge Agreement, and the Guarantee Agreement were executed. In other words, a "simultaneous closing" was planned. Regarding the settlement of disputes Lockheed had with DOD, data in the hands of the Board showed the following information:

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*/ As a part of the settlement, Lockheed agreed to waive all claims under the C-5A contract, including those claims involved in the appeal which it had taken to this Board. (R4, Tab A-54, pp. 6-8).

**/ Lockheed also agreed to waive all claims under the development contract and under the defaulted production contract, as part of the settlement, and to withdraw with prejudice its appeal to this Board from the default termination. (R4, Tab A-54, p. 10).

" . . . on February 1, 1971, Lockheed reluctantly accepted the basis proposed by DOD for settlement of the last of the four disputed programs, having no real choice to do otherwise, on terms that produced a total loss of $484 million before taxes, as follows:

C-5A	$247
Cheyenne	124
SRAM motor	24
Ships	89
Total	$484" (Id., p. 35).

The action taken by the Board, after considering all of the data available to it, was to approve the forms of the Credit Agreement, Security and Pledge Agreement and Guarantee Agreement as presented, and to approve the making by the lending banks of an initial loan of $50,000,000, subject to the execution of the agreements and satisfaction of all the conditions specified therein. (Id., p. 18).

53. Among other conditions spelled out in the 1971 Credit Agreement, was one that required Arthur Young and Company to give their opinion with respect to the consolidated financial statements referred to in Section 2.C., in substance satisfactory to the majority banks and the Guarantor (R4, Tab A-72, at p. 14). To meet this condition, Arthur Young and Company published a supplement (Exh. G-66, pp. 4-16) to their Auditor's Report of 24 May 1971. (Finding 38). This supplement took the form of a Note 13 in which they brought all of the facts regarding the DOD program disputes, the U.K. Government's funding of Rolls Royce, the purchase agreement between Lockheed and Rolls Royce, the airline agreements, and the new 1971 Credit Agreement up to date. Regarding the ship claims, Note 13 had the following to say:

"During 1971 the Company completed agreements, giving effect to settlements previously reached of the disputes with the U.S. Government described in Note 2, other than those relating to claims under ship construction contracts. Tentative agreements giving effect to the negotiated settlement of claims under ship construction contracts are subject to further administrative proceedings within the Department of the Navy. However, the Company believes the final contractual document will not result in any further loss. . . . " (Id., p. 15).

In the opinion letter accompanying the auditors' report, Arthur Young and Company had the following to say:

" . . . As described in Note 13, there has been a satisfactory resolution of all these matters with the exception of finalization of amendments to ship construction contracts.

"In our opinion, subject to the realization of the L-1011 TriStar inventories and finalization of amendments to certain ship construction contracts as discussed in Notes 3 and 13, the statements mentioned above present fairly the consolidated financial position of Lockheed Aircraft Corporation and its subsidiaries at December 27, 1970. . . ." (Id., p. 4).

54. The 1971 Credit Agreement established a further condition of making the loans in Section 3.B.(4), relating to settlement of the four DOD programs in dispute. To satisfy this condition, Lockheed's Vice President and General Counsel addressed a letter dated 14 September 1971 to the agent banks and the Emergency Loan Guarantee Board as guarantor, in which he outlined the status of the four settlements. With regard to the outstanding ship claims, the letter states that tentative settlement in the amount of $62,000,000 had been reached, "subject to further administrative review within the Department of the Navy . . . ." (R4, Tab A-73D, p. 1). In the details supplied in Enclosure 4 to the letter, the following additional information was supplied in relation to the $62,000,000 tentative settlement:

" . . . Of that amount, $49,419,000 has been provided by execution of provisional contract modifications and the difference remains to be finalized and executed." (Id., p. 5).

55. The 1971 Credit Agreement and the Guarantee Agreement were executed by Lockheed, the banks, and the Emergency Loan Guarantee Board on 14 September 1971, as planned. (Tr. 13-117). The parties to these agreements, as well as the major airline customers of Lockheed and Rolls Royce, all had notice of the information contained in the documents discussed in the preceding paragraphs.

The Eventual Denial of Appellant's Claim - 15 September 1971 to 14 June 1973.

56. On 28 September 1971, shortly after the 1971 Credit Agreement had been executed by all parties and while Lockheed was attempting to provide the additional supporting data which Admiral Woodfin of

NAVSHIPS had requested on 9 August (Finding 48), Admiral Sonenshein testified on shipbuilding claims before the Subcommittee on Priorities and Economies in the Government, chaired by Senator Proxmire. During the course of his testimony, Admiral Sonenshein summarized the history of the Lockheed and Avondale claims. Both claims, he testified, had been presented by the shipbuilders, and evaluated by NAVSHIPS, on the basis of estimates and engineering judgments. In April 1971, about three months after the tentative agreement had been reached with Lockheed on its ship claims, he continued, the GAO issued a report on the Todd settlement in which it concluded that claims evaluation should not be based on estimates and engineering judgments alone, but should be supported by more tangible evidence, particularly in the area of delay and disruption costs. (Finding 37a). When the settlement of the Lockheed claims was submitted by NAVSHIPS to the CCCSG for review in March and June 1971 (Finding 32), Admiral Sonenshein said, it was on the basis of estimates and judgments in keeping with prior practice. When the CCCSG disapproved the Avondale claims settlement, he testified that he withdrew the Lockheed submission to the CCCSG and had it reviewed by a special team, which concluded that it was indeed inadequate in that the engineering judgments on which it was predicated were not fully supported by tangible back-up data. Accordingly, he concluded, NAVSHIPS anticipated requesting Lockheed to supply the necessary additional supporting data. (R4, Tab C-7-1). Mr. Rule also testified for the Proxmire Subcommittee on the same day, reiterating the criteria he had applied in disapproving the Avondale claim settlement proposal. (Ibid.).

57. On 1 November 1971, the Supervisor of Shipbuilding in Seattle, who now had a leading role in the evaluation of Lockheed's claims, wrote Lockheed to the effect that its claims must be fully supported before they could be approved, and that reliance on engineering judgments and estimates, as distinguished from "definitive tangible evidence," could be expected to "jeopardize" a contractor's successful support of its claim. To this end, he notified Lockheed that four review teams had been formed to make a complete review of the ship claims, and requested Lockheed to provide supporting data for claim items involving delay and disruption. (R4, Tab C-8). Mr. Waters, who was then in charge of Lockheed's cost recovery organization, testified that he considered this a complete change in the Navy's approach. (Tr. 767-68).

58. By late 1971, the Navy still had $1,000,000,000 of outstanding shipbuilding claims. Recognizing the need to improve the handling of these claims, Mr. Ill, Assistant Secretary of the Navy (I&L), by memorandum of 8 November 1971, requested the Chief of Naval Material to review the Navy's claim procedures. (R4, Tab C-8-1). Shortly afterwards, the following events occurred:

a. Mr. Rule resigned as Chairman of the CCCSG on 12 November 1971. (R4, Tab C-8-2).

b. On 1 December 1971, a General Board was established in the Naval Material Command with membership limited to ranking military personnel within NAVMAT and the Systems Commands. (R4, Tab C-8-3).

c. On 7 December 1971, the CCCSG was disestablished and replaced by the General Board. (R4, Tab C-8-4).

d. On 11 January 1972, the Chief of Naval Material formalized the decisions regarding the CCCSG and the General Board, and established a subordinate Claims Board to assist the General Board in its review of claims. The policy announced in this directive was " . . . to have claims settled promptly at the lowest possible level in the contracting framework as they come up." (R4, Tab C-8-9).

e. Dissatisfaction with the changes in the Navy's claims procedures was expressed by both Admiral Rickover (R4, Tab C-8-10) and Senator Proxmire (R4, Tab R-68).

f. Following his and Admiral Rickover's expressions of disapproval of the Navy's new claims procedures, Senator Proxmire and his Subcommittee took the testimony of the Chief of Naval Material and Mr. Rule on 28 March 1972. During the course of the questioning, Senator Proxmire won from the Chief of Naval Material a promise to proceed in a manner similar to that recommended by Admiral Rickover, that is, to pay only bills that are "uncontestable", and "anything else I am going to say, take it to court." (R4, Tab C-8-21, pp. 1484-5).

59. With the adoption by the Navy of the new and stricter criteria for examining claims, Lockheed attempted to provide the Supervisor of Shipbuilding with the additional data that the latter had requested on 1 November 1971. (Finding 57). By 7 April 1972, 215 written and verbal requests from the SUPSHIPS team had been answered. (R4, Tab C-8-23, par. 10). On the same day, Admiral Woodfin advised Lockheed that the fact finding efforts of SUPSHIPS were nearing completion and that NAVSHIPS hoped to be able to complete all required actions necessary for negotiation of a final settlement prior to 30 June 1972. (R4, Tab C-9).

60. On 8 June 1972, the NAVSHIPS Claims Board unanimously recommended approval of the DE 1052 claim in the amount of $13,600,000, and on 15 June the same Board unanimously recommended approval of the LPD claims in the amount of $48,400,000 (R4, Tab C-10), bringing the total of the proposed ship claims settlements to $62,000,000.

61. Notwithstanding the approvals given by the NAVSHIPS Claims Board, the ship claims settlements still required the approval of the NAVMAT Claims Board before they became final. Accordingly, the proposed settlements, or business clearances, were duly submitted to the NAVMAT Claims Board. (R4, Tab C-10-1, and C-10-2). Admiral Woodfin attended the proceedings before the NAVMAT Claims Board in June and listened to the presentation by the Supervisor of Shipbuilding and NAVSHIPS personnel who were supporting the proposed settlements. He testified at the hearing that he came away from the proceedings convinced that the presentation by the Supervisor of Shipbuilding and NAVSHIPS was "very defective". In so testifying, he observed that the presentation was the Navy's, not Lockheed's, and the fact that it was not a convincing presentation had nothing to do with the merits of the case, but, rather, how well it was put together. (Tr. 2204-05).

62. In July and August, NAVSHIPS and the Supervisor of Shipbuilding offered supplementary data to the NAVMAT Claims Board in support of the proposed settlements (R4, Tabs C-10-3, C-10-4, and C-12-1) to no avail. By 31 August 1972, the Supervisor of Shipbuilding advised Admiral Sonenshein that notwithstanding work that had been done to that date, it remained "almost impossible to arrive at specific definite costs . . . which are capable of being definitively documented." In this regard, he quoted from the legal memorandum which accompanied the LPD business clearances to the effect that "In lieu of any other more definitive method of arriving at an equitable adjustment the so-called 'jury method' is permissible." (R4, Tab C-12-1).

63. While the business clearances for the Lockheed claims were under consideration by the NAVMAT Claims Board, a policy directive relating to total cost-and-time-based claims was published by NAVMAT on 11 August 1972. (R4, Tab C-12). In the background discussion, the directive pointed out the need for a demonstration of causality between a changes claim and the resulting quantum of a contractor's recovery against the Government. On 27 September 1972, the Chief of Naval Material returned the three LPD business clearances to NAVSHIPS, with the request that they be supplemented as necessary to comply with the 11 August policy directive. (R4, Tab C-13).

64. While the business clearances were pending before the NAVMAT Claims Board, Admiral Woodfin met with Mr. Osborn, Lockheed's Senior Vice President in charge of shipbuilding matters, to brief him on the progress of the ship claims review. A memorandum of 30 June 1972 (Exh. G-13), which Mr. Osborn sent to Mr. Haughton, described the situation as follows:

a. Admiral Woodfin was trying to get the claims through the NAVMAT review, and had briefed not only the Chief of Naval Material but also members of the Navy Secretariat.

b. Mr. Osborn was optimistic that the settlement would be approved "by this fiscal year", and that it was unnecessary for Lockheed personnel to intervene.

c. Admiral Woodfin was reported as having been in touch with Mr. Shillito, Assistant Secretary of Defense (I&L), to determine whether Lockheed's ship claims were part of the credit agreement or on a "stand alone" basis. He was advised by Mr. Shillito that it was on a "stand alone" basis.

65. In his testimony concerning his meeting with Mr. Shillito, Admiral Woodfin confirmed Mr. Osborn's account, and reported that Mr. Shillito had advised him to "proceed as you are, more or less, with your claims investigation." (Tr. 2200-02).

66. Following the return of the business clearances to NAVSHIPS by the NAVMAT Claims Board, the Navy sought further supporting documentation from Lockheed in keeping with the new claims policy directive. (See R4, Tab C-13-4). Not only were these efforts unavailing (R4, Tab C-14), but also Lockheed's difficulties were augmented when, on 16 January 1973, the Navy published another policy directive requiring strict proof of a contractor's claims, including a demonstration of causal support and documentation of quantum. (R4, Tab C-15-1A).

67. After further correspondence and meetings between the parties bore no results, the contracting officer in NAVSHIPS reached a tentative conclusion that appellant had demonstrated a causal connection between the Navy's actions or inactions and appellant's damages with respect to only approximately $7.1 million of the total amount claimed. A copy of the tentative NAVSHIPS position was delivered to Lockheed on 20 March 1973. (R4, Tab C-22). Thereafter, in the absence of a final decision of the contracting officer, appellant took its appeal to this Board on 24 May 1973. On 14 June 1973, the contracting officer issued his final decision, to the effect that appellant was

entitled to recover only $6,785,549 of the amount claimed (R4, Tab C-28), from which appellant also appealed. The two appeals were consolidated, as described in the Background section of this opinion, supra.

ULTIMATE FINDINGS OF FACT

68. Based on the entire record, as summarized thus far, we make the following ultimate findings of fact:

a. From the time he received Mr. Haughton's letter of 2 March 1970 informing him of Lockheed's financial difficulties, Secretary Packard considered that an overall or company-wide plan must be devised in order to work a satisfactory solution for Lockheed, because of the magnitude and complexity of its problems. (Findings 4, 6b, 7, 10, 14, 17, 18b, 19, 21, 22, 25, 27, 43 and 50).

b. The letter of 30 December 1970 to Senator Stennis, copies of which were furnished to Lockheed and its banks, set forth Secretary Packard's overall plan for dealing with the four DOD programs of Lockheed then in dispute. (Findings 17, 18, 19, 25b, c, d and f, and 40).

c. Lockheed's ship claims, which comprised one of the four DOD claims dealt with in Secretary Packard's overall plan, were by his express direction left to the Navy to resolve in accordance with its established procedures. (Findings 6d, 9, 11, 17c and d, 19, 20, 36, and 50).

d. Neither Secretary Packard nor any one on his staff in the Office of the Secretary of Defense, ever evaluated or inquired into the merits of the ship claims, nor did he ever order the Navy to settle those claims for any particular sum of money. (Findings 6d and 36).

e. Information concerning the Navy's $58,000,000 offer of settlement, made on 27 October 1970, and the $62,000,000 tentative settlement of 29 January 1971, came to Secretary Packard from the Navy, after it had spent several years investigating the ship claims. (Findings 13, 14, 22, 25d and e, and 50).

f. Representatives of Lockheed as well as Secretary Packard knew that the $62,000,000 tentative settlement of 29 January 1971 was subject to the approval of higher Government authorities in accordance with applicable regulations, and that such approval had not been given as of 14 September 1971, the date of the closing on the 1971 Credit Agreement. (Findings 20, 29, 30, 31, 37c, 38a, 47, 48, 49, 50, 53, and 54).

g. Although he knew that the $62,000,000 tentative settlement was subject to approval of higher authorities and that that condition had not been satisfied by 14 September 1971, Secretary Packard, uninformed of the details of the Navy's claims procedures, assumed that the settlement would be finally approved in the amount of $62,000,000 and worked that figure into his overall financial plan for Lockheed. (Findings 17d and g, 18d, 25e, 36, 39, 43, 45, and 50).

h. In the exchange of correspondence between Mr. Haughton and Secretary Packard, from 30 December 1970 to 1 February 1971, Lockheed accepted the latter's overall plan, which imposed on it a fixed loss of $200,000,000 in the C-5A program and required it to withdraw two appeals which it had taken to this Board under the C-5A and Cheyenne contracts. (Findings 17f, 22, 25f, and 51b).

i. Lockheed's bankers, with whom Secretary Packard was in close touch throughout 1970 and 1971, understood that the ship claims had been settled by the Navy for $62,000,000 subject only to finalization of documents. (Findings 8, 9, 24, 26, and 45).

j. In planning the 1971 Credit Agreement with Lockheed, the bankers had from the start required that all of Lockheed's disputes with DOD be settled as a condition precedent to their execution of the Agreement; therefore, on the basis of their dealings with Secretary Packard, they assumed that the Government would pay Lockheed $62,000,000 in accordance with the settlement that had been reached on the ship claims, and worked this assumption into their planning. (Findings 18b, 22, 26, 33c, 34, 42c, 55).

k. The Government, through responsible officers in the Defense and Navy secretariats, had full knowledge of the critical facts relating to the $62,000,000 settlement, including the fact that the approval on which the settlement was conditioned was not a mere formality and would not be given without exhaustive evaluation and documentation of facts and an in-depth legal review. (Findings 20, 31, 37c, and 49).

l. As established by the statements and conduct of Secretary Packard during the critical period from 30 December 1970 to 14 September 1971, the Government assumed and impliedly promised that the Navy would approve the ship claims settlement for $62,000,000 and intended that Lockheed, its bankers and airline customers, and the Emergency Loan Guarantee Board should act in reliance on this assumption and implied promise. (Findings 25e and f, 36, 39, 43, 50, 52, 54, and 55).

m. Although aware of the approval on which the $62,000,000 settlement was conditioned, senior officials of Lockheed, reasonably relying on the assurances and the promise given by or implicit in the conduct of responsible Government officers, assumed that the approval would be readily given once the necessary documentation was obtained, and thus they were ignorant of the "true facts," that the settlement would be subjected to a searching, exhaustive review which existing documentation could not possibly satisfy. (Findings 25e, 44, 47, 48, 49 50 and 53).

n. Acting in reliance on Secretary Packard's overall financial plan of 30 December 1970, Lockheed agreed, on 1 February 1971, to accept a fixed loss of $200,000,000 on the C-5A program and to withdraw the appeals that it had taken to this Board under the C-5A and Cheyenne contracts, and subsequently accepted the loss and withdrew from the litigation, on the assumption that all four of its DOD disputes, including the ship claims, would be settled in accordance with the plan. (Findings 17, 18a, 19, 22, and 51b).

DECISION

I. Introduction.

In this case, we are called upon to decide only the limited issue whether the tentative $62,000,000 settlement of appellant's ship claims became legally enforceable against the Government, even though the settlement was never approved by higher authorities in accordance with applicable regulations, as spelled out in the contract modifications of 24 February 1971 which embodied the tentative settlement. Accordingly, in the trial of this case the parties did not litigate, nor do we reach, the merits of the ship claims.

In arguing for the legal enforceability or finality of the $62,000,000 settlement, appellant makes three principal contentions: first, that a contract of overall settlement between Lockheed and the Government, represented by Secretary Packard, controls the tentative settlement embodied in the Navy contract modifications, or, in the alternative, that the Government is estopped to deny the finality of the settlement under all the circumstances of the case; second, that the tentative settlement met all of the requirements of the contract modifications for "approval by higher Government authorities in accordance with applicable regulations," and it is therefore binding on the Government; and third, that the Government may not assert the failure of higher authorities to approve the tentative settlement as a defense to its enforcement, since the Government failed for two

years to take action in accordance with the applicable review standards, during which time Government action in the review process was subverted by Congressional pressure. Since our analysis of this case permits us to reach a decision under appellant's first contention, it is unnecessary for us to discuss the remaining two contentions or to express any views thereon.

II. Lockheed's Overall Settlement With the Government Does Not Control the Tentative Settlement of the Ship Claims.

We have found that from the time he received Mr. Haughton's letter of 2 March 1970 informing him of Lockheed's financial difficulties, Secretary Packard considered that an overall or company-wide plan had to be devised in order to work a satisfactory solution, in view of the magnitude and complexity of the problems with which Lockheed was then faced. (Finding 68a). We have also found that Secretary Packard's plan was set forth in his letter of 30 December 1970 to Senator Stennis, and that the plan embraced all four DOD programs then in dispute between Lockheed and the Government. (Finding 68b).

Appellant contends that by the time this plan was accepted by Lockheed on 1 February 1971, all four DOD programs involved in the plan were necessarily resolved, and that the Government is bound by that overall agreement as of that date. The Government, on the other hand, strongly argues that there was no such overall plan, either in Secretary Packard's letter of 30 December 1970 or in the agreement reached on 1 February 1971.

A reading of the correspondence that culminated in Lockheed's acceptance of Secretary Packard's plan on 1 February 1971 makes it abundantly clear not only that Secretary Packard had an overall plan that embraced the four DOD programs but also that that overall plan did not purport to settle the ship claims. To the contrary, the ship claims were by Secretary Packard's express direction left to the Navy to resolve in accordance with its established procedures. (Finding 68c).

The contract modifications which formalized the tentative ship claims settlement of 29 January 1971 were entered into on 24 February 1971, nearly a month after the overall settlement of 1 February. Those modifications made the ship claims settlement subject to a condition precedent, namely, that higher Government authorities must approve it in accordance with applicable regulations, a condition that was never satisfied. The tentative nature of the $62,000,000 ship claims settlement does not mean that it was not part of Secretary Packard's overall

plan, but rather it goes to the method by which the settlement was to be finalized. Secretary Packard's plan was to have the Navy finalize the ship claims settlement in accordance with its procedures, and without any intervention or direction on his part. (Finding 68d).

In the present record, the representations made by Government personnel were both consistent and explicit on the point that the $62,000,000 settlement that appellant had reached with NAVSHIPS on 29 January 1971 was tentative. It was tentative and not to become final until higher authorities had approved it. Under these circumstances, we conclude that this case falls under the general rule, expressed in Monroe v. United States, 35 Ct. Cl. 199, aff'd., 184 U.S. 524 (1902), to the effect that where a final reviewing and approving judgment is given to a Government officer in such terms as to constitute a condition precedent to the taking effect of a contract, the contract is not a binding obligation until such approval is given.

As we understand appellant's argument, it is that the overall settlement of 1 February 1971 controls the tentative ship claims settlement of 29 January 1971 at that time. Accordingly, it is unnecessary for us to consider whether this case falls within an exception to the general rule, to the effect that the unreasonable delay of the Government's reviewing authorities in expressing their approval or disapproval of the tentative settlement operated to fulfill the executory condition. See Darragh v. United States, 33 Ct. Cl. 377 (1898).

Another exception to the general rule expressed above may exist in the case of contracts subject to approval by higher Government authority, if the contract is approved in substance by an official who knows the essential elements of the contract and is authorized to grant such approval. Penn-Ohio Steel Corporation v. United States, 173 Ct. Cl. 1064, 354 F.2d 254 (1965). In the present case, however, Secretary Packard conceded that he had never evaluated or inquired into the merits of the ship claims, nor did he ever order them to be settled for any particular sum of money. (Finding 68d). For this reason, we conclude that the present case does not fall within the Penn-Ohio exception.

In view of the foregoing discussion, we conclude that since the condition precedent to the taking effect of the tentative ship claims settlement, that is, the approval of higher Government authorities, was never fulfilled, the tentative settlement of 29 January 1971 did not become final or legally enforceable against the Government on 1 February 1971, the date on which Lockheed accepted Secretary Packard's overall plan.

III. The Government is Estopped to Deny the Legal Enforceability of the $62,000,000 Settlement of Lockheed's Ship Claims.

A. The Nature and Conditions of Equitable Estoppel Against the the Government.

Appellant's alternative argument for the legal enforceability of the tentative $62,000,000 settlement of its ship claims is to the effect that the Government is estopped to deny its legal enforceability because of events that happened after 1 February 1971 and before 14 September 1971, on which date the participants in this case became irrevocably committed to the 1971 Credit Agreement and related financial documents. To resolve this question, we must first consider the nature of estoppel and whether appellant's case meets the threshold conditions for applying an estoppel against the Government.

A cursory reading of court decisions on this point indicates that the doctrine of estoppel is an equitable one which adjusts the relative rights of the parties based upon considerations of justice and good conscience. United States v. Georgia-Pacific Company, 421 F.2d 92, at 95 (9th Cir. 1970). Before one may assert the doctrine against the Government, the Court of Claims has held that it is necessary for that party to show that " . . . the party against whom an equitable estoppel is set up acquiesced in the transaction in such a manner as to change the relationship of the parties and make its repudiation of the proceedings contrary to equity and good conscience." Emeco Industries, Inc. v. United States, 202 Ct. Cl. 1006, at 1014; 485 F.2d 652, at 657 (1973).

The Restatement defines promissory estoppel as follows:

> "A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires." Restatement, Contracts 2d sec. 90 (Tent. Drafts Nos. 1-7, 1973).

Since there is no real distinction between substantial reliance on a representation or promise as to past, present or future facts, it seems reasonable to enforce a promise if the promisor knows that his promise will induce the promisee to take action of a substantial character and the promisee does in fact rely on it. See the discussion in Williston on Sales, 4th Ed. (1973), Vol. 1, Sec. 7-4, pp. 251-256.

The courts generally hold that two threshold conditions must be satisfied before an estoppel may be found against the Government: first, the Government must be acting in its proprietary, rather than in its sovereign, capacity; and second, the Government's representative, whose acts form the basis for the estoppel, has been acting within the scope of his authority. Georgia-Pacific, supra, pp. 100-101. While the cases are not entirely clear in defining the activities encompassed by the Government's proprietary and sovereign roles, the Court in Georgia-Pacific, suggested this distinction:

> "In its proprietary role, the Government is acting as a private concern would; in its sovereign role, the Government is carrying out its unique governmental functions for the benefit of the whole public." (Id., at 101).

In the present case, when the Government entered into the tentative ship claims settlement on 29 January 1971, it is plain that it was dealing with Lockheed as a private concern would in a commercial contract, rather than carrying out unique governmental functions for the benefit of the whole public. We conclude that the Government was acting in its proprietary capacity.

The remaining threshold condition for an estoppel against the Government is whether Secretary Packard and members of the Navy secretariat, the Government's representatives whose acts formed the basis for the estoppel here, were acting within the scope of their authority. Because of the significance of this issue we shall deal with it at length in the next section of this opinion.

B. In Their Dealings with Lockheed, Secretary Packard and Members of the Navy Secretariat Acted Within the Scope of Their Authority.

In United States v. Ulvedal, 372 F.2d 31 (8th Cir. 1967), the Court observed obiter that "even if grounds normally sufficient for estoppel in a suit between private parties were present here (which they are not), the United States is not subject to estoppel because of an act of its agent." (Id., p. 35). For this proposition the Court cited the case of Federal Crop Insurance Corp. v. Merrill, 332 U.S. 380 (1947), among others. In Georgia-Pacific and Emeco, supra, the Ninth Circuit and the Court of Claims both held that an estoppel could lie against the Government. While the reasoning of the courts on this point is not always clear, the apparent discrepancy can be resolved on the basis that in Merrill the Government agent acted in a manner inconsistent with certain governing regulations and therefore exceeded the scope of his actual

authority, whereas in Georgia-Pacific and Emeco, the agents acted within the scope of their actual authority. In this sense, the dictum in Ulvedal is a shorthand expression for the proposition that estoppel may lie in a suit between private parties under circumstances in which an estoppel could not be made out against the Government. This is especially so if the agent of the Government, whose acts are the basis for the purported estoppel, has apparent, rather than actual, authority. See Whelan and Dunigan, "Government Contracts: Apparent Authority and Estoppel," 55 Geo. L.J. 830 (1967).

In arguing for estoppel in this case, appellant relies on the statements and course of conduct of Secretary Packard and members of the Navy secretariat. In defending, the Government argues that those officials were bound by the applicable regulations of the Navy, which required the tentative $62,000,000 settlement of Lockheed's ship claims to be approved by higher authorities. In support of its argument, the Government cites United States v. Nixon, _____ U.S. _____, 41 L. Ed. 2d 1039 (1974), in which the Court held, among other things, that a regulation issued by the Attorney General of the United States pursuant to statutory authority had the force and effect of law as long as it was permitted to remain in force. On this point, the Court observed:

> "Here, as in Accardi, it is theoretically possible for the Attorney General to amend or revoke the regulation defining the Special Prosecutor's authority. But he has not done so. /Footnote omitted/ So long as this regulation remains in force the Executive Branch is bound by it, and indeed the United States as the sovereign composed of the three branches is bound to respect and to enforce it. Moreover, the delegation of authority to the Special Prosecutor in this case is not an ordinary delegation by the Attorney General to a subordinate officer: with the authorization of the President, the Acting Attorney General provided in the regulation that the Special Prosecutor was not to be removed without the 'consensus' of eight designated leaders of Congress." (Id., at 1057).

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So too, in Merrill, supra, the Supreme Court found that the wheat crop insurance regulations in question there were binding on all who sought to come within the Federal Crop Insurance Act.

Neither party questions the authority of Secretary Packard as Deputy Secretary of Defense, the second ranking officer in the Department after the Secretary, to approve the tentative settlement or to waive the Navy's regulation. See 10 U.S. Code sec. 134(c). But he did not do so. Thus, the issue raised turns, in effect, on whether the Navy regulation is of like character with the regulations in Nixon and Merrill, so as to cause it to have a binding force and effect on Secretary Packard and the Government so long as it remained in effect. It is not disputed that Secretary Packard did not expressly amend, repeal, or waive the Navy regulation.

In G. L. Christian and Associates v. United States, 160 Ct. Cl. 1, 312 F.2d 418, reh. denied, 160 Ct. Cl. 58, 320 F.2d 345, cert. denied, 375 U.S. 954 (1963), the Court of Claims, in its initial opinion, decided that the contract in question was subject to the ASPR requirement for insertion of the standard termination for convenience clause. It reasoned that since the ASPR was issued under statutory authority, that regulation has the force and effect of law. In its second opinion, the Court of Claims cited Maryland Casualty Company v. United States, 251 U.S. 342 (1920) for the following proposition:

> "Regulations reasonably adapted to the administration of a Congressional Act, and not inconsistent with any statute, have 'the force and effect of law.'"
> 160 Ct. Cl. 58, at 65, 320 F.2d 345, at 350.

Regulations such as that part of ASPR which was held to require the insertion of the standard termination for convenience clause are said to be legislative regulations, and the courts have uniformly held that such regulations have the force and effect of law. On the other hand, regulations which are internal to the Government, which prescribe certain procedures, documentation, or generally speaking, management functions, may be broadly classified as procedural, or non-legislative in character. See Braude and Lane, "Modern Insights on Validity and Force and Effect of Procurement Regulations - A New Slant on Standing and the Christian Doctrine," 31 Fed. Bar J. 99, pp. 105-120 (1972).

In the case of a contract which violated a procedural or non-legislative regulation, which was designed solely for the benefit of the Government rather than for the creation of any rights in individuals

dealing with the Government, the Court of Claims held that the contract was enforceable by the Government and that the other party could not be heard to complain that the regulations were not complied with. Hartford Accident and Indemnity Co. v. United States, 130 Ct. Cl. 490, 127 F. Supp. 565 (1955). Similarly, in the case of a contract entered into informally and not in compliance with a statute which required contracts to be in writing, the Supreme Court held that the contract was not void, but voidable at the election of the Government, since the requirement was intended solely for the protection of the Government. United States v. New York and Porto Rico S.S. Co., 239 U.S. 88 (1915). Mr. Justice Holmes, speaking for the Court, expressed the following conclusion:

> "Even when a statute in so many words declares a transaction void for want of certain forms, the party for whose protection the requirement is made often may waive it, 'void' being held to mean only voidable at the party's choice." (Id., p. 93).

In the case before us, the Navy regulation on which the Government relies and which required the tentative $62,000,000 settlement to be approved by higher authorities before it became final, was quite obviously a procedural or non-legislative type of regulation which was intended for the benefit and protection of the Government. It did not purport to create any rights in third persons dealing with the Government. Following the reasoning employed in the Hartford and New York and Porto Rico cases, we conclude that it was of such a character as to permit its waiver by responsible Government officials with or without the assent of contractors, such as appellant, having claims against the Government that fell within its terms. Indeed, shortly after Secretary Packard released his letter of 30 December 1970 setting forth his overall plan for Lockheed, Mr. Rule, Chairman of the Navy's Contract Claims Control and Surveillance Group correctly observed:

> "Obviously, Mr. Packard, et al, can exempt any Lockheed claim settlement from that review procedure . . . " (Finding 18d).

And if Secretary Packard or members of the Navy secretariat could have waived the regulation in this instance without the assent of appellant, it follows that they could, by their representations or conduct, provide a basis for estopping the Government from denying the legal enforceability of the $62,000,000 ship claims settlement. See Georgia-Pacific, supra, at 97.

In sum, we conclude that the Navy regulation, which established the condition that the tentative $62,000,000 settlement be approved by higher authorities before it became final, was intended solely for the protection of the Government, and hence could be waived by a Government official having the requisite authority to do so. We also conclude that Secretary Packard and members of the Navy secretariat had the authority to waive the regulation, or, by their representations or conduct, provide a basis for estopping the Government from denying the legal enforceability of the settlement solely because of the application of the regulation.

C. Facts Constituting the Four Elements of An Equitable Estoppel Are Present in This Case.

In the Emeco case, supra, the Court of Claims stated that it would, in appropriate cases, apply the doctrine of equitable estoppel to prevent the Government from denying the existence of a contractual agreement. Citing Georgia-Pacific, supra, the Court indicated that the following four elements must be present in order to establish an estoppel:

> "(1) The party to be estopped must know the facts; (2) he must intend that his conduct shall be acted on or must so act that the party asserting the estoppel has a right to believe it is so intended; (3) the latter must be ignorant of the true facts; and (4) he must rely on the former's conduct to his injury." 202 Ct. Cl. 1006, at 1015; 485 F.2d 652, at 657.

Based on our examination of the record, we have no difficulty reaching the conclusion that all of these essential elements are present in this case.

1. The Government Knew the Facts.

Like a private corporation, the Government acquires knowledge through its agents. Under well-established principles of agency, a principal is bound by the knowledge of its agent concerning a matter upon which it is the agent's duty to give the principal information. It is no defense that the agent did not in fact communicate his knowledge to his principal. Georgia-Pacific, supra, at 97, Note 9, and authorities cited.

The record before us indicates that from the time he assumed the duties of his office as Deputy Secretary of Defense, Secretary Packard was involved with Lockheed's financial problems, first, in ascertaining their nature and scope, and second, in working out an overall plan that would preserve Lockheed's capability to perform its several defense programs. His analysis of Lockheed's financial problems was first expressed in his letter of 30 December 1970 to Senator Stennis. (Finding 68b). In that letter, he presented a plan for dealing with each of the four disputed DOD programs, including appellant's ship claims. With regard to the latter, he left the investigation, negotiation, and settlement of the claims to the Navy to work out in accordance with its regular procedures. (Finding 68c). Neither he nor any member of his staff intervened in these procedures, nor did he attempt to evaluate the merits of appellant's ship claims. (Finding 68d).

Because of the complexity of Lockheed's financial problems, especially after the Rolls Royce insolvency was announced on 2 February 1971, Secretary Packard found it necessary to have frequent exchanges with representatives of the many diverse organizations and interests on whom Lockheed's problems impinged. Thus, as events unfolded, Secretary Packard dealt on a continuing basis with the following: members of the Navy secretariat; Mr. Haughton, Chairman of Lockheed's Board of Directors; Mr. Leary, representing the 24 banks with whom Lockheed had its credit agreements; Secretary Connally and his staff assistants in the Department of the Treasury, through whom he was apprised of the proceedings of the Emergency Loan Guarantee Board as well as of the involvement of the U.K. Government with Rolls Royce; and finally, with various members of the Congress in both Senate and House. To assist him in his coordinating role, Secretary Packard relied on members of his staff, including the Lockheed Monitoring Committee, which kept him informed of Lockheed's cash flow problems.

From all of these sources, it is plain that the Government had full knowledge of the critical facts relating to the tentative $62,000,000 settlement. Thus, when Admiral Sonenshein reported the settlement to the Assistant Secretary of the Navy (I&L) on 29 January 1971, he stated that Lockheed understood that the settlement was subject to the approval of the Chief of Naval Material and the Assistant Secretary. (Finding 20). Before the contract modifications of 24 February 1971 were executed, both the Assistant Secretary of the Navy (I&L) and Mr. McCullough, Chairman of the Lockheed Monitoring Committee, were advised that the additional provisional payments provided for therein were being authorized without prejudice to a full and complete review of the merits of the settlement by the Navy's reviewing authority. (Finding 31). On 28 May 1971, the Secretary of the Navy, responding to questions put by Senator Proxmire concerning the Navy's claims settlement procedures, emphasized that the tentative settlement in the Lockheed case would not be approved "without exhaustive evaluation and documentation of facts and an in depth legal review." (Finding 37c). Finally, on

13 August 1971, the Assistant Secretary of the Navy (I&L) discussed with a senior official of Lockheed the withdrawal of the business clearance for the tentative settlement from the Navy reviewing authority, and encouraged the Lockheed officials to think that it was better not to try to force a decision out of the reviewing authority. (Finding 49).

Taken together, these statements made by responsible Government officials establish that the Government knew that the tentative settlement was subject to approval by higher authorities, and that such approval was not a mere formality and would not be given lightly. (Finding 68k). Furthermore, the Government knew that the condition of further approval had not been satisfied as of 14 September 1971, when all the participants in the events in this case, including the banks, the airlines, the U.K. Government, Rolls Royce, the U.S. Government, and Lockheed became fully committed to the 1971 Credit Agreement and its related financial documents.

2. The Government Intended that Its Conduct and Representations Should Be Acted Upon by Lockheed.

At the hearing, Secretary Packard testified that he fully expected the Navy to implement the tentative $62,000,000 settlement that it had worked out, and that in his discussions with both Lockheed and its bankers, he intended "to convey to them my conviction that this whole claim would be settled for the $62 million." (Finding 25e).

His statements and conduct during the time when the events in this case were taking place were fully consistent with his intention as described at the hearing. Thus, when he testified before the Congress on two separate occasions in May 1971, Secretary Packard described the ship claims as having been "generally resolved now at this time" (Finding 36), and that final payment on the ship claims will be made "after we do the double checking to be sure the claims can be appropriately verified." (Finding 39). On 22 July 1971, he wrote Senator Stennis a letter in which he said, among other things, "the settlements have been completed on the shipbuilding claims" (Finding 43).

Corroboration of Secretary Packard's understanding of the finality of the $62,000,000 settlement can also be seen in the actions taken by Lockheed's bankers and its airline customers during the critical period after 29 January 1971, when the settlement was arrived at.

We have found that Lockheed's bankers, represented by Mr. Leary, were in close touch with Secretary Packard throughout 1970 and 1971, and that as a result of their meetings and exchange of information, they understood that the ship claims had been settled by the Navy for $62,000,000 subject only to finalization of documents. (Finding 68i). We have also found that in planning the 1971 Credit Agreement, the bankers had from the start required that all of Lockheed's disputes with DOD be settled as a condition precedent to their execution of the Agreement; and that therefore, on the basis of their dealings with Secretary Packard, they assumed that the Government would pay Lockheed $62,000,000 in accordance with the settlement that had been reached on the ship claims, and worked this assumption into their planning. (Finding 68j).

The airlines, too, required that all outstanding amounts owed to Lockheed as the result of claims settlements entered into with DOD be paid before they reaffirmed their L-1011 orders. (Finding 50). And the Emergency Loan Guarantee Board in turn required that the airlines' orders be reaffirmed before any of the guaranteed loan be made available to Lockheed. (Finding 54).

The actions taken by the bankers and the airlines were well known to Secretary Packard and others in the Government, as events moved on toward 14 September 1971, the critical closing date on the 1971 Credit Agreement. Thus, Secretary Packard knew that not only Lockheed but also its bankers, its airline customers and the Emergency Loan Guarantee Board, were acting in response to his intention that the total plan for Lockheed, as outlined in his 30 December 1970 letter to Senator Stennis, be consummated so that Lockheed could be kept going and its defense capability preserved. (Finding 25f). Given this knowledge, his silence, or failure to advise Lockheed, its bankers, and its airline customers not to act on their assumption of the finality of the ship claims settlement, firmly establishes his intention in the matter and constitutes an implicit promise that the settlement would be finally approved in the amount of $62,000,000.

It is not necessary that the party against whom an estoppel is urged make a representation of any kind. It is enough if he engages in a course of conduct upon which he intends the other party to act, for then he will be estopped to repudiate the effect of his conduct. Emeco, supra, 202 Ct. Cl. 1006, at 1015; 485 F.2d 652, at 657. Similarly, many kinds of activities or inactivity may be an adequate basis for an assertion of estoppel. A party's silence, for example, may work an estoppel if, under the circumstances, he has a duty to speak. Georgia-Pacific, supra, at 97. In the period immediately before the simultaneous

closing on the 1971 Credit Agreement, we think that Secretary Packard had a duty to speak if he thought that the manifest reliance by Lockheed, its bankers and airline customers on the promise implicit in his silence had been misplaced.

On this record, therefore, we conclude that the Government, through the statements and conduct of Secretary Packard during the critical period from 30 December 1970 to 14 September 1971, assumed and impliedly promised that the Navy would approve the ship claims settlement for $62,000,000, and intended Lockheed to act on this assumption and implied promise. (Finding 681).

3. Lockheed Was Ignorant of the True Facts.

We have found that representatives of Lockheed knew that the $62,000,000 tentative settlement of 29 January 1971 was subject to the approval of higher Government authorities in accordance with applicable regulations, and that such approval had not been given as of 14 September 1971, the date of the closing on the 1971 Credit Agreement. (Finding 68f). Furthermore, the contract modifications entered into on 24 February 1971 formalizing the tentative settlement expressly stated that approval by higher authorities in accordance with applicable regulations was a condition of the settlement's finality. (Finding 29). From that time until March 1973, when the contracting officer delivered a copy of the tentative NAVSHIPS position on the ship claims to Lockheed (Finding 67), the parties continued their attempts to document the $62,000,000 tentative settlement in hopes of securing its final approval.

Notwithstanding their evident awareness of the unsatisfied condition to which the tentative settlement was subject, representatives of Lockheed, throughout the critical period ending 14 September 1971, assumed that the approval would be readily given once the necessary documentation was obtained. In this sense, Lockheed was "ignorant of the true facts," if the "true facts" are that the $62,000,000 settlement would be subjected to a searching, exhaustive review which existing documentation could not possibly satisfy. See Georgia-Pacific, supra, p. 98.

Contemporary evidences of this belief are frequent in the record. Thus, Lockheed's financial forecasts in the spring and summer of 1971 showed the ship claims as having been settled for $62,000,000 in January 1971 and forecast the collection of the balance due under the settlement in a future quarter. (Finding 44). These forecasts were presented to the Department of Defense, the Department of the Treasury (in connection with the then pending emergency loan guarantee legislation), as well

as to the lending banks. The Executive Vice President of Lockheed who supplied the data to the Corporate Controller for the ship claims portion of these forecasts testified that he assumed, based on information he received from Navy officials, that the $62,000,000 settlement was final and that what remained was simply a collection problem. He also testified that he had been instructed by his superior in February 1971 to discontinue the bi-weekly "outstanding ship claims" report and to limit his future reports to "how much you collect." (Ibid.).

A similar attitude was expressed by Mr. Osborn, a Senior Vice President of Lockheed, who met with Mr. Ill, the Assistant Secretary of the Navy (I&L), on 13 August 1971. Mr. Osborn's reaction to the meeting was to recommend that assistance be given NAVSHIPS in documenting the claims settlement proposal so as to obtain the necessary approval. A memorandum which he prepared at the time concluded that there was no problem of obtaining the approval, but rather, of how the claims were written by NAVSHIPS, which had the duty to prepare the necessary justification for the Navy's claims reviewing authority in NAVMAT. This reaction was verified by the testimony of Secretary Ill. (Finding 49).

Corroboration of the belief of Lockheed officials that approval of the ship claims settlement would be given in due course may be found in the auditors' supplemental report of 14 September 1971. Noting that the settlement was "tentative" and "subject to further administrative proceedings within the Department of the Navy," the auditors concluded that "the Company believes the final contractual document will not result in any further loss." (Finding 53).

Corroboration of the reasonableness of Lockheed's belief may be seen in the reliance placed by Lockheed's bankers and airline customers on Secretary Packard's implied promise that the ship claims settlement would ultimately be approved in the amount of $62,000,000. While it was undoubtedly in Lockheed's interest to foster this reliance, it was nonetheless fully within Secretary Packard's power to negate it had he desired to do so. The evidence all points to the conclusion that he, too, desired to foster that reliance.

In June 1972, when, after considerable new fact finding, the NAVSHIPS Claims Board unanimously approved a revised settlement proposal or business clearance which was thereupon presented to the Navy's reviewing authority, a memorandum for Mr. Haughton prepared by Mr. Osborn reflected the latter's optimism that the settlement would be approved shortly. His optimism was based on discussions he had had with Admiral Woodfin of NAVSHIPS. (Finding 64).

Although the contract modifications of 24 February 1971 plainly conditioned the tentative settlement on approval by higher authorities, we think that it was eminently reasonable for the officials of Lockheed to conclude, from assurances they had received from Secretary Packard, members of the Navy secretariat, and other responsible Government officers, and from the promise implicit in the conduct of Secretary Packard (see the discussion at III.C.2., supra), that the settlement would be finally approved for $62,000,000. Since there is nothing in the record to suggest that the officials of Lockheed ever had any dealings with the Navy's claims reviewing authority in the office of the Chief of Naval Material, it seems more than likely that they did not receive persuasive information to the contrary.

Regarding Lockheed's ignorance of the true facts, the Government suggests that Lockheed is not entitled to claim the equitable remedy of estoppel because it failed to represent the $62,000,000 settlement as "tentative" in its financial forecasts during the spring and summer of 1971. Having thus misled the other parties to the simultaneous closing on 14 September 1971, so the argument goes, Lockheed, and hence appellant, have come to the Board with unclean hands. We have already dealt with the substance of this contention in our discussion thus far. It suffices here to repeat that it was entirely reasonable, in our view, for the officials of Lockheed to act as they did in reliance on the assurances and the promise given by or implicit in the conduct of Secretary Packard, the Assistant Secretary of the Navy (I&L), and the other Government representatives with whom they were in such close touch throughout the period in question. At the very least, we think that there may have been a failure of communication in this case, but that that failure was wholly within the Government.

We conclude that the officials of Lockheed, reasonably acting on the assurances and the promise given by or implicit in the conduct of responsible Government officers, assumed that approval of the tentative settlement by higher authorities would readily be given once the necessary documentation was obtained, and thus they were ignorant of the "true facts" regarding the scope and depth of the review, which existing documentation could not possibly satisfy. (Finding 68m).

4. Lockheed Relied on the Conduct of Government Officials to Its Detriment.

In Secretary Packard's overall plan for Lockheed, as set forth in his letter of 30 December 1970, and as finally agreed to by Mr. Haughton for Lockheed in his letter of 1 February 1971, an essential condition was that Lockheed accept a fixed loss of $200,000,000 on the

C-5A program and agree to withdraw the appeals which it had taken to this Board under the C-5A and Cheyenne contracts. Subsequently, Lockheed did in fact withdraw its appeals and accepted the $200,000,000 fixed loss. (Finding 68h). It did so in reliance on Secretary Packard's letter of 27 January 1971. (Findings 19, 22).

Both Mr. Haughton and Secretary Packard, as we have observed, considered the plan worked out by the latter to be a comprehensive one, embracing all four of the disputes which Lockheed then had with DOD. The ship claims settlement of $62,000,000 was an important building block in the overall plan. It was, to use Secretary Connally's figure, one of the possums which had to be kept up in the tree until the overall plan could be accomplished. (Finding 42c). We conclude that the fixed loss and the withdrawal from litigation in the C-5A and Cheyenne programs are sufficient to establish Lockheed's reliance on the conduct of responsible Government officials to its detriment. (Finding 68n).

IV. Conclusion.

On all of the facts in the record before us, we hold that justice and basic fairness require that the Government be estopped to deny the legal enforceability of the $62,000,000 settlement tentatively reached by representatives of appellant and NAVSHIPS on 29 January 1971 and formalized in the contract modifications of 24 February 1971.

In reaching this result, we have given careful consideration to the views expressed in dissent. Those views do not seem to us to take into account the practical realities of the situation confronting Lockheed during the critical period ending with the simultaneous closing on the 1971 Credit Agreement on 14 September 1971. Thus, what Lockheed knew is not as significant to us as the source of the information it received from the Government. Our decision is simply this, that although Lockheed was given confused and contradictory information regarding its expectation that the $62,000,000 settlement would be approved, it reasonably relied on the signals ultimately given by and implicit in the conduct of the Deputy Secretary of Defense that he would take any action necessary to assure that his overall plan would be fully executed. Lockheed's reliance on those signals was precisely what Secretary Packard intended. The reliance was reasonable because Secretary Packard held the second highest office in the entire department, and had plenary authority over all of the DOD programs.

In our decision, we have cited the reliance of Lockheed's bankers and airline customers on Secretary Packard's implied promise merely to corroborate the reasonableness of Lockheed's reliance. While we are

not called upon to decide the issue, we observe that the most recent Restatement definition, quoted in the text above, would afford third parties, such as the banks and airlines here, a right to invoke an estoppel against the promisor, or Government, similar to that of the promisee, Lockheed.

The appeal is sustained. The Government is estopped to deny the legal enforceability of the $62,000,000 settlement reached with appellant. There is reserved for further proceedings the question of interest due on the unpaid balance of the settlement, in keeping with our ruling as set forth in the background section of this opinion, supra.

Dated 13 May 1975.

B. LEE BIRD
Administrative Judge
Member of Division No. 5
Armed Services Board of
Contract Appeals

I concur

ELVIR A. FAY, Lt. Colonel, USAF
Administrative Judge
Member of Division No. 5
Armed Services Board of
Contract Appeals

I dissent. See attached dissenting opinion.

JOHN LANE, JR.
Administrative Judge
Member of Division No. 5
Armed Services Board of
Contract Appeals

(Signatures continued)

I concur

RICHARD C. SOLIBAKKE
Administrative Judge
Chairman, Armed Services Board
of Contract Appeals

I concur

HARRIS J. ANDREWS, JR.
Administrative Judge
Vice Chairman, Armed Services
Board of Contract Appeals

I certify that the foregoing is a true copy of the decision and opinion by the Armed Services Board of Contract Appeals in ASBCA No. 18460, Appeal of Lockheed Shipbuilding & Construction Co., rendered in conformance with the Board's Charter.

Dated: May 14, 1975

GEORGE L. HAWKES, Recorder
Armed Services Board of
Contract Appeals

DISSENTING OPINION BY
ADMINISTRATIVE JUDGE LANE

I do not believe that the majority's decision states a convincing case for estoppel. I agree with the majority's basic findings of fact, but I believe that those facts require the conclusion that the Government is not estopped from asserting that the $62 million tentative settlement of the ship claims was never approved by higher authorities in accordance with applicable regulations and so is not binding upon the Government.

The majority properly recognizes that any estoppel must be based on the conduct or representations of persons within the Government either with authority to grant approval of the tentative settlement under the applicable regulation or with authority to waive the approval requirement of the regulation -- that is, the Navy Secretariat or Secretary Packard.

I. No Significant Difference in Factual Knowledge of the Parties on Crucial Dates

I do not believe the Findings of Fact show any significant discrepancy between Lockheed's knowledge and that of the Navy Secretariat and/or Secretary Packard with respect to any material facts, as of the time when Lockheed acted in detrimental reliance*/ -- that is, as of 7 June 1971 and/or mid-August 1971. The timing is important; all the elements of estoppel must be present concurrently for an estoppel to take place.

The majority has found that both Lockheed and Secretary Packard knew that the tentative settlement was subject to approval of higher Government authorities in accordance with applicable regulations. (FF 68f; Point III C 3 of Decision) Moreover, Lockheed was continually aware that approval had not in fact been given, even on

*/ The Lockheed actions found to constitute detrimental reliance were acceptance of the $200 million fixed loss on the C-5A contract and withdrawal of the C-5A and Cheyenne appeals to this Board. The C-5A contract was restructured to establish the fixed loss by contract modification effective 7 June 1971 (FF 51 b). The C-5A and Cheyenne appeals (ASBCA Nos. 14854 and 14183) were requested to be withdrawn in mid-August 1971 (apparently by motions dated 13 August 1971) and the appeals were dismissed on 13 August and 19 August 1971 respectively.

14 September 1971 when the new credit agreement was executed. (Ibid.) Thus Lockheed at all relevant times knew that the ship claims settlement was not final.

The majority has noted that Lockheed believed the approval would be readily given once the necessary documentation was obtained. In my view, however, this did not represent a difference in the parties' factual knowledge, because the belief was and is correct. The problem was in the difference between Lockheed's and Mr. Rule's understanding of what constituted necessary documentation. The majority has made no finding that the Navy Secretariat or Secretary Packard made any representations as to what particular form or type of documentation would be necessary. I have no doubt that initially they were as ignorant as Lockheed as to what Mr. Rule would require. But as the factual discussion below indicates, I believe that the Navy Secretariat, Secretary Packard, and Lockheed all became aware (or should have become aware) relatively concurrently of Mr. Rule's criteria. Specifically, I do not believe that on the crucial dates of actions in detrimental reliance, Lockheed was oblivious to the multiplying warning signs as to the difficulty of obtaining Navy approval.

The points of alleged factual ignorance emphasized by the majority are that approval was not a mere formality and would not be given lightly, but rather the $62 million settlement would be subjected to a searching, exhaustive review which existing documentation could not possibly satisfy. There is no finding by the majority, however, that Lockheed ever believed the review and approval by higher authority would be a rubber stamp, or other than on the substantive merits of the claims. Rather, it was expressly understood in the exchange of letters between Secretary Packard and Lockheed of 27 January and 1 February 1971 agreeing to the overall settlement that the final resolution of the ship claims would be left to "normal procedures." There is no finding that Lockheed then believed that normal procedures were a "mere formality" under which approval would be "given lightly." Nor is there any finding that Lockheed later came to believe this.

On the contrary, as events unfolded between February 1971 and the crucial reliance dates of 7 June and mid-August 1971, Lockheed had to become increasingly aware of the substantive nature of the review and of the fact that approval would not be a mere formality lightly given.

On 2 April 1971, after preliminary review, Mr. Rule rejected the Business Clearance Memorandum as "entirely unsatisfactory"

(FF 32), though the majority does not find whether Lockheed knew this. In any event, Secretary Packard testified before the Senate Armed Services Committee on 7 May 1971 that the ship claims "will continue to be handled by the same procedures we use otherwise. I think there is no special action of any kind needed on that,"and his prepared statement noted that the agreement (with some confusion as to its identification which could not have misled Lockheed) "is still in the process of review by the Navy." (FF 36) Lockheed had to be aware of this testimony. It confirmed the applicability of the usual Navy review procedure.

During April and May 1971 several events took place (as detailed in FF 37) which must have alerted Lockheed to the increasing disfavor with which not only the Comptroller General, Senator Proxmire, and Vice Admiral Rickover (all influential persons), but also Mr. Rule himself, viewed the Navy's approach toward settling ship claims, including in particular the judgmental as opposed to tangible evidence approach. Whether or not Lockheed was actually aware of the Secretary of the Navy's 28 May 1971 letter to Senator Proxmire, emphasizing that the Lockheed claims would be given "exhaustive evaluation and documentation of facts and an in depth legal review," (FF 37c) it had to become aware of the worsening political climate and of the substantially stricter approach which Mr. Rule was taking in his claims settlement review function.

On 26 May 1971, Secretary Packard testified before the House Appropriations Committee that, on the ship claims, the Government was doing "doublechecking to be sure the claims can be appropriately verified." (FF 39) This was a public avowal of the substantive nature of the review.

It was at that point, as of 7 June 1971, that the C-5A contract was restructured -- the first act of detrimental reliance.

Events intervening between that date and mid-August, when the other actions in detrimental reliance were taken, made Lockheed ever more aware of the substantive nature of the Navy review. On 23 July 1971 Mr. Rule rejected the Avondale settelement and severely criticized NAVSHIP's settlement procedure (FF 46). In the period 3-9 August 1971, Admiral Sonenshein withdrew Lockheed's claims from Mr. Rule's CCCSG, and Lockheed was informed of the fact, together with the reasons, including evidentiary deficiencies by reason of the absence of cause and effect correlation and precise quantification of costs. (FF 47-48)

On 13 August 1971, the same day that Lockheed apparently requested dismissal of its C-5A and Cheyenne appeals, a meeting took

place between Lockheed's Mr. Osborn and Assistant Secretary of the Navy Ill, to which the majority seems to attach great significance. They discussed withdrawal of the claims from Mr. Rule. Secretary Ill testified at our hearing:

> ". . . I did state at that time that it was better that we not try to force a decision out of the Gordon Rule Committee that we retract it. And I thought we would get the claim settled faster if we did it that way." (FF 49)

Unlike the majority, I view that statement as all the more confirming the substantive nature of the review by Mr. Rule, and as indicating that the Secretariat would not bypass Mr. Rule.

(Events thereafter are irrelevant to this discussion of the estoppel issue, since the detrimental reliance found by the majority was completed in mid-August 1971 with the withdrawal of the C-5A and Cheyenne appeals.)

Thus I do not believe that on the crucial reliance dates, there was any significant difference between Lockheed's factual knowledge and that of the Navy Secretariat and Secretary Packard, regarding the substantive and indeed exhaustive nature of the review Mr. Rule was conducting.

II. No Implied Promise by Government Officials to Direct, Overrule, or Bypass Mr. Rule

I do not believe the facts found by the majority can support a finding of an implied promise to Lockheed, in the conduct and encouragement by Secretary Packard or the Navy Secretariat, that if necessary they would direct, overrule, or bypass Mr. Rule or waive the approval requirement. Lockheed knew that its settlement had been withdrawn from Mr. Rule by NAVSHIPS. Lockheed also knew of the increased strictness of Mr. Rule's criteria in evaluating settlements. When it sought help from Secretary Packard's office and the Navy Secretariat, they urged Lockheed to continue trying to satisfy Mr. Rule, even as late as 13 August, six and a half months after the settlement had been tentatively reached and at a time when the execution of the credit agreement was closely pending. Moreover, Lockheed was necessarily aware of the political climate described earlier.

In this context, I do not believe Lockheed could have reasonably construed the conduct or encouragement of Secretary

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Packard and the Navy Secretariat to pursue the existing course as an implicit promise to direct, overrule, or bypass Mr. Rule if necessary. On the contrary, I believe the events and context must have made Lockheed aware that they could or would not do so.

III. Government Officials' Assumptions and Expectations Not a Reasonable Basis for Reliance

If an implied promise to direct, overrule, or bypass Mr. Rule cannot be found, then the most that could be said is that Secretary Packard and the Navy Secretariat conveyed to Lockheed their assumption and expectation that the claims could and would be properly documented and that Mr. Rule would approve the settlement, when they should have known better, and on that basis encouraged Lockheed to take detrimental action in reliance. I regard this proposition, however, as insufficient in both law and fact to support an estoppel.

As a matter of law, I regard an assumption or expectation, even on the part of Secretary Packard or Secretary Ill, as an inherently unreliable basis for Lockheed to act. Inherent in the concepts of "assumption" and "expectation" is the possibility of error. Lockheed was certainly not so naive in such matters as to be entitled to rely blindly on the Secretaries' assumptions, nor do the findings of fact indicate that Lockheed had any reason to believe the Secretaries had any inside knowledge that Mr. Rule was planning to exercise his judgment in favor of the settlement. Under these circumstances, as a matter of law, Lockheed's action was not reasonable reliance but an assumption of the risk of failure of the settlement.

Moreover, on the facts, as demonstrated earlier, Lockheed had full reason to know that the Secretaries' assumptions and expectations were overly optimistic. Thus the facts show that any reliance by Lockheed on the Secretaries' expectations and on their encouragement based thereon was unreasonable.

IV. Reliance by Lockheed

The ultimate basis for the majority's decision I believe is the view that it would be unfair not to estop the Government where Secretary Ill expressly, and Secretary Packard impliedly, encouraged Lockheed to accept and implement agreements to substantial losses on the C-5A and Cheyenne contracts, and to drop its appeals on those contracts, as part of a package deal of which the $62 million ship claims settlement was an integral part, when they knew or should have known that absent their personal intervention, the $62 million settlement was doomed.

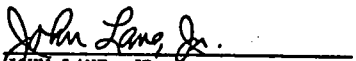
I agree that the Government encouraged Lockheed to proceed as it did, but I do not believe that Lockheed was misled. As I have said, I think Lockheed was essentially aware of the problem in obtaining ship claims approval. Lockheed's very existence was at stake, however, and it could not red flag the problem without jeopardizing the entire credit agreement, which was premised on settlement of the ship claims as well as the other disputes, and which would enable it to avoid bankruptcy.

Lockheed had approached the Secretaries, who urged it to continue trying to satisfy Mr. Rule -- which at least implicitly told Lockheed that they could or would not at that time direct, overrule, or bypass Mr. Rule. Lockheed may well have decided it had no practical alternative but to proceed on the planned course of disposing of the C-5A and Cheyenne disputes and continuing the processing of the ship claims through normal channels. Thus, high Government officials may have encouraged Lockheed to proceed without forcing the approval issue, but I believe Lockheed proceeded with full awareness that the ship claims settlement might very well not go through. In doing so, Lockheed may well have been acting in its own self-interest rather than in reliance on Government conduct or assurances. I am not satisfied that the contrary has been shown.

V. Conclusion

For the foregoing reasons, I would not find estoppel against the Government in this appeal. This would not, of course, be a denial of the claims, but at worst would force Lockheed to litigate the ship claims before this Board on the merits.

Parenthetically, I agree with the majority's implicit finding that appellant, the shipbuilding subsidiary, should be treated as one with its parent, Lockheed, who took the actions found to be detrimental reliance. The conduct of the parties seems to establish a proper basis for piercing the corporate veil.



JOHN LANE, JR.
Administrative Judge
Member of Division No. 5,
Armed Services Board of Contract Appeals

ITEM 4c.—*June 12, 1975—Navy Appeal of Armed Services Board of Contract Appeals decision in the Lockheed case. The Board rejected the Navy's request for reconsideration*

ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of	)
	)
LOCKHEED SHIPBUILDING AND CONSTRUCTION COMPANY	)
	) ASBCA No. 18460
Under Contract NObs-4660	) (Appeal No. 1)
NObs-4765	)
NObs-4785	)
and NObs-4902	)

RESPONDENT'S MOTION FOR RECONSIDERATION AND FOR REFERRAL TO THE SENIOR DECIDING GROUP

E. GREY LEWIS
General Counsel

WILLIAM L. BROWN
Deputy General Counsel

MORRIS AMCHAN
Associate Counsel

ROBERT E. LIEBLICH
Associate Counsel

12 June 1975

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LIST OF TABS REFERRED TO

Principal Witnesses and Participants

Office Secretary of Defense

David Packard

Deputy Secretary of Defense
(January 1969 - December 1971)
(Tr. p. 5)

Barry J. Shillito

Assistant Secretary of Defense (I&L)
(February 1969 - February 1973)
(Tr. p. 1244)

Hugh McCullough

Special Assistant to ASD(I&L)
(September 1969 - June 1972)
Head of OSD Monitoring Team re Lockheed
(March 1970 - June 1972)
Principal Deputy to ASD(I&L)
(June 1972 - June 1973)
(Tr.Exh. G-78, pp. 9 et. seq.)

John M. Spratt, Jr.

Member of OSD Monitoring Team, from Assistant Secretary of Defense, Comptroller's office
(Fall of 1969 - May/June 1971)
(Tr. p. 14-5)

Secretary of the Navy

John H. Chafee

Secretary of the Navy
(January 31, 1969 - May 1972)

John W. Warner

Under Secretary of the Navy
(February 14, 1969 - May 1972)
Secretary of the Navy
(May 1972 - April 1, 1974)
(Tr. p. 1992 et. seq.)

Frank Sanders

Assistant Secretary of the Navy (I&L)
(February 1969 - July 1971)
Assistant Secretary of the Navy (Financial Management)
(August 1971 - May 1972)
(Tr.Exh. G-74, p. 6)

Charles L. Ill

Special Assistant to Secretary of Navy, for ship-building matters
(Early 1969 - July 1971)
Assistant Secretary of Navy (I&L)
(July 17, 1971 to May 15, 1973)
(Affidavit attached to Motion to Dismiss ; also, Tr. p. 2063 et. seq.)

Office of Naval Material

Admiral Joseph Galantin

Chief of Naval Material
(March 1, 1965 - June 30, 1970)
(Tr.Exh. G-73, p. 6)

Admiral J. D. Arnold

Chief of Naval Material
(July 1, 1970 - November 1971)

Admiral I. C. Kidd

Chief of Naval Material
(November 1, 1971 - date)

Admiral R. G. Freeman, III

Deputy Chief of Procurement, (under Admirals Galantin, Arnold and Kidd)
(1968 - 1973)
(Tr. p. 928 et. seq.)

Gordon W. Rule

Chairman, Contract Claims Control and Surveillance Goup, under Chief of Naval Material
(October 30, 1969 - November 12, 1971)
(Tr. p. 1573 et. seq.; Tr.Exh. G-76)

Naval Ship Systems Command

Admiral N. Sonenshein

Commander, NAVSHIPS
(July 31, 1969 - July 31, 1972)
(Tr. p. 1428 et. seq.)

Admiral Kenneth L. Woodfin

Deputy Commander for Contracts, NAVSHIPS
(Aug. 1, 1970- June 20, 1973)
(Tr.Exh. G-81)

Captain Arthur W. Holfield

Special Assistant For Claims to COMNAVSHIPS
(October 1, 1969 - June 30, 1971)
(Tr.Exh. G-75, p. 15)

Lockheed Aircraft Corporation

Daniel J. Haughton

Chairman of the Board
(May 1967 to date)
(Tr. p. 150)

Ralph J. Osborn

Senior Vice President, in charge of Shipbuilding Company matters since 1967 -
(Tr.Exh. G-68, p. 7; Tr. p. 1107 et. seq.)

Roy A. Anderson

Vice President and Comptroller
(December 1969 - August 1971)
Senior Vice President, Finance
(August 1971 to date)
(Tr. p. 349)

John E. Cavanagh

Chief Counsel and Assistant Secretary
(1968 - 1971)
Vice President and General Counsel
(1971 - date)
(Tr. p. 1190)

Lockheed Shipbuilding and Construction Company

Arch M. Folden

President
(September 1964 - January 1, 1973)
Note - After February 1, 1971 Folden was not active due to assignment to L-1011 problem
(Tr.Exh. G-67, p. 75, also Tr. pp. 628-629 (Waters)

Robert N. Waters

Executive Vice President, V. President, Administration
(Fall 1969 - February 1972)
In August 1968, Mr. Waters was put in charge of Cost Recovery Organization, and after February 1, 1971, was for all practical purposes, Chief Executive Officer of the Shipbuilding Company, notwithstanding change in title on 1 November 1971 to Assistant Treasurer LAC.
(Tr. p. 624 et. seq.)

Turner Joy

Washington representative, maintained liaison with NAVSHIPS
(R4, R-88)

OTHERS

Frederick J. Leary

Senior Vice President, Bankers Trust Company
(Tr. p. 1852 et. seq.)

Ralph Murray

Attorney for Bankers Trust Co.
(Tr. pp. 13-116 et. seq.)

Timothy G. Greene

Special Assistant to General Counsel, Treasury
(March 71 - August 25, 1971)
(Tr. p. 1292 et. seq.)

RESPONDENT'S MOTION FOR RECONSIDERATION
AND FOR REFERRAL TO THE
SENIOR DECIDING GROUP

I

Introduction

This motion for reconsideration is made pursuant to Rule 29 and for referral to the Senior Deciding Group under paragraph 4 of the Board's charter which provides for referral of an appeal when it is "of unusual difficulty, significant precedential importance, or serious dispute within the normal decision process." The decision of the Board was released on 14 May 1975 and Respondent received a certified copy thereof on the same day. The majority opinion by Administrative Judge Bird is 60 pages, and the minority opinion of administrative Judge Lane is 6 pages (pp. 62-67). It is submitted that each of these two opinions indicates on its face that the criteria for referral to the Senior Deciding Group are met in this case.

We shall, in this submission, discuss several of the principles on which the majority based its conclusion that the Government is "estopped to deny the legal enforceability of the $62,000,000 settlement tentatively reached by representatives of Appellant and NAVSHIPS on 29 January 1971" and shall indicate what, in our view, the Board overlooked

or misapprehended in this regard. We shall also request that certain supplemental findings of fact be made as we contend that the findings made are inadequate and that they overlook significant facts. This request for such supplemental findings and the evidentiary support therefor will appear in the context of the argument to which they pertain.

II

Outline of Analysis

There are several major defects in the majority opinion in this case. Essentially, however, they all revolve around the principle of estoppel and the elements that give rise to an estoppel against the Government. To facilitate the Board's understanding of the many reasons why the majority opinion is in error in holding that the Government is estopped to deny the existence of a settlement agreement between the Government and Lockheed, the analysis has been divided into three major sections, each with several subsections.

A. The Government cannot be estopped if acting in its sovereign rather than its proprietary capacity.

In this section it will be argued that even if Deputy Secretary Packard, whose actions have been held to give rise to the estoppel, did promise a $62 million payment to Lockheed as part of a larger package, his promise could have been

fulfilled only by an exercise of the sovereign power of the Government under Public Law 85-804 or under the Emergency Loan Guarantee Act, and therefore there was no enforceable proprietary obligation on the part of the Government. The point will also be made that this Board is itself performing an unauthorized sovereign act in ruling as it has.

B. Secretary Packard lacked the authority to make an agreement of the sort that the Board has ruled the Government is estopped to deny.

It is well settled that actions of a Government agent beyond the scope of his authority are not binding on the Government. In this section of the analysis it will be argued first, that the Deputy Secretary of Defense is unable to obligate specifically appropriated funds, and therefore could not enter into an agreement of the sort that the Board has created by estoppel; second, that Navy regulations actually known to Lockheed made it quite clear to all parties that only certain senior Naval officers and officials could ratify the proposed settlement and make it binding on the Government; and third, that the regulations were binding on all individuals and organizations involved.

C. Several crucial elements of estoppel are lacking.

It is unclear whether the Board found a promissory estoppel or a simple equitable estoppel.

A promissory estoppel is lacking, if for no other reason, because not even Deputy Secretary Packard ever promised a $62 million settlement to Lockheed. In addition, it is clear that Lockheed was fully knowledgeable of the "true facts" and that Lockheed's actions were induced by financial desperation rather than by reliance on anything that Secretary Packard or other Government representatives did. Lastly, the attempt by the Board majority to bootstrap a reliance by Lockheed out of actions taken by Lockheed's bankers and representations made to them is clearly misplaced.

III

Analysis of Majority Opinion

A. The Majority erred in concluding that the Government was acting in a proprietary rather than a sovereign capacity and therefore could be estopped.

The majority opinion, citing United States v. Georgia-Pacific Company, 421 F. 2d 92 (9th Cir. 1970), holds that an estoppel may be found against the Government if two conditions are satisfied, "first, the Government must be acting in its proprietary, rather than in its sovereign, capacity; and second, the Government representative whose acts form the basis for the estoppel has been acting within the scope of his authority" (at p. 48).

Quoting from Georgia-Pacific, supra, the majority defines action by the Government in its sovereign capacity to be when it "is carrying out its unique Governmental function for the benefit of the whole public." With this premise, the majority opinion concludes (at p. 48):

> "In the present case, when the Government entered into the tentative ship claims settlement on 29 January 1971, it is plain that it was dealing with Lockheed as a private concern would in a commercial contract, rather than carrying out unique Governmental functions for the benefit of the whole public. We conclude that the Government was acting in its proprietary capacity."

But this holding of the majority is inconsistent with its own conclusion that estoppel is predicated on "events that happened after 1 February 1971 and before 14 September 1971, on which date the participants in this case became irrevocably committed to the 1971 Credit Agreement and related financial documents." (at p. 47)

1 February 1971 is the date when Lockheed responded [FF 22] to Mr. Packard's letter of 27 January 1971 which announced [FF 19] that while litigation was pending on the C-5A and Cheyenne contract disputes, "DOD would not make any payments in excess of the contract ceiling nor could it restructure the existing contracts."*

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* Footnote on following page.

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14 September 1971 is the date when the "1971 Credit Agreement and the Guarantee Agreement were executed by Lockheed, the banks, and the Emergency Loan Guarantee Board." (FF 55)

The majority opinion is thus guilty of a glaring non sequitur. The tentative settlement agreement of 27 January 1971 may have been made by NAVSHIPS acting for the Government in a proprietary, contractual capacity. But the actions that the Board majority has held create an estoppel against the Government were sovereign acts taken by Deputy Secretary Packard after the tentative agreement was reached. Hence the issue here is whether Secretary Packard was acting for the Government in a contractual or a sovereign capacity, and it is clear from the uncontested evidence that all his actions were of a sovereign nature. Secretary Packard acted under the authority of P.L. 85-804 in restructuring the C-5A and Cheyenne contracts; with his encouragement, the Emergency

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* FF 18a summarizes Haughton's letter of 5 January 1971 to Mr. Packard, as a rather lengthy discussion of the intricacies of the C-5A program and as an election to litigate the core of the disagreements rather than to accept a fixed loss of $200 million. What Lockheed wanted was for the Air Force to finance its litigation before the Board by continuing to pay on the C-5A contract an amount in excess of the ceiling. This Mr. Packard in his 27 January 1971 letter stated the Air Force could not do. The 1 February 1971 reply agreed to accept a fixed loss and to withdraw the C-5A appeal. The letter is attached hereto as TAB "A". Mr. Packard's memorandum of 4 June 1971 (FF 40) to the Secretaries of the Army and Air Force fixes the amount which Lockheed would need to complete the contract at approximately $700 million (TAB "B" attached hereto, at p. 6).

Guarantee Loan Board executed the Credit Agreement under the authority of the Guarantee Loan Act. In each case, the act was sovereign, not proprietary.

1. Since Public Law 85-804 action requires a finding that a proposed contract action without consideration will "facilitiate the national defense", it follows that any such action by the Government is not one of a proprietary nature.

The 4 June 1971 memorandum of Secretary Packard (FF 40) directing the Secretaries of the Army and Air Force under the authority of P.L. 85-804* to restructure the Cheyenne and C-5A contracts (R4, A-54, sets forth the history of the C-5A contract dispute, (TAB "B"). The required statutory determination under P.L. 85-804, that the action will "facilitate the national defense" is made with the following statement:

> "If the C-5A disputes were left unsettled to proceed through litigation, Air Force progress payments would cease and Lockheed would be required to fund production costs pending the outcome of litigation many years in the future. The Air Force latest estimate of Lockheed's total cost to produce the 81 C-5A aircraft is $3248.2 million for basic airframe exclusive of initial spares and ground equipment against which, based on interpretation most favorable to the Government of the existing contract's provisions, only an estimated $2528.8 million can be paid to Lockheed. Therefore, the financial burden, in terms of allowable costs, on the Corporation which it would have to carry in order to fund the contract to completion is approximately $700 million. The Corporation's financial situation is such that production cannot continue if most of this amount is not made available by the Air

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* Footnote on following page.

Force. The point has now been reached where it is necessary to amend the contract and to commence the use, in accordance with section 504 of P.L. 91-441, of the $200 million made available by the Congress for this purpose."

"The C-5A aircraft is to provide a long range airlift capability for the transportation of equipment and supplies in support of combat units, including items too large for any other type of aircraft. The timely completion of the C-5A program is necessary for the maintenance and improvement of the airlift capability needed to enable the United States to respond rapidly and adequately to military contingencies around the world. It is considered essential to the national defense. The Air Force has taken delivery on production aircraft number 40, which is in accordance with the present two per month schedule leading to delivery of the 81st aircraft in February 1973. It appears that the program can be brought to a more successful conclusion technically and under better cost and management control with a revised contractual arrangement.

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* The text is set out in ASPR 17-501 (Act of August 28, 1958, 50 U.S.C. §1431-1435). It provides in Section 5 thereof that it shall be effective "only during a national emergency declared by Congress or the President and for six months after the termination thereof . . . " etc. Section 1 provides that "any department or agency of the Government which exercises functions in connection with the national defense, acting in accordance with regulations prescribed by the President for the protection of the Government" may be authorized by the President, "to enter into contracts or into amendments or modification of contracts heretofore or hereafter made and to make advance payments thereon, without regard to any other provisions of law relating to the making, performance, amendment, or modification of contracts, wherever he deems such action would facilitate the national defense." (Emphasis added).

The Executive Orders issued thereunder (ASPR-17-502) recite that "in view of the existing national emergency . . . and deeming that such action will facilitate the national defense it is hereby ordered."

"In view of the above, I have determined that the following action is necessary to permit the continuance of this essential defense program. Such action will thereby facilitate the national defense.

"Pursuant to the authority contained in Public Law 85-804 and in accordance with the tentative agreement reached with the Lockheed Aircraft Corporation, the Department of the Air Force will enter into a supplemental agreement with the Corporation which will convert the present fixed price incentive contract to a cost-reimbursement contract with provision for a fixed loss of $200 million. The Government's obligations thereunder will be expressly made subject to applicable statutory restrictions and the availability of appropriations. The fixed loss will be comprised of costs otherwise allowable for reimbursement under the restructured contract. Provision will be made in the restructured contract for the contractor to maintain its investment of unreimbursed allowable costs of $100 million. This amount will not be reimbursed by the Government and will constitute one-half of the fixed loss. While the Air Force will initially fund the contractor as costs are incurred for the remaining $100 million of the fixed loss, the contract will provide for its repayment in installments to the Government commencing with the beginning of the first calendar year following delivery and final acceptance of the 81st aircraft. Terms of repayment shall be ten percent of net corporate earnings before taxes per annum or $10 million, whichever is the greater with interest on the unpaid balance at the prime rate then in effect. A lien on the Lockheed Marietta plant and facilities will be taken as security for repayment. Provisions will be included in the restructured contract which provide for the acceleration of the payments in the event of a Lockheed bankruptcy or at the option of the Government upon default of any payment and for an increase in annual payment in any year dividends are paid." (Emphasis added).*

* FF 15 finds that as early as October 1970, Lockheed was informed that the restructuring of the C-5A and Cheyenne contracts would have to be under the extraordinary authority of P.L. 85-804. At that time the SRAM dispute had already been settled as the finding indicates. (See also FF 17c, e).

Lockheed also knew at that time that the "blue suit" Navy had sustained its position with DOD (meaning OSD) that it would handle the shipbuilding claims itself and DOD should stay completely out of the Navy's affairs in this area. DOD did not regard the ship claim as part of the total Lockheed problem (Tr.Exh. G-31). FF 6d states: "From the start, Appellant was aware that its ship claims were to be handled by the Navy rather than the Office of the Secretary of Defense (OSD) and that they were not to be treated as merely a part of the total problem." (Emphasis added).

Lockheed also knew, at that time, as its own internal memorandum showed (Tr.Exh. G-31), that the shipbuilding claims could only be taken away from the Navy by OSD by the use of P.L. 85-804 authority granting it extraordinary relief. Thus, in explaining the Navy position with DOD, the memorandum states:

> " . . . there can be no doubt that they [the Navy] are additionally adamant in this position because of the total claims now filed against the Navy. If they were to give what might be termed 'extraordinary relief' to Lockheed, they would be hard pressed not to do it for all the shipyards with claims. All in all the Navy is apparently trying to minimize any claims settlement with Lockheed so as to clear its skirts of as much wrongdoing as possible as well as set a precedent for resolution of the other shipyard claims. The Navy can then toss the ball back to DOD to grant Lockheed 'extra-contractual' relief if DOD desires to do so." (Emphasis added).

Mr. McCullough agreed that Mr. Packard had authority under P.L. 85-804 to include the shipbuilding claims in his overall plan. He testified (Tr. pp. 1669, 1670): " . . . he could have exercised 85-804 for the shipbuilding claims. If you really go that far, I think that he had the authority to do that. And I just draw the distinction between using 85-804 for Cheyenne and the C-5A and not using it for ships."

Lockheed had been asked "to present under Section 17 of ASPR the elaborate documentation for an 85-804 proceeding which required that they apply for that kind of relief with our [sic] consideration" for the C-5A and Cheyenne. (McCullough, G-78, at p. 83).*

Even if the Board majority is correct in its finding that the shipbuilding tentative settlement was part of the overall plan** (FF 68a, 68d), the overall plan -- as Lockheed fully knew -- could only be carried out under the authority of Public Law 85-804. It necessarily follows that in executing the overall plan the Government was acting not in a proprietary role, but rather in its sovereign role. The cases hold unequivocally that estoppel does not apply in such a situation.

* "Highlight" entry of 5 Dec. 1970 states (R4, R89) "Lockheed is developing data for a Public Law 85-804 certified statement and audit. Our plan is to tie the GAO into this audit." Entry of 8 January 1971 reads "DCAA has been given a 15 January deadline to complete their audit of the Lockheed data in accordance with the ASPR requirements under 85-804".

** We think this finding is not supported by substantial evidence and will discuss that post.

2. The Emergency Loan Guarantee Act was a legislative act of a sovereign nature and not proprietary. The execution of the credit agreement on 14 September 1971 between Lockheed, the Banks and the Emergency Loan Guarantee Board was pursuant to the authority of that Act and does not make the Government action proprietary.

Before a guarantee of a loan could be made under the Act, the Guarantee Board was required to make a specific finding, among other things, that:

> "the loan is needed to enable the borrower to continue to furnish goods or services and failure to meet this need would adversely and seriously affect the economy of or employment in the Nation or any region thereof. (Emphasis added).

That finding was made by the Board on September 9, 1971. (See discussion, pp. 32-43, Tr.Exh. G-17, supra).

Even Mr. Leary considered that the credit agreement was no longer a Department of Defense matter, but that of the Secretary of the Treasury. He was asked what he would have done had he been told prior to 14 September 1971 that NAVSHIPS had been informed by higher Navy authority that its submission requesting approval of the tentative settlement was defective and NAVSHIPS had withdrawn its request. He replied he would delay the closing and talk to the Secretary of Treasury (Tr. 13-62-65) not the Secretary of Defense. He then testified as follows (Tr. pp. 13-64, 65):

> "Q . . . if you had those facts prior to September 1971, why would you not have gone to the Secretary of Defense and told him that here is a package deal, and the Navy is reneging on that deal. Did you ever do that?
>
> A . . . I did not go to the Secretary of Defense . . . The situation which existed as between the banks and the United States Government in its total concept, had substantially changed during the summer of 1971 to the extent that the Congress of the United States became involved, which is a state of facts quite different from the state of facts prior to the legislation."

And at Tr. p. 13-63, he further testified:

> "At that point, we were working together in the public interest . . . "

In the light of the foregoing it can hardly be contended that the 1971 Credit Agreement was a proprietary Government act.

Accordingly, there can be no estoppel against the Government by virtue of action taken under the Emergency Guarantee Loan Act.

3. The ASBCA does not have secretarial authority and cannot in substance grant extraordinary contractual relief under the guise of "Justice and basic fairness" by applying estoppel against the Government.

The jurisdiction of the Board is limited by the scope of the "Disputes" clause. The decision of the Board in this case reaches beyond its jurisdiction into an area of extraordinary contractual relief, and in reality is an exercise of P.L. 85-804 authority.

We have already argued that Mr. Packard could not circumvent the requirements of P.L. 85-804 by undertaking to embrace the Lockheed shipbuilding claims in an overall plan proposed to the Congress as a P.L. 85-804 action and without making the required determination that the action would facilitate the national defense (the determination that was made as to the C-5A and Cheyenne). Notwithstanding Mr. Packard's denial that he included the ship claims within the umbrella of his P.L. 85-804 authority, he has in fact done so if the Board accepts that as a basis for estoppel against the Government. If, as we argue, this by-passing of P.L. 85-804 and its accompanying requirement of Congressional approval constitutes action beyond Mr. Packard's authority, similarly the ratification by the Board of such action makes it a participant in granting extraordinary contractual relief. This, we submit, is beyond its jurisdiction.

B. Secretary Packard Lacked Contractual Authority to Enter into a Settlement of the Sort the Board Held He is Estopped to Deny.

In its conclusion (at p. 59), the majority opinion states:

> "Our decision is simply this, that although Lockheed was given confused and contradictory information that the $62,000,000 settlement would be approved, it reasonably relied on signals ultimately given by and implicit in the conduct of the Deputy Secretary of Defense that he would take any action necessary to assure that his overall plan would be fully executed. Lockheed's reliance on those signals was precisely what Secretary Packard intended. The reliance was reasonable because Secretary Packard held the highest office in the entire department and had plenary authority over all of the DOD programs." (Emphasis added).

This conclusion is a blanket adoption of Mr. Packard's telegram to Deputy Secretary Clements on 3 October 1974 (Tr.Exh. G-28, a copy of which is attached hereto as TAB "C").

But this assumption on the part of the majority that the Deputy Secretary of Defense has plenary authority over all DOD programs including the use of Navy shipbuilding appropriated funds after they have been obligated by the Navy is, we submit, clearly erroneous; it overlooks express statutory limitations on the authority of the Secretary of Defense to enter into contractual agreements. It is not enough that Mr. Packard believed he had this authority (Tr. pp. 606-608);* lacking such authority in actuality, he could not bind the Government.

1. Once the Secretary of Defense has approved the scheduled rates of obligation of funds appropriated to the departments he may not interfere with the internal administration of appropriated funds within the military departments.

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* He was not referring to authority under P.L. 85-804. That authority we concede he has. Our point is that a substantive 85-804 action may not be accomplished indirectly, and this, we submit, is the error in the majority decision, particularly since Congressional approval of such actions in amounts over $25 million is a statutory requirement and cannot be circumvented by equivalent action.

The National Security Act of 1947 as amended by P.L. 85-599 of August 6, 1958 indicates (50 USC §401) the Congressional declaration of purpose as follows:

> " . . . to provide a Department of Defense, including the three military Departments of the Army, the Navy (including naval aviation and the United States Marine Corps), and the Air Force under the direction, authority, and control of the Secretary of Defense; to provide that each military department shall be separately organized under its own Secretary and shall function under the direction, authority and control of the Secretary of Defense; to provide for their unified direction under civilian control of the Secretary of Defense; but not to merge these departments or services . . . (Emphasis added).

The Department of Defense with the Secretary of Defense as its head was established by the Act cited as "The National Security Act Amendments of 1949". The legislative history of those amendments (1949 U.S. Code Congressional Service p. 1771 et seq), shows the responsible committees reporting (at p. 1773):

> "A significant provision of the declaration of policy [50 U.S.C. §401] is that the three military Departments of the Army, the Navy and the Air Force shall retain their identity and shall be administered on a departmental basis." (Emphasis added).

A new Title IV was added, "Promotion of Economy And Efficiency Through Establishment of Uniform Budgetary and Fiscal Procedures And Organizations", and under that title appeared the following (attached as TAB "D", 3 pages):

"Obligation of Appropriations

> "Sec. 404. In order to prevent overdrafts and deficiencies in any fiscal year for which appropriations are made, on and after the beginning of the next fiscal year following the date of enactment of this Act appropriations made to the Department of Defense or to the military departments, and reimbursements thereto, shall be available for obligation and expenditure only after the Secretary of Defense shall approve scheduled rates of obligation, or modifications thereof: Provided, That nothing in this section shall affect the right of the Department of Defense to incur such deficiencies as may be now or hereafter authorized by law to be incurred." (Emphasis added).

House Report No. 1064 (to accompany H.R. 5632) explained this Section 404, as follows:

"Obligation of appropriations (sec. 404)

> This section requires the Secretary of Defense to approve scheduled rates of obligation of funds appropriated to the departments and agencies of the National Military Establishment before they may obligate any such funds. The power granted to the Secretary of Defense, however, is not intended to interfere with the internal administration of appropriated funds within the three departments and the agencies through the normal internal allotment and allocation procedures once the Secretary of Defense has approved the scheduled rates of obligation authorized under this section.

> "The purpose of the section is to prevent overdrafts or deficiencies. An exception is provided, however, where deficiencies are permitted under existing law, as in case of expenditures for fuel, subsistence, and transportation." (Emphasis added).

(A copy of the excerpt of the Report and H.R. 5632 is attached hereto as TAB "E", four pages).

Senate Report No. 366 (to accompany S. 1843 [the U.S. Code Congressional Service 1949 in quoting this report erroneously identifies S. 1832]) had the same provision as Section 406 of the Senate Bill.

Its explanatory statement is the same as that of the House (See TAB"F" attached hereto which contain excerpts of both the Report and Section 406 of S. 1843).

The 1962 amendments (P.L. 87-651, TAB "G" attached hereto) retained the substance of Section 404 (Obligation of appropriations) when it amended 10 U.S.C. §2204 to make it read as follows:

> "§ 2204. Obligation of appropriations
>
> "To prevent overdrafts and deficiencies in the fiscal year for which appropriations are made, appropriations made to the Department of Defense or to a military department, and reimbursements thereto, are available for obligation and expenditure only under scheduled rates of obligation, or changes thereto, that have been approved by the Secretary of Defense. This section does not prohibit the Department of Defense from incurring a deficiency that it has been authorized by law to incur." (Emphasis added).

The intention of the Congress is plain that the Secretary of Defense, once he has approved the scheduled rates of obligation to the departments, may not interfere with the internal administration of the departments as to the use of those funds.

We submit that the premise in the majority opinion (p. 59) that Secretary Packard "held the highest office in the entire department and had plenary authority over all of DOD programs"* is based on a misapprehension and a failure to distinguish between authorization of a program by him (which is implicit in his plenary control over rate of obligation of appropriated funds) and the administration of an authorized program by the department concerned. If the Secretary of Defense, may impliedly promise a contractor that a claim will be settled at a given figure, after assuring the Congress that he will not interfere with the Navy Department's administration of the contract and evaluation of the claim, then the Congressional mandate that each military department "shall retain their identity and shall be administered on a departmental basis" is meaningless.

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* Even the authority of the President of the United States is limited, as the Court held in Youngstown v. Sawyer 343 U.S. 579 (1952) where he issued an Executive Order in the purported exercise of his authority as Chief Executive and Commander in Chief of the Armed Forces, (reciting the fighting then in Korea) directing the Secretary of Commerce to take possession of and operate the nation's steel mills.

2. OSD and the Secretary of the Navy Informed the Congressional Committees of the substance of the Navy Regulation and represented that it would be strictly followed.

From the very beginning of his involvement in Lockheed's financial problems, Secretary Packard had assured Lockheed and the Congressional Committees that Lockheed's "shipbuilding claims would be handled in the usual Navy procedures and will not be treated unusually in an unusual manner because they are in financial difficulty"* (Tr. p. 82). Thus on 27 May 1970 he testified before the Senate Armed Services Committee (Tr. Exh. G-4, Tr. pp. 81, 82):

> "I have contended in my initial discussions with Lockheed management that these claims similar in nature to those of other shipbuilders will be processed through the established Navy procedures and that they should not be treated in an unusual manner only Lockheed should not be -- because Lockheed now finds itself in financial difficulty."

The majority makes no finding on this. While we agree with FF 6-d, a supplemental finding with respect to the above is needed particularly in the light of FF 10 relating to a meeting between Mr. Packard and the bankers a month (20 April 1970) before his testimony before the Committee. We shall deal with this further, in a subsequent section.

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* Footnote on following page.

A year later, almost to the day (26 May 1971), Mr. Packard testified before the House Appropriations Subcommittee (R4, A-52 and 52A). He was accompanied by Mr. Shillito, Mr. Buzhardt (DOD General Counsel) and the entire "Monitoring Committee" (Messrs. McCullough, Spratt and Benefield) (R4, A-52, 52-A at p. 1334). With respect to the shipbuilding claims, he testified (p. 1343):

> "The claims on ongoing contracts amounted to $159.8 million. We have a tentative settlement of $62 million, part of which has been paid. The final payment will be made after we do the double checking to be sure the claims may be appropriately verified." (Emphasis added).

At the trial Mr. Packard testified as follows (Tr. p. 544):

> Q. . . . Now, are you undertaking to testify that notwithstanding what the review would disclose, you would approve 62 million or some modification within the 58 and 62. Is that your testimony?"

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* He testified further (Tr. pp. 83, 84):

> "Q. May 27, 1970. My question to you is: Did you testify at any time thereafter before any kind of Congressional Committee that because of the unusual financial situation they [Lockheed] would be treated differently with respect to shipbuilding claims?"
>
> "A. No. No, my position was - - - .
>
> "Q. My question was did you testify?"
>
> "A. I said no.
>
> Judge Bird: He said no."

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> "A. That's what I'm saying, yes. If the modification had been substantial so that it was not in the general order of magnitude to support the overall understanding I had, I would have had no choice but to make a determination. That's correct. I testified last week, I think, that if necessary, I would have directed a change. That's what I would have suggested that Secretary Clemens do." (Emphasis added).

The term "determination" must have meant a P.L. 85-804 determination that the action would facilitate the national defense. Otherwise FF 68-c and d, that Secretary Packard never ordered the Navy to settle claim for any particular sum of money and that he expressly left it to the Navy to resolve in accordance with its established procedures, make no sense. At that same hearing, Mr. Packard testified with respect to the tentative settlement and the provisional payment thereon:

> "It was apparent to me from the beginning that we shall deal with these particular claims in the same way we are dealing with the shipbuilding claims of other contractors. In other words, I did not recommend, and we are not taking, any special action on shipbuilding claims other than that which we would have taken for anyone else." (Emphasis added).

The majority opinion does not make this finding. In FF 39 it quotes part of his testimony, where after referring to the provisional part payment, he testified:

> "The final payment will be made after we do the double checking to be sure the claims can be appropriately verified."

Mr. Packard explained (Tr. p. 593) that he meant double checking by the Navy and "clearly we would expect the claim to be supportable in the light of all the facts and conditions involving the claim."*

Subsequent events must be judged in the light of Mr. Packard's testimony of 26 May 1971, which adhered to the theme that settlement of the shipbuilding claims was strictly the Navy's business, and also in the light of other representations then being made to Congress by OSD.

FF 37c (p. 26) refers to a letter of 28 May 1971 from the Secretary of the Navy to Senator Proxmire, as Chairman of the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee, in which the Secretary describes the review procedures under the Navy Regulation and

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* Yet Mr. Packard testified (which is not covered in any finding), as follows (Tr. p. 610):

> "Q. Would you have issued a direction to the Navy to make payment to Lockheed of $62 million, even though you knew that the Naval Material Command had questioned the sufficiency of the justification of the tentative settlement for $62 million?"
>
> "A. At this point, I believe I would have, yes. There had been too much water gone over the dam at this point for me to try and back off."
>
> Again, he must have been speaking of his authority under P.L. 85-804. He could not direct any contracting officer to make a determination of liability in any amount, absent a P.L. 85-804 determination.

assures the Committee that approval of all tentative settlements, including the one with Lockheed Shipbuilding, will not be given "without exhaustive evaluation and documentation of facts and an in-depth legal review." A copy of that letter went to Mr. Shillito, Assistant Secretary of Defense (I&L) (Tr. p. 2029), and is attached hereto as TAB "H".

Three days before, on 25 May 1971, Mr. Shillito had testified before the Proxmire Committee and had been asked about the Avondale and Lockheed shipbuilding claims, particularly whether the claims were settled without the formalization of a written report establishing legal responsibility under the contract for the claim. He had replied (Tr.Exh. G-9, at pp. 1165-1167):

> "The claims still have not been submitted to the Chief of Naval Material.* Due to the dollar magnitude they have to go to the Assistant Secretary of the Navy (I&L). They still have not gone to him. So these claims have not been finalized and they have not been signed off. If the tentative agreements are incorrect, they will be modified." (Emphasis added).

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* Footnote on following page.

It was not until June 1971 that this solid wall of Congressional testimony developed a crack.

On 9 June 1971, Mr. Packard and Mr. McCullough appeared before the Senate Committee on Banking (R4, A-56, at pp. 164, 165). This was on the Loan Guarantee Legislation. Mr. McCullough testified that a $50 million provisional payment had been made on the shipbuilding claim; that "the claim has not yet been settled, as Mr. Rule indicated to you recently. It has not been settled." (Emphasis added). The record then shows the following:

> "Senator Proxmire: Isn't it true one of the reasons for the multi-million dollar payments [referring to C-5A Cheyenne and ship claims] or agreements was to prevent Lockheed from going into bankruptcy?

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* This, Mr. Sanders perceived "as a major permanent change in the Navy's method of handling claims in that before this the Secretariat had not been included at all in the authority of the Command structure . . . to approve claims." (Tr.Exh. G-74, pp. 24, 25) (Emphasis added).

In the light of FF 58c that the CCCSG was disestablished on 7 December 1971 by NAVMAT and replaced by a new General Board, this action of the Chief of Naval Material could not affect the major procurement change represented by Mr. Sanders' memorandum of 16 May 1969. Mr. vom Baur who represented Lockheed also represented, at that time, Avondale. This is especially significant in view of the fact that on 23 July 1971, NAVMAT (CCCSG) formally disapproved the tentative settlement made by NAVSHIPS as to Avondale (FF 46), and Lockheed immediately knew about it. Next week NAVSHIPS withdrew its request for approval of the Lockheed settlement because it had the same infirmities (FF 47).

> Mr. Packard. No. Let me go back and clarify something. The shipbuilding program in particular involved change orders which were changes to the contract. When you say they were over and above the contract, these are amounts for which the Government asked Lockheed to do additional work that was not called for in the contract, so what they are arguing about is how much that additional work should cost. That particular claim, as I told the Committees, was settled in the same way all the shipbuilding claims are settled with all other contractors." (Emphasis added).

Mr. Packard may have been referring to the settlement a year earlier in May 1970 of five other contract claims for $17.9 million (FF 9c). If he intended to refer to the $62 million tentative settlement, he was obviously mistaken.

The majority opinion (at p. 54) quotes from a letter of Mr. Packard to Senator Stennis of 22 July 1971, the following (and adds emphasis from FF 43):

> "the settlements have been completed on the shipbuilding claims . . .

Again, it is clear Mr. Packard was mistaken and had misread the reports to him by his staff. The "Highlight" entry of 23 July 1971 (R4, R-89), reporting on Lockheed's short-term cash position, stated that "Final settlement of the outstanding ship claims would add another $12 million." The "Highlight" entry of 20 August 1971 states:

> "Shipbuilding claims. Navy recommended settlement of the Lockheed ship claims ($159 million) to be settled for $62 million. The settlement was subject to review by the ships claims committee. $49 1/2 million provisional payments have been paid to Lockheed. After the committee had rejected the Avondale settlement, the Naval Ships Command withdrew the Lockheed claims and is now obtaining additional documentation to satisfy that Committee." (Emphasis added).

The entry concludes:

> "We shall continue to stay in touch with the progress of the ship claims within the Navy."

Mr. Packard was clearly mistaken, and to the extent the majority based its decision on these statements (p. 54), the majority was in error. First of all, the statements were hardly clear representations that the major ship claims had been settled. In fact the letter itself (attached hereto as TAB "J") is a casual discussion, rather than a studied report, and it is directed to a different subject, the Cheyenne dispute. Secondly, this is hardly the sort of solid evidence on which estoppel is based. Is the Government to be estopped every time an official makes a factual representation that proves to be erroneous?

For more than a year Secretary Packard and every other official of the Department of Defense who had had occasion to communicate with Congress had stated unequivocally that the shipbuilding claims were to be settled by the Navy.

Suddenly, Mr. Packard seemed to be saying that the claims had been settled. In the context of all that had gone before, the obvious inference had to be that Mr. Packard was bringing news of the Navy's actions, since he had made completely clear that he was not the person to settle the claims. Yet these glad tidings made so little impression on Congress that nobody addressed a single question to Mr. Packard about them. And Lockheed had to know that the Navy had not settled the claims, since Lockheed was in the trenches trying to reach a settlement with the Navy.

Two casual and unsubstantiated remarks by Secretary Packard, in the course of lengthy communications on other subjects, are not the sort of representations on which estoppels are based. Particularly not when nobody rose to the bait at the time the representations were made. And even more particularly not when Mr. Packard had spent more than a year stating a position that made it impossible for anyone to believe that there had been approval of the tentative settlement.

The majority opinion (at pp. 55, 56) states "A party's silence, for example, may work an estoppel, if, under the circumstances, he has a duty to speak. In the period before the simultaneous closing on the 1971 Credit Agreement, we think that Secretary Packard had a duty to speak if he

thought that the manifest reliance by Lockheed, its bankers and airline customers on the promise implicit in his silence had been misplaced."

But there can be no duty to speak where there is no reliance in the first place. If anyone was misguided by Secretary Packard's statements, surely that person had a duty to inquire. Given the innumerable indications contrary to Mr. Packard's statement that a settlement had been reached, nobody -- not Lockheed, not Congress, not OSD or the Navy -- could take such a statement at face value. The reason nobody sought clarification is that none was required; everyone in a position to inquire still knew that the Navy had not reached a settlement with Lockheed and was not going to do so until fully satisfied with the claim presentation. Remember -- Mr. Packard never said he had settled; he only said -- erroneously -- that a settlement had been completed.

The Board has completely misconceived the situation as it existed in the summer of 1971. Congress knew full well what was going on, and Lockheed also had full knowledge of the situation. Not only did Mr. Packard in fact have no actual authority to enter into a contractual settlement with Lockheed, but he never even represented that he did have such authority. For the Board to leap from his constant denials of such authority to a holding that he is estopped to deny that he exercised such authority is a negation of law and logic.

3. The majority erred in holding that Secretary Packard was not bound by the Navy Review Regulation.

In Service v. Dulles 345 U.S. 363 (1957), discussed in our brief at p. 259, (but not mentioned in the majority opinion), the Court held (at p. 372):

> " . . . regulations validly prescribed by a Government administrator are binding upon him as well as the citizen, and that principle holds true even when the administrative action under review is discretionary in nature." (Emphasis added).

In Vitarelli v. Seaton, 359 U.S. 535 (1959), discussed in our brief at p. 259 (and not mentioned in the majority opinion) Mr. Justice Frankfurter, in a concurring opinion, stated (at pp. 546, 547):

> "An executive agency must be rigorously held to the standards by which it professes its actions to be judged . . . Accordingly, if dismissal from employment is based on a defined procedure, even though generous beyond the requirements that bind such agency, that procedure must be scrupulously observed. See Service v. Dulles, 354 U.S. 363." (Emphasis added).

In this context we also discussed in our brief (at pp. 258, 259) Accardi v. Shaughnessy, 347 U.S. 260 (1954) where the Attorney General tried to bypass regulations promulgated by him relating to discretionary authority given to him by statute to deport certain aliens. In rejecting his claim that since the statute gave him the discretion he could exercise it despite his delegation of it to the Board, the Court stated (at p. 267):

> " . . . as long as the regulations remain operative, the Attorney General denies himself the right to sidestep the Board or dictate its decision in any manner "

The Board overlooked the discussion of the above cases and the application of the rule to this situation. In effect, the majority holding, contrary to Accardi, is that Mr. Packard may expressly avoid the regulation if he so chooses, and therefore he may also indirectly dictate to the Navy the settlement figure by estoppel.

The majority opinion seems to accept the principle that a regulation duly promulgated by an executive agency is binding on the Government so long as it is in effect. It acknowledges that "Secretary Packard did not expressly amend, repeal or waive the Navy regulation." (at p. 50)*

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* Mr. Packard's testimony is much more explicit. He was shown an internal Lockheed document (Tr.Exh. G-31) which discussed the "Total Lockheed Problem". The document stated:

> "The total Lockheed DOD problem is working to our disadvantage in relation to our claims. The 'blue suit' Navy is a different breed. It is very clannish and jealous of its prerogatives. It has apparently to date sustained its position with DOD that (1) it in no way regards the Navy claims as being a part of the total Lockheed problem, (2) it will handle these claims itself, and (3) it wants the DOD to keep completely out of its affairs in this area."

He was asked (Tr. p. 598) whether in his testimony before Congressional Committee he intended to advise them that the Navy and not DOD would be handling the shipbuilding claims. He replied, "that's a correct statement . . . I wanted the Navy to settle this themselves in accordance with their established procedures . . . " and he further testified that he never told any Congressional Committee that he disagreed with the position of the "blue suit" Navy as represented in the Lockheed document.

But then it misreads, we submit, the Nixon decision* and misapplies the principle developed in the Service, Vitarelli and Accardi cases.

The majority made a specific finding (at p. 50) that "Secretary Packard did not expressly amend, repeal or waive the Navy regulation." But the majority concludes that the Navy Regulation could be waived by representations or conduct tantamount to a formal waiver. It finds something special in the Navy Regulation when it states (pp. 51, 52) that the Regulation was:

> "quite obviously a procedural or non-legislative type of regulation which was intended for the benefit and protection of the Government. It did not purport to create any rights in third persons dealing with the Government. Following the reasoning employed in the Hartford [Accident and Indemnity Co. v. United States, 130 Ct. Claims 490-(1955)] and [United States v. New York and Porto Rico, 239 U.S. 88 (1915)] cases, we conclude that it was of such a character as to permit its waiver by res-

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* The majority opinion (at p. 49) quotes from United States v. Nixon which noted that with respect to the regulation defining the Special Prosecutor's authority, it had a special feature, namely, that he "was not to be removed without the 'consensus' of eight designated leaders of Congress". When Mr. Packard and Mr. Shillito gave assurances to the many Congressional Committees that the Navy regulation would be strictly followed, that falls squarely within the factor that the Court pointed out in Nixon; no removal without a consensus of Congressional leaders.

Why is not Mr. Packard required to similarly seek a consensus from Congressional leaders when he proposed to take action on the shipbuilding claims in a manner contrary to the assurances he had given them? We submit, therefore, that reconsideration is warranted on the question of the application of what the majority calls the Nixon rule to the instant situation.

> ponsible Government officials with or without the assent of contractors, such as apellant, having claims against the Government that fell within its terms . . . "
> "In sum, we conclude that the Navy regulation, which established the condition that the tentative $62,000,000 settlement be approved by higher authorities before it became final, was intended solely for the protection of the Government, and hence could be waived by a Government official having the requisite authority to do so. We also conclude that Secretary Packard and members of the Navy secretariat had the authority to waive the regulation, or, by their representations or conduct, provide a basis for estopping the Government from denying the legal enforceability of the settlement solely because of the application of the regulation."

The majority opinion (at p. 50), in drawing a distinction between procedural and non-legislative regulations and legislative regulations, cites the article by Braude and Lane, "Modern Insights on Validity and Force and Effect of Procurement Regulations -- A New Slant on Standing and the Christian Doctrine" 31 Fed. Bar J. 99, 105-120 (1972), in support of its conclusion that the Navy Regulation in this case is of such a character "as to permit its waiver by responsible Government officials with or without the assent of contractors, such as appellant, having claims against the Government that fell within its terms." (at p. 51). That article seeks to extend the classification of administrative regulations that apply to independent regulatory agencies subject to the Administrative Procedures Act to the procurement area and it

discusses what the authors conceive to be a "For Whose Benefit" rule for "Non-Legislative" Procurement Regulations. That rule, the article (at p. 113) states

> " . . . can be most helpful in determining what regulations can be waived by theGovernment as being merely directory and not mandatory. If a regulation on its face attempts to create or define substantive non-Governmental rights, it is presumptively for the benefit of contractors and binds both parties. On the other hand, if a regulation has no significant effect on private rights and obligations, but is merely an internal guideline promulgated solely for the benefit of the Government, the contractor cannot complain that the regulation was not complied with and neither party bound by it. Decisions actually reaching this result are rare, but they do exist and are consistent with the 'whose benefit' approach." (Emphasis added).

The article then cites the Hartford and Porto Rico SS Co. cases.

The majority opinion (p. 51) picks this up bodily, including the citation of cases. But these two cases neither pronounce nor apply such a rule. Thus, in Hartford, the Court of Claims held that a non-standard construction contract entered into by both parties was enforceable by the Government, despite a Government regulation prescribing a standard form, because the procuring agency was expressly authorized to use a non-standard form. 130 Ct.Cl. at 494-5. In United States v. Porto Rico SS Co., 239 U.S. 88 (1915), the

Supreme Court held that a contract resulting from an exchange of correspondence was enforceable against the contractor despite his claim that the statute required the contract to be reduced to writing and signed by the contracting parties at the end thereof; the Court stated (pp. 92-93):

> " . . . while it is established that a contract not complying with the statute cannot be enforced against the Government, it has never been decided that a contract cannot be enforced against the other party . . . The United States needs the protection of publicity form, regularity etc . . . in order to prevent possible frauds upon its officers. A private person needs no such protection against a written undertaking signed by himself. The duty is imposed upon the officers of the Government not upon him. Even when a statute in so many words declares a transaction void for want of certain forms, the party for whose protection the requirement is made often may waive it, void being held to mean only voidable at the party's choice." (The emphasis portion only is quoted in the major opinion at p. 51).

It is clear from the holdings in these two cases that they do not establish a "for whose benefit" rule. The Hartford case has nothing to do with the issue, since in that case there was no question of authority to perform the act in question, and the best that can be said for it is that it includes an equivocal dictum that could be considered consistent with the holding in the Porto Rico SS Co. case. But even in Porto Rico there was an express contractual agreement between the two parties, reduced to writing in

separate pieces of correspondence, and the only issue was whether the private party could prevent the Government from enforcing the agreement by asserting that the Government had not followed its own formalities in making the contract.

There may not yet be a "for whose benefit" rule in the cases, but if there is to be one, then its proper application would require dismissal of Lockheed's appeal. If there is a rule about waiver of required procedures and binding regulations, it is that the Government may waive them when they are asserted against the Government by one who stands to gain from their enforcement. In this case, the Government is asserting its regulations against Lockheed, rather than vice versa, and Lockheed stands to gain from their non-enforcement. In such a case the Government benefits from enforcing the regulation, and there is no waiver.

The word "waiver" is, in any event, inappropriate to such a case. The Government does not "waive" its regulations in cases such as Porto Rico; rather, it waives its right to void an agreement that is voidable at its option. It elects whether to insist on enforcement of the regulation. The choice is conscious, and it is made at the time that the contested regulation is expressly asserted and made an object of controversy.

What actually happened in the Lockheed case? Taking the majority's findings at their most beneficial to Lockheed, Secretary Packard gave "signals" that Lockheed took to be an indication that he would settle (or had settled) the shipbuilding claim. But this was no election to waive the benefits of the Navy regulation. Even if it be assumed that Secretary Packard could elect not to be bound by that regulation, he would have had to do so expressly; he cannot be bootstrapped into position to do so. The majority holds that Secretary Packard had authority to settle with Lockheed because he impliedly waived the regulation requiring the Navy to reach the approved settlement; but he could only waive the regulation if he had settlement authority in the first place apart from P.L. 85-804. If Mr. Packard had wanted this result, he could have used P.L. 85-804 and gone through the front door.

The Braude and Lane article also notes that even "non-legislative" regulations are treated as mandatory and are given weight where "special administrative competence" is involved. In promulgating the Navy Regulation, and in setting up the Contract Claims Control and Surveillance Group (FF 30) Assistant Secretary of the Navy (I&L) Sanders testified (Tr.Exh. G-74, pp. 101, 102):

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> "We had set up the Control Group to thoroughly review any proposed settlements and subject to something being forwarded to me after being reviewed by the Chief of Naval Material . . . these were the management tools I relied on from the beginning and I never deviated from it."

Admiral Galantin, Chief of Naval Material testified (Tr.Exh. G-73, pp. 45, 46), as to this Group:

> "I wanted to point up the need for professional analysis, professional review, strict adherence to good business practises . . . "

Since, as appears from the Braude and Lane article, on which the majority relies, that the particular expertise of an administrative agency is relevant to the question of whether a "non-legislative" type of regulation will be treated as mandatory, we request that the following Proposed Supplemental Finding of Fact be made.

> PSFF 30a. The Contract Claims Control and Surveillance Group was designed to and consisted of professional civil servant experts in procurement negotiation, engineering production and accounting.

This comes from the testimony of Admiral Galantin (Tr.Exh. G-73, pp. 40-46, p. 87), Admiral Freeman (Tr. pp. 932-945), Mr. Sanders (Tr.Exh. G-74, pp. 16, 17), Mr. Ill (Tr. p. 2068 -- "They wanted to put on that board the best brains that they could get hold of to review so that we [the Secretariat] would have the benefit of more than just the SYSCOM review of any large claim".)

We therefore submit that the majority opinion's conclusion that the Navy regulation may be waived by estoppel, is based on a misreading of the nature of the Navy Regulation which has at its base the CCCSG as the professional group to review the tentative settlements of the System Commands, and a misapprehension of the holdings in the Hartford and Porto Rico cases.

There is no authority of which Government counsel is aware for the proposition that a Government official may, by his conduct, impliedly waive, or estop the Government from asserting, the protection of a regulation written for the benefit of the Government.

C. Several Elements of Estoppel Are Absent

We do not take issue with the statement in the Board's opinion of the four elements necessary to establish the defense of estoppel.

We do submit the Board misapplied the four elements to the evidence, thereby reaching the wrong result.

1. Lockheed Was Not Ignorant of the "True Facts."

The most significant finding in the majority opinion on which it bases its conclusion that Lockheed was ignorant of the true facts (at p. 56) "if in the sense the 'true facts' are that the $62,000,000 settlement would be subjected to a searching, exhaustive review which existing documentation

could not possibly satisfy," is FF 49. The opinion relies on that finding and on FF 44 to support its conclusion. Thus, the majority opinion (at p. 57) states:

> "The Executive Vice President of Lockheed [Mr. Waters FF 44] who supplied the data to the Corporate Controller [Mr. Anderson, FF 45] for the ship claims portion of these forecasts testified that he assumed, based on information he received from Navy Officials, that the $62,000,000 settlement was final and that what remained was simply a collection problem. He [Mr. Waters] also testified that he had been instructed by his superior [Mr. Osborn] in February 1971 to discontinue the bi-weekly 'outstanding ship claims' report and to limit his future reports to 'how much you collect'. [FF 44].
>
> A similar attitude was expressed by Mr. Osborn, a Senior Vice President of Lockheed, who met with Mr. Ill, the Assistant Secretary of the Navy (I&L), on 13 August 1971. Mr. Osborn's reaction to the meeting was to recommend assistance be given NAVSHIPS in documenting the claims settlement proposal so as to obtain the necessary approval. A memorandum which he [Osborn] prepared at the time concluded that there was no problem of obtaining the approval, but rather of how the claims were written by NAVSHIPS, which had the duty to prepare the necessary justification for the Navy's claim reviewing authority in NAVMAT. This reaction was verified by the testimony of Secretary Ill. (Finding 49)."

The dissenting opinion of Administrative Judge Lane takes a different view of Mr. Ill's statement and the interpretation placed on it by the majority opinion. He states (at p. 65):

> "Unlike the majority, I view that statement [of Mr. Ill] all the more confirming the substantive nature of the review by Mr. Rule, and as indicating that the Secretariat would not by-pass Mr. Rule."

The majority opinion overlooked significant testimony of Mr. Ill, which we set forth in proposed supplemental findings (PSFF 49a-g), hereafter. This evidence plainly indicates that Mr. Ill told Senior Lockheed officials that the documentation would be subject to "intensive review". (PSFF 49b).

The problem was not how NAVSHIPS would rewrite the claims but what documentation Lockheed could furnish NAVSHIPS in support of the claim. Lockheed cannot avoid its responsibility for adequate documentary support by its self serving statement (which the majority opinion accepts) that it was a matter of how NAVSHIPS rewrites its presentation to NAVMAT. Accordingly, we request that the following Proposed Supplemental Findings of Fact be made:

PSFF 49a. Mr. Ill testified that the provisional payment which was authorized in February 1971 "had nothing to do with the finalization of the $62 million settlement (Tr. p. 2081)". Such provisional payments were "subject to an express understanding that the SYSCOM's Commander [Admiral Sonenshein] was not relieved of his obligation to present full documentary support seeking final approval of the settlement" (Tr. p. 2081).

PSFF 49b. Mr. Ill testified that he discussed with Mr. Rule "the fact that there had to be adequate documentation to support intensive review by other agencies because it was clear that this was going to happen. GAO was going to be in it. Senator Proxmire was going to be in it. And everybody was" (Tr. p. 2088).

"This was discussed with the senior Lockheed officials also. The best thing for everybody involved was going to be to have a clean total package that could stand review from all outside sources that were going to review it after the Navy had approved it." (Tr. p. 2089)

PSFF 49c. Mr. Ill testified that he advised the Shipbuilding Council of America that the standard of proof that would be required in claims was "if the Government had caused delays or changes and was not properly added to the contract. They had to document that information in such a way that it could be tied directly to their overall operation" (Tr. pp. 2090, 2091). The Shipbuilding Council passed the substance of that on to Lockheed (Tr. p. 2092).

PSFF 49d. Mr. Ill testified that he never approved the $62 million tentative settlement (Tr. p. 2094); that he knew of the proposed final decision of the contracting officer for $7.1 million and did not disapprove of the action, stating "Frankly, I was in favor of having a contracting officer decision" (Tr. p. 2094).

PSFF 49e. Mr. Ill testified that Lockheed officials complained about the Gordon Rule Group holding up the $62 million settlement, "they were interested in knowing whether there was a reasonable chance of resolving the claim with what appeared to be a biased opinion of the Rule Group at that time" (Tr. p. 2095). He would not overrule Gordon Rule because "I had a great respect for his technical knowledge. I also had respect for the other members of the Committee that he had, and if they saw a valid reason to reject a claim I certainly was not going to overrule all my experts without a detailed evaluation of the claim myself. (Tr. p. 2095) . . . I had to rely on expert staff and on those people who were trained much better than I was to give me opinions. That is the reason that we established the Gordon Rule Committee. That is the reason that we got representatives with technical expertise, legal expertise, and procurement expertise to review this" (Tr. p. 2096).

PSFF 49f. Mr. Ill testified that he never had any discussion with Secretaries Chafee or Warner "about the Lockheed financial situation and the relationship of its disputes with the Department of Defense to the resolution of the Lockheed financial situation" and that he was not informed about the substance of the problem and the means for its resolution "other than what I read in the newspapers." (Tr. p. 2119)

PSFF 49g. Mr. Osborn was advised by Mr. Folden on 18 September 1971 to see Mr. Ill and try to get the Navy "to back up their original agreement and discontinue the Supship review." (Tr. Exh. g-55; Tr. p. 915-918).

The majority opinion, in concluding that Lockheed was ignorant of the true facts in the sense (at p. 56) that "the $62,000,000 settlement would be subjected to a searching, exhaustive review which existing documentation could not possibly supply" relies principally on the testimony of Packard, Osborn, Waters and Anderson (FF 44-49), and cites certain pages of the transcript. There is, we submit, substantial evidence in the record, not cited or referred to in the majority opinion, which leads us to believe that it was overlooked, and which negates any conclusion that Lockheed was ignorant of the true facts. What emerges from the following discussion is a refusal of the Lockheed officials to face the fact that the Gordon Rule Group review was not pro forma and that the "signals" (to borrow a word from the majority opinion) which he gave in testimony before Congressional Committees, and which Admiral Rickover gave, were ignored.

The critical period is from 3 August 1971 (when NAVSHIPS withdrew its request for approval of the tentative settlement) to 14 September 1971 when the Credit Agreement with the loan guarantee was executed. That Administrative Judge Lane was correct in stating (at p. 67):

> "... I do not believe that Lockheed was misled...I think Lockheed was essentially aware of the problem in obtaining ship claims approval. Lockheed's very existence was at stake, however, and it could not red flag the problem without jeopardizing the entire credit agreement,..." (Emphasis added)

will be shown by the additional evidence now discussed.

The key figure is Mr. Osborn. He is the one whose understanding of the situation as reported to his superiors is relied on by the majority opinion (at p. 57). Rather than summarize Mr. Osborn's testimony, we ask the Board to read his cross-examination which is attached hereto as TAB "K".

We also ask the Board to read the documents attached hereto as TAB "L", which are referred to in Mr. Osborn's cross-examination.

We shall consider first the information furnished Mr. Osborn from the period 3 August 1971, when he was informed that NAVSHIPS had withdrawn its approval request, and the way he handled that information through 14 September 1971. We shall then consider what information Lockheed had, prior to 3 August 1971, and what "signals" were given

that the review of the tentative settlement would be more than pro forma.

In addition to the explanation offered by Administrative Judge Lane of the action of Lockheed officials, that (at p. 67) they could not "red flag" the problem without jeopardizing the entire credit agreement when its very existence was at stake, is the refusal of Mr. Osborn to accept the fact that the tentative settlement had to be reviewed by higher Navy authority. This is evident from his testimony that it was no concern of his what Mr. Rule's review authority was nor of Admiral Sonenshein's. Thus he testified (Tr.Exh. G-68, pp. 28, 29):

> "A. I don't even today know what his (Gordon Rule's) authority is other than in an advisory capacity, and this is the way I have always observed it as I have replied to that question on numerous occasions.
>
> Q. . . . could you . . . indicate what you understood his advisory capacity to extend to?
>
> A. Not really, because I was doing business with Admiral Sonenshein and talking to Captain Holfield, which were the areas that had been set up for my course of conversation on ship claims, and to whomsoever they would call upon for their assistance, information or whatever they might need for their negotiating and discussion purposes was entirely their end of the business. I dealt with them directly rather than with anybody else . . .

> I knew after we had reached a tentative agreement with Admiral Sonenshein that it had to go through certain procedures.
>
> Now, as far as I was concerned, that was up to Admiral Sonenshein to do whatever he needed to do to get the documents or the papers or whatever that he needed cleared to become an offical agreement." (Emphasis supplied).

This dominant theme, that it was up to Admiral Sonenshein to do whatever "he needed to do", sets the stage for Mr. Osborn's interpretation of the information that came to him indicating there were deficiencies in the Lockheed documentation and justification. He always viewed this (as the Board found, at p. 33) as a matter of how the claims are written by NAVSHIPS for presentation for final approval.

Again, Mr. Osborn's dominant theme is stated as follows (Tr.Exh. G-68, at p. 32):

> "A. I knew the settlement was tentative as he (Admiral Sonenshein) states, but what other approvals . . . that he needed to get, I did not know of, but that was again, as far as I am concerned, I had reached an agreement with him on the sixty-two million, and it was up to him to do whatever was necessary to obtain the documentation approvals within his own organization." (Emphasis added).

Again, this is Mr. Osborn's central theme. He testified, (supra, at p. 36):

> "Q. Now, when you walked into that meeting on 29 January 1971 with Admiral Sonenshein what did you understand to be the review procedure within the Navy for approval of claim settlements?
>
> A. I was not interested in the review procedure.* I was really interested in reaching an agreement with Admiral Sonenshein on claims because he was the individual with whom -- the office with whom we were negotiating and I was negotiating with. I was not negotiating with his review procedure . . . I didn't know the full review procedure of the Navy, and I wasn't interested in it because I felt, as I said before, that was Admiral Sonenshein's problem and it was up to him to obtain the necessary review within his organization." (Emphasis added).

Mr. Osborn further testified (supra at p. 37), that he "didn't know the specifics of the review procedure, if there was one, and I was not concerned with it because I was

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* Mr. Osborn had received from Mr. Folden a memorandum (Tr.Exh. G-31) which was prepared by Mr. Waters (Tr. pp. 850-852) and which under the heading "Fact Finding vs. Negotiation" reported:

> "After the Navy sessions on 'fact finding' they review their position in house, attempting to correlate and reconcile the views of their contract, technical and legal representatives. If they cannot come to a meeting of minds among these three segments, the issue is then taken to Admiral Sonenshein for the establishment of a 'Command (NAVSHIPS Command) position'. If this so-called command position is in excess of $5 million on a contract it must then go to Gordon Rule (ONM) and then on to ADM. Galantin (Chief of Naval Material) for his blessing. If it is less than $5 million it goes directly from ADM. Sonenshein to ADM. Galantin," (Emphasis added).

trying to reach an agreement with the top of the United States Navy, and that's the individual that I needed to talk to and I needed to reach an agreement with. The rest of it was entirely up to him and his problem". Mr. Osborn was asked what he understood Admiral Sonenshein's authority was with respect to committing the Navy, or did he understand that some sort of review was required. He answered (supra, p. 39):

> "A. No, sir, I thought he had the authority to commit the Navy as I had the authority to commit the corporation and that's what the two of us were there for."

Mr. Osborn had testified that he had discussions with Mr. Folden and Mr. Waters respecting the delay in finalizing the tentative settlement and he was asked whether anyone ever told him that it was Gordon Rule and his Group that was asking for additional information. His answer, "I don't recall." Then (supra, pp. 51):

> "Q. Did you inquire as to what outfit in the Navy was asking for the additional information?
>
> A. I don't think I did. I don't recall that I did because, as far as I was concerned, I was looking to Admiral Sonenshein and Captain Holfield as the organization under him to obtain the necessary approvals, whatever they may be, . . . As far as I was concerned, that was his responsibility."

Mr. Osborn's own files show that on 12 May 1971, he wrote a memorandum giving information on the balance due on the $62 million settlement and advised that SUPSHIPS in Seattle was in the process of obtaining information to enable the legal department to write the final paper supporting the claim, and then (Tr.Exh. G-68, p. 141):

> "The claim then moves to ONM (Office of Naval Material) and it is felt that since a considerable amount of material has been submitted and they have had ample time to review it, it is possible that they could give final approval within a week."

Mr. Osborn could not give the source for his information that was reflected in his 12 May 1971 memo. On 18 May 1971, comes another internal memorandum from Mr. Osborn. He reports on information received during a trip to Washington, although he testified he does not know where the information came from (supra, pp. 141, 142). He now reports that SUPSHIPS Seattle mailed the information to Washington and the documents must go to ONM and "hopefully they will have completed their review and affix signatures to the document which will enable us to obtain our money by June 15, 1971".

In his testimony before the Board, Mr. Osborn stated that in all probability he got the information set forth in those documents from Captain Holfield "or from the shipyard or both" (Tr. pp. 1128-1130).

3 August 1971. NAVSHIPS withdraws approval request submitted to NAVMAT. Admiral Woodfin explains to Mr. Osborn that because of the formal rejection of the Avondale tentative settlement, a formal rejection of Lockheed would follow because it had the same deficiencies. Mr. Waters confirmed that Osborn told him of his conversation with Admiral Woodfin (Waters, Tr. pp. 756-757; Woodfin, Tr. pp. 2164-2178).* Osborn testified that Admiral Woodfin told him Lockheed "had to rewrite the claims" (Tr. pp. 1134, 1154-1156).

6 August 1971. Waters asks Turner Joy, Lockheed's Washington representative, for a list of the documents that NAVSHIPS submitted to NAVMAT. Turner Joy gets the information from Captain Holfield's secretary and transmits it to Waters who forwards it to Osborn** (Waters, Tr. pp. 907-909; Tr.Exh. G-54).

8 August 1971. Waters meets with Captain Holfield. He tells Osborn about it who then writes a memorandum, dated 9 August 1971, (memo 8/9/71) in which he states (TAB "L" hereto attached):

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* On 30 July 1971, the House by a vote of 192 to 189 passed the Emergency Loan Guarantee Bill. On 2 August 1971, an amended bill passed the Senate by a vote of 49 to 48. (See Cong. Record for those dates.) The bill was signed and became effective on 9 August 1971.

** Turner Joy's records and that of the Washington liaison office were destroyed (R4, R-88).

> "Bob Waters stated from his discussions with Captain Holfield that Holfield was of the opinion that Rule would not approve the claims under any circumstances regardless of what we did unless settlement amount was reduced and that, in Holfield's opinion, we should get together with Avondale* and see if we could jointly work out a better solution perhaps including going to Board of Appeals ($5 million)."

The $5 million figure obviously referred to the point at which NAVMAT and ASN(I&L) had to approve claim settlements; but Mr. Osborn could not explain what it meant or why it was put in there (Tr. pp. 1130, 1131). It should be noted that this memorandum was not in Mr. Osborn's files when his deposition was taken nor were the originals produced (Tr. pp. 1132-1134). No mention is made in FF 48 and 49 of this memorandum or of any of the documents in TAB "L" hereto attached. The last paragraph of the 8/9/71 memo is significant on the question -- Did Lockheed know the true facts? That paragraph reads:

> "Verano of General Dynamics told Waters they are in process of submitting claims in excess of $200 million and the Navy told them no provisional payments.

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* That tentative settlement for $73.5 million (¶2 of the 8/9/71 memo) was formally rejected by Gordon Rule's Group on 23 July 1971 and Osborn's memo notes (¶ 3) that "Rule had written a letter to all Navy Commands which stated that if they have claims to submit to his office they should be done in a concise manner instead of the slop he has been receiving from Sonenshein".

> He suggested that Lewis, Chairman of General Dynamics, Haughton, Chairman of Lockheed and the Chairman of Ogden Corporation (company that owns Avondale) get together and go see Packard and find out what they can do about the Rule problem." (Emphasis supplied).

Mr. Osborn testified that he did not have any discussion with Mr. Haughton about the Rule problem (Tr. p. 1161), that he did not know what the Rule problem was and was merely quoting what Verano had suggested to Bob Waters although "they" (leaving us in the dark whether it meant General Dynamics, Avondale and Waters, or who) "would all be familiar with what the so-called Rule problem was" (Tr. p. 1162).

Mr. Haughton had a note in his own handwriting to take up with Mr. Packard the "Gordon Rule problem". Haughton testified he did not know what the Gordon Rule problem was and did not take it up with Mr. Packard (Tr. p. 260-262). Osborn was asked how Mr. Haughton could make an entry of an agenda item to discuss with Mr. Packard the Gordon Rule problem if no one in Lockheed told him what the Rule problem was (Tr. p. 1163). He was asked whether he knew what the Rule problem was, and he answered (Tr. p. 1164):

> "No sir, I don't know what the Rule problem might have been that Mr. Verano was referring to. I have no idea what he had in mind."

He was then asked whether he had any conversation with Mr. Haughton in which he undertook to discuss, one way or another, the Gordon Rule problem. And he answered, "I do

not recall having any" (Tr. p. 1165).

FF 49 does not mention the Osborn memoranda of 8 August 1971 or 16 August 1971 (discussed hereafter). Instead, FF 49 quotes part of his memorandum to Mr. Cavanagh, Lockheed's Vice President and General Counsel, written three weeks after Lockheed filed its loan guarantee application with the Board (18 August 1971), and two weeks after the Board's first meeting of 25 August 1971, when it considered Lockheed's loan application. In anticipation of a further meeting of the Board (9 September 1971), when it would consider what additional evidence would be required of Lockheed before making a commitment for a $250 million guarantee, and what representations and certificates would be required for execution of the Credit Agreement and a first takedown of $50 million (Tr.Exh. G-17, pp. 11, 12), Osborn wrote his 8 September 1971 memorandum to Cavanagh. FF 49 quotes the last two sentences of the memorandum. That alone is, we submit, not enough to predicate a conclusion that Lockheed did not know the true facts. We will discuss in a moment Mr. Osborn's memorandum of 16 August 1971, to which no reference is made in FF 49.

In his 8 September 1971 memorandum to Mr. Cavanagh, the fact that the Avondale claim was rejected by the "Navy Committee" is noted as the basis for the NAVSHIPS decision

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"to pull our claims out of the Review Committee for further review in relation to the reasons that the Avondale claim had been rejected". He then refers to the fact that SUPSHIP, Seattle were reviewing the claim and submitting additional reports to Washington with whom meetings were scheduled. After these meetings, advised Mr. Osborn, "we will be in a better position to determine the rewrite that will be necessary and the approximate time it will take us to perform such a program. Other things that obviously affect the program are the fact that GAO is in fact making investigations of our old claims and I am sure of other shipyard claims submitted heretofore and paid by the Navy. In addition to that, of course, you know the political problems as well as publicity problems that have accompanied the general overall situation".

As we noted in PSFF 49b, ante, p. 41, this is precisely what Mr. Ill testified he discussed with Senior Lockheed officials, documentation to support "intensive review" by GAO, Congress and everybody. This, we submit, was overlooked by the Board, and Mr. Osborn's memorandum of 8 September 1971 fully confirms Mr. Ill's testimony. In the light of the foregoing, we submit that the conclusion by the Board (at p. 57) that Mr. Ill "verified" Mr. Osborn's understanding that he was told at the 13 August 1971 meeting "that there was no problem of obtaining the approval,

but rather of how the claims were written by NAVSHIPS, which had the duty to prepare the necessary justification for the Navy's reviewing authority in NAVMAT", finds no support in the evidence.

The last two sentences quoted in FF 49 are not a fair summary of the 8 September 1971 memorandum. The last two paragraphs of the memo read:

> "In working with the Navy and the Secretary's office, I am sure if it would be of any assistance to us we could get the proper people to talk to the bankers. However, I am generally opposed to this for the reasons explained to you. But, if need be, it obviously could be accomplished.
>
> I will be in a far better position to evaluate the time necessary to close and obtain our money after the SUPSHIP personnel return to Seattle the first part of next week. I don't think there is a problem of the claims being approved. I think it is a matter of how the claims are written for presentation for final approval." (Emphasis added).

The emphasized two sentences is what is in FF 49 on which the conclusion is made Lockheed did not know the true facts.

If there already was a package deal, why the cryptic reference to "get the proper people to talk to the bankers". The majority opinion fixes 14 September 1971 as the end date for estoppel reliance. So we are left in the dark on Mr. Osborn's statement of being in a better position to

evaluate the situation after the SUPSHIP personnel return to Seattle. But on the question, did Lockheed know the true facts and what happened after SUPSHIPS personnel returned to Seattle, we have a memorandum dated 18 September 1971 from Mr. Folden to Mr. Osborn (Tr.Exh. G-55; Tr. pp. 915-918) which recommended how Lockheed should try to get the Navy to discontinue the SUPSHIP review and have Osborn see Mr. Ill, and Haughton see Mr. Warner.

Mr. Osborn testified he did not know if any of the suggestions in the 18 September 1971 memorandum were put in effect or whether he saw Mr. Ill in response to that memo, or whether anyone suggested to Mr. Haughton to take the matter up with Mr. Packard (Tr. pp. 1167-1170).

16 August 1971. Osborn reports internally (TAB "L" hereto attached, R4, B-19) on "LSCC claims status", as follows:

> "Following my meetings in Washington, D.C. on Friday, August 13, 1971, it is my opinion it will take a minimum of 90 days to obtain approval of our claims.* The composition of the Review Committee will have to be changed and I believe it will (this is very sensitive and not to be discussed) if these dates are to be met."

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* We have indicated that he previously estimated completion of review by the end of the week of 12 May 1971, and then (on 18 May 1971) by 15 June 1971. Now we have a new opinion fixing a date at a minimum by the end of November 1971.

This significant memorandum of Mr. Osborn of 16 August 1971, was overlooked in FF 49 which refers to Osborn's memorandum of 8 September 1971, as to what his understanding of his conversation with Mr. Ill on 13 August 1971. Administrative Judge Lane is correct in his conclusion (at p. 65) that Mr. Osborn knew what the substantive nature of Mr. Rule's review was and that Mr. Ill indicated the Secretariat would not by-pass Mr. Rule. Had the majority opinion in any finding referred to this 16 August 1971 memorandum of Mr. Osborn, the Board could not, we submit, have agreed to FF 49 and the conclusion drawn thereupon.

In the 16 August 1971 memorandum, Mr. Osborn further reported:

> "In my analysis, it will take us 30 to 60 days to rewrite the LPD claims which are being reviewed by Admiral Woodfin and his people in such a way that would, in his opinion, allow us to move to the second and final step and that review should not take in excess of 30 days.
>
> I do not feel that we should threaten or seriously consider at this point taking the claims to litigation as it would not only be expensive but would take a considerable amount of time (3 to 5 years) to accomplish the task. If we did go to litigation, however, we feel we could successfully increase the settlement amount and should be able to obtain in the area of $80 million or more."

This last statement deserves reflection. Why, if there was a package deal or overall plan of settlement, should Osborn talk about litigation? He testified that he

probably told Mr. Haughton of the NAVSHIPS withdrawal (Tr. p. 1157). But he never suggested to Mr. Haughton to go to see Mr. Packard to remind him "of the package deal agreement and that the Navy was reneging on that agreement" (Tr. pp. 1165, 1166). Nor did Mr. Haughton ever make any such approach to Mr. Packard (Tr. pp. 288-292). And Mr. Packard, after he got a staff report on 20 August 1971 (FF 50) that NAVSHIPS withdrew the request for approval of the settlement, never suggested to the Navy that their action was contrary to his overall plan.*

To continue with Mr. Osborn's memorandum of 16 August 1971:

> "If we were to litigate, we would receive a contracting officer's finding of fact and undoubtedly the amount would be considerably lower than the amount received as a provisional payment against the $62 million. How the Navy would treat the difference between the two figures is difficult to assess although they might determine that we should return the difference (approximately $50 million) and whatever the Findings of Fact turned out to be."

It's remarkable what foresight Mr. Osborn had. He forecast what the Navy would do two years hence. What does not appear in this forecast (nor in FF 67) is the refusal of Lockheed to furnish the Navy its bid data, budget and

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* FF 51 shows the Guarantee Loan legislation passed on 9 August 1971, and Lockheed had submitted its application for a guarantee of up to $250 million on 18 August 1971.

planning data together with management reports prepared during the performance of the contracts (R4, C-12-2; C-13-3; C-15-1). The final contracting officer's decision, in finding the amount that it did, relied principally on the fact that there was a failure of proof because of Lockheed's refusal to furnish the requested data.

Finally, Osborn in his 16 August 1971 memorandum recommends that "we endeavor to get the claims rewritten as Admiral Woodfin would like them*, resubmit them at the earliest possible time and endeavor to collect the last of our money". He continued:

> "If at the end of the 90-day period of time this does not become a reality, then I would want to reassess our position based on the facts at that time and possibly, if progress has not been made and it looks as if we would not collect reasonably soon, we would want to consider taking action wherever we feel necessary and of whatever nature would be our best advantage."

We submit that the Board overlooked Osborn's memoranda of 9 August 1971, 16 August 1971, and the full disclosure in the 8 September 1971 memorandum which on examination would establish the error in its conclusion that Lockheed did not know the true facts. We also call attention to the withholding by Lockheed officials, from the Bankers and the Treasury staff, the fact that NAVSHIPS had withdrawn its

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* Admiral Woodfin testified he wanted return costs rather than estimates, and evidence of causal connections (Tr. pp. 2179, 2188).

request for approval.

Mr. Anderson undertook to explain why in the revised forecast of 30 August 1971, in reporting that the "claims were settled in January 1971" with a collection date indicated, the word "tentative" before "settled" was omitted (Tr. p. 1046). It was Mr. Waters who told him that "it was tentative only with respect to completing the documentation and going through administrative channels to get the final sign off" (Tr. p. 1047). Mr. Anderson "always thought we had a total settlement" (Tr. p. 1048). Although the successive forecasts showed the anticipated collection dates kept "slipping", at "no time was there indicated to us that the amount of the settlement was really under contest" (Tr. p. 1049). Prior to the 30 August 1971 revised forecast, neither Mr. Waters nor Mr. Osborn told him that the claim approval had been withdrawn by NAVSHIPS and was being reopened (Tr. pp. 1050, 1051). When he asked Mr. Waters "How come its (payment) taking so long", the latter replied, they've got to build up documentation supporting the claim so it can go forward for final payment. Mr. Waters told him that "periodically, from the time we got the provisional on up to when it was finally realized . . . what the Navy was up to, that they were building a case to break the

claim, or break the settlement . . . I should have become suspicious probably, because of the delay" (Tr. p. 1051). Again, Mr. Waters did not tell him prior to 30 August 1971 that NAVSHIPS had withdrawn its request for approval of the $62 million settlement (Tr. p. 1052). Had he been informed of that, he would have brought that fact out in his forecast schedule (Tr. pp. 1052, 1053). "If I were to rewrite the document that you're referring to (the Financial Forecast of 8-30-71), I would put tentative in there. I would have put tentative. It wasn't left out with the purpose to mislead, and you know that . . . and the facts are that the people who got these documents, who relied on them, knew that the final payments had been delayed, that documentation was going on by the Navy, but we did not know at the time that they were going to be contested again, because we thought we had a final settlement" (Tr. p. 1059). He further testified that the 1970 Annual Report and the Supplemental Report of 14 September 1971 referred to the ship claims as tentatively settled and thus the people to whom the forecasts were sent "were aware of what was going on" (Tr. p. 1068)*.

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* Mr. Leary, however, testified he had "every reason to believe that the $62 million was the final settlement" (Tr. pp. 13-44) and in the context, "this meant that it was settled for $62 million" (Tr. pp. 13-47).

When an expenditure plan was submitted, on 30 July 1971, it noted an "anticipated delay in final payment of ship claims -- 12.2 million -- previously expected in August, now not expected until October" (Tr. p. 1071). He got that information from Mr. Waters then (Tr. p. 1071):

> "Q. Did he tell you why it was not expected until October?
>
> A. Every time that I called him on this, it was related to the same thing, completion of documentation for final submission.
>
> Q. Did he, at the time he gave you the information that it's not to be expected until October, tell you that it had been withdrawn by NAVSHIPS from NAVMAT, that the request for clearance and approval had been withdrawn?
>
> A. Not to my recollection."

His statement in the financial forecasts was intended by him "to represent, as the Navy said, a tentative settlement, subject to documentation and administrative review through higher authorities, or whatever, to just represent it that way. There wasn't a question in my mind but what it wasn't [sic] going to be honored" (Tr. pp. 1078, 1079). Mr. Anderson never inquired as to the substance of the contract modification as to Lockheed's contractual rights. He left that up to Mr. Waters and the lawyers (Tr. p. 1082). Although he saw a 6- and 7-month delay in payment, he did not during this period ever ask anybody on his staff why it was being delayed, or what were their legal rights (Tr. p. 1082). He was only told the claims were to be reworked, "not adjusted down, they had to be resubstantiated."

As to the auditor's report by Arthur Young (Tr.Exh. 66) of 14 September 1971, Lockheed people spoke to Arthur Young prior to the issuance of the report and could not recall whether any of the Lockheed people who talked to Arthur Young told them that NAVSHIPS had withdrawn from NAVMAT its request for approval of the tentative settlement (Tr. pp. 1098, 1099).

There is further evidence not referred to in the findings of "signals" given from which Lockheed knew or should have known the true facts, that is review by Mr. Rule's group would be more than pro forma.

On 16 December 1969, Mr. Folden had a conference with Mr. Rule and made a presentation of his claim (Tr. pp. 817-819).* Mr. Waters was present at the conference (Tr. p. 820).

On 30 December 1969, Mr. Rule testified before the Proxmire Committee and indicated that he considered the Lockheed claim a total cost claim and he would scrutinize it very carefully (Tr. pp. 821-823). Mr. Waters knew about this testimony which was discussed within Lockheed (Tr. p. 821).

Mr. Osborn's files produced a memorandum dated November 25, 1969, from the Shipbuilding Council of America, which reported on a conversation with Mr. Ill, as follows (Tr.Exh. G-68, TAB "H", Osborn's deposition):

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* Mr. Folden was advised on 6 December 1969 by Mr. vom Baur of the Navy press release setting up the Gordon Rule Group and Mr. Folden underlined the part reading "The group will review any request for contract adjustment amounting to 5 million or more and involving constructive change orders.", and sent it to Mr. Waters (Tr. pp. 681, 809-811).

> "He went on to indicate a belief that the $1 billion needed to satisfy pending or prospective claims would come out of regular Navy Shipbuilding and Conversion (SCN) funds and that additional or special appropriations for these purposes could not realistically be anticipated. He further stated that all claims, from henceforth will be minutely scrutinized, and that there would be no tendency toward munificense on the part of the Government." (Emphasis added).

Mr. Ill, in his testimony, confirmed the accuracy of this report (Tr. pp. 2091, 2092).

Mr. Waters was Executive Vice President of appellant (not Lockheed) [footnote p. 2 of opinion] in charge of its (the shipyard's) cost recovery organization.*

He reported to Mr. Osborn. Mr. Waters dealt principally with Captain Holfield, Admiral Sonenshein's assistant for claims (Tr. pp. 717, 723). It was Mr. Waters who prepared the Lockheed internal memorandum (Tr.Exh. G-31) for Mr. Folden who sent it to Mr. Osborn (Tr. pp. 850-852). See the quotation from this memo in the footnote on page 47.

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* In August 1968 he was in charge of the shipyard's cost recovery organization. After February 1, 1971, Mr. Folden, President of the shipyard company, was assigned to work on the L-1011 problem and thereafter Mr. Waters was for all practical purposes Chief Executive officer of the shipbuilding company, although given a title of Assistant Secretary, Lockheed Aircraft on 1 November 1971. From the fall of 1969 to February 1972 he was Executive Vice President of the shipyard (Tr. pp. 621-624, 628).

Capt. Holfield testified (Tr.Exh. G-75, pp. 427-430 that in his dealings with Mr. Waters and Mr. Folden, on all occasions when negotiation offers were made to appellant's personnel which exceeded $5 million, they were told that such offers were subject to approval of the Chief of Naval Material and Assistant Secretary of the Navy (I&L). As Lockheed's internal memorandum (Tr.Exh. G-31) disclosed, they knew about the review by Gordon Rule's Group.

After the execution of the contract modification on 24 February 1971, Mr. Waters met with Captain Holfield in Washington on 17 March 1971 (Tr. p. 748) and was told NAVSHIPS was "going to be holding a meeting to attempt to finalize the legal memorandum relating to the LPD contracts".* Mr. Waters then prepared, in March 1971, a financial forecast showing that the balance of the $62 million ($11.6 million) "would be collected during the second quarter of 1971 in accordance with the projected amount of completion on these contracts would occur during that quarter" and he based that forecast information "on the anticipation as Captain Holfield and I had, that the final Mod. should be completed approximately March the 30th" (Tr. pp. 753, 754).

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* FF32 shows NAVSHIPS did not submit its business clearance memorandum to NAVMAT until 25 March 1971 which was rejected on 2 April 1971 as "entirely unsatisfactory" and this was followed by a supplemental submission by NAVSHIPS on 9 June 1971.

The majority opinion refers to FF 44 and to the testimony of Mr. Waters that he was instructed by his superior in February 1971 to discontinue the bi-weekly "outstanding ship claims" report and to limit his future reports to "how much you collect". This instruction explains why the premise of Lockheed policy to assume that the settlement was final, subject only to collection or finalization, made no allowance for developments which clearly signalled that the review procedure would be thorough. It explains why Messrs Waters, Osborn and Anderson refused to believe, even after it was explained to them on 3 August 1971, that NAVSHIPS would withdraw its request for approval of the tentative settlement because the Lockheed claim and its justification had the same infirmities and deficiencies as the Avondale tentative settlement that Gordon Rule's Group had formally rejected on 23 July 1971.

On 28 and 29 April 1971, Admiral Rickover testified before a Congressional Committee (Tr.Exh. G-30, R4, C-02, at p. 582) and was critical of the Navy settling claims by bargaining, and he gave his opinion that:

> "the Navy should not be making payments for claims unless these payments are based on strict legal entitlement and a factual determination of amounts due. Any claim, or any item in a claim, that is not solidly grounded in fact or in law should be eliminated from claim settlements."

Mr. Packard was aware of Admiral Rickover's views on the subject (Tr. pp. 587, 588). FF 37 refers to the testimony before Congressional Committees in April and May 1971 that caused the Navy to reexamine the methods and standards by which ship claims would be settled. And FF 39 refers to Mr. Packard's testimony of 26 May 1971, assuring the Committee that the Lockheed tentative settlement was being "double-checking to be sure the claims can be appropriately verified".

Lockheed can only ignore these signals at its peril and cannot be excused because of its policy directive to "report only what you will collect".

The majority opinion (p. 49) cites Whelan and Dunnigan, "Government Contracts: Apparent Authority and Estoppel," 55 Geo.L.J. 830 (1967). That article (at p. 837) refers to Newman v. United States, 133 Ct.Cl. 429(1955) where an Army Regulation which was not published in the Federal Register* provided that final responsibility on tariff rates was with the Chief of Transportation of the Army. An agreement on temporary rates was made with other Government officials. The Court held that the Government was not bound by the agreement and stated (p. 438):

> "Plaintiff claims he had no knowledge of this Army Regulation, but this is immaterial because it is settled that he who enters into an agreement with the Government takes the risk that those who purport to act for the Government have the authority to do so. This is true even though the representatives of the Government may have been unaware of the limitations on their authority." (Emphasis added).

* (Footnote on following page.)

In our brief we discussed the case of United States v. Zenith - Godley Co. 180 F. Supp. 611 (S.D. N.Y. 1960), aff'd 295 F 2d 634 (2d Cir. 1961). The District Court, after stating the general rule (at page 616) that the United States may not be estopped by the unauthorized acts of its agents "nor may such agents waive the rights of the United States by their unauthorized acts", stated:

> "It would be meaningless to hold on the one hand that an agent cannot bind the Government directly unless he has actual authority, and then hold on the other hand that he may bind the Government by his own representation of authority, thus raising an estoppel."

In discussing detrimental reliance the District Judge stated (at p. 616):

> "If, then, it must be said that the present law provides that one dealing with the Government must not only learn the actual authority of agents but must also learn the actual scope of statutes and regulations, it is of no weight that the defendants** here claim that they suffered a loss because they incorrectly interpreted a statute. The burden of correct interpretation being upon them, the loss suffered by their misinterpretation must also be upon them, and the money disbursed without authority must be returned to the Government." (Emphasis added).

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* The article by Braude and Lane, 31 Fed. Bar J.99 (1972) cited in the majority opinion at p. 50, states that (at p. 105) "In cases where such basic regulatory requirements implementing dominant procurement policies are ignored by the contracting officer, the Government is not estopped to assert the invalidity of his actions," and notes (footnote 30) that this applies notwithstanding that the controlling regulations were not published for general public reference.

** The Government sued to recover sums paid by the Department of Agriculture through the Commodity Credit Corporation on the ground they exceeded the authority of the Department.

At this point we call attention to FF 49 where the majority opinion refers to a meeting on 13 August 1971* between Mr. Osborn of Lockheed and Mr. Ill (some ten days after Lockheed was informed by NAVSHIPS that its request for NAVMAT approval had been withdrawn) when the latter advised that it was better not to force a decision out of Gordon Rule. Mr. Osborn, reporting to his superiors three weeks later on 8 September 1971 (after Lockheed filed its application for a loan guarantee with the Board and after the Board had already met to consider the application),** stated:

> "I don't think there is a problem of the claims being approved. It is a matter of how the claims are written for final approval."

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* This was four days after the enactment of the Emergency Loan Guarantee Act (FF 51).

** FF 51 and 52. The First Annual Report of the Board (Tr. Exh. G-17, pp. 11, 12) refers to the two Board meetins of 25 August and 9 September 1971 and to the fact that at the second meeting "it committed the Government to guarantee loans up to the full extent of the $250 million limit under the Act and authorized the first takedown in the amount of $50 million."

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In view of the rest of Mr. Osborn's testimony, this is hard to believe. But assume it to be true, arguendo. On this fragile basis alone, ignoring the mass of evidence to the contrary, the majority opinion concludes that Lockheed was ignorant of the "true facts", that is (at pp. 56, 57) that the $62,000,000 settlement would be subject to a searching, exhaustive review.* Apart from Administrative Judge Lane's observation that Lockheed could not "red flag the problem without jeopardizing the entire credit agreement", the point we make here is that as a matter of law, on the authority of United States v. Zenith-Godley Co., supra , Lockheed's "incorrect interpretation" of the Navy Review regulation is, as the Court put it, "of no weight." They suffered a loss because of their incorrect interpretation of Admiral Sonenshein's authority or of that of Gordon Rule's Group.

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* We discuss supra in our request for Supplemental Findings, the additional testimony of Mr. Ill, Waters, Osborn and Anderson, which we submit the Board overlooked, in support of our argument that Lockheed knew the "true facts". This additional evidence further supports Administrative Judge Lane's views on this point (p. 65), particularly his observation (at p. 67) that Lockheed's very existence was at stake "and it could not red flag the problem without jeopardizing the entire credit agreement. The date of Mr. Osborn's report is significant in this regard."

2. There is no finding that a "promise" was made to Lockheed to pay the $62 million. Hence promissory estoppel is not applicable, absent such promise.

The majority opinion quotes (p. 47) from Restatement, Contracts 2d sec. 90 (Tent. Drafts Nos. 1-7, 1973) on its definition of promissory estoppel. That definition requires the existence of a "promise" which induces action or forbearance, and reliance by a promisee. There is no finding that such a "promise" was made by an authorized official of the Government.

Thus FF 25e, quoting Mr. Packard's testimony:

> " . . . In my discussions with the company and the banks I certainly intended to convey to them my conviction that this whole claim would be settled for the $62 million.
>
> I intended to imply by my statement to the lawyers etc. . . " (Emphasis added).

Again FF 681.

> "As established by the statements and conduct of Secretary Packard during the critical period from 30 December 1970 to 14 September 1971, the Government assumed and impliedly promised that the Navy would approve the ship claim settlement etc. . . . "

And in FF 68m:

> "Although aware of the approval on which the $62,000,000 settlement was conditioned, senior officials of Lockheed, reasonably relying on the assurances and the promise given by or implicit in the conduct of responsible Government officials, assumed that the approval would be readily given once the necessary documentation was obtained, and thus they were ignorant of the 'true facts', that the settlement would be subject to a searching, exhaustive review which existing documentation could not possibly satisfy. (Findings 25-e, 44, 47, 48, 49, 50 and 53)."*

We submit that the Board overlooked the case of Campania Itherea de Vapoves S. H. v. United States, 137 Ct.Cl. 860, cert. denied 355 U. S. 817 (1957) (which was discussed in our brief at p. 97), and that there must be a "promise to pay the amount agreed upon" before action on the settlement will lie. There, too, was a settlement agreement which the Maritime Commission had approved "subject to clearance of the General Counsel". In rejecting the plaintiff's suit on the

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* The dissenting opinion of Administrative Judge Lane (at pp. 65, 66) cannot even find support for "an implied promise to Lockheed". Our point is that the promissory estoppel rule invoked by the majority opinion requires a finding of an actual promise; an implied promise is not enough. See also Proposed Supplemental Findings of Fact 49a-g, ante pp. 41-43.

settlement agreement, the Court stated (p. 863):

> "We are not sure what the Commission meant by its approval of the agreement by the plaintiff and the Chief of the Bureau of Operations, 'subject to clearance by the General Counsel'; but whatever the Commission may have meant by this, it is clear that no final action had been taken approving the settlement and, therefore, the Commission never promised to pay the amount agreed upon. Since there was no promise to pay, plaintiff's only right of action is on its original claim; there was no promise upon which it can sue." (Emphasis added).

FF 68i states that Lockheed's bankers "understood that the ship claims had been settled by the Navy for $62,000,000 subject only to finalization of documents". (Emphasis added) But this is not the equivalent of a promise as the Court further pointed out in Campania, supra, at p. 863:

> "If we assume as plaintiff contends, that the phrase 'subject to clearance by the General Counsel' means only, subject to putting the agreement into formal legal terminology, still there was no promise to pay until this had been done. Even if the phrase meant what plaintiff contends, no promise to pay would have arisen until after counsel had prepared the necessary documents setting forth the agreement and a promise to pay, in consideration of the release by plaintiff of its claim against the defendant, or whatever else counsel may have thought necessary and proper to include in the documents. As we have seen, this was never done." (Emphasis added).

Nor are "signals ultimately given by and implicit in the conduct of the Deputy Secretary of Defense" (at p. 59) the equivalent of a "promise" within the estoppel rule.

Corbin on Contracts (1963 Ed) discusses promissory estoppel in Section 200, "Limits of the Action in Reliance Doctrine." First, he states, action or forbearance must amount to a substantial change of position. Second, such action or forbearance must have been actually foreseen by the promisor or reasonably foreseeable, and third (at p. 218):

> "an actual promise must have been made and this promise must itself have induced the action or forbearance in reliance on it." (Emphasis added).

See, also, 1 Williston on Sales §7-4 (4th ed 1973) at 255:

> "Therefore, in order that the general contractor [promisee] could successfully establish his cause of action based upon promissory estoppel, he had to show that he received a clear and definite offer from the subcontractor [promisor], that the subcontractor [promisor] could expect reliance of a substantial nature, and that actual reasonable reliance on the general contractor's [promisee's] part was present and detrimental. (Emphasis added).

There is no finding of a promise by Mr. Packard to pay the $62 million tentative settlement. Nor is there any finding that Mr. Packard even promised to obtain Navy approval of the settlement. In fact the finding is (FF 6d) that "Secretary Packard was explicit in testifying that negotiation of a settlement of the ship claims was to be the responsibility of the Navy."

Mr. Packard reaffirmed in his testimony (Tr. p. 53) the truth of an affidavit he executed in August 1973:

> "I have been asked by counsel to state whether I or the Secretary of Defense gave approval to any such settlement [referring to tentative settlement of $62 million, which was subject to approval by higher authorities]. I can categorically state that I did not give approval to said tentative settlement of $62 million and to the best of my information and belief neither did the Secretary of Defense."

Mr. Packard talked to Mr. Shillito prior to executing the affidavit in August 1973 and was told that the affidavit was substantially correct and that it was all right for him to sign (Tr. p. 51). Mr. Shillito also signed (Tr. p. 60).

Mr. Packard was asked whether he ever told Mr. Haughton that he approved the $62 million tentative settlement. He answered (Tr. p. 54):

> "A. I told Mr. Haughton that I was confident the $62 million would be paid . . . because I thought it would . . . "

He then testified that he told Mr. Haughton "in the context on the whole deal" when he sent him a copy of the letter of 30 December 1970 that he wrote to Senator Stennis (Tr. p. 55). He was asked whether he used his official authority to (Tr. pp. 59, 60):

> "[Q] . . . say to Lockheed or take any action with respect to Lockheed which says that I in my capacity [as Deputy Secretary of Defense] did approve the $62 million tentative settlement and you needn't bother with the normal procedure of the Navy? I in my capacity as that officer gave that approval -- Did you do any such thing?

> A. No. As I've already explained, I felt it was better for all these issues to the extent they could be resolved by the services themselves . . . and I did not want to get in and have to make all the decisions for each one of these services on this matter . . . And I did not give specific approval to this settlement. I did not intend to nor did not want to. I wanted the Navy to do it. (Emphasis added).

Mr. Haughton was asked whether Mr. Packard ever told him he approved the $62 million settlement. He replied: "No sir . . . I never said that DOD approved the $62 million tentative settlement." (Tr. pp. 281, 283).

We submit that there was no promise by Mr. Packard to Lockheed that he would approve the tentative settlement. And, as indicated, absent a promise, there can be no promissory estoppel.

3. Lockheed May Not Invoke Estoppel Based On Alleged Representations Made, Not To It, But To Its Bankers.

In our brief we argued that if representations were made to the bankers by Mr. Packard, they may perhaps assert estoppel and they could only show detriment if Lockheed had defaulted on its loan. That would be the point where damage or injury occurred. Lockheed, we submitted, could not be the beneficiary of representations to the bankers and stand in any better position than the bankers, if they were to sue in their own right. The majority opinion, without discussion on this point, simply states its conclusion as follows (pp. 59, 60):

> "In our decision, we have recited the reliance of Lockheed's bankers and airline customers on Secretary Packard's implied promise merely to corroborate the reasonableness of Lockheed's reliance. While we are not called upon to decide the issue, we observe that the most recent Restatement definition quoted in the text above, [at p. 47] would afford third parties, such as banks and airlines here, a right to invoke an estoppel against the promissor, or government similar to that of the promisee, Lockheed." (Emphasis supplied).

We submit, that the Board is called upon to decide the issue whether when (as the findings state) the representations were made to the bankers as a basis for their extending credit to Lockheed and the bankers in turn to the airline customers of Lockheed's L-1011, Lockheed may assert estoppel based on those representations. No discussion of cases is contained in the majority opinion, nor is there any discussion of Comments in the Restatement indicating the extent to which its definition has been applied or accepted by the Courts. The Government is, we submit, entitled to have this point considered and dealt with, as it raises a substantial question of law whether Lockheed may maintain estoppel under the circumstances.

CONCLUSION

In view of the foregoing, we ask that the Motion for Reconsideration be granted and this appeal be referred to the Senior Deciding Group; that these motion papers be submitted to said Senior Deciding Group for their consideration; and that the appeal be thereafter set down for oral arugment before the Senior Deciding Group with leave to Respondent to submit such additional memoranda in support of its position as it may deem available.

Respectfully submitted,

E. GREY LEWIS
General Counsel

WILLIAM L. BROWN
Deputy General Counsel

MORRIS AMCHAN
Associate Counsel

ROBERT E. LIEBLICH
Associate Counsel

ITEM 5.—*November 8, 1976—Justice Department Brief in Opposition to Newport News Motion for Entry of Judgment or, in the Alternative, for Dismissal with Prejudice*

UNITED STATES DISTRICT COURT, EASTERN DISTRICT OF VIRGINIA,
NEWPORT NEWS DIVISION

Civil Action No. 75–88–NN

UNITED STATES OF AMERICA, PLAINTIFF,

v.

NEWPORT NEWS SHIPBUILDING AND DRY DOCK COMPANY, AND TENNECO INC., DEFENDANTS.

PLAINTIFF'S BRIEF IN OPPOSITION TO DEFENDANTS' MOTION FOR ENTRY OF JUDGMENT OR, IN THE ALTERNATIVE, FOR DISMISSAL WITH PREJUDICE

PRELIMINARY STATEMENT

In this action the United States of America seeks specific performance of its contract wiht Newport News Shipbuilding and Dry Dock Company (hereinafter "Newport News") for the construction of a nuclear powered frigate, the DLGN–41,[1] which is necessary to the national defense. The complaint alleges that the contract for the construction of the DLGN–41 arose on January 31, 1975 when the Navy, on behalf of the United States, exercised its option with Newport News for the construction of the ship [Complaint, ¶ 11].

Subsequently, on August 25, 1975, Newport News notified the Navy of its intention to cease all construction activities on the DLGN–41. On August 29, 1975, the United States filed its complaint for specific performance and simultaneously moved for a temporary restraining order directing Newport News to resume work on the DLGN–41. On that same day, a hearing was held on the Motion for Temporary Restraining Order, and, during a recess, the parties negotiated a stipulation which was read into the record of proceedings. That stipulated agreement which was entered as the Order of this Court, provides, in part:

* * * * * * *

1. The Contractor [Newport News] will immediately resume the procurement of material and the performance of shop fabrication and other preliminary work for the DLGN–41 and proceed to undertake construction. Payment for such work will be made by the Navy on the same basis as payments were made prior to June 6, 1975.

* * * * * * *

It is understood by the parties that all of the changes made in the plans and specifications for DLGN–38, DLGN–39 and DLGN–40 that are applicable will be incorporated in the plans and specifications for DLGN–41, and the parties agree to negotiate in good faith the appropriate equitable adjustments for all such changes.

2. The parties agree to negotiate in good faith to reach an agreement as rapidly as possible to modify those contract provisions requiring amendment or to take other appropriate action.

* * * * * * *

5. This stipulation and any action taken by either party pursuant hereto shall be without prejudice to the rights or legal positions of either party.

---

[1] The DLGN–41 has been reclassified to bear the designation CGN–41.

The Court's Order was to remain in effect for one year unless cancelled or modified by mutual agreement or by Order of the Court at the request of either party. On June 25, 1976, the Court, at the joint request of the parties, extended its August 29, 1975 Order for an additional one-year period.

On October 14, 1976, defendants filed a Motion For Entry of Judgment Or, In The Alternative, For Dismissal With Prejudice. In moving for entry of judgment, defendants allege that on August 20, 1976 the parties reached a negotiated settlement of the issues underlying the present action and that this Court should enter its judgment in accordance with the negotiated settlement. In moving alternatively for dismissal with prejudice, defendants allege that plaintiff has failed to negotiate in good faith pursuant to this Court's Order of August 29, 1975.

In the present brief, with its supporting affidavits, we demonstrate that any agreement in principle which may have been negotiated between the contracting officer and Newport News on August 20, 1976, is not binding on the United States because any alleged settlement was outside the scope of the contracting officer's authority and has not received the approval of the Department of Justice. We further demonstrate in the present brief that, contrary to defendants' allegations, Navy has engaged in good faith bargaining with Newport News pursuant to this Court's Order.

The Parties Have Not Negotiated Any Final Settlement Agreement Which Is Binding on the United States

INTRODUCTION

In their Brief in Support of their Motion For Entry of Judgment, defendants argue that an enforceable agreement was reached between Navy and Newport News on August 20, 1976 which settles the issues raised by the present action. (Defendants' Brief, pp. 19–21). On the facts as set forth below, no such binding agreement could have been reached between the parties on August 20, 1976 because at that time any agreement, even in principle, had not been reduced to writing. Additionally, there is, to date, still no binding agreement between the parties because there has been no meeting of the minds on the terms of the agreement and any proposed Modification executed by the contracting officer was outside the scope of his authority; has not yet received the approval of the Department of Justice; and was subject to two express written conditions which have not occurred. Further, this Court lacks jurisdiction to enter a judgment effectuating the terms of the alleged settlement agreement.

STATEMENT OF FACTS

Defendants contend that an enforceable agreement was reached between Navy and Newport News on August 20, 1976, which settles the issues raised by the present action. Defendants' Brief, p. 19. The facts pertinent to defendants' legal conclusion are largely undisputed between the parties and show that, to the contrary, no such binding agreement could have been reached on August 20, 1976, or to date, under relevant legal principles.

Between August 29, 1975, when this Court entered its Order and July 1976, Navy and Newport News engaged in negotiations concerning their dispute over the DLGN–41, with Navy being represented by different lead negotiators. Affidavits of Charles E. Dart, filed with this Court in July 1976, by defendants. On July 16, 1976, Assistant Secretary of the Navy Jack L. Bowers delegated to the Office of the Chief of Naval Material responsibility for the DLGN–41[2] negotiations and assigned to Mr. Gordon Rule the role of primary negotiator.[3] Affidavit of Admiral Frederick H. Michaelis, dated November 1976. ¶4 [hereinafter referred to as the "Michaelis Affidavit"]; Affidavit of Vice-Admiral Vincent A. Lascara, dated November 1976, ¶ 6 [hereinafter referred to as the "Lascara Affidavit"].

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[2] Since Defendants' Brief refers to the cruiser at issue as the DLGN–41, plaintiff's brief will use a similar reference, although the DLGN–41 is now properly referred to as the CGN–41.

[3] Mr. Gordon Rule is the Director, Procurement Control and Clearance Division, Naval Material Command. His normal function is reviewing for business clearance proposed contracts and contractual modifications negotiated by the various Naval procuring offices. In that position Mr. Rule reports to Gerald J. Thompson. Lascara Affidavit, ¶4.

From the time of his appointment until August 19, 1976, Mr. Rule advised his superior, Admiral Lascara, that he was securing information from both Navy and Newport News officials in an effort to prepare himself for the negotiations. During this period, Admiral Lascara cautioned Mr. Rule on at least one occasion that any agreement he might negotiate would require review and approval of higher authority. Lascara Affidavit, ¶ 7.

On August 19, 1976. Captain Gerald J. Thompson issued a Certificate of Appointment to Mr. Rule as a contracting officer for the purpose of formally vesting in him authority to negotiate with Newport News on the DLGN–41 controversy. The form Certificate limited the appointment by making it: "subject to the limitations contained in the Armed Services Procurement Regulation and to any further limitations set forth" in the Certificate itself. Mr. Rule's warrant also stated that he had: "Unlimited authority with respect to *negotiations* with Newport News Shipbuilding and Dry Dock Company for construction of CGN–41 under Contract N00024–70–C–0252." (Emphasis added.) Captain Thompson employed the language "Unlimited authority with respect to n*egotiations* * * *" (emphasis added) for the express purpose of showing, on the face of the Certificate, that Mr. Rule's authority was to conduct negotiations only. Affidavit of Captain Gerald J. Thompson, ¶¶ 5, 6, 7, dated November, 1976 (hereinafter "Thompson Affidavit").

On August 20, 1976, Mr. Rule met in Washington with representatives of Newport News to commence negotiations with respect to the DLGN–41. Affidavit of Charles E. Dart, dated October, 1976, ¶ 29(a), filed by defendants [hereinafter "Dart October Affidavit,"] Transcript of Deposition of Mr. Gordon W. Rule, p. 83.[4] A preliminary oral agreement in principle was negotiated between Mr. Rule and Newport News on a number of items which were specifically established by the prior written Contract N00024–70–C–0252, as modified, for the construction of the DLGN–41. For example, Mr. Rule tentatively agreed, among other matters, to a later delivery date for the DLGN–41 and an escalation clause which was more favorable to Newport News. Tr. Rule Dep., p. 88. At the conclusion of the meeting on August 20, 1976, Newport News agreed to prepare the first written draft covering the items agreed to in principle. Dart October Affidavit, ¶ 29 (p).

On August 23, 1976, Mr. Rule briefed Admiral Lascara on the details of the proposal for settlement. Admiral Lascara again advised him that any proposal for settlement would have to be submitted for higher approval and that a business clearance for that purpose should be prepared. Lascara Affidavit, ¶9.

Also, on August 23, 1975, Mr. Rule stated at his deposition that he informed Deputy Secretary of Defense William P. Clements of the progress of the DLGN–41 negotiations. Contrary to the representations made by Newport News in paragraph 30(a) of the Dart October Affidavit, however, Mr. Rule states that Mr. Clements did not approve the agreement in principle. Rather, Mr. Clements, after his briefing, responded: " 'Fine. We've got a lot to work out.' " Tr. Rule Dep., p. 91.

Subsequently, on August 25, 1975, Assistant Secretary of the Navy Bowers telephoned Mr. John P. Diesel, President of Newport News, and informed Mr. Diesel that he was perturbed by a press release issued by Newport News indicating a settlement of the DLGN–41 dispute. Dart October Affidavit, ¶ 35. Mr. Bowers informed Mr. Diesel that Navy was going to issue a press release that would say the matter was an agreement in principle only, subject to review by higher authority. Dart October Affidavit, ¶ 35; Lascara Affidavit, ¶ 12.

On August 30, 1976, Newport News provided Mr. Rule with the first draft of a proposed Contract Modification, labeled Modification P00031. Dart October Affidavit, ¶ 38. On that same day, Admiral Michaelis, by memorandum, formalized the procedure for review of the proposal of settlement by appointing Admiral Lascara, who was to be assisted by named personnel, to review the DLGN–41 proposed agreement in principle. Michaelis Affidavit, ¶6. The memorandum further provided that Mr. Rule was to submit: "the proposed contract amendment, the business clearance justifications, and other supporting papers for review prior to signature by the contracting officer." Lascara

[4] The deposition of Mr. Rule was taken by defendants on October 21, 22, and 26, 1976. Although the transcript of the deposition may not yet have been filed with the Court, we attach a copy of the transcript hereto and refer to it throughout this Brief since signature has been waived and the transcript should be filed shortly. The transcript of the Rule deposition will be referred to hereinafter as "Tr. Rule Dep."

Affidavit, ¶ 13; Michaelis Affidavit, ¶ 6. Subsequently on August 30, Admiral Lascara advised Mr. Dart of the team which had been established to review Mr. Rule's proposal of settlement. Dart October Affidavit, ¶ 39; Lascara Affidavit, ¶ 13.

Between August 30, 1976 and October 7, 1976, Mr. Rule and Newport News officials met on a number of occasions concerning a series of changes in various items which were negotiated in general principle on August 20. Those revisions included a deletion of the "changes in law component" of the agreement in principle and a major change in the proposed escalation clause. Dart October Affidavit, ¶¶ 38, 46, 48, 50, 51; Tr. Rule Rep., pp. 90, 113–115, 249, 252–255.

On September 1, 1976, Admiral Lascara met with Mr. Clements and reported on the status of the DLGN–41 negotiations. Mr. Clements reiterated that the negotiations between Mr. Rule and Mr. Dart must be reviewed by proper authority in the Navy Department and that he personally wanted to see the overall final impact of the proposed contract amendments. Lascara Affidavit, ¶ 15.

On September 27, 1976, a second draft of the proposed settlement was delivered to Mr. Rule by Newport News officials. Dart October Affidavit, ¶ 49. The need for further revisions in the second draft was discussed between Newport News officials and Mr. Rule on October 1, 1976. Dart October Affidavit, ¶ 50.

In late September, 1976, Mr. Rule received a copy of an analysis prepared by the Defense Contract Audit Agency which set forth the first estimate of costs to the Government of the proposed settlement agreement. Tr. Rule Dep., pp. 249–251, 254–255, 281. Mr. Rule immediately informed Mr. Dart of Newport News that the analysis showed a serious problem with the escalation clause contained in drafts of the proposed agreement. Tr. Rule Dep., pp. 114–115, 252–255. The analysis showed that under the drafts of the escalation clause in the proposed settlement, "we would be paying escalation in costs that they [Newport News] hadn't incurred." Tr. Rule Dep,, p.255. Mr. Rule then informed Mr. Dart that unless Newport News would agree to a change in the escalation clause so that the Government would pay on the basis of the contractor's actual experience or the BLS Indices time 1.25, whichever is less, there could be no agreement between the parties. Tr. Rul Dep., p. 253. Mr. Dart told Mr. Rule he would only agree to that change if it was the "hingepoint" to any agreement. Tr. Rule Dep., pp. 115, 253, 255.

On October 7, 1976, Newport News delivered to Mr. Rule a document entitled Modification P00031, executed by Mr. Dart on behalf of Newport News. Dart October Affidavit, ¶ 51. The document delivered to Mr. Rule did not include the change in the escalation clause earlier discussed by Mr. Rule with Mr. Dart. Tr. Rule Dep.. p. 253.

Also on October 7, 1976, Admiral Michaelis sent a memorandum to Mr. Rule which stated:

1. This will acknowledge receipt of reference (a), which requests my approval of the arrangement that you have negotiated with NNSBDDC. Unfortunately, neither I nor the review group that I appointed to assist me have a copy of the proposed modification that accurately reflects the results of your efforts. In addition, as you know, the legal review by OGC of reference (b) was submitted to the Justice Department on 5 October 1976 for review and assessment of the litigative risk.

2. Pending completion of these actions and the subsequent review specified in reference (c), final government approval or disapproval of the proposed modification of the CGN–41 contract cannot be consummated. Accordingly, please submit the proposed modification documents and such other documents as may be required by my review group.

Mr. Rule received the memorandum on that same day. Michaelis Affidavit, ¶ 8; Lascara Affidavit, ¶ 18; Tr. Rule Dep., 285.

At approximately 5:00 p.m. on October 7, 1976, Mr. Rule informed Admiral Lascara that he had received an executed copy of proposed Modification P00031 from Newport News. Lascara Affidavit, ¶18. After discussing that fact with Admiral Michaelis. Admiral Lascara immediately wrote a memorandum to Mr. Rule, dated October 7. 1976, which stated:

I would like to reiterate that you do not have the authority to bind the Government contractually on the proposed modification to the CGN–41 contract until the legal and business reviews have been completed and you have

been advised accordingly. If there is any doubt about this, please discuss it with me.

The events which occurred on October 7, 1976, after Mr. Rule met with Admiral Lascara, were set forth vividly by Mr. Rule at his deposition:

And I went back upstairs, and I think on that same day Admiral Michaelis sent another memorandum about what we had done having to be reviewed by this review group, and I thought a lot about it all afternoon. I could see, in my opinion, I could see what was happening to this whole negotiated settlement. I knew the object of the negotiation. I knew why I had been picked to negotiate a settlement pursuant to the order of the court, which I had done. I could see the Rickover-Proxmire, et al., influence at work everywhere.

And I finally decided that, if the desires of the Department of Defense as embodied by Mr. Clements, his desire to build ships and get out of the courts; if there was ever to be any meaning to that, he has, after all, told the Armed Services committees of the Congress that this ship and these ships involved in the controversy, the nuclear ships with Newport News—that this is a matter—these are a matter that will constitute a vital interest to the national defense. And when he wraps that mantle of national defense to the extent that he has done around the negotiation of this ship and the other ships, I'm frank to say I fall in line.

And I decided those things all—those things all ran through my mind—I wasn't unmindful of the roadblocks and the lack of cooperation that I had gotten and was getting from the office of General Counsel. When my Contracting Officer's statement was turned over to the Office of General Counsel for their review, they then asked me for substantiating documents. I gave them those documents which you have. They were requested by Admiral Lascara to please not write anything until we can get together and discuss this: Let's at least discuss it. Rule had said one thing. Now, review it and let's get together and discuss it before you write anything.

They never did. They wrote a 85-page document. They had lawyers working their butts off. They wrote an 85-page document and turned it over to the Department of Justice. And I don't know what it says today. They won't tell me. These are my own lawyers that are supposed to be helping me. They've never told me what was in there.

Well, on the 7th of October when these things ran across my face, before my eyes, I said: Something's got to be done. I'm a Contracting Officer. I've got the authority. Now I'm going to sign the goddam thing. And I signed it.

Tr. Rule Dep., pp. 99–101.

On October 8, 1976, at approximately 7:30 a.m., Mr. Rule met with Admiral Lascara in Lascara's office. Admiral Lascara then handed to Mr. Rule the memorandum, dated October 7, 1976, which Admiral Lascara had written to Mr. Rule the previous evening. Lascara Affidavit, ¶ 19; Tr. Rule Dep., p. 103. Mr. Rule informed Admiral Lascara that he already had executed the proposed Modification given him by Newport News. Tr. Rule Dep., p. 105. Admiral Lascara directed Mr. Rule to give him the executed document to put in his safe, and Mr. Rule countered by offering to place it in Mr. Clement's office for safekeeping. Admiral Lascara had to depart for a meeting with Mr. Clements at the Pentagon at that point. Lascara Affidavit, ¶ 19; Tr. Rule Dep., pp. 104–105.

According to Mr. Rule, at the end of his meeting with Admiral Lascara: "I went back upstairs and again started thinking. And I finally decided to take the Mod out of the drawer and hand it to Newport News. I think it was Mr. Ewell", who was apparently waiting in Mr. Rule's office. Tr. Rule Dep., p. 105; Affidavit of Vincent F. Ewell, Jr., ¶ 4 dated October, 1976, filed by defendants in support of their present motion [hereinafter "Ewell October Affidavit"]. With representatives of Newport News in his office, Mr. Rule then called his secretary and dictated, in front of them, a letter which was to accompany the proposed Modification which he had executed. Ewell October Affidavit, ¶4, Tr. Rule Dep., p. 106. The letter which was dictated in front of Newport News representatives stated, *inter alia*, that:

This Mod has been executed by me as Contracting Officer on two conditions as follows:

(i) That ultimate approval must be received from Deputy Secretary of Defense Clements, and

(ii) That escalation under this Mod will be paid by the Government on the basis of the contractor's actual experience or the BLS Indices times 1.25, whichever is less.

Ewell October Affidavit, ¶ 4, and attachment thereto. Mr. Rule then gave to Newport News the Proposed Modification P00031 which he had signed and shortly thereafter the letter which he had dictated. Tr. Rule Dep., pp. 106–107 and Exh. 39 thereto.

At approximately 10:00 a.m. on October 8, 1976, Mr. Rule was called back to Admiral Lascara's office and informed that Mr. Clements wanted the document which Mr. Rule had signed given to the Under Secretary of the Navy. Mr. Rule responded that he already had given it to Newport News representatives who had been waiting in his office. Lascara Affidavit, ¶ 19; Tr. Rule Dep., p. 106. Subsequently on October 8, 1976, by Memorandum, Captain Gerald J. Thompson formally revoked Mr. Rule's contracting officer's warrant to negotiate in the DLGN–41 dispute. Thompson Affidavit, ¶ 8.

Between 10:00 a.m. and 12:00 a.m. on October 8, 1976, Mr. E. Grey Lewis, General Counsel for Navy, spoke with Newport News officials and informed them that Mr. Rule had no authority to act finally in the DLGN–41 dispute. Ewell October Affidavit, ¶6. Similarly, on October 8, Admiral Michaelis, when he was informed that Mr. Rule had delivered a fully executed copy of proposed Modification P00031 to Newport News, telephone Mr. Dart to explain the situation to him and asked that the signed copy of the proposed Modification be returned. Mr. Dart said that he would respond later in the day. Michaelis Affidavit, ¶ 9. Admiral Michaelis also, in the afternoon of October 8, 1976, sent a letter to Mr. Diesel, President of Newport News, which stated. *inter alia*, that the:

Modification has not yet received requisite reviews and approvals by the Department of the Navy, the Department of Defense and the Department of Justice, all of which are steps you have previously been advised would be necessary conditions to its execution. Accordingly, it was executed without authority to bind the Government and should not be mistakenly relied upon by you as committing the Government to the proposed CGN–41 settlement reflected therein.

Michaelis Affidavit, ¶ 9.

On October 15, 1976, Mr. Clements forwarded the proposed Modification P00031 to the Department of Justice for its consideration and action.

ARGUMENT

A. Any agreement which may have been negotiated on August 20, 1976 is unenforceable under Government procurement law because it was oral.

Defendants argue that the "oral agreement reached between the parties on August 20, 1976, is final and binding on the parties." Defendants' Brief, p. 20. Assuming *arguendo* that Mr. Rule had the authority to enter a contractual modification settling the DLGN–41 controversy on August 20, 1976, and attempted to do so, the failure of the parties to reduce this agreement to writing renders the agreement unenforceable.

31 U.S.C. § 200(a)(1) provides that:

After August 26, 1954, no amount shall be recorded as an obligation of the Government of the United States unless it is supported by documentary evidence of:

(1) a binding agreement in writing between the parties thereto, including Government agencies, * * *

In *United States* v. *American Renaissance Lines, Inc.*, 494 F.2d 1059 (D.C. Cir. 1974), *cert. denied*, 419 U.S. 1020 (1974), the Court of Appeals for the District of Columbia Circuit held that under 31 U.S.C. § 200(a)(1), an oral contract for the carriage of goods between the Commodity Credit Corporation, a governmental agency, and a private party was unenforceable. The Court rejected the government's argument, in seeking to enforce the oral contract, that ". . . the statute [31 U.S.C. § 200(a)(1)] is simply a recordation statute to facilitate auditing and has no effect on government contracts with private parties." *Id.* at 1062. Rather, the Court found:

We hold that the statute does establish a requirement that government contracts of this type be in writing, and that contracts which are merely oral are unenforceable * * * we feel that the Congress was concerned that the executive might avoid spending restrictions by asserting oral contracts, and so enacted the requirement of a writing.

* * * * * * *

We view the statute as establishing a requirement that a government contract as involved here be in writing before either party may be allowed to

obtain court enforcement of the agreement. The statute admittedly is not phrased as the typical statute of frauds. It is more specific, in that it requires that the contract be supported by documentary evidence of a binding agreement in writing. Although the statute simply bars recording oral contracts as obligations of the Government, this does not mean that recordation is the only purpose or effect of the statute. (Footnote omitted) *Id.* at 1062; 1064–1065.

In discussing the requirements of 31 U.S.C. §200(a)(1), in *American Renaissance, supra*, the Court of Appeals also considered the decision of the Court of Claims in *Penn-Ohio Steel Co.* v. *United States*, 173 Ct.Cl. 1064, 354 F.2d 254 (1965), upon which defendants rely to support their position that the "oral agreement" of August 20, 1976, is binding. Defendants' Brief, p. 20. The Court found the *Penn-Ohio* decision to be unhelpful since "* * * no citations to the statute at hand * * * appear in the Court of Claims opinion." *American Renaissance, supra*, at 1064, footnote 21.

Any oral modification, in principle, which may have been negotiated on August 20, 1976, is similarly unenforceable under Armed Services Procurement Regulation, § 1.201.2 That section defines "contract modification" to be a "written alteration." In discussing an almost identical Federal Procurement Regulation, §1–1.219, the Court, in *America Renaissance, supra*, found that such a regulation supports "* * * our view that a written contract is necessary to bind ARL here." *Id.* at 1065. Moreover, in discussing the effect of the Armed Services Procurement Regulation generally, the Supreme Court has recognized:

> The present Regulation [1.301] makes no such allowances, contains no such qualifications, and provides for no such exception. Its unqualified command is that purchases for the Armed Services be made on a competitive basis, and *it has, of course, the force of law.* [Emphasis added.] *Paul* v. *United States*, 371 U.S. 245, 255 (1963).

Hence, the regulatory requirement of ASPR §1.201.2 for a writing has the force of law and precludes any oral contract modification which may have been negotiated on August 20, 1976, from being enforceable.

B. Under general principles of contract law, there still has been no contract modification because the minds of the parties have not met.

Even if the alleged oral agreement in principle of August 20, 1976, had been negotiated between private parties outside the peculiar requirements of government procurement law, no contract was consummated on August 20 or to date. It is a well-established principle of general contract law that if the parties' actions evidence an intent not to be bound until a written document is executed, there is no meeting of the minds which can give rise to a contract prior to the execution of that document.

The Court of Appeals for this Circuit, in *Orient Mid-East Great Lakes Serv.* v. *Inter'l Export Lines*, 315 F.2d 519, 523–524 (4th Cir. 1963), has indicated that the following factors should be considered in determining whether the minds of private parties have met prior to the execution of a written document:

(1) whether from the very beginning the parties manifested an intent to await the execution of a written memorial of terms already discussed;

(2) whether the bargaining between the parties ever came to a rest;

(3) whether the nature of the agreement proves that it was too much for a verbal understanding only.

When those factors are applied to the present facts, it is clear that there still has been no meeting of minds even between the contracting officer, Mr. Rule, and Newport News.[5]

From the very beginning, both Mr. Rule and Newport News contemplated that a series of written drafts would be prepared by the parties subsequent to

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[5] *Banking and Trading Corp.* v. *Floete*, 257 F.2d 765 (2nd Cir. 1958), also involved the question of the enforceability of a contract prior to the execution of an integrated writing. There, too, a government agency was involved. Among the factors noted to be taken in account in such a situation were:

(1) "[W]hether [the contract] has few or many details";

(2) "[W]hether the amount involved is large or small";

(3) "[W]hether the negotiations indicated that a written draft is contemplated as the final conclusion of the negotiations. If a written draft is proposed, suggested, or referred to during the negotiations, it is some evidence that the parties intended it to be the final closing of the contract";

(4) "[W]hether during the negotiations the parties have fully agreed upon all of the details of the transaction, or whether pending final execution of a written document some of those details have remained unsettled";

(5) And whether one of the parties is a government agency. *Id.* at 769.

their August 20 meeting. Indeed, on August 20 Newport News offered to prepare the first draft of the alleged oral agreement in principle. Dart October Affidavit, ¶ 29(p). On August 30, 1976, Newport News supplied Mr. Rule with such a first draft and on September 27, 1976, Newport News supplied Mr. Rule with a second draft. Dart October Affidavit, ¶¶ 29(p), 49. It was not, however, until October 7, 1976, that Newport News delivered an actually *executed* copy of any document to Mr. Rule. Dart October Affidavit, ¶51. Moreover, it was not until late in September that Mr. Rule himself even obtained an estimate of the increased costs to the Government which the alleged agreement in principle of August 20 would involve. Tr. Rule Dep., pp. 249–251, 254–255, 281. On those facts, it is clear that neither Mr. Rule nor Newport News intended to be bound prior to the execution of a written document embodying the terms of their oral negotiations. Since no such document has yet been executed by a government agent acting within the scope of his authority,[6] there is still no contract between the parties embodying their prior negotiations.

The Court of Appeals in *Orient Mid-East Great Lakes Serv., supra* at 523, also indicated that if the parties continue bargaining, this is further evidence that there has been no meeting of the minds. In the instant case, Mr. Rule and Newport News officials, between August 20, 1976 and October 8, 1976, were engaged in repeated discussions which, at the least, were aimed at clarifying the terms of any agreement in principle of August 20, 1976. Dart October Affidavit, ¶¶ 38, 42, 46, 48, 50, 51; Tr. Rule Dep., pp. 90, 113–115, 249, 252–255. Moreover, it was not until the week of October 7, 1976, that the parties were able to reach agreement on a change in law clause which Mr. Rule states was a "substantive, semi-substantive point." Tr. Rule Dep., p. 90.

Of further significance is the fact that on October 8, 1976, Mr. Rule and Newport News were still in disagreement over the manner in which escalation was to be paid to Newport News under the August 20 agreement in principle. Mr. Rule's position was that escalation had to be paid based on the Bureau of Labor Statistics Indices times 1.25 or actual cost, whichever is less. Otherwise, "they'd [Newport News] be getting escalation costs they didn't actually incur." Tr. Rule Dep., p. 114. Mr. Dart objected to such a provision but, according to Mr. Rule, indicated "if that point became the hingepoint for the whole negotiation, he would give on it." Tr. Rule Dep., pp. 115, 253, 255. Mr. Rule further stated that this issue was considered to be substantive as of October, 1976. Tr. Rule Dep., pp. 113, 253, 255, 282. In view of the continual bargaining which occurred between August 20 and October 8, 1976, it is inconceivable that either Mr. Rule or Newport News believed that they could have a binding contract prior to the execution of a written document.

Additionally, when Mr. Rule delivered to Newport News, on October 8, the first executed copy of a document which ellegedly embodied their agreement in principle of August 20, 1976, he specifically made the effectiveness of the document subject to two written conditions:

(i) That ultimate approval must be received from Deputy Secretary of Defense Clements, and

(ii) That escalation under this Mod will be paid by the Government on the basis of the contractor's actual experience or the BLS Indices times 1.25, whichever is less. [Exhibit 2 to Ewell October Affidavit.]

According to Mr. Rule, prior to the signing and delivery of the document on October 8, 1976, he had repeatedly made it clear to Newport News officials that "the whole deal is off" unless Newport News agreed to condition (ii).[7] Tr. Rule Dep., pp. 114–115, 252–253, 277. In an analogous situation, the Court in *Orient Mid-East Great Lakes Serv., supra* at 522, held that: "* * * neither party is bound until the condition or reservation has been withdrawn or satisfied." Since that condition is still outstanding, there is no agreement to date.

Finally, in determining whether the minds of the parties have met prior to the execution of a written document, the Court in *Orient Mid-East Great Lakes Serv., supra* at 523, emphasized the importance of the complexity of the underlying transaction. The Court stated that:

The nature of the charter [contract] proves that it was too much for verbal understanding only. A worldwide charter [contract], with a duration of more

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[6] See text at pp. 21–31, *infra,* for discussion of the reasons why Mr. Rule lacked the authority to enter a contractual modification binding on the United States.

[7] If condition No. (ii) is ineffective, the additional cost to the Government will be approximately 9.4 million dollars. Tr. Rule Dep., p. 282.

than a year and a rate of hire of the not inconsiderable sum of $29,000 per month was at stake. Additional to the standard clauses, numerous special stipulations had to be taken care of. Parties so experienced in maritime matters, it is not readily conceivable, would leave their insistences and forebearances in an undertaking of this scope to the vagaries of human recollection.

In the instant case, Mr. Rule and Newport News' negotiations of August 20, 1976, involved changes in a prior construction contract for a nuclear cruiser which extended over a period of years. Those changes involved, among other items, a complex escalation cost provision which Mr. Rule states kept the computers in Washington busy for months. Moreover, the additional cost to the Government, according to Mr. Rule, of the alleged oral agreement in principle could be as much as $33.9 million. Tr. Rule Dep., pp. 250–251, 277. In view of the complexity of matters being negotiated, it is inconceivable that the parties intended to be bound prior to the execution of a written document which specificially set forth the terms of their negotiations.

C. The United States is not bound by any agreement negotiated by the contracting officer since applicable regulations have not been complied with and the requisite governmental clearances have not been granted.

The Supreme Court, in *Federal Crop Insurance Corp.* v. *Merrill*, 332 U.S. 380, 384 (1947), recognized that:

Whatever the form in which the Government functions, anyone entering into an arrangement with the Government takes the risk of having accurately ascertained that he who purports to act for the Government stays within the bounds of his authority. The scope of this authority may be explicitly defined by Congress or be limited by delegated legislation, properly exercised through the rulemaking power. And this is so even though, as here, the agent himself may have been unaware of the limitations upon his authority.

In the instant case any authority granted to the contracting officer, Mr. Rule, to negotiate in the DLGN–41 controversy had to be exercised in accordance with the Armed Services Procurement Regulation [hereinafter "ASPR"] which the Supreme Court has held has "* * * the force of law." *Paul* v. *United States*, 371 U.S. 245, 255 (1963). *Accord, Public Utility Comm. of Calif.* v. *United States*, 355 U.S. 534, 542–543 (1958). The ASPR, which is published in the Code of Federal Regulations (32 C.F.R. §1.100, *et seq.*), are "binding on all who [seek] to come to contract with the Government." *Atlantic Gulf & Pacific Co. of Manila, Inc.* v. *United States*, 207 Ct.Cl. 995, 996 (1975); *accord, Chris Berg, Inc.* v. *United States*, 426 F.2d 314, 317 (Ct.Cl. 1970); *Winston Bros. Co.* v. *United States*, 458 F.2d 49, 52 (Ct. Cl. 1972); *Steinthal & Co.* v. *Robert Seamans, Secretary of Air Force*, 455 F.2d 1289, 1299 (D.C. Cir. 1971).

Section 3–807.3 of ASPR [32 C.F.R. §3.807–3] provides, in pertinent part:

3.807–3. *Cost or Pricing Data* (a) The contracting officer shall require the contractor to submit, either actually or by specific identification in writing, cost or pricing data in accordance with 16–206 of this chapter and to certify by use of the certificate set forth in 3–807.4, that, to the best of his knowledge and belief, the cost or pricing data he submitted was accurate, complete, and current prior to:

* * * * * * *

(2) the pricing of any modification to any formally advertised or negotiated contract, whether or not cost or pricing data was required in connection with the initial pricing of the contract, when the modification involves aggregate increases and/or decreases in costs plus applicable profits expected to exceed $100,000. (For example, the requirement applies to a $30,000 modification resulting from a reduction of $70,000 and an increase of $40,000, or as another example, when the modification results in no change in contract price because there is an increase of $200,000 and a reduction of $200,000.[8]

[8] This section of ASPR implements 10 U.S.C. §2306(f), which provides, in pertinent part, as follows:

(f) A prime contractor or subcontractor shall be required to submit cost or pricing data under the circumstances listed below, and shall be required to certify that, to the best of his knowledge and belief, the cost or pricing data he submitted was accurate, complete and current.

* * * * * * *

(2) Prior to the pricing of any contract change or modification for which the price adjustment is expected to exceed $100,000 * * *.

The alleged contract modification which defendants contend was negotiated, in principle, on August 20, 1976, as well as the subsequent purported modification which Mr. Rule states he signed on October 7, 1976, indisputedly involves increases in costs to the Government well in excess of $100,000. Tr. Rule Dep., p. 251. Indeed, Mr. Rule states that as of October 5, 1976, he had estimated the increased cost to the Government of his proposed modification to be approximately $33.9 million. Tr. Rule Dep., p. 277. Yet to date, Mr. Rule[9] has not obtained from Newport News the certificate of cost data [Form 633] required by ASPR 3-807.3, in implementation of 10 U.S.C. §2306(f). Tr. Rule Dep., pp. 251-252, 270. Since the proposed modification purports to definitize the pricing of the DLGN-41, without meeting the requirements of ASPR 3-807.3 and 10 U.S.C. § 2306(f), the proposed modification is not binding on the United States.

Defendants may argue, however, that since Mr. Rule's contracting officer's warrant granted "unlimited authority with respect to negotiations" in the DLGN-41 controversy, Mr. Rule had been given the actual authority to waive the requirement for cost data, which he did by signing the proposed contract modification on October 7, 1976. Such an argument would be untenable for three reasons.

First, it totally ignores the legal principle previously discussed that a government agent's actual authority is limited by, at the least, published regulations and that these regulations are binding on all who deal with the agent "regardless of actual knowledge of what is in the Regulations or of the hardship resulting from innocent ignorance." *Federal Crop Insurance Corp.* v. *Merrill, supra,* at 385. Second, such an argument ignores the fact that Mr. Rule's contracting officer's warrant specifically made his authority "subject to the limitations contained in the Armed Services Procurement Regulation," which includes the requirement for cost data. Third, the duty imposed on a contracting officer under ASPR 3-807.3 to obtain cost data from a contractor implements 10 U.S.C. § 2306(f),[10] which expressly requires the contractor to submit such cost data. Since the duty to furnish the requisite cost data is statutorily imposed on the contractor, it obviously cannot be waived by a government agent:

> The duty to furnish accurate, complete, and current data [under 10 U.S.C. § 2306(f)] is a duty imposed on Government contractors by a statute, and, therefore, that duty cannot be waived by a Government agent. *M-RX-S Mfg. Co.* v. *United States,* 492 F.2d 835, 841 (Ct. Cl. 1974).

Even if Newport News had supplied the cost data required by ASPR 3-807.3 and 10 U.S.C. § 2306(f), any agreement negotiated still would not bind the United States in view of additional limitations imposed on the negotiator's authority by Naval Procurement Directives[11] (hereinafter "NPD"). The NPD, published in 32 C.F.R., Part 737, require, *inter alia,* that a contracting officer's negotiated results receive business clearance and approval, which it is contemplated will be made "at a level higher than that of the individuals assigned to the negotiations." 10 C.F.R. § 737.1-403-51(2). Section 737.1-452-1 of the NPD also states that "The Office of General Counsel [Navy] shall approve as to form and legality all contracts to be entered into by any procuring activity." These two directives implement the general contracting requirement of ASPR, § 1.402, within the Department of Navy.[12]

In the instant case, Mr. Rule's normal function is reviewing for business clearance proposed contracts and contract modifications negotiated by the various Navy Procuring Activities and Officers. Lascara Affidavit, ¶ 4. Since that function would have resulted in Mr. Rule conducting the business review of his own negotiations contrary to the intent of NPD regulations, he was informed prior to the August 20 negotiations by his superior, Admiral Lascara,

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[9] Mr. Rule's contracting officer's warrant to act in the DLGN-41 controversy was formally withdrawn on October 8, 1976. Tr. Rule Dep., p. 116, and Exh. 6 thereto.

[10] The relevant portions of 10 U.S.C. §2306(f) are set forth in footnote 8, *supra.*

[11] A detailed discussion of the Naval Procurement Directives is set forth in the Lascara Affidavit, ¶ 3, and the Michaelis Affidavit, ¶ 5.

[12] ASPR §1-402 makes the authority of contracting officers at purchasing offices subject to the "requirements prescribed in § 1-403 * * * and any further limitations, consistent with this Regulation imposed by the appointing authority." ASPR §1-403 provides that: "No contract shall be entered into unless all applicable requirements of law and of this Regulation, and all other applicable procedures, *including business clearance and approval,* have been met." [Emphasis added.]

that any agreement he might negotiate in the DLGN–41 controversy would require a business review and approval by an independent, higher authority. Lascara Affidavit, ¶ 7. Mr. Rule was again informed of that fact by Admiral Lascara and also by the Chief of Naval Material, Admiral Michaelis, both orally and in writing, on at least three occasions prior to Mr. Rule's delivering the proposed modification to Newport News on October 8, 1976. Lascara Affidavit, ¶¶ 7, 9, 13, 18; Michaelis Affidavit, ¶¶ 6, 7, 8; Tr. Rule Dep., pp. 93, 96–97, 99–101, 103–106, 143, 207–208, 248, 249, 285.

Similarly, the requirement for a legal clearance from Navy's Office of General Counsel, as set forth in NPD 737.1–403–51(2), prior to the consummation of any final agreement was specifically, and repeatedly, drawn to Mr. Rule's attention between August 30 and October 8, 1976, by his superiors. Lascara Affidavit, ¶¶ 13, 18, 19; Michaelis Affidavit, ¶¶ 6, 8. Indeed, Mr. Rule himself, by Memorandum dated October 5, 1976, requested a legal clearance and also final approval from the Chief of Naval Material of his negotiations with Newport News.[13] Lascara Affidavit, ¶ 17.

To date, however, there has been neither a business nor a legal clearance of any agreement which Newport News claims it negotiated with Navy, as required by the NPD's and as Mr. Rule was expressly informed was required. Hence it is clear that any agreement which Mr. Rule attempted to consummate with Newport News on October 8, 1976, was outside the scope of his actual authority.

That the Government is not bound by the acts of its agent acting outside the scope of his actual authority was recognized by the Supreme Court in *Federal Crop Insurance Corp.* v. *Merrill*, *supra*, at 384:

[A]nyone entering into an arrangement with the Government takes the risk of having accurately ascertained that he who purports to act for the Government stays within the bounds of his authority.

Earlier, the Court had noted that:

Although a private agent, acting in violation of specific instructions, yet within the scope of his general authority, may bind his principal, the rule as to the effect of the like act of a public agent is otherwise, for the reason that it is better that an individual should occasionally suffer from the mistakes of public officers or agents, than to adopt a rule which, through improper combinations, or collusion, might be turned to the detriment and injury of the public. *Whiteside* v. *United States*, 93 U.S. 247, 257 (1876).

The Court of Appeals for the Second Circuit restated the rule on a Government agent's authority as follows:

* * * the Government is not bound by the unauthorized acts of its agent even if within the scope of the agent's apparent authority. *United States* v. *Zenigh-Godley Co.*, 295 F.2d 634, 635(2d Cir. 1961).

The same principle was recognized by Judge Davis in his concurring and dissenting opinion in *Carrier Corp.* v. *United States*, 164 Ct. Cl. 664, 668 (1964):

Among the most ancient of the principles of federal procurement is that the Government is not bound by the agreement of an agent without actual authority even though he would be held to have apparent authority if the private law of agency controlled. (Citing *Federal Crop Insurance* v. *Merrill*, 332 U.S. 380 (1947); *United States* v. *Stewart*, 311 U.S. 60, 70 (1940); *Sutton* v. *United States*, 256 U.S. 575 (1921); and *Whiteside* v. *United States*, 63 U.S. 247, 256–257 (1876.)[14]

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[13] Mr. Rule was also informed by Memorandum from Admiral Michaelis, dated October 7, 1976, that final governmental action on his negotiated results could not occur until the Department of Justice completed its review of the proposed settlement. The requirement that the Department of Justice approve any settlement of issues which are pending in a district court before the settlement can be final is imposed by law and cannot be waived. " * * * [t]he United States is neither bound nor estopped by acts of the officers or agents in entering into an arrangement or agreement to do or cause to be done what the law does not sanction or permit." *United States* v. *San Francisco*, 310 U.S. 17, 32 (1940), quoting from *Utah Power & Light Co.* v. *United States*, 243 U.S. 389, 409 (1917). See text at pp. 32–38 *infra* for a detailed discussion of the Department of Justice's authority.

[14] 1 McBride & Wachtel, *Government Contracts*, §5.30[1] (1976), states the rule on a government contracting officer's authority as follows:

Whether one agrees with it or not, it appears to be a well-settled principle of Government contract law that a person dealing with the Government must ascertain for himself the extent of the contracting officer's authority, and that the doctrine of apparent authority has no place in this field.

Additionally, assuming *arguendo* that an agent acting within the scope of his apparent authority, rather than his actual authority, could bind the United States to a contract, Mr. Rule did not have such apparent authority. Instead, on August 25, 1976,[15] before Newport News had even prepared a first draft of the alleged agreement in principle of August 20, 1976, the company was informed by Assistant Secretary of the Navy Bowers that any agreement reached in negotiations had to be reviewed by higher authority in the Navy before a binding contract modification could be consummated. Lascara Affidavit, ¶ 12; Dart October Affidavit, ¶ 35. Moreover, Newport News officials were repeatedly reinformed of that essential fact, as well as the need for Department of Justice approval, between August 25, 1976, and October 8, 1976, by Mr. Rule's superiors, Admiral Lascara and Admiral Michaelis, and by Mr. E. Grey Lewis, General Counsel for the Navy. Michaelis Affidavit, ¶ 9; Lascara Affidavit, ¶ 13; Dart October Affidavit, ¶ 39; Ewell October Affidavit, ¶ 6. Hence, as of August 25, 1976, Mr. Rule lacked even the apparent authority to settle the DLGN–41 controversy absent further governmental approval.

Moreover, at the time of the August 20 negotiations, Mr. Rule's contracting officer's warrant did not show that he had the authority to consummate a binding contract modification. Rather, the warrant gave him unlimited authority only "with respect to negotiations." Unlimited authority to conduct negotiations would not appear, in common understanding, to imply the unlimited authority to enter a contract modification binding on the Government where the cost to the Government is estimated to be in the millions of dollars. Indeed, Captain Thompson, who issued Mr. Rule his contracting officer's warrant, used the term "negotiate" for the express purpose of exhibiting on the face of the certificate itself that Mr. Rule's authority extended solely to the conduct of negotiations. Thompson Affidavit, ¶ 8.

Finally, a defendant may argue that after Mr. Rule received a contracting officer's warrant in the DLGN–41 controversy, it was improper for those who would normally be his superiors to require his negotiated results be subject to higher approval within the Navy.[16] The decision of the Court of Claims in *Congress Construction Corporation* v. *United States*, 161 Ct. Cl. 50 (1963), however, supports the proposition that when a subordinate Government official in the executive branch is authorized to perform a discretionary function, his work is subject to restrictions imposed by his superior if they impose those restrictions before his actions are final.

In *Congress Construction Corporation, supra*, the Court confronted the issue of whether the Assistant Secretary of Defense could require Navy to submit to him for prior clearance all real estate transactions which had to go to congressional committees. Prior to this directive from the Assistant Secretary, Navy had accepted generally a proposal from plaintiff for the construction of housing for naval personnel which was conditioned on "Navy obtaining favorable action by Congressional Committees for acquisition of the site." *Id.* at 53.

The Court found, *inter alia*, that the broad powers conferred on the Secretary of defense over Navy by Congress gave the Secretary, acting through his subordinates, the right to decide which transactions Navy could seek to have approved by congressional committees. The Court then noted that:

* * * when purely executive functions of a discretionary nature are imposed on a subordinate official of the Government, it is an implied condition that his actions (before they become final) are subject to the review and supervision of his superiors * * * *Id.* at 55.

The Court of Claims subsequently restated that principle in the context of a government contracting officer in *Thompson* v. *United States*, 357 F.2d 638, 689 (Ct. Cl. 1966):

There are many instances in federal procurement in which a lower echelon official is the authorized contracting officer even though the contract may be subject to approval or veto by high echelon. Cf. *Congress Constr. Corp.* v. *United States*, 314 F.2d 527, 161 Ct. Cl. 50 (1963), *cert. denied*, 375 U.S. 817, 84 S.Ct. 53

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[15] No final enforceable contract modification could have been negotiated prior to August 25, 1976, since at that time there was no written evidence of it. See text at pp. 14–20, *supra*.

[16] In the instant case, it should be noted that the relevant NPD's which required business and legal clearances for negotiated agreements were in effect *on the* date Mr. Rule was issued his warrant. See discussion at text, pp. 25–26, *supra*.

[remaining citations omitted]. In such cases the contracting officer can deal with the contractor, although all may go for naught if the response of the higher level is negative.

In the instant case Mr. Rule, when acting in his normal job position of reviewing business clearance for contracts, is subordinate to both Admiral Lascara and to Admiral Lascara's superior, the Chief of Naval Material, Admiral Michaelis. Lascara Affidavit, ¶ 4. At no time before or after Mr. Rule's appointment as negotiator in the DLGN–41 dispute were his superiors ever informed by any higher authority that Mr. Rule, by virtue of his appointment as contracting officer, was to be considered above and beyond the jurisdiction of the Chief of Naval Material. Lascara Affidavit, ¶ 20; Michaelis Affidavit, ¶ 10. Hence, the requirement that Mr. Rule's negotiated results be submitted for higher approval within Navy, which was imposed by the Chief of Naval Material, was both entirely proper and timely since the requirement was communicated to both Mr. Rule and Newport News prior to any agreement in principle being reduced to writing.[17]

D. Because the Attorney General possesses exclusive and absolute authority over the prosecution and compromise of matters referred to him for purposes of litigation, this purported settlement, which has not been approved by the Attorney General, cannot be effective.

The foregoing discussion demonstrates that the purported settlement upon which defendants seek to rely, when examined in the light of general contract principles and government procurement law, is wholly ineffective. However, even if one were to assume *arguendo* that Newport News and the Navy had reached an agreement of some sort, that agreement, to use defendants' own words, would encompass "the matters underlying this action." Defendants' Brief, p. 2. As such, it would constitute an effort to settle this lawsuit which cannot be consummated without the approval of the Attorney General.

In all matters entrusted to his responsibility for litigative purposes, the Attorney General exercises plenary authority. Thus, once a dispute has been referred to the Department of Justice, it is the Attorney General, and not the client agency, who exercises the Executive Branch's discretion in determining the propriety and desirability of settling or compromising a dispute. This broad authority which reposes in the Attorney General is derived from various sources.

One source is the Attorney General's inherent power to control the lawsuits which he institutes on behalf of the United States. As the Supreme Court clearly recognized:

Appointed, as the Attorney General is, in pursuance of an act of Congress, to prosecute and conduct such suits, argument would seem to be unnecessary to prove his authority to dispose of these cases * * *, but if more be needed, it will be found in the case of *The Gray Jacket* [72 U.S. (5 Wall.) 342, 371 (1866)], in which this court decided that in such suits no counsel will be heard for the United States in opposition to the views of the Attorney General, not even when employed in behalf of another of the executive departments of the government.

Confiscation Cases, 74 U.S. (7 Wall.) 454, 458 (1868). *Accord. New York* v. *New Jersey*, 256 U.S. 296, 308 (1921).

A second source of the Attorney General's exclusive power to compromise an action which he institutes is title 28 of the United States Code, section 516, which provides:

Except as otherwise authorized by law, *the conduct of litigation in which the United States*, an agency, or officer thereof *is a party*, or is interested, and securing evidence therefor, *is reserved to officers of the Department of Justice*, under the direction of the Attorney General. [Emphasis addd.]

Section 519 of the same title provides:

Except as otherwise authorized by law, *the Attorney General shall supervise all litigation to which the United States*, an agency, or officer thereof *is a party*, and shall direct all United States attorneys, assistant United States attorneys, and all special attorneys appointed under section 543 of this title in the discharge of their respective duties. [Emphasis added.]

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[17] As already discussed at length, at pp 14–20, *supra*, even if Mr. Rule had the actual authority on August 20, 1976, to bind the United States to a contract, no contract was consummated at that time both because it was not reduced to writing and because there was no meeting of the minds.

By the express terms of these statutory provisions, the Attorney General is given plenary power and supervision over all litigation to which the United States is a party.[18] *Federal Trade Commission* v. *Guigon*, 390 F.2d 323, 324 (8th Cir. 1968).[19]

A third source of the Attorney General's exclusive power to compromise a suit which he institutes is Executive Order No. 6166, June 10, 1933, 5 U.S.C. §901 (1970),[20] which, at section 5, provides:

The functions of prosecuting in the courts of the United States claims and demands by, and offenses against, the Government of the United States and of defending claims and demands against the Government, and of supervising the work of United States attorneys, marshals, and clerks in connection therewith, now exercised by any agency or office, are transferred to the Department of Justice.

As to any case referred to the Department of Justice for prosecution or defense in the courts, the function of decision whether and in what manner to prosecute, or to defend, or to compromise, or to appeal, or to abandon prosecution or defense, *now exercised by any agency or officer, is transferred to the Department of Justice* * * *. [Emphasis added.]

Executive Order No. 6166 was issued because: "By investigation it was determined, and properly so, that the Department of Justice should have the right to compromise cases which it was charged to institute or defend." *Duncan* v. *United States*, 39 F. Supp. 962, 964 (W.D. Ky. 1941). Thus, by the express terms of Executive Order No. 6166, the decision on whether to continue to prosecute or to compromise the present claim against defendants, which Navy previously referred for prosecution, has been formally transferred to the Department of Justice. *Aviation Corp.* v. *United States*, 46 F. Supp. 491, 494 (Ct. Cl. 1942), *cert. denied*, 318 U.S. 771 (1943).

Additionally, "[t]he opinions of the Attorney General since 1831 uphold his authority to compromise Government litigation." *Halback* v. *Markham*, *supra*, 106 F. Supp, at 480. Those opinions are summarized in the opinion of Attorney General Cummings of October 2, 1934, 38 Op. Att'y Gen. 98 (1934). There, the Attorney General spoke of his authority in the following fashion:

* * * I have no hesitation in declaring that it is a power, whether attaching to the office or conferred by statute or Executive order, to be exercised with wise discretion and resorted to only to promote the Government's best interest or to prevent flagrant injustice, but that it is broad and plenary may be asserted with equal assurance, and it attaches, of course, immediately upon the receipt of a case in the Department of Justice, carrying with it both civil

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[18] By including the language "except as otherwise authorized by law," Congress provided a narrow exception for instances in which an agency is expressly and specifically authorized to proceed without the supervision of the Attorney General. *See, e.g., Cas* v. *Bowles*, 327 U.S. 92, 96 (1946) (Emergency Price Control Act specifically empowered Price Administrator to commence actions); *Crouse Cartage Co.* v. *United States*, 343 F.Supp. 1133, 1139 (N.D. Iowa 1972) (28 U.S.C. §2323 specifically provides that Interstate Commerce Commission may prosecute, defend, or continue actions or proceedings unaffected by the action or nonaction of the Attorney General). No comparable statutory provision exists granting the Department of Defense authority to determing the manner in which the instant lawsuit is to be conducted. Thus, the provisions of 28 U.S.C. §§516 and 519 are controlling here. *See Halback v. Markham*, 106 F.Supp. 475, 480 (D. N.J. 1952), *aff'd*, 207 F.2d 503 (3rd Cir.), *cert. denied sub nom., Bumsted* v. *Markham*, 347 U.S. 933 (1953).

[19] The broad power of the Attorney General and his subordinates to conduct actions in which the United States may be interested may be tracked back to the Judiciary Act of 1789, ch. 20, §35, 1 Stat. 92, which provided:

It shall be the duty of every district attorney *to prosecute* in his district, all delinquents for crimes and offenses cognizable under the authority of the United States, and *all civil actions in which the United States are concerned.* * * * [Emphasis added.]

In addition, in the Act of June 22, 1870, ch. 150, § 14, 16 Stat. 162, which formally established the Department of Justice and from which 28 U.S.C. §516 is ultimately derived it was provided:

[The officers of the Department of Justice under the supervision of the Attorney General] shall, for and on behalf of the United States, procure the proper evidence for, and conduct, prosecute and defend all suits and proceedings * * * in which the United States, or any officer thereof, is a party or may be interested.

Thus, the authority to conduct the litigation of the United States has, from the earliest years of our nation's history, reposed in the Attorney General and his subordinates.

[20] By Act of June 30, 1932, ch. 314, §403, 47 Stat. 413, and Act of March 3, 1933, ch. 212, §403, 47 Stat. 1518, Congress granted to the President authority to coordinate the various agencies and departments of the Executive Branch of the Government. Executive Order No. 6166 was issued pursuant to these Acts.

and criminal features, if both exist, and any other matter germane to the case which the Attorney General may find it necessary or proper to consider before he invokes the aid of the courts. * * *

Id. at 102. *See D.D.I., Inc.* v. *United States*, 467 F.2d 497, 499 (Ct. Cl. 1972), *cert. denied*, 414 U.S. 830 (1973) (portion of Attorney General's opinion quoted above deemed a "reasonable interpretation" which court saw no compelling reason to disapprove). In an opinion issued approximately one month later, the Attorney General again construed his compromise authority under Section 5 of Executive Order No. 6166:

The effect of [section 5 of Executive Order 6166] is to vest in the Attorney General exclusive control of any case after it has been referred to his department. It should be observed, however, that the provision did not in any way curtail the Attorney General's prior and plenary power. It merely withdrew from all other officers such power and authority as they theretofore held, leaving the Attorney General in plenary control of any case once it has been referred to the Department of Justice.

38 Op. Att'y Gen. 124, 125 (1934).[21] These contemporaneous and long-standing constructions placed upon Executive Order No. 6166 are reasonable and are enttiled to great deference. *See Harrison* v. *Vose*, 50 U.S. (9 How.) 372, 374 (1850); *First National Bank* v. *United States*, 206 F. 374, 379 (8th Cir. 1913).

Finally, the rationale for vesting complete and exclusive authority in the Attorney General to conduct or compromise lawsuits involving the interests of the United States is readily apparent. Congress has provided that the Attorney General shall be responsible for protecting the rights of the United States in court. To discharge this responsibility, "[h]is powers must be coextensive with his duties." *Sutherland* v. *International Ins. Co. of New York*, *supra*, 43 F.2d at 970. Were he not free to control the actions of the United States in litigation, it would be impossible for him to protect the Government's rights.[22]

Moreover, such a concentration of authority permits the responsibility for the conduct of the Government's litigation to be centered in one place. The Government speaks with one voice, thereby avoiding the expression of divergent views or the adoption of inconsistent positions on matters in litigation. Equally important, there exists one person from whom the views of the United States may be solicited. The litigative interests of the United States are thus protected and promoted.

Whether measured by the terms of the Attorney General's inherent powers, or by the requirements of 28 U.S.C. §§516 and 519, Executive Order No. 6166, the opinions of the Attorney General, or the decisions of the Supreme Court and lesser tribunals, it is clear that insofar as the interests of the United States in litigation are concerned, those interests, and the matters germane to those interests, are subject to the exclusive and absolute control of the Attorney General. Hence, in an instance such as this, where defendants assert that a settlement has been reached, notwithstanding the lack of involvement or approval by the Attorney General, the purported "settlement" must fail.

The proposal for settlement has been referred to the Department of Justice and is presently undergoing review. Questions involving the adequacy of consideration[23] and the availability of appropriations[24] must be scrutinized and resolved. Defendants and the Court will, of course, be advised promptly once a decision is made. But, for present purposes, the critical fact remains

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[21] In *United States* v. *Sandstrom*, 22 F. Supp. 190, 191 (N.D. Okla. 1938), the Court, reviewing Executive Order No. 6166 and the opinions of the Attorney General, concluded that the Attorney General was fully authorized to refuse a compromise notwithstanding the contrary recommendation of the Secretary of the Interior. *See also, Federal Trade Commission* v. *Claire Furnace Co.*, 274 U.S. 160, 174 (1927) (Attorney General required to exercise sound, independent discretion with respect to matters referred to him by client agency); *Helco Products Co.* v. *McNutt*, 78 U.S. App. D.C. 71, 137 F.2d 681, 683 (1943) (Attorney General to decide whether to initiate prosecution of action notwithstanding recommendation of client agency).

[22] In a somewhat similar vein, it has been observed that it would indeed be strange if the Justice Department, which is "charged with the responsibility of instituting and defending [cases], should be distrusted in determining whether from a legal standpoint the client's interests would best be served by compromise." *Duncan* v. *United States*, *supra*, 39 F. Supp. at 965.

[23] 38 Op. Att'y Gen. 98, 98–99 (1934).

[24] 38 Op. Att'y Gen. 124, 127 (1934).

that it is the Attorney General who makes the settlement decisions of the United States and not a client's negotiator. Here, the Attorney General has not yet approved the proposal for settlement and therefore the proposal is wholly ineffective.

E. This court lacks jurisdiction to enter judgment for Newport News effectuating the purported settlement agreement.

As demonstrated in prior segments of this Brief, a settlement agreement has never been consummated between the parties. However, even assuming *arguendo* that such an agreement did exist, the Court would lack jurisdiction to enter a judgment effectuating that settlement.

It is axiomatic that the United States, as sovereign, is immune from suit absent specific congressional authorization. *United States* v. *Sherwood*, 312 U.S. 584, 589 (1941); *United States* v. *Shaw*, 309 U.S. 495, 500–501 (1940). This immunity is not waived merely because the United States files suit. *United States* v. *United States Fidelity & Guaranty Co.*, 309 U.S. 506 (1940); *Nassau Smelting & Refining Works, Ltd.* v. *United States*, 266 U.S. 101, 106 (1924).

The consent of the United States to be sued upon its contracts is set forth in the Tucker Act, 28 US.C. §1346(a)(2), which provides, *inter alia*, that:

The district court shall have original jurisdiction, concurrent with the Court of Claims, of * * * (2) Any civil action or claim against the United States, not exceeding $10,000 in amount, founded * * * upon any express or implied contract with the United States.

Contract claims against the Government for amounts in excess of $10,000 can be maintained only in the Court of Claims. *See, e.g., United States* v. *6.321 Acres of Land*, 479 F.2d 404, 407 (1st Cir. 1973); *United States* v. *87.30 Acres of Land*, 430 F.2d 1130, 1132 (9th Cir. 1970).

It cannot be disputed that entry of a judgment effectuating the purported settlement here would result in a judgment against the United States for an amount far in excess of $10,000.[25] Accordingly, by express terms of the Tucker Act, this Court lacks jurisdiction to enter the judgment which defendants seek.[26]

This result connot be avoided by characterizing the judgment as one for an equitable reformation of the DLGN–41 contract between Newport News and the Navy or by treating the judgment as an order directing the Government to perform specifically the purported settlement agreement. In *Richardson* v. *Morris*, 409 U.S. 464 (1973), a district court assumed jurisdiction under the Tucker Act then enjoined enforcement of a statute. The Supreme Court ruled that the Tucker Act:

* * * has long been construed as authorizing only actions for money judgments and not suits for equitable relief against the United States. See *United States* v. *Jones*, 131 U.S. 1 (1889). The reason for the distinction flows from the fact that the Court of Claims has no power to grant equitable relief, see *Glidden* v. *Zdanok*, 370 U.S. 530, 537 (1962) (Harlan, J., announcing the judgment of the Court), and the jurisdiction of the district courts under the Act was expressly made "concurrent with the Court of Claims." See *United States* v. *Sherwood*, 312 U.S. 584, 589–591 (1941); *Bates Mfg. Co.* v. *United States*, 303 U.S. 567, 570 (1938). What was said in *Sherwood, supra*, at 591 applies here:

> "[T]he Tucker Act did no more than authorize the District Court to sit as a court of claims and . . . the authority thus given to adjudicate claims against the United States does not extend to any suit which could not be maintained in the Court of Claims."

Id. at 465–466; *accord, Lee* v. *Thorton*, 420 U.S. 139, 140 (1975) (Tucker Act does not empower district courts to grant injunctive or declaratory relief); see *United States* v. *King*, 395 U.S. 1 (1969) (Court of Claims does not have jurisdiction to enter declaratory judgments). As these cases clearly

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[25] Mr. Gordon W. Rule's estimate on October 5, 1976, of the maximum cost to the Government of the proposal for settlement was $33.9 million. Tr. Rule Dep., pp. 273, 278. Other estimates of the proposal's cost to the Government range from $22.0 million to $28.0 million. Tr. Rule Dep., p. 278.

[26] Defendants' citations of authority regarding the enforcability of settlements by a district court are limited to agreements reached between *private* litigants. Defendants' Brief, pp. 21–23. Those cases are inapposite to the instant action where, as a threshold question, it must be determined that jurisdiction exists before any judgment may be entered against the United States. Such jurisdiction does not exist and judgment may not, therefore, be entered.

demonstrate, equitable relief in the nature of reformation of the DLGN–41 contract is not available to defendants under the Tucker Act, and the Court is therefore jurisdictionally barred from entering a judgment which would effect such relief.

THE UNITED STATES HAS COMPLIED WITH THE COURT'S ORDER OF AUGUST 29, 1975, AND THIS ACTION, THEREFORE, SHOULD NOT BE DISSMISED

INTRODUCTION

Defendants also have moved, in the alternative, for dismissal of the complaint, with prejudice, on the ground that plaintiff has been guilty of bad faith since the entry of this Court's Order of August 29, 1975. Defendants' allegation of bad faith is premised on two related theories.

First, defendants content that the parties' obligation to negotiate in good faith concerning "other appropriate action," as required by the Court's Order of August 29, 1975, was intended to include bargaining over "wholly new and different terms on which to build DLGN 41" and that "both Navy and Newport News shared this understanding of the scope * * * of the language used." Defendants' Brief, p. 4. Defendants then argue that Navy refused to bargain over a new delivery date and more favorable escalation provisions for the DLGN–41 prior to the appointment of Mr. Rule as the Navy negotiator in July of 1976. Defendants conclude that such a refusal by Navy constitutes bad faith bargaining in violation of the Court's Order which justifies dismissal of the complaint.

Second, defendants contend that although the Navy's negotiator, Mr. Rule, did bargain in good faith over changes in delivery date and escalation provisions for the DLGN–41, plaintiff is now attempting to repudiate the agreement Mr. Rule reached with Newport News. Such action, defendants conclude, is further bad faith conduct on the part of plaintiff which justifies a dismissal of the complaint, with prejudice.

Both of the defendants' arguments in support of their Motion to Dismiss are based on the premise that when this Court entered its Order of August 29, 1975, the parties agreed that the language "or to take other appropriate action" means to bargain over wholly different terms for the construction of the DLGN–41. The facts, however, as set forth below, demonstrate that contrary to defendants' representations, the parties have had a continuing dispute over what the language "or to take other appropriate action" means, which disagreement antedated the use of that language in the Court's Order of August 29, 1975. Moreover, the facts as set forth below, also show that plaintiff's actions, both before and after the appointment of Mr. Rule, were taken in good faith.

STATEMENT OF FACTS

History of the language "Or To Take Other Appropriate Action" as incorporated into this Court's order of August 29, 1975

The language "or to take other appropriate action," as used in this Court's Order of August 29, 1975, has a long history which began in 1974 when Newport News expressed its opinion that the DLGN–41 option, exercisable by February 1, 1975, was invalid. In order to avoid an immediate court confrontation concerning the validity of the option, the parties met on January 30, 1975, in an effort to preserve the status quo. The result of that meeting was a document entitled "Memorandum of Understanding" which was signed by representatives of Newport News and Navy on January 31, 1975. [Exhibit J to Complaint.]

Paragraph 2 of the Memorandum of Understanding provided:

2. The parties agree to negotiate in good faith to reach an agreement as rapidly as possible to modify those contract provisions requiring amendment or to take other appropriate action.

The language in paragraph 2 of the Memorandum of Understanding is identical to the language incorporated into paragraph 2 of this Court's Order of August 29, 1975, which language forms the basis for defendants' present Motion to Dismiss.

During the drafting of the Memorandum of Understanding in January of 1975, the language to be included in paragraph 2 evoked considerable discussions. Navy originally proposed that the following language be used in paragraph two:

The parties agree to negotiate in good faith to modify those contract provisions requiring amendment as identified in the aforesaid Article 28 as set forth in Contract Modification P00018.[27]

Affidavit of David W. James, Jr., dated July 19, 1976, ¶ 10 (hereinafter "James Affidavit"). Attorneys for Newport News objected to the phrase "as identified in the aforesaid Article 28 as set forth in Contract Modification P00018," on the ground that the incorporation of such language might prejudice their legal position that the option, as defined by Modification P00018, was invalid. They suggested that the phrase be replaced by the words, "or to take other appropriate action." James Affidavit, ¶ 10.

Navy, however, objected to such a substitution, fearing that an incorporation of Newport News' language would open the door to a renegotiation, without contractor entitlement or adequate new legal consideration, of the entire DLGN–41 option. Such a course might contradict, and possibly prejudice, Navy's legal position that the option was valid. Navy made its position on that point clear to Newport News. Attorneys for Newport News acknowledged Navy's position and assured that their proposed wording was not intended to prejudice the legal positions of either party. James Affidavit, ¶¶ 10 and 11. Thus, on January 30, 1975, Newport News was fully advised of Navy's intent that the disputed language "or to take other appropriate action" was to be construed to refer to the eight items left for negotiation in Modification P00018 and other items only where the contractor could show government fault or where new legal consideration was involved.[28]

Subsequently, by letter dated February 3, 1975 ,Newport News acknowledged Navy's exercise of the DLGN–41 option, but reasserted its view that the option was ineffective. Navy felt constrained to respond for the record but sought to avoid upsetting the "cease fire" then existing under the Memorandum of Understanding. Accordingly, Mr. James, before transmitting Navy's response, called Mr. Ewell, General Counsel for Newport News, and read to him that response. Mr. Ewell suggested that the following language in the proposed response might be deleted as it could provoke a letter-writing contest:

We look forward to the early receipt of your proposal addressing the items left for agreement of the parties in Modification P00018.

To avoid such a contest, Mr. James agreed to delete this language. At no time during this conversation, however, did Mr. Ewell suggest that the sentence was inconsistent with Navy's position on the proper construction of the Memorandum of Understanding. James Affidavit, ¶¶ 15–17.

Navy thus was resolute in its position that under the Memorandum of Understanding the parties were to negotiate only those eight items listed in Modification P00018. Modifications in the delivery date or the escalation clause were to be negotiated only in the context of new legal consideration or if there were delays or construction cost increases for which the Government was responsible. That position was enunciated by Navy and understood by Newport News prior to the execution of the Memorandum of Understanding. Moreover, that position was consistently maintained by Navy after such execution as evidenced by the negotiations which occurred pursuant to the Memorandum.

Those negotiating sessions, which were transcribed by agreement of the parties, were held during the spring of 1975. Newport News, in accordance with the

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[27] On February 1, 1973, the parties had agreed to extend the time for the exercise of the construction options for the DLGN–41 and DLGN–42 by amending Article 28 of the original contract. Eight specific items were left to be negotiated in good faith by the parties. This agreement was embodied in Modification P00018 to the contract.

[28] Contrary to the impression which Newport News seeks to convey, the Navy's position set forth above was not the product of some frantic, after-the-fact effort on the part of Admiral H. G. Rickover, Deputy Commander, Naval Sea Systems Command, Nuclear Power Directorate, and David T. Leighton, Naval Sea Systems Command, Nuclear Power Directorate. While these individuals were initially concerned over the possible meaning which could be attached to the somewhat ambiguous language incorporated in the Memorandum of Understanding, their concerns were allayed by Mr. James' recitation of the sequence of events described above. Affidavit of D. T. Leighton, dated November 4, 1976 (hereinafter "Leighton Affidavit"), ¶ 15; James Affidavit, ¶ 14. Admiral Rickover, concerned nevertheless that the Memorandum of Understanding might be misrepresented to other personnel in Navy and the Department of Defense, circulated a memorandum which did nothing more than recite the already existing Navy position which had been conveyed to and was understood by Newport News prior to its signing of the Memorandum of Understanding. Leighton Affidavit, ¶ 19.

position it had espoused at the time the Memorandum of Understanding was executed, submitted proposals which did not recognize the effectiveness of the DLGN–41 option. Navy submitted proposals consistent with its divergent view that the DLGN–41 option and its exercise were indeed effective.

On August 25, 1975, Newport News cancelled the Memorandum of Understanding and subsequently suspended all work on the DLGN–41. On August 29, 1975, the Untied States filed its complaint for specific performance and immediately moved for a temporary restraining order directing Newport News back to work on the DLGN–41. A hearing was held on plaintiff's motion which the Court recessed to give the parties an opportunity to reach a stipulated agreement.

During the recess, the parties and their counsel pursued discussions with a view to reaching agreement upon the form of an order to be entered by the Court. The parties were segregated into separate rooms with negotiations effected by discussions or exchanges of proposed language between Messrs. K. Martin Worthy and Jeffrey Axelrad, counsel, respectively, for Newport News and the United States. Affidavit of Jeffrey Axelrad, dated November 1976, ¶¶ 2, 3, 4 and 5 (hereinafter "Axelrad Affidavit").

Paragraph two of the Court's Order, which includes the language "or to take other appropriate action," evolved in the following fashion. Newport News proposed that the stipulation include reference to the fact that changes in specifications must be agreed upon in order for the construction of the ship to proceed to completion. Inclusion of the language "or to take other appropriate action" was explained by Newport News to Mr. Axelrad as necessary to insure that the parties' representatives at the working level would consider themselves free to negotiate day-to-day resolutions of problems that might arise but which might not be considered or constitute contract modifications. On this basis, the parties reached an agreement on the language which was to become paragraph two of the Court's Order. Axelrad Affidavit, ¶ 5.

At no time during the August 29, 1975, discussions did representatives of Newport News state that they considered inclusion of paragraph two to require the parties to negotiate over an entirely new contract or to alter the basic terms of the existing contract for construction of the DLGN–41. Axelrad Affidavit, ¶ 6.

The negotiations between August 29, 1975 and July 1976

Since the August 29, 1975, Order of the Court incorporated, in part, paragraph 2 of the precedent Memorandum of Understanding, it is not too surprising that the parties commenced negotiations under the Order in accordance with their earlier positions on the meaning of the language "or to take other appropriate action." The result was that Newport News continued to view all negotiations as a mechanism by which to obtain a Navy concession that the DLGN–41 option was invalid. In so doing, Newport News adopted an approach to bargaining under another portion of the Court's Order which impeded meaningful negotiations. That portion of the Court's August 29, 1975, Order, provides as follows:

It is understood by the parties that all of the changes made in the plans and specifications for DLGN–38, DLGN–39 and DLGN–40 that are applicable will be incorporated in the plans and specifications for DLGN–41, and the parties agree to negotiate in good faith the appropriate equitable adjustments for all such changes.[29]

In an attempt to carry out the above portion of the Court's Order, Navy agreed that during the interim period, while good faith negotiations were conducted to reach mutually acceptable equitable adjustments for each change, Newport News should proceed on the basis that all the applicable changes would be incorporated in the contract. [Letter dated September 19, 1975, to Newport News, a copy of which is attached as Exhibit 3 to Defendants' Motion, filed July 13, 1976.]

Newport News, however, insisted that all changes must be incorporated into the contract before it would negotiate in good faith concerning any appropriate equitable adjustment for any changes, notwithstanding that such a position was contrary to normal contract administration. *See* Memorandum from L. E. Hopkins to President, Newport News Shipbuilding & Dry Dock Company, dated October 24, 1975 [a copy is attached as Exhibit 5 to Defendants' Motion filed

[29] This portion of the Court's Order will be referred to hereinafter as the "technical baseline" portion.

July 13, 1976.] Additionally, Newport News insisted that before negotiations on changes could be conducted, Navy would have to negotiate a new delivery date. To accept Newport News' position would have required Navy to abandon its own legal position that the DLGN–41 option was valid and controlled delivery date, absent new consideration or proof of delays attributable to the Government. *Id.*

On October 31, 1975, Admiral S. J. Evans was appointed by Navy to act as Chairman of its DLGN–41 negotiating team.[30] Admiral Evans was directed to comply with the August 29, 1976, Order by negotiating to achieve construction of the DLGN–41 in accordance with the terms of the option exercised by Navy, including such modification required by the option's terms or otherwise authorized by law or the Armed Services Procurement Regulation. Evans Affidavit, ¶ 2. In preparing for the negotiations, Admiral Evans sought the advice of Navy's General Counsel regarding the meaning of the disputed "negotiate in good faith" clause in the August 29, 1975, Order. He was advised that, consistent with the position assumed by Navy and conveyed to Newport News even before execution of the Memorandum of Understanding, the parties' negotiations were limited in scope to the eight items set forth in Modification P00018 for later resolution. "Other appropriate action" was permissible only if new and adequate consideration were to flow from Newport News to Navy, or Newport News could show that delays or increased costs were caused by the Government. Evans Affidavit, ¶ 6.

On November 25, 1975, Admiral Evans met with Mr. Creech and Mr. Dart of Newport News to discuss the procedures to be followed in the course of negotiations. At this meeting Admiral Evans suggested maintaining a set of minutes of the negotiating sessions which would be signed by both parties. Mr. Dart initially expressed doubts concerning the suggestion but, after Admiral Evans recounted the success which he had achieved with that procedure in earlier negotiations with Grumman Aerospace Corporation, Mr. Dart agreed to try it. Evans Affidavit, ¶ 8. Subsequently, after the parties had been unable to agree upon all the ground rules which would serve as a framework for negotiations, Admiral Evans advised Mr. Dart of his belief that a stenographic record was the best means of recording what transpired in the negotiating sessions. Admiral Evans' decision was based upon a desire to maintain an accurate record of the negotiations, thereby avoiding the possibility of subsequent misinterpretation or misunderstanding.[31] Evans Affidavit, ¶ 9.

In furtherance of the "technical baseline" portion of the Court's Order, Admiral Evans proposed that equitable adjustments for changes in the specifications for the DLGN–41, which resulted from changes made in the specifications of the DLGN–38, 39, and 40, be discussed at the first negotiating session. In response, Newport News restated its position that all issues related to the validity of the DLGN–41 option had to be negotiated before any attempt was made to resolve the technical baseline issue. (Letter from Newport News, dated December 5, 1975, a copy of which is attached as Exhibit 7 to Defendants' Motion, filed July 13, 1976.) Newport News, however, did forward lists of formal changes which it asserted were required in the DLGN–41 baseline. *Id.*

Negotiations involving the technical baseline of the DLGN–41 were conducted between Navy and Newport News on December 10 and December 18, 1975. Agreement was reached on the incorporation of changes into the technical baseline of the DLGN–41 and on the production manhours, engineering manhours and material costs of these changes. No agreement was reached on the indirect costs of these changes.[32]

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[30] In addition, a DLGN–41 Contract Negotiation Steering Group was appointed to exercise final decision authority over any resolution of the DLGN–41 controversy. Affidavit of Admiral S. J. Evans, dated November 1976, ¶ 3 (hereinafter "Evans Affidavit").

[31] Admiral Evans' request for stenographic notes should not be viewed in a vacuum. In earlier negotiations surrounding the creation of the DLGN–41 option, Newport News unilaterally had maintained inaccurate minutes of negotiating sessions and then attempted to condition a subsequent contract on them. At the request of the Navy, Newport News subsequently acknowledged that those minutes were inaccurate in virtually all respects. Leighton Affidavit, ¶ 8.

[32] Newport News proposed to allocate significant indirect costs to these changes—indeed, up to three times the direct productive manhour cost for actual change installations. Admiral Evans deemed this proposal capricious on its face. Evans Affidavit, ¶ 12. Newport News would not agree to Navy's proposal that indirect costs for anticipated delay and disruption be priced in accordance with costs actually associated with change incorporation. *Id.*

In the course of these negotiations, Newport News asserted that in the absence of all changes being incorporated into the DLGN–41 technical baseline, the company could not determine what specific equipment configuration or material to procure from their long lead time subcontractors. In investigating this position, Admiral Evans requested the Navy Supervisor of Shipbuilding, Conversion and Repair, at Newport News, to review the company's purchase order files. The results of this review convinced Admiral Evans that Newport News entertained no doubts with respect to the technical baseline for the DLGN–41 or the materials to be placed on subcontract. In the words of Admiral Evans, he "concluded that the position taken by the company was without foundation." Evans Adavit, ¶15.

Negotiations continued between Newport News and Navy throughout the spring of 1976. Newport News remained entrenched in its negotiating position that Navy must concede the invalidity of the DLGN–41 option and agree to a new delivery date and a new escalation clause. By letter dated January 16, 1976, Newport News confirmed this position by urging that future negotiations be directed toward agreement: "on a realistic ship construction period and delivery date without regard to contractual responsibility." [A copy of the January 16, 1976, letter is attached as Exhibit 10 to Defendants' Motion, filed July 13, 1976.] Admiral Evans, on the other hand, maintained his position that, absent a prior determination of Government responsibility for construction delays or new and adequate consideration flowing from Newport News to Navy, such concessions were improper. Evans Affidavit, ¶ 17.

Beginning in March 1976, an effort was made by the Department of Defense to provide various shipbuilders, including Newport News, with extraordinary relief, without consideration, under Public Law 85–805, 50 U.S.C. 1431. As part of such relief, it was proposed that the DLGN–41 option be reformed, without consideration, to revise and extend the escalation provisions. The details of that effort and the lack of success which it achieved are detailed in the Affidavit of Maxwell G. Ward, dated November 1976. It is Admiral Evans' opinion that the relief which Newport News was offered pursuant to the Public Law 85–804 proposal, "* * * without regard to responsibility or consideration, was precisely the form of negoiation Newport News was attempting to conduct with me and beyond my authority or power." Evans Affidavit, ¶34. The effort under Public Law 85–804 was terminated on June 9, 1976.

On June 11, 1976, Rear Admiral L. E. Hopkins, who succeeded the then retired Admiral Evans as Chairman of the DLGN–41 Navy Negotiating Team, wired Newport News, urging that; in light of the withdrawal of the resolution under Public Law 85–804, Navy and Newport News resume their negotiations concerning the DLGN–41. Soon thereafter, on July 12, 1976, the DLGN–41 Contract Negotiations Steering Group and the DLGN–41 Navy Negotiating Team were disestablished. As already discussed,[33] the conduct of further negotiations then was assigned to the Office of the Chief of Naval Material and Mr. Gordon W. Rule was appointed as primary negotiator.

ARGUMENT

A. Navy's unwillingness to renegotiate the terms of the DLGN–41 option, absent contractor entitlement or new and adequate consideration, did not constitute bad faith.

Defendants' argument that, prior to the appointment of Mr. Rule, Navy refused to negotiate in good faith pursuant to this Court's Order is based almost exclusively on a single assumption. Defendants assume that the parties had agreed, prior to entry of the Court's Order in August 1975, on the meaning of the language "or to take other appropriate action," and that they mutually intended the language to encompass a renegotiation of the DLGN–41 contract.

The facts, as set forth above, however, demonstrate that defendants' assumption is patently erroneous. Rather than agreeing with Newport News, Navy repeatedly had informed Newport News prior to August 29, 1975, that Navy placed a more limited construction on identical language when such language was contained in the prior Memorandum of Understanding. Navy's construction of such language was that it encompassed a renegotiation of specific clauses

[33] The events which occurred subsequent to Mr. Rule's appointment on July 1976 already have been discussed at length at pp. 4–13, *supra*, of this Brief.

in the DLGN–41 contract only if adequate consideration were offered to the Government, or if delays had been caused by the Government.

Further, on August 29, 1975, when the parties negotiated the stipulation which was to become the Court's Order, it was Newport News that proposed inclusion of the phrase "or to take other appropriate action." When queried by government counsel regarding the reason for the inclusion of this language, Newport News' counsel advised that it would insure that the parties' representatives at the working level would not feel constrained in negotiating and resolving day-to-day problems which might arise in the ship's continued construction but which would not constitute contract modifications. At no time during those discussions did counsel for Newport News even intimate that this language was intended to encompass a renegotiation of the DLGN–41 contract absent an offer of new consideration. In view of those facts, defendants' contention that Navy's refusal to bargain over a renegotiation of the DLGN–41 contract constituted a bad faith violation of this Court's Order cannot be sustained.[34]

This Court's Order of August 29, 1975, when read as a whole, likewise precludes a finding of bad faith in Navy's unwillingness to renegotiate the DLGN–41 contract pursuant to that Order, absent an offer of new consideration.[35] The Court's Order expressly provides that the Order itself, as well as any actions taken pursuant to it, shall be without prejudice to the rights or legal positions of either party.[36] To require Navy to pursue negotiations on a ground which implicitly, if not explicitly, would require a concession that the DLGN–41 option was invalid could hardly be more prejudicial to the rights and legal position of the United States. Yet this is exactly what defendants now urge is required by the Court's Order. Indeed, it is difficult to imagine anything more prejudicial to the rights and legal position of the United States than to permit defendants to obtain dismissal of this action on the ground that the United States would not concede the invalidity of the very contract which it seeks in this action to have specifically enforced.

In addition to being inconsistent with the terms and spirit of the August 29, 1975 Order, defendants' argument involves a "heads I win, tails you lose" reasoning. If the Court's Order requires Navy to assume a negotiating posture which concedes the invalidity of the DLGN–41 option and negotiate items beyond the eight listed in Modification P00018 [without regard to contractor entitlement or new and adequate legal consideration], then the Order must similarly require Newport News to assume a bargaining posture which concedes the validity of the DLGN–41 option and negotiate only over the eight items listed in Modification P00018.[37] Newport News has steadfastly refused to assume

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[34] Defendants, at various points in their Brief, seek to infer that in continuing construction on the DLGN–41, they were relying detrimentally upon Navy's purported agreement to broaden the scope of negotiations and the purported agreement allegedly reached with Mr. Gordon W. Rule. In the first place, as the prior discussion demonstrates, any such reliance on the part of Newport News was unfounded. Secondly, as explained above and with greater detail in the affidavits of Messrs. Cole and Picot, Newport News has suffered little detriment. Affidavit of Brady M. Cole, dated October 20, 1976 [hereinafter "Cole Affidavit"]; Affidavit of Julien C. Picot, Jr., dated October 21, 1976. Notwithstanding contrary payment provisions in the DLGN–41 option, Newport News has been paid on a cost plus 7% fixed fee basis. This has resulted in Newport News being paid a greater amount than that to which it is entitled under the contract. Cole Affidavit, ¶9.

[35] It should be emphasized that Navy has always been willing to negotiate regarding any element of the DLGN–41 contract if new and adequate consideration were furnished by Newport News or if contractor entitlement were shown. Contractor entitlement would encompass such items as excusable delay or cost or delay for which the Government was responsible. *See*, e.g., Evans Affidavit, ¶6.

[36] 5. "This stipulation and any action taken by either party pursuant hereto shall be without prejudice to the rights or legal positions or either party."

[37] Defendants argue, "Just as Newport News was obligated to negotiate on whether it will accept an obligation to build the DLGN–41 (despite its belief that the option and its exercise was [sic] invalid), Navy was obligated to negotiate [items beyond those left open in Modification P00018]." Defendants' Brief, p. 5. Contrary to defendants' inference, there is no inconsistency between the belief that the option and its exercise were invalid and a duty to negotiate on whether a duty imposed by that option *will be accepted*. The two are entirely consistent and defendants' syllogism is therefore incorrectly stated. If Navy is obligated to negotiate items beyond those left open in Modification P00018, thereby abandoning its legal position that the DLGN–41 option is valid, then Newport News' concomitant duty is not to negotiate on whether it *will accept* an obligation to build the DLGN–41. Rather, if defendants' reasoning is applied equally, Newport News' concomitant duty is to recognize the validity of the DLGN–41 option and negotiate on a limited basis the eight remaining open items of that option.

that posture. Instead, consistent with its legal position, Newport News has insisted throughout the course of the negotiations that elements of the contract, reaching far beyond the eight items left open in Modification P00018, must be renegotiated. Having itself refused to assume a posture antithetical to its litigation position, Newport News can hardly expect the United States to assume such a posture and, when the United States justifiably refuses, cry bad faith.

In their Brief defendants rely on a series of cases in the labor-management relations area to support their position that Navy has refused to negotiate in good faith pursuant to the Court's Order.[38] Yet defendants ignore the fact that even in the labor-management relations area, a steadfast insistence upon a bargaining position is not necessarily a refusal to bargain in good faith. *N.L.R.B.* v. *American Nat'l Ins. Co.*, 343 U.S. 395, 404 (1952).

If the insistence is genuinely and sincerely held, if it is not mere window dressing, it may be maintained forever, though it produce a stalemate. Deep convictions, firmly held and from which no withdrawal will be made, may be more than the traditional opening gambit of a labor controversy. It may be both the right of the citizen and essential to our economic legal system, thus far maintained, of free collective bargaining. * * * The obligation of the employer to bargain in good faith does not require the yielding of positions fairly maintained.

N.L.R.B. v. *Herman Sausage Co.*, 275 F.2d 229, 231 (5th Cir. 1960). *Accord*, *N.L.R.B.* v. *Almeida Bus Lines, Inc.*, 333 F.2d 729, 731 (1st Cir. 1964). The obligation to bargain in good faith, therefore, does not require a party to yield positions fairly and genuinely held.

From January 31, 1975, until July 1976, Navy remained unwilling to broaden the scope of negotiations beyond the eight items left open in Modification P00018, absent new and adequate consideration or a showing of contractor entitlement. This position conformed to Navy's legal view that the DLGN–41 contract is valid. Navy's position also was consistent with the terms of the Memorandum of Understanding and the Court's August 29 Order, as well as the understanding which existed between the parties when those documents were executed. Additionally, Navy's position recognized that extraordinary relief from shipbuilding contracts, without any requirement for consideration, exists under Public Law 85–804, 50 U.S.C. §1431 *et seq.*, under which a proposal was made to give Newport News the relief it had been attempting to gain in negotiations. Since Navy's position was fairly and genuinely held, and since Newport News was informed of that position prior to entry of the Court's Order, it cannot constitute a failure to negotiate in good faith.

Finally, it should be noted that Newport News apparently was able, in August of 1976, to engage in bargaining with Mr. Rule over a renegotiation of the DLGN–41 contract, including a new delivery date and an extension in escalation clause favorable to Newport News.[39] According to Mr. Rule, this bargaining occurred because he read the language "or other appropriate action" in the Court's August 20 Order to require such bargaining. Tr. Rule Dep., pp. 82, 131, 204–205, 323. Mr. Rule's analysis of that language in the Court's Order, however, totally ignores its derivation. He was not present at any of the meetings between Newport News and other Navy officials which preceded the use

[38] Defendants' reliance upon cases in the labor-management relations area is misplaced. The cited cases articulate the standard of conduct required for good faith bargaining on items deemed mandatory for bargaining under Section 8(d) of the Labor Management Relations Act, 28 U.S.C. §158(d). Under Section 8(d) of the Labor Management Relations Act, 29 U.S.C. §158(d), "wages, hours and other terms and conditions of employment" constitute "mandatory" subjects for bargaining. Any other subject is deemed a "voluntary" one. While "voluntary" subject may be placed on the table by either side, there exists no requirement that the other side bargain with respect to such items or agree to their inclusion in the contract. Insistence upon a voluntary subject as a condition to the execution of a collective-bargaining contract is itself a violation of good faith bargaining. *N.L.R.B.* v. *Wooster Division of Borg-Warner Corp.*, 356 U.S. 342, 348–350 (1958). If any analogy is to be made in requiring Navy to concede the invalidity of the DLGN–41 contract, such a concession necessarily must be characterized as a "voluntary" subject. As such, Newport News could lawfully place the subject on the table but its subsequent insistance upon the subject as a condition of executing an agreement between the parties would be unlawful. *Id.*

[39] As already discussed at pp. 53–54, supra, the proposal to settle the DLGN–41 dispute under Public Law 85–804, without consideration, included a proposal for similar changes.

of that language in the Memorandum of Understanding, nor was he present at the discussions between the Department of Justice and Newport News' counsel in which the meaning of that language was discussed. [See Brief, pp. 44–48, *supra*; Tr. Rule Dep., p. 23] On the basis of those discussions, Navy's position concerning the construction of the language "or to take other appropriate action," as reflected in prior negotiations was, at the very least, consistent wtih total good faith bargaining.

B. The United States cannot repudiate an agreement which does not exist and therefore cannot be accused of bad faith.

Defendants also allege bad faith on the ground that the United States has purportedly repudiated the "agreement" between Newport News and Mr. Gordon W. Rule. Such a contention necessarily presupposes a binding agreement which is capable of being repudiated. As already demonstrated, none exists and defendants' contention, therefore, must fail.

Moreover, even if the fact were ignored that Mr. Rule lacked the authority to bind the Navy, and that the Department of Defense lacked the authority to bind the United States in litigative matters, it is nevertheless apparent that even Mr. Rule does not believe he has reached a final agreement with Newport News. As late as October 26, 1976, Mr. Rule, in discussing whether any agreement could be effective if Newport News did not accept a condition he placed on the cost escalation clause contained in the proposed settlement, stated:

It won't be, can't be. It cannot be under any circumstances. The whole deal is off. And I can't make that any clearer. The deal is off if they don't accept that condition. [Tr. Rule Dep., p. 277.]

It is impossible to repudiate a settlement agreement which does not exist. Consequently, it is impossible to sustain an argument that the conduct of the United States or the Department of the Navy since July 13, 1976, constitutes bad faith or a violation of the Court's August 29 Order.

Finally, it should be noted that at the hearing on Plaintiff's Motion For Temporary Restraining Order, counsel for Newport News, K. Martin Worthy, devoted a considerable portion of his argument to Navy's alleged refusal to define the technical baseline for the DLGN–41 under the option contract. According to Mr. Worthy:

As is indicated in Mr. Creech's affidavt, on April 8, 1974, on May 2, 1974, on May 10, 1974, May 14, 1974, and on June 19, 1974, Newport News reiterated its concerns that without the designs and specifications [for the DLGN–41] being modified to incorporate the changes made in the 38, 39 and 40, *it was wholly impracticable to build the 41.* [Emphasis added; Tr. Hearing of August 29, 1975, p. 24.]

Mr. Worthy continues on to say that:

One of our difficulties with the issuance of a temporary restraining order today is that we *don't know what it is we are to build.* [Emphasis added; Hearing of August 29, 1975, p. 30.]

* * * * * * *

Do they [Newport News] buy materials according to the revised specifications for the 38, 39 and 40, which is what Navy says we really eventually intend, or do they buy materials according to the specifications for the 38, 39 and 40 as those specifications existed almost three years ago? (Tr., p. 29.)

Yet in spite of Newport News' expressed concern that it cannot construct the DLGN–41 until these changes in technical baseline specifications are resolved, the "settlement agreement" which it now asks this Court to adopt does not even refer to those changes. Rather, according to Mr. Rule, "* * * the parties

agreed to leave that to the negotiation between the Supervisor of Shipbuilding and Newport News. It wasn't in order words, a substantive matter * * *." Tr. Rule Dep. p. 299. Hence, the purported settlement agreement negotiated between Mr. Rule and Newport News would leave unsettled the very issue which Newport News earlier claimed precludes it from constructing the DLGN–41.

CONCLUSION

For the foregoing reasons, defendants' Motion for Entry of Judgment or, in the Alternative, for Dismissal with Prejudice, should be denied.

Respectfully submitted,

REX E. LEE,
Assistant Attorney General,
WILLIAM B. CUMMINGS,
United States Attorney,
By: MICHAEL A. RHINE,
Assistant United States Attorney.
STUART E. SCHIFFER,
PATRICIA N. BLAIR,
J. CHRISTOPHER KOHN,
Attorneys for Plaintiff.

Of Counsel:
E. GREY LEWIS,
General Counsel,
Department of the Navy.
JAMES A. MACMILLIAN,
Counsel, Navy Sea Systems Command.
EUGENE P. ANGRIST,
Deputy Counsel,
Procurement, Navy Sea Systems Command,
JAMES L. STERN,
Assistant Counsel,
Navy Sea Systems Command.

CERTIFICATE OF SERVICE

I hereby certify that I have this 8th day of November, 1976, caused to be hand delivered a true copy of the foregoing Plaintiff's Opposition To Defendants' Motion For Entry Of Judgment, Or In The Alternative, For Dismissal With Prejudice to:

John DeGooyer, Esquire
Hamel, Park, McCabe & Saunders
1776 F Street, N.W.
Washington, D.C. 20006

and I further certify that I have, this same day, mailed a copy of that same document to:

William McL. Ferguson, Esquire
Ferguson and Mason
225 Eighth Street
Newport News, Virginia 23607.

PATRICIA N. BLAIR,
Attorney, Department of Justice,
Washington, D.C.

ITEM 6.—*March 8, 1977—Decision of Judge MacKenzie, U.S. District Court, Eastern District Court of Virginia, granting the Newport News motion to enforce the CGN41 settlement*

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF VIRGINIA

Newport News Division
Civil Action No. 75–88–NN

UNITED STATES OF AMERICA, PLAINTIFF

v.

NEWPORT NEWS SHIPBUILDING AND DRY DOCK COMPANY, AND TENNECO, INC.,

DEFENDANTS

ORDER

In accord with a Memorandum Opinion dated and filed March 8, 1977, and to which reference is made,

It is ORDERED:

(1) That the motion of the defendants to enforce the compromise and settlement agreement between the parties is GRANTED.

(2) This action of the plaintiff being therefore moot, the same is DISMISSED.

CHAS. WALKER, Jr.,
United States District Judge.

Norfolk, Virginia,
March 8, 1977.

IN THE UNITED STATES DISTRICT COURT FOR THE
EASTERN DISTRICT OF VIRGINIA, NEWPORT NEWS DIVISION

Civil Action No. 75–88–NN

UNITED STATES OF AMERICA, PLAINTIFF

v.

NEWPORT NEWS SHIPBUILDING AND DRY DOCK COMPANY, AND TENNECO, INC.,
DEFENDANTS

MEMORANDUM OPINION

I

JURISDICTION AND PARTIES

The plaintiff, the United States of America, has brought this action seeking specific performance of a shipbuilding contract it purports to have entered into with the defendant, Newport News Shipbuilding and Dry Dock Company (the Shipyard). Defendant, Tenneco Inc. is the parent corporation of the Shipyard, and its liability is allegedly based on its guarantee of the Shipyard's contractual duties.

The Court has jurisdiction pursuant to 28 U.S.C. § 1345.

II

NATURE OF THE MOTION BEFORE THE COURT AND THE COURT'S RESOLUTION OF THE ISSUES PRESENTED

The Shipyard here contends that a valid compromise agreement has been reached between itself and the United States which moots and settles all of the issues presented in the Government's action; it moves for an entry of judgment to enforce the settlement and to dismiss this litigation, and in the alternative, for a dismissal with prejudice of the Government's action because of its bad faith toward this Court and the defendants. The United States maintains that it has negotiated towards the settlement in good faith, but that any agreement reached between the Shipyard and the Government is invalid for a variety of reasons.

We have no problem with the case and hold that a compromise agreement has been reached; that it is binding on the United States; that the matters before the Court are moot; and that judgment should be entered enforcing the settlement and thus dismissing the litigation.

We find that the United States voluntarily bound itself, contractually and by the consent order of this Court, to negotiate in good faith to resolve all of the disputes between itself and the Shipyard with respect to the construction of the DLGN–41. The United States utterly failed, until the appointment of Gordon Rule, to so negotiate in good faith. It insists that it was only required to negotiate certain items and not all of the matters that are in dispute. This false insistence evidences the Government's complete bad faith toward this Court and the Shipyard. The Government, as well as the defendants, had every right to seek a quick judicial determination of their respective rights under the disputed contract. However, the parties agreed to an order entered in this Court, on August 29, 1975 and again a year later, that judicial action should be stayed to allow the parties to negotiate in good faith to resolve all their differences. Had we been aware that the Government would later attempt to assert that it was not required to so negotiate, this Court would never have entered the stipulated agreement of the parties to negotiate as an order. We would have moved the parties along to a swift adjudication of the validity of the disputed contract.

We conclude that sovereign immunity does not deprive this Court of jurisdiction to declare that the compromise agreement here binds the United States. The Department of Defense, in this case, delegated its executive authority to Gordon Rule to bind the United States to an agreement which compromises and settles the rights of the parties to this suit. We need not reach the issue whether it would have been proper for the Department of Defense, once the disputed contract became the subject of litigation, to negotiate a compromise agreement without the consent and approval of the Department of Justice. That issue is not before the Court because the Department of Justice represented to this Court, in August, 1975, that the United States would be bound to negotiate in good faith, and yet we find that the Department of Justice has refused to directly participate in any of the negotiations over the past seventeen months. The United States here is estopped to deny the authority of the Department of Defense to bind the United States to a compromise agreement.

We find that the United States is fully bound to the compromise agreement negotiated on August 20, 1976 between Gordon Rule, for the Government, and the Shipyard. This agreement is evidenced by the documents executed by Rule which memorialize the prior oral agreement. The documents which speak to the compromise agreement are Contract Modification P00037 and Rule's cover letter imposing two conditions.

These documents satisfy any statue of frauds requirement. There was a meeting of the minds of the parties on August 20, 1976; there is adequate consideration to support this compromise agreement; and failure to provide cost of pricing data does not invalidate the agreement. We find that Deputy Secretary of Defense Clements, who initiated the negotiation efforts, has approved the compromise agreement.

III

THE FACTS

A. THE DISPUTED CONTRACT: JUNE 25, 1970 TO AUGUST 25, 1975.

This acrimonious confrontation between the United States Navy and the Newport News Shipyard over the construction of the DLGN–41, a nuclear-powered guided missile frigate, a high priority national defense item, is considerably affected by the public interest.

On June 25, 1970 the Navy entered into a contract (Contract N00024–70–C–0252) with the Shipyard for the preconstruction preparation necessary for the construction af nuclear guided missile frigate, DLGN–38. This contract also contained an option exercisable by the Navy for the actual construction of the DLGN–38.

Subsequently various documents, identified as Contract Modifications P0001 *et seq.*, have been executed and enlarged the scope of the original contract, and modified its terms. The most important of these, for our purposes, are Contract Modifications P0007, P00018, P00024, and P00037. They raised issues upon which the parties disagree as to their legal effects.

P0007 was executed on December 21, 1971. Therein the Navy purported to exercise its construction options for the DLGN–38 and two ships of the same

class, the DLGN–39 and 40. In addition, P0007 in Article 28 granted the Navy two options for the construction of two additional ships of the same class, the DLGN–41 and DLGN–42, the options to be exercised by February 1, 1973 and February 1, 1974 respectively. The Shipyard does not admit these legal effects.

On February 1, 1973 the parties executed P00018. The United States maintains that this document amended Article 28 to extend the time for the exercise of the construction options for DLGN–41 and DLGN–42 by two years. Two provisions are important for our purposes. One is the option provision which the Navy purported to exercise which states:

On or before 1 February 1975, the Government, by modification to this contract, may require the contractor to construct and deliver DLGN 41, but only if the Government, by modification to this contract, by 1 December 1973, authorizes the contractor to expend funds in an amount of $29,062,200 for material procurement, shop fabrication, and other preliminary work.

The second relevant provision states:

The Parties agree to negotiate in good faith to reach an agreement as rapidly as possible on the provisions of this contract which require modification in order to express the agreement of the parties as to new option provisions for DLGN 41 and DLGN 42. Therefore, such contract modification will:

(i) establish a target cost, a target price, a ceiling price, and a share ratio within the profit-cost envelope set forth below for each option so exercised separate from that for the other ships under this contract, and revise Article 7, entitled "LIMITATION OF CONTRACTORS' LIABILITY FOR CORRECTION OF DEFECTS" to provide a limitation on the Contractor's liability for correction of defects for each vessel to two percent (2%) of the initial Target Price for that vessel,

(ii) provide for a total final negotiated cost pursuant to Article 5 hereof entitled "INCENTIVE PRICE REVISION (FIRM TARGET)" separate from that for DLGN 38, 39 and 40 combined,

(iii) establish escalation tables separate and different from those for the DLGN 38, 39 and 40 combined,

(iv) modify the payment provisions as necessary to provide payment for DLGN 41 and 42 separate from DLGN 38, 39 and 40,

(v) revise the project milestones in Article 17 and DLGN 41 and 42,

(vi) establish a fixed fee, and other terms and conditions on account of the work which may be required by the Option Conditions described below which will be effective until the corresponding option is exercised, or the work, which may have been continued pursuant to the direction of the Contracting Officer, stops,

(vii) contain a provision for computing equitable adjustment on account of changes in the Longshoremen and Harbor Workers' Act, the Federal Insurance Compensation Act, state workmen's compensation, unemployment, disability compensation and public liability acts occurring since June of 1970, and

(viii) revise Schedule "A" to provide for DLGN 41 and DLGN 42 equipment delivery schedules the same as those listed for DLGN 39.

If, despite the best efforts of both parties, the aforesaid agreement is not executed before the Government exercises either or both options, the parties agree that interim billings will be in accordance with the terms and conditions of th payment provision for the DLGN 38, 39 and 40 using the maximum profit-cost envelope * * * until such time as the aforesaid agreement is reached, said interim billings not to exceed total incurred costs for DLGN 41 and DLGN 42.

On November 29, 1973 the parties executed P00021. The United States maintains that modification extended the delivery dates for the DLGN–41 and DLGN–42 to October 1978 and June 1979 respectively, in return for an extension of the date by which the Navy must provide funding for the preconstruction work on the DLGN–41 and DLGN–42 in order to exercise the options for actual construction. On February 27, 1974 the Navy executed P00022 which recites that the Shipyard is authorized to expend 35 million dollars to accomplish the preconstruction work on the DLGN–41. The bulk of this authorization was a prerequisite under Article 28 to an exercise of the DLGN–41 construction option.

The Shipyard does not agree with the Government as to the legal effects of these modifications, and maintains, and we find as a fact, that it notified the Navy during August 1974 that it no longer considered the DLGN–41 option to be valid.

The Navy was well aware of the Shipyard's position when, on January 31, 1975, it executed P00024 which recites that the Navy exercises its construction option for the DLGN–41. In fact, the Shipyard and the Navy agreed, prior to the execution of P00024, that an agreement, which was contained in a document entitled a Memorandum of Understanding, would become effective on February 3, 1975. Under this agreement, which was to remain in effect for at least thirty days and to continue until one party had given forty-eight hours' notice, the Shipyard agreed to continue the preconstruction work for the DLGN–41, and each party agreed

* * * to negotiate in good faith to reach an agreement as rapidly as possible to modify those contract provisions requiring amendment *or to take other appropriate action.* [Emphasis added.]

Some attempts to negotiate were made by both parties; however, they failed because of the parties' disagreement over the meaning of the phrase, "or take other appropriate action." The same language was incorporated into the Court's order of August 29, 1975. Certain elements in the Navy maintain that this phrase did not obligate the Navy to negotiate outside of the eight specific items which the Navy was already obligated in February 1975 to negotiate pursuant to P00018. We find this contention to be incredible in light of the drafters' deliberate rejection of language which would have specifically limited negotiations to those eight areas contemplated by P00018, and in light of the fact that the Shipyard consistently maintained that the exercise of the DLGN–41 option was invalid.

On May 28, 1975 the Navy sent the Shipyard a letter advising the Shipyard of the Government's maximum acceptable position. This Navy position basically was that the exercise of the DLGN–41 construction option was valid and therefore the Navy was not required to negotiate outside of the eight items in P00018; this meant no change in the October 1978 delivery date or the production schedule, no change in target cost, profit, or ceiling price, and no change in the incentive formula. The Navy would not negotiate outside of the eight items to accomplish a modification of the contract unless the Shipyard could prove that it was entitled to an equitable adjustment due to Government responsibility, or the Shipyard could furnish new consideration.

The disputed contract for the construction of the DLGN–41 is a fixed-price, incentive-type contract, with a cost-price envelope defined in terms of a target cost, target profit, target price, and ceiling price as follows:

Target cost	$76, 050, 000
Target profit	+9, 691, 000
Total target price	85, 741, 000
Ceiling price	100, 951, 000

The contract compensation provisions also contain adjustment and escalation clauses for the contingencies that actual costs may exceed target costs, and that there may be inflation of labor and material costs.

On August 25, 1975 the Shipyard notified the Navy that it was exercising its right to cancel the Memorandum of Understanding, and that all preconstruction work on the DLGN–41 would be suspended as of August 27, 1975.

B. THE COURT'S ORDER: AUGUST 29, 1975 TO JULY 13, 1976

On August 29, 1975 the United States filed in this Court its complaint and a motion for a preliminary injunction and a temporary restraining order. On that same date, a hearing was held before the Court on the motion for a temporary restraining order. It was at this hearing that the Court first became aware of the positions of the parties. The Shipyard maintained that the exercise of the DLGN–41 construction option was invalid because: (1) there were insufficient appropriations, that the exercise was in contravention of 41 U.S.C. § 11(a), 31 U.S.C. § 665(a), and the Armed Services Procurement Regulations (ASPR): (2) the Navy had failed to notify the Shipyard of the specifications for the DLGN–41; and (3) under various legal theories, the option was unenforceable, e.g. commercial impracticability.

After arguments on the TRO motion and a brief recess, the parties asked the Court to allow an agreement, which had been reached between the parties, to be read into the record and to be entered as an Order of the Court. The Court, be-

lieving that all good faith attempts to reach a settlement should be encouraged, agreed. This Order, by the Court, mooted the TRO issue and stayed the judicial proceedings. It directed, first, that the Shipyard would immediately resume the preconstruction work and proceed to undertake construction of the DLGN–41. The Navy agreed to pay for such work. In addition, all changes heretofore made in the specifications for the earlier DLGN–38, 39 and 40 were to be considered as incorporated into the specifications for the DLGN–41, and the parties agreed to negotiate in good faith the appropriate equitable adjustments for all specification changes. Second, it stated that:

The parties agree to negotiate in good faith to reach an agreement as rapidly as possible to modify those contract provisions requiring amendment or to take other appropriate action.

Third, the parties agreed to urge the Comptroller General to expedite his opinion on the issues previously submitted by the Shipyard concerning whether the exercise of the DLGN–41 construction option violated 41 U.S.C. § 11(a), 31 U.S.C. § 665(a), or the ASPR's.

Mr. Jeffrey Axelrad, representing the United States and the Department of Justice, stipulated to the Court that E. Grey Lewis, the Navy's General Counsel, would "undertake to ensure the Navy's obligation" to negotiate under the Order.

Unfortunately, the United States' agreement to negotiate has been undercut by the existence of diverse points of view within the Navy, with the result that the record discloses, without possible peradventure, that the United States has fully and totally ignored not only its own February, 1975 agreement, but also the Order of this Court, that negotiations in good faith should ensue. Even before the Memorandum of Understanding took effect on February 3, 1975 there was an effort within the Navy to limit negotiations only to certain items listed in P00018. Although counsel for the United States, Mr. Axelrad, in open court acknowledged that the Navy's General Counsel would ensure the Navy's compliance, on October 29, 1975, Mr. Lewis, that General Counsel, was ordered by higher Navy officials to stop all negotiations.

Despite the Navy's appointment of two succeeding chief negotiators, we find that in the eleven months following our August 29, 1975 Order, the United States *totally* failed to meet its obligations to negotiate in good faith, although at the same time it was receiving the benefits of the Shipyard's continued performance under the disputed contract.

C. RULE'S APPOINTMENT AND THE COMPROMISE AGREEMENT: JULY 13, 1976 TO DATE

On July 13, 1976 the Shipyard instituted, by a motion, an effort to enforce the United States' agreement to negotiate in good faith and it asked the Court to suspend the Shipyard's obligation under the Order of August 29, 1975, to continue work on the DLGN–41 until the United States did undertake to negotiate in good faith to resolve all disputes between the parties concerning the DLGN–41.

On that same date, July 13, 1976, Gordon Rule was summonsed, with others, to the office of Deputy Secretary of Defense Clements to a meeting concerning the DLGN–41 dispute. The United States has claimed executive privilege concerning certain Government minutes of meetings, documents, and records of conversations, which frankly the Court has viewed with an eye to ruling thereon. However, there is ample evidence in the record, to which no privilege is asserted, to justify our findings of fact that:

1. Gordon Rule was appointed by the Deputy Secretary of Defense as chief negotiator for the DLGN–41 dispute with the authority to bind the United States to a compromise agreement. *In fact, the United States admitted this fact during its argument on January 13, 1977.*

2. Deputy Secretary Clements instructed Rule that he wanted to see four items negotiated in any DLGN–41 compromise agreement: (a) a new escalation clause; (b) a new "changes in the law" clause; (c) a new ceiling price; and (d) a new delivery schedule.

3. Rule was appointed as chief DLGN–41 negotiator in direct response to the Shipyard's filing of its July 13, 1976 motion.

4. Deputy Secretary of Defense Clements specifically called this meeting of July 13, 1976 for the purpose of prodding the Navy to reach a DLGN–41 compromise agreement with the Shipyard. In this regard, Clements instructed the high

Navy officials in attendance that they should thereafter meet with him on a daily basis to keep him informed of Rule's progress in negotiating a compromise.

5. The Shipyard interpreted the appointment of Rule as an indication of the United States' willingness to negotiate, for the first time, in good faith. As a result, the Shipyard asked this Court, on July 19, 1976, to stay action on its July 13, 1976 motion.

6. On July 16, 1976 Assistant Secretary of the Navy Bowers issued a memorandum which designated Rule as the Navy's chief DLGN–41 negotiator. On August 19, 1976 the Navy issued Rule a Certificate of Appointment as Contracting Officer which recited that he had "*unlimited authority*" to negotiate with the Shipyard concerning the DLGN–41 contract dispute. It is significant that Bowers' memorandum recites that Rule was appointed, after consultation with the Department of Justice, to deal directly with the Shipyard, without the involvement of the Department of Justice, and that Rule was to be assisted by the Navy's General Counsel.

7. Rule is a high ranking civilian Navy employee who is normally assigned as the Director of the Procurement Control and Clearance Division in the Office of the Chief of Naval Material. It is his job function to approve or disapprove the business clearance on all Navy procurement contracts. He is referred to as the "top civilian contracting officer in the Navy." Rule had previously signed for the United States an unrelated contract modification involving over $1,037,000,000.

8. Serious negotiations between Rule and the Shipyard began on July 15, 1976, continued on an almost daily basis, and resulted on August 20, 1976 in an oral agreement between Rule and the Shipyard on all of the outstanding substantive issues concerning the construction of the DLGN–41, including those specifically charged to him by Secretary Clements. The negotiators agreed that a written document, to be labelled Contract Modification P00037, would confirm and memorialize the terms of the August 20, 1976 agreement.

9. On August 20, 1976 the parties orally agreed to a change in the delivery date from October 1978 to August 1980, to a new escalation clause appropriate to the new delivery date, to new and separate fringe benefits and energy cost provisions, and to agree later on a new "changes in the law" provision as they were already obligated to do under the earlier P00018.

10. At the completion of the August 20, 1976 meeting the parties intended themselves to be bound by the agreement reached and only contemplated a memorialization of this agreement in a written document.

Despite the United States' admission that Rule was initially appointed with full authority to bind the United States, an effort was mounted within the Navy before August 20, 1976 to undercut Rule's specific authority, and to bring it under further *Navy* scrutiny. Even in the face of that internal Navy effort, such action would not have revoked Rule's authority as granted by the Deputy Secretary of Defense on July 13, 1976, and by Assistant Secretary of the Navy Bowers, on July 16, 1976, and as expressed as "unlimited" in the Contracting Officer's warrant issued.

Further Navy efforts to undermine Rule's authority occurred after the agreement was reached on August 20, 1976. On August 30, 1976 an Admiral Michaelis sought to appoint a review panel of three Navy persons, and purported to grant them the sole final authority to bind the Navy to a compromise agreement.

On August 23, 1976 Rule met with Deputy Secretary Clements and reported to him that an agreement had been reached with the Shipyard on August 20, 1976. On August 25, 1976 Admiral Reich, a top consultant to Clements, approved a press release announcing that a settlement agreement had been reached.

A final draft, setting forth the agreement as reached on August 20, 1976, was prepared by the Shipyard, and signed by Rule, subject to two conditions, on October 7, 1976, at 6:00 P.M. On the morning of October 8, 1976, Rule was called to his immediate superior's office where he was handed a document which stated:

* * * you do not have the authority to bind the Government contractually on the proposed modification to CGN–41 contract until the legal and business reviews have been completed * * *.

This document, although dated October 7, 1976, was received by Rule on the morning of October 8th.

Rule delivered Contract Modification P00037 to the Shipyard but expressly conditioned his execution and delivery of the document that:

(1) Clements approve the document as memorializing the compromise agreement between the parties; and

(2) the labor escalation clause contained in P00037 be modified to provide that the Shipyard would receive the lesser of its actual experience in escalated labor costs, or 125% of the Bureau of Labor Statistics indices. These conditions were dictated to a secretary, in the presence of the Shipyard's agent, and later incorporated in the cover letter for the executed P00037.

Later, on October 8, a memorandum from a Navy Captain Thompson was sent to Rule's office, reciting that Rule's warrant as a Contracting Officer was revoked.

On October 15, 1976 Deputy Secretary of Defense Clements forwarded a copy of the writings executed by Rule to Attorney General Levi. In his cover letteer Clments states that the writings present "*a reasonable resolution of this complex matter.*" He further states:

In any event, the District Court instructed the parties as follows: "The parties agree to negotiate in good faith to reach an agreement as rapidly as possible to modify those contract provisions requiring amendment or to take other appropriate action." Mr. Rule, in the spirit of this order, negotiated a contract modification which, if approved, would undoubtedly facilitate the construction of the badly needed CGN–41.

The Department of Justice has since informed the Court that the Attorney General would disapprove the Rule compromise agreement and contends that therefore there is no compromise agreement binding on the United States.

IV

Conclusions of Law

A. THE UNITED STATES' FAILURE TO ACT IN GOOD FAITH TOWARD THIS COURT AND THE SHIPYARD

Even if there is a valid contract the breach of which would entitle the aggrieved party to a damage remedy at law, the specific performance of that contract is not a matter of right under either federal or state law. The granting of the remedy of specific performance rests in the sound discretion of the trial court, which is to exercise its discretion according to the established principles of equity and the facts of the case, Williston on Contracts § 1418 (3rd Ed., 1976 Supplement) citing among other cases, *Manufacturers' Finance Co.* v. *McKay*, 294 U.S. 442, 55 S.Ct. 444 (1934); *Barnes* v. *Sind*, 341 F.2d. 676 (4th Cir. 1965); *Raney* v. *Barnes Lumber Corp.*, 195 Va. 956, 970, 81 S.E. 2d 578, 586 (1954).

A fundamental equity principle is that one who asks for specific performance of a contract must have "clean hands": he must have acted in a fair and equitable fashion with respect to the party against whom he seeks to have the contract enforced.

Long before the Navy purported to exercise its option rights on January 31, 1975, the Shipyard informed the Navy that it considered the DLGN–41 construction option to be void. If this litigation had proceeded to trial, this Court would have been required to pass on the validity of the original DLGN–41 option provision. However, the Court's decision today that the subsequent compromise agreement is binding on the United States moots this issue and settles this litigation.

Certain personalities within the Department of the Navy have taken the position that the Navy should not negotiate with the Shipyard on the matters required to be negotiated pursuant to the January 31, 1975 Memorandum of Understanding and, of more importance to us, *this Court's Order of August 29, 1975.* The Navy was not coerced by anyone, including this Court, to agree to negotiate in good faith to resolve the DLGN–41 dispute. The Government, if it were so positive of the validity of the original option provision. could have had this Court's final adjudication of the validity of that provision within six or seven months after the filing of its complaint. However, the United States, through its Department of Justice, represented to this Court that no immediate adjudication of the validity of the disputed option provision was desired, but rather that good faith efforts would be undertaken by the Navy to resolve this dispute through an out-of-court compromise agreement, and that while the Court's Order remained in effect the Shipyard would be obligated to continue its construction of the DLGN–41, despite its contention that the exercise of the option contract was invalid.

If that group within the Navy which disapproved of any negotiations or settlement of DLGN–41 dispute had attained ascendancy in the Navy's decision-making hierarchy, they could have asked this Court to revoke its Order of August 29, 1975, and to proceed to adjudicate the validity of the exercise of the option. This did not occur. Instead the official position of the Government was that good faith negotiations to resolve all of the DLGN–41 dispute were desired, while certain Navy elements were even then undercutting the progress of any efforts toward good faith negotiation. We do not decide whether it was in the best interests of the United States to negotiate or to litigate the DLGN–41 dispute; we only conclule that the Navy, and the United States, has not acted in good faith. For this reason, the United States does not have clean hands to ask this Court to specifically enforce the original DLGN–41 construction option.

B. A DECLARATORY JUDGMENT THAT THE UNITED STATES IS BOUND BY THE COMPROMISE AGREEMENT IS JUSTIFIED

The United States has raised numerous legal objections to the validity and enforceability of the August 20, 1976 compromise agreement. These objections include: (1) that sovereign immunity deprives the Court of jurisdiction to declare that the United States is bound by a compromise agreement which settles and moots this action; (2) that Rule lacked authority to bind the United States; (3) that the August 20, 1976 agreement is unenforceable because it was oral; (4) that there has been no meeting of the minds; (5) that the compromise agreement is void because of the Shipyard's failure to provide the Government with cost and pricing data; (6) that Rule could not bind the United States without the approval of the Attorney General; and (7) that the compromise agreement is not supported by adequate consideration. While we consider some of these charges to be of no moment, nevertheless, we separately address each of these legal objections and conclude that none of them prevent the compromise agreement from binding the United States.

1

SOVEREIGN IMMUNITY

We need not dwell long on the two sovereign immunity arguments raised by the United States. By granting judgment for the Shipyard neither do we grant a damages judgment against the United States, nor do we order the equitable reformation of a contract to which the United States is a party. We merely declare that the parties are legally bound by a compromise agreement. This compromise agreement moots the issue as to whether that prior contract was enforceable.

Certainly if the facts show that the issues are moot in a suit brought by the United States for specific performance of a contract, the Court has jurisdiction, under 28 U.S.C. § 1345, to so find, and to dismiss with prejudice the Government's case. It makes no practical difference whether the Court's judgment is styled a dismissal with prejudice because of mootness, or a declaratory judgment for the defendant that the settlement agreement is binding. The *res judicata* and *collateral estopped* effects are the same.[1]

We need not decide whether the enactment on October 21, 1976 of Public Law 94–574, 90 Stat. 2721, which amends 5 U.S.C. § 702, grants this Court any additional jurisdiction with respect to this litigation.

2

RULE'S AUTHORITY

The United States admits that Gordon Rule had complete and final authority to bind the United States when he was appointed on July 13, 1976, as chief Navy negotiator in the DLGN–41 dispute. However, the United States contends that, subsequent to his appointment and prior to any agreement reached between himself and the Shipyard, his authority was limited to the negotiation

[1] We find it a little tenuous for the Government, after instituting this suit in this Court, to now question the jurisdiction of the Court to hear and determine the whole matter, including a bona fide settlement of the dispute.

of a proposed settlement, which required the further approval of a higher authority in the Departments of Defense or Navy, and the approval of the Attorney General. We disagree.

Gordon Rule was appointed as the Navy's chief negotiator for the DLGN-41 dispute by Deputy Secretary William P. Clements during a meeting held in Clements' office attended by the high-level Department of Defense and Navy personnel concerned with this dispute with the Shipyard. Rule's appointment was in direct response to the Shipyard's having filed a motion to compel the United States to comply with this Court's Order of August 29, 1975. *It was Mr. Clements' stated and recorded belief that the Navy had failed so far to negotiate with the Shipyard in good faith.* The Department of Justice admits that the Attorney General was aware of this grant of authority to Rule.

The Justice Department attempts now to discredit the settlement worked out by Rule. It suggests that Rule did not act with the best interests of the United States in mind. We find nothing in the record to support this view. In fact, Rule was appointed by Clements because of this reputation in negotiating settlements with contractors. That segment of the Navy command which was upset at Rule's appointment, but was then unable to prevent it, now attempts to discredit his completed settlement.

On August 19, 1976 Rule was issued a contracting officer's warrant signed by Captain Gerald J. Thompson, Deputy Chief of Naval Material. That document stated that Rule had "*unlimited authority to negotiate with the Shipyard concerning the DLGN-41 dispute.*" This warrant was not revoked until October 8, 1976. It is incredible to the Court that the United States now maintains that "unlimited authority to negotiate for the United States" does not include the authority to bind the United States. This argument is contrary to the dictates of common sense and the English language. If the warrant authority did not include the power to bind the United States, why did certain Navy officials feel the need to revoke the warrant on October 8, 1976? Rule had signed and delivered the draft setting out the Contract Modification P00037 prior to this revocation.

3

STATUTE OF FRAUDS

The United States claims that even if Rule had the authority on August 20, 1976 to bind the United States, any agreement reached on that date would not be enforceable because it was oral.

The United States contends that 31 U.S.C. § 200(a) establishes that an agreement must be evidenced by documents before it can be binding on the United States. This provision states in pertinent part:

After August 26, 1954 no amount shall be recorded as an obligation of the Government of the United States unless it is supported by documentary evidence of—

> (1) a binding agreement in writing between the parties thereto, including Government agencies, in a manner and form and for a purpose authorized by law, executed before the expiration of the period of availability for obligation of the appropriation concerned for specific goods to be delivered, real property to be purchased or leased, or work or services to be performed; or
>
> * * * * * * *
>
> (6) a liability which may result from pending litigation brought under authority of law; or
>
> * * * * * * *
>
> (8) any other legal liability of the United States against an appropriation or fund legally available thereto.

The Government cites *United States v. American Renaissance Lines, Inc.*, 494 F.2d 1059 (1974) where the Court of Appeals for the District of Columbia Circuit held that an oral charter agreement was unenforceable against the United States because of § 200(a). That Court rejected the argument that § 200(a) was merely "a recordation statute to facilitate auditing" by Congress of the Executive's spending in order to determine future appropriation requirements; rather it held that the statute makes oral contracts with the Government unenforceable. It is unnecessary for us to reach the issue whether § 200(a) is applicable to the August 20, 1976 compromise agreement

for we find that the requirements of § 200(a) have been met under both subsections (1) and (6).

Under subsection (1) the oral compromise agreement on August 20, 1976 is evidenced by the document (Contract Modification P00037) which Rule signed on October 7, 1976, and the cover letter of October 8, 1976.

Secondly, the requirements of subsection (6) have been met. The oral agreement which was reached on August 20, 1976 was negotiated pursuant to this Court's Order of August 29, 1975. This oral agreement entered into by the duly authorized agents of the parties to this pending litigation certainly establishes the liability of the parties after this Court accepts that agreement as the settlement of this action.

4

MEETING OF THE MINDS

The United States maintains that there was no meeting of the minds on August 20, 1976 and therefore no binding agreement. As evidence of this contention they cite the parties' agreement that a draft of the agreement be formalized. It is well settled that the mere fact that the parties contemplated a reduction of an oral agreement to writing does not prevent the agreement from becoming binding as of the date of the oral agreement. Here, a draft was agreed to in order to correctly reflect the August 20th oral agreement.

The precise language and operation of the labor costs escalation clause had been a major item of disagreement between the parties in the negotiations. The parties agreed on August 20th to grant the Governmen the most favorable escalation provision as disclosed by the Shipyard's actual experience. In the original DLGN–41 construction option contained in Article 28 of P0007, the Shipyard was to receive the lesser of its actual experience *or* 125% of the Bureau of Labor Statistics' index for wage costs. The basic writing signed by Rule on October 7, *i.e.*, Contract Modification P00037, recited only that the Shipyard would receive 125% of the BLS index irrespective of its actual experience; however, Rule conditions his signing and delivery of the document on the modification of the writing to go back and incorporate the same type provision as was in force in P0007. The Shipyard has agreed. We find that this modification by Rule of P00037 reflects the substance of the oral agreement reached by the parties on August 20, 1976. 17 C.J.S., Contracts, § 31.

At the August 20th meeting the parties did not work out the specific language for a labor cost escalation clause. At subsequent sessions it was found that all parties were operating under the mistaken impression that the Shipyard was experiencing a rate of increase in labor costs greater than the BLS index. To give the Government the best position, the 125% of the BLS index provision was chosen to reflect the August 20, 1976 agreement. When, however, by October 7, it became known that the Shipyard had sometimes been experiencing a rate of increase in labor costs less than the BLS index, the change in language imposed by Rule was appropriate to reflect th actual August 20, 1976 agreement.

We need not worry whether the parties contemplated on August 20, 1976 that approval by Deputy Secretary Clements was necessary to bind the Government, for we find that Clements, in any case, has granted such approval. In his letter of October 15, 1976 to Attorney General Levi, Clements granted his approval to the Rule compromise agreement. We do not agree with the Government that Clements must use the magic words "I approve" before this Court can conclude that Clements in fact has approved the compromise agreement. Clements stated:

In view of the long-standing, acrimonious, and disruptve controversy between the Navy and its sole present new construction surface nuclear warship contractor. I consider it vital to the national defense that this dispute be resolved as quickly as possible. I consider the proposed modification a reasonable resolution to this complex matter.

5

FAILURE TO PROVIDE COST OR PRICING DATA

The United States argues that the compromise agreement negotiated between Rule and the Shipyard is not binding on the Government because the Shipyard failed to submit cost or pricing data to the Government. This argument rests on the proposition that such data is required by Armed Services Procurement

Regulations (ASPR) § 3-807.3 and by statute, 10 U.S.C. § 2306(f), that the absence of such data invalidates the agreement, and that the requirements cannot be waived. 10 U.S.C. § 2306(f) states in pertinent part:

A prime contractor or any subcontractor shall be required to submit cost or pricing data under the circumstances listed below, and shall be required to certify that, to the best of his knowledge and belief, the cost or pricing data he submitted was accurate, complete and current—

* * * * * * *

(2) Prior to the pricing of any contract change or modification for which the price adjustment is expected to exceed $100,000, or such lesser amount as may be prescribed by the head of the agency * * *

Section 3-807.3 of ASPR [32 C.F.R. § 3.807] implement this statute and provides:

(a) The contracting officer shall require the contractor to submit, either actually or by specific identification in writing, cost or pricing data in accordance with 16-206 of this chapter and to certify by the use of the certificate set forth in 3-807.4, that, to the best of his knowledge and belief, the cost or pricing data he submitted was accurate, complete and current prior to:

* * * * * * *

(2) the pricing of any modification to any formally advertised or negotiated contract, whether or not cost or pricing data was required in connection with the initial pricing of the contract, when the modification involves aggregate increases and/or decreases in cost plus applicable profits expected to exceed $100,000.

The Shipyard has not furnished the Navy the certificate of cost data as specified by ASPR 3-807.3.

The original contract (N00024-70-C-0252) contained a now standard "Price Reduction for Defective Cost of Pricing Data" clause which reads:

(a) If the Contracting Officer determines that any price, including profit or fee negotiated in connection with this contract was increased by any significant sums because the Contractor * * * furnished incomplete or inaccurate cost or pricing data not current as certified in the Contractor's Certificate of Current Cost or Pricing Data, then such price shall be reduced accordingly and the contract shall be modified in writing to reflect such adjustment.

This provision was included in the contract, as required by 10 U.S.C. § 2306(f), which states:

Any prime contract or change or modification thereto under which such certificate [Certificate of Current Cost or Pricing Data] is required shall contain a provision that the price to the Government, including profit or fee, shall be adjusted to exclude any significant sums by which it may be determined by the head of the agency that such price was increased because the contractor required to furnish such a certificate, furnished cost or pricing data which, as of date agreed upon between the parties * * * was inaccurate, incomplete, or non-current * * *

It appears obvious from these quotations that the submission of price and cost data is not a precondition to a finding that the Government is bound by the contract or any subsequentm odificattionthereof. The failure on the part of the Shipyard to ultimately furnish complete and accurate price and cost data does not relieve the Government of its duty to perform under the contract, but rather only gives it the right to seek a reduction in the price of the contract to the Government.

Nor need we decide whether the United States has waived the statutory and contractual requirements that the Shipyard furnish cost and pricing data. The Government cites *M-R-S Manufacturing Company v. United States*, 495 F.2d 835, 841 (Ct. Claims 1974) for the proposition that a Government agent cannot waive this requirement. However, this decision supports our conclusion, for the only relief granted the Government in that case was a reduction in price.

We note that 10 U.S.C. § 2306(f) provides that no cost and pricing data is required where:

* * * in exceptional cases * * * the head of the agency determines that the requirements of this section may be waived and states in writing his reasons for such determination.

It might be concluded that Deputy Secretary of Defense Clements has taken such action as evidenced by his letter forwarding the compromise agreement to the Department of Justice.

DEPARTMENT OF JUSTICE APPROVAL

The United States maintains that this is an instance where a private contractor asserts that an agreement has been reached between itself and a federal contracting agency, here the Department of Defense, which settles civil litigation involving a government contract, *"notwithstanding the lack of involvement or approval by the Attorney General,"* and therefore "the purported 'settlement' must fail." Plaintiff's Brief, 37. [Emphasis added.] Such a fact situation is not before this Court.

On August 29, 1975 the Department of Justice stated in open Court to this Court that the Navy's General Counsel would "undertake to ensure the Navy's obligations" to negotiate in good faith a settlement of the dispute over the Shipyard's construction of the DLGN-41. The United States, through its Department of Justice, voluntarily agreed and subjected itself, through the Order of this Court, to negotiate in good faith, thus making a deliberate decision not to seek an immediate judicial determination of its rights under the disputed option contract. *At the request* of the Department of Justice this Court incorporated into its Order of August 29, 1975 the agreement of the United States to negotiate in good faith.

The Department of Justice decided as evidenced by the testimony of its counsel, Jeffrey Axelrad, to rely upon the Navy and not to send any of its officers to directly participate in the DLGN-41 negotiations. This remained the position of the Justice Department despite the Department of Justice's knowledge that the Navy was not in fact negotiating and that Navy officials were in utter default before the appointment of Gordon Rule. On July 13, 1976 the Shipyard filed in this Court a motion to enforce the Court's Order of August 29, 1975. In direct response to the filing of that motion, the Department of Defense appointed Rule as its chief negotiator for the DLGN-41 dispute. The Department of Justice was aware of Rule's appointment and the authority conferred on him,[2] and in light of this appointment requested counsel for the Shipyard not to press its July 13th motion. This request was granted.

The Department of Justice agreed to and promoted the Court Order of August 29, 1975 that negotiations "to reach an agreement as rapidly as possible" on behalf of the United States should be conducted by the Navy officials, it reaffirmed this agreement at the time of the appointment of Rule, and it neglected to fulfill its obligations to this Court and the Shipyard to ensure good faith negotiations by the United States, except through its implicit delegation of any authority it had to settle this litigation to the Department of Defense. It therefore is estopped to deny the authority of the Deparment of Defense officials to approve an agreement which in effects moots or settles this litigation. 15A Am. Jur. 2d, Compromise and Settlement, § 12.

While we hold the Department of Justice, under its action in this case, is estopped to deny the settlement, nevertheless, for appellate purposes we note that in *United States* v. *Sandstrom*, 22 F.Supp. 190 (N.D. Okla. 1938), where the Attorney General successfully resisted a settlement, that action was based upon the lack of original authority in the Secretary of the Interioor to act in the first place. That is not the case here.

We do not decide whether the Department of Justice can block an agreement reached by another executive agency which in effect settles litigation, when the Department has neither participated in nor approved the settlement. Here, we hold, the Department *has* participated. However, we note without comment that the Court of Appeals for the Fourth Circuit has held in *Leonard* v. *United States Postal Service*, 489 F.2d 814 (1974) that the Department of Justice could not block a compromise agreement reached by the Postal Service which mooted a claim against it for employment discrimination, while the case was pending in the District Court.

We repeat that this is not a case where a federal executive agency has attempted to usurp the authority of the Department of Justice to initiate or con-

[2] During oral argument the Department of Justice stipulated that at the time of Rule's appointment he had the authority to bind the United States; however, the Department of Justice maintains that, subsequent to his appointment, any settlement that he negotiated with the Shipyard became subject to further review and final approval by the Department of Justice.

trol litigation involving the United States. Rather all of the negotiations involving the DLGN–41 between the Shipyard and the Navy were carried out pursuant to an agreement to which the Department of Jutsice officials gave their express approval, and which, at the express request of the Department of Justice, was incorporated as an order of this Court.

The purpose of the agreement to negotiate in good faith to resolve the differences between the parties with respect to the DLGN–41 was to avoid "vexatious and expensive and, to the contractor oftentimes, ruinous litigation." *Kihlberg* v. *United States*, 97 U.S. 398, 401 (1878), as quoted in *S & E Contractors, Inc.* v. *United States*, 406 U.S. 1, 8, 92 S.Ct. 1411, 1416 (1972). Both parties to the agreement ceded their rights "to seek immediate judicial redress for [their] grievances," and have bound themselves to proceed with the construction of the DLGN–41 during the negotiation process. *S & E Contractors, Inc., supra* at 1416. "A citizen has the right to expect fair dealing from his government" with respect to such an agreement. *Id.* at 1417.

There is no contention here that this compromise agreement was arrived at as a result of any fraud or bad faith on the part of the Shipyard. *Id.* at 1419–1420. The Department of Justice has exercised its power to control the United States position in this litigation—it did so in asking this Court to enter a consent order, as a result of which the United States became bound to negotiate in good faith to resolve the disputes between the parties concerning the DLGN–41. Having exercised this power, it cannot now repudiate its decision. It cannot now maintain that another executive agency has attempted to usurp its control over litigation with the United States.

7

CONSIDERATION

The United States contends now that the Rule compromise is "almost totally one-sided in favor of Newport News." It argues that the compromise will cost the Government 22 million dollars. In addition it cites the 22-month deferred delivery date, and the fringe benefits and energy provisions. [It should be noted that under our construction of the compromise agreement the labor escalation clause is the same type as that in the antecedent option contract.] The United States concludes that "the only new consideration coming to the Government under the proposed modification is that it no longer must assume the litigative risk inherent in pursuing its present action for specific performance." (Plaintiff's January 7, 1977 Brief, 4.) This argument must fail for there is ample and sufficient consideration to support a compromise agreement if it is based upon a claim, unliquidated or disputed in good faith, and if the parties make or promise mutual concessions.

A good statement of the legal requirements in the way of consideration for establishing a binding compromise agreement is found in 15A Am. Jur.2d, Compromise and Settlement, § 13, p. 785:

A compromise, like any other contractual agreement, must be supported by consideration. If there is a liquidated and undisputed claim, and if an effort is made to accomplish an accord and satisfaction through the payment of an amount different from what is undisputably due, there must generally be some new or additional consideration for the accord and satisfaction to be effective. If, however, there is a disputed or unliquidated claim, based upon the parties' doubts and uncertainties, and if the parties, for the purpose of avoiding or putting an end to litigation, agree to resolve their differences amicably and by means of mutual concessions, the promise or execution of such concessions by one party constitutes good consideration for the promise or execution of such concessions by the other party. Thus, a compromise, as distinguished from other types of accord and satisfaction, is supported by good consideration if it is based upon a disputed or unliquidated claim and if the parties make or promise mutual concessions as a means of terminating their dispute; no additional consideration is required.

All of the requisites for consideration to support a binding compromise agreement are found here. The parties dispute in good faith the validity of the antecedent option agreement and the United States' purported exercise on January 31, 1975 for the construction of the DLGN–41; the parties' obligations under this antecedent option agreement were unliquidated. The *basic* price for the construction of the DLGN–41 contained in the compromise agreement

is the same as that contained in the antecedent option agreement. And even the antecedent option agreement (Modification P00018) required the parties to negotiate in good faith concerning the inclusion of the DLGN construction contract of a provision for "computing equitable adjustments on account of changes in various laws," *e.g.*, Longshoremen and Harbor Workers' Act. The compromise agreement specifies that it constitutes a full and final settlement of all issues which are the subject of dispute in this case, *i.e.* the validity of the Shipyard's obligation to build the DLGN–41.

In addition there is a consideration furnished by the Shipyard's release of "[a]ll claims for delay and delay costs in the delivery schedule of DLGN–41, resulting from, caused by or incident to any and all events, including Government actions or inactions * * *" We find that the Shipyard has asserted these "delay" claims in good faith, and that the release of these claims is not illusory consideration. There is some evidence that the Government delayed for more than a year, from mid-1974 until the August 29, 1975 hearing in this Court to inform the Shipyard whether it would incorporate into the specifications for the DLGN–41 all of the changes already made in the DLGN–38, 39, and 40. The Shipyard has alleged that this delay made it impossible to establish an appropriate schedule for the construction of the DLGN–41.

The United States argues that compromise agreements to which the Government is a party require *adequate* consideration. (Plaintiff's January 7, 1977 Brief, 4 n.2.) The United States would have this Court apply a special rule to Government contracts and ignore the hornbook contracts law rule that a Court will not review the adequacy of consideration as long as some valid consideration supports the contract. In the absence of any allegation of fraud or bad faith on the part of the private contractor, we reject that role.

None of the cases cited by the United States support its view that the Court is to review the adequacy of consideration supporting Government contracts. The cases cited by the Government did not address the consideration issue, but rather the issue whether the Government agent had the actual authority to modify a Government contract.

The law favors the resolution of controversies and uncertainties through compromise and settlement rather than through litigation, and it is the policy of the law to uphold and enforce such contracts if they are fairly made and are not in contravention of some law or public policy.

15A. Am. Jur.2d, Compromise and Settlement, § 5, p. 777, citing *Williams v. First National Bank*, 216 U.S. 582, 30 S.Ct. 441 (1909).

An appropriate Order, in accord with this Memorandum Opinion, will be separately entered this date.

JOHN A. MACKENZIE,
United States District Judge.

Norfolk, Virginia,
March 8, 1977.

ITEM 7.—*Actions Concerning Payment Restrictions on Claims:* a. *Aug. 22, 1976—Excerpt from Senate Appropriations Committee report to accompany H.R. 14262, 94th Cong., 2d Session*

Sec. 747. Payment of Claims.

The Committee recommends addition of a general provision which prohibits the use of any funds appropriated within the Act to pay any claim against the United States until it has been examined by the Department of Defense and a report made to the Armed Services Committees and Appropriations Committees.

b. *Sept. 22, 1976—Excerpt from PL 94–419, Sec. 747 prohibiting use of defense appropriations for payment of claims unless they are thoroughly examined and evaluated by DOD officials and a report made to Congress as to their validity*

SEC. 747. None of the funds appropriated in this Act may be used to pay any claim over $5,000,000 against the United States, unless such claim has been thoroughly examined and evaluated by officials of the Department of Defense responsible for determining such claims and a report is made to the Congress as to the validity of these claims.

Claim payments, restriction.

c. *April 29, 1977—Defense Procurement Circular, No. 76–7, Item 1, putting into effect Pub. L. 94–419, Sec. 747*

ITEM I—PAYMENT RESTRICTION ON CLAIMS

The following memorandum concerning the provision in the Fiscal Year 1977 DoD Appropriation Act concerning claims over $5,000,000 is published for the information of all concerned.

ASSISTANT SECRETARY OF DEFENSE,
Washington, D.C., January 25, 1977.

[Memorandum for Assistant Secretary of the Army (I&L), Assistant Secretary of the Navy (I&L), Assistant Secretary of the Air Force (I&L), Director, Defense Civil Preparedness Agency, Director, Defense Communications Agency, Director, Defense Contract Audit Agency, Director, Defense Intelligence Agency, Director, Defense Mapping Agency, Director, Defense Nuclear Agency, and Director, Defense Logistics Agency.]

Subject: Payment Restriction on Claims, Section 747 of Public Law 94–419, Department of Defense Appropriations Act 1977.

The following payment restriction on claims was included in the Department of Defense Appropriations Act, 1977 (Public Law 94–419):

Sec. 747. None of the funds appropriated in this Act may be used to pay any claim over $5,000,000 against the United States, unless such claim has been thoroughly examined and evaluated by officials of the Department of Defense responsible for determining such claims and a report is made to the Congress as to the validity of these claims.

It is our understanding that this section was inserted because of the interest of Congress in the resolution of large claims in connection with shipbuilding contracts. However the language in this section as enacted by Congress in referring to "claims" does not restrict it to shipbuilding contract claims, and thus claims must be considered in a broader sense.

In accordance with this broader sense, Department of Defense components will report to the Congress the validity of a claim (whether or not arising under contract) of $5,000,000 or more prior to the payment of any such claim. Illustrative of such claims would be tort claims and contract claims, including claims made pursuant to a contract clause which permits the contractor to make a claim. Examples of such contract clauses are the "Changes" clause and other clauses which permit the submission of claims for equitable adjustment in accordance with the procedures of the "Changes" clause, the "Termination for Convenience of the Government" clause, the "Government Delay of Work" clause, the "Stop Work Order" clause and clauses providing for Government indemnification of the contractor. The report is not required to be made with respect to a payment resulting from the final price settlement of changes to drawings, designs or specifications which were previously incorporated into the contract by mutual agreement of the parties at not-to-exceed prices. Requests for routine contract payments (e.g., requests for payment for accepted supplies and services, routine vouchers under cost reimbursement type contracts and progress payment invoices), final adjustments under incentive provisions of contracts and requests for relief under Public Law 85–804 are also not considered the type of actions for which reporting would be required.

Department of Defense activities will report to Congress, prior to payment, on the validity of any claim (proposed settlement amount) over $5,000,000 against Actual disbursement is permissible once the report has been made. The report the United States to be paid out of funds appropriated under Public Law 94–419. Actual disbursement is permissable once the report has been made. The report will be made by the Assistant Secretary for Installations and Logistics of the Military Department, the Director of the Defense Agency, or their designees. Delegation of this authority will not be made below the Head of a Procuring Activity. A copy of each report will be forwarded to the Office of the Assistant Secretary of Defense (Comptroller), Attention: Director for Information Operations and Control, Washington, D.C. 20301.

The report shall indicate that the claim has been thoroughly examined and evaluated by officials of the Department of Defense responsible for determining the validity of such claim. Identical reports will be sent to the President of the Senate and the Speaker of the House of Representatives. The attached sample letter has been developed for use by reporting officials. Report Control Symbol DD–I&L(AR) 1449 is assigned.

Should conditions arise that indicate a need to substantially vary from the guidance furnished in this memorandum, these conditions will be brought to the attention of the Assistant Secretary of Defense (Installations and Logistics), Washington, D.C. 20301.

J. S. GARDNER,
Acting Assistant Secretary of Defense.

Enclosure.

SAMPLE FORMAT

President of the Senate
Washington, D.C. 20510

(Address as appropriate. Joint addressee letters will not be used.)

Speaker of the House of Representatives
Washington, D.C. 20515

Dear Mr. President:

Dear Mr. Speaker:

Pursuant to Section 747 of Public Law 94–419, this is to report to Congress that the claim described below against the United States over $5,000,000 has been thoroughly examined and evaluated by officials of the Department of Defense responsible for determining such a claim, and is valid for payment in the amount stated below.

Name and Address of Claimant: _____
_____
_____

Amount of Claim Valid for Payment: $_____

Nature of Claim: (Attach additional data if necessary to understand the claim)
_____

Appropriation from which Payment will be Made: _____
_____

Sincerely,

○