[COMMITTEE PRINT]

SUMMARY OF TESTIMONY ON ADMINISTRATION REQUEST FOR TWO-YEAR EXTENSION OF THE RENEGOTIATION ACT OF 1951

AT

PUBLIC HEARING

MAY 2, 1973

HELD BY THE

COMMITTEE ON WAYS AND MEANS

PREPARED BY THE STAFF

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THE RENEGOTIATION PROCESS

The Renegotiation Act of 1951, in general, provides that the Renegotiation Board is to review the total profit derived by a contractor during a year from all of his renegotiable contracts and subcontracts in order to determine whether or not this profit is excessive. Contractors with renegotiable sales exceeding the $1,000,000 statutory "floor" for a fiscal year must file a report with the Renegotiation Board. "Renegotiable" contracts and subcontracts are those with the following agencies: the Departments of Defense, the Army, the Navy, and the Air Force, the Maritime Administration, the General Services Administration, the National Aeronautics and Space Administration, the Federal Aviation Administration, and the Atomic Energy Commission.

The Board is empowered to eliminate those profits found to be excessive in accordance with certain statutory factors. Thus, renegotiation is determined not with respect to individual contracts but with respect to all receipts or accruals from renegotiable contracts and subcontracts of a contractor during a year. These contracts vary in form from cost-plus-fixed-fee to firm fixed-price contracts. Some may be prime contracts, while others are subcontracts, and they may be concerned with many different services and products. With respect to any given year they may also reflect only partial payments made on the contracts.

For purposes of renegotiation, profits generally are defined and determined in much the same way as for tax purposes. This similarity is also reflected in that provision is made in renegotiation for a 5-year loss carryforward, as well as the offsetting of losses and profits on different contracts within the year.

The Act provides, in general terms, that the Renegotiation Board in determining whether profits are excessive is to give favorable recognition to the efficiency of the contractor with particular regard to attainment of quantity and quality production, reduction of costs, and economy. The Board must also consider the reasonableness of costs and profits, the net worth (with particular regard to the amount and source of public and private capital employed), the extent of the risk assumed, the nature and extent of the contribution to the defense effort, and the character of the business. Thus, in effect, the Board in its judgment must consider all of these factors, and the producer, where these factors are present to the greatest extent (e.g., is most efficient or makes the greatest contribution to the defense effort), is permitted to retain more profit than the producer who satisfies these factors to a lesser extent.

Various types of contracts are excluded from the Act: some on a mandatory and others on a permissive basis. The mandatory exemptions include contracts with a State, local, or foreign government, those dealing with certain agricultural commodities, those dealing with unprocessed minerals or timber and related products, competitively-bid construction contracts, those with certain regulated common

carriers or public utilities, those for standard commercial articles or services, those with tax-exempt organizations, and certain contracts determined not to have a direct and immediate connection with the national defense.

RENEGOTIATION BOARD PROPOSAL FOR EXTENSION OF RENEGOTIATION ACT OF 1951

In the absence of legislation, the Renegotiation Act of 1951 will expire as of June 30, 1973. The Renegotiation Board recommends that the Act be extended for 2 years, or to June 30, 1975.

RECENT LEGISLATIVE HISTORY

The Renegotiation Act of 1951 was extended for two years in 1971 and for three years in 1968.

1971 extension

The 1971 extension (Public Law 92–41) included two amendments. The first provided that the rate of interest to be used with respect to determinations of excessive profits is to be determined by the Secretary of the Treasury for each 6-month period (beginning on July 1, 1971) by taking into account the current rates of interest on new private commercial loans with maturities of approximately 5 years. (The previous 4-percent interest rate continued to apply to determinations of excessive profits made prior to July 1, 1971.) The second amendment transferred the sole jurisdiction over Renegotiation Board determinations of excessive profits from the U.S. Tax Court to the U.S. Court of Claims for cases filed after July 1, 1971 the date of enactment of the 1971 Act.

1968 extension

The 1968 extension was preceded by a staff report by the Joint Committee on Internal Revenue Taxation.[1] This study was requested by the Committee on Ways and Means during the consideration of the 1966 extension of the Renegotiation Act.

The 1968 Act (P.L. 90–634) amended the renegotiation statute with regard to the exemption for standard commercial articles and services in a number of respects to insure that items qualifying for the exemption are, in fact, of a "commercial" nature. For example, the percentage-of-sales standard for an item which must be made commercially for the exemption to apply was raised from having to be at least 35 percent commercial (i.e., not subject to Renegotiation) to 55 percent. Further, the exemption would not apply if the article or service were sold to the Government at a higher price than charged to a civilian commercial purchaser.

SUMMARY OF TESTIMONY

Testimony was received at a public hearing on May 2, 1973, before the Committee on Ways and Means on the Administration's proposed two-year extension of the Renegotiation Act of 1951. The proposal would extend the Act from June 30, 1973, until June 30, 1975. Sum-

[1] *Report on the Renegotiation Act of 1951*, April 2, 1968.

marized below are the statements of public witnesses as well as written statements submitted to the Committee.

Renegotiation Board, Richard T. Burress, Chairman.—Recommends a 2-year extension of the present Renegotiation Act. Points out that the Commission on Government Procurement and others have made certain recommendations to place renegotiations on a permanent basis, or extend it for periods of 5 years; extend the coverage of the Act to all Government agencies; and increase the jurisdictional amount under the Act from $1 million to $2 million or decrease it to $100,000. States that the Board is studying these proposals but because of the complexities of the issues raised and the changing characteristics of the Board's workload, additional time is required to complete the Board's analysis and, consequently, has limited its proposal to a simple 2-year extension.

Announces that the Renegotiation Board, as a result of congressional and public attention, has instituted an internal reevaluation and set in motion a program to improve and accelerate the renegotiation process.

Announces that, in an effort to promote flexibility in negotiation between the Board and contractors during the renegotiation process, "tentative determinations" are no longer used during the early proceedings. States that a fully explanatory Memorandum of Decision is now provided to contractors after clearances or findings of excessive profits, except when the contractor has agreed to a refund to the Government. Predicts that increased use of industry data in determining excessive profits will facilitate development of written guidelines now lacking in the renegotiation process.

Explains that the Board has helped small business by appointing a special Small Business Advisor, by exempting competitively bid construction contracts awarded as a result of small business restricted advertising under small business set-aside programs, and by increasing the minimum amount of excessive profits before a company need repay to the Government from $40,000 to $80,000, and from $10,000 to $20,000 for brokers and agents.

Testifies that the Board has established a special screening program for contractors appearing on the Defense Department's list of 100 companies receiving the largest dollar volume of prime contract awards, and that a computerization program has been instituted for quick provision of all meaningful ratios applicable to a case.

Asserts that the Board now proposes to require consolidation in subsequent years, until otherwise authorized or directed by the Board, once a consolidation election has been made.

Adds that the numbers of filings required to be screened annually has been declining, while case backlog has been reduced, but that the Board headquarters will continue to face an unusually heavy workload for some time to come.

Honorable Henry B. Gonzalez, Member of Congress, Texas.—States that the Renegotiation Board has recouped $1.1 billion in excessive profits since its inception, as well as $1.4 billion in voluntary refunds and price reductions. Reiterates that he supports the Renegotiation Board as a safeguard against the continuing danger of a misuse of public funds.

Lists as arguments for retention of the Board that many defense-related Government contracts must be negotiated with no cost experi-

ence, the continued high level of defense procurement, and that renegotiation pays for itself many times over. Compares the $40.2 million in excessive profits and $9.4 million in voluntary refunds and price reductions obtained in fiscal 1972 with the $4.7 million expenses of the Board.

Characterizes the Board and its procedures as fair and "more than reasonable." Claims that even contractors with excessive profits agree with this as is shown by the fact that less than eight percent of the Board's determinations of excessive profits are appealed to the courts.

Indicates that the rise to $80,000 of the amount of excessive profits that must be exceeded before the Board will issue an excessive profits determination possibly may have subverted the intention of renegotiation in an effort to ease some of the burdens of contractors in renegotiation.

Recommends extending the Renegotiation Act for five years to allow time for study of recommendations that have resulted from recent examinations of the Renegotiation Board by the House Government Activities Subcommittee, the Commission on Government Procurement, and by the General Accounting Office.

Suggests that, in the long run, the Board will need the security, independence and status that only permanence will provide. Also, proposes clarifying the statutory criteria for defining excessive profits.

Rejects proposal that two- or three-year extensions of the Act provide incentives for appropriate congressional review of the Board. Suggests that a five-year extension of the Act would induce a searching examination of renegotiation as opposed to an examination that is under the gun because of an extension of only two years.

States that the recommendation of the Commission on Government Procurement that all governmental contracts, not just defense-related contracts, should be subject to the Board's jurisdiction will demand study.

Suggests that Congress should concern itself with whether the increasing percentage of filings that are being cleared at headquarters instead of being assigned to the regional boards might be due to inadequate staffing of the Board or to a relaxation in its standards. Wonders why only a few of the largest defense contractors undergo renegotiation, whether total fiscal year renegotiation should be replaced by contract-by-contract renegotiation, and whether increased sophistication in renegotiation procedures or staff might be needed.

Asks also why the Government Activities Subcommittee's study found that, even after determinations of excessive profits, the Board allowed half of these contractors to retain profits which gave them a return on net worth equal to that of the most profitable company listed in the 1971 Fortune directory of the five hundred largest industrial corporations. Inquiries why procurement officials are not alerted to contractors who have made excessive profits.

Machinery and Allied Products Institute, Charles W. Stewart, President.—Opposes the Renegotiation Act as being "bad law" because it permits the taking of private property upon the basis of largely subjective judgments Characterizes renegotiation as "taxation without a rate book" and as an arbitrary procedure due to the lack of definitive and objective standards of what constitutes "excessive profits."

Maintains that the renegotiation function has been preempted by the highly sophisticated defense procurement and audit techniques currently available. Contends that these procedures and statutory requirements (such as the Truth-in-Negotiations Act, P.L. 87–653), along with GAO audit functions, are more than adequate to ensure against excessive profits on defense contracts.

Indicates that the problem is not one of excessive profits but rather one of inadequate profits in defense contracting as a whole. Points out that the 1971 GAO study, *Defense Industry Profit Study*, reported that profits on defense work were lower than those on commercial work under three standards of measurement.

Asserts that the cost for industry to comply with the renegotiation process is significant. Estimates that this cost at one-tenth of one percent of renegotiable sales. Indicates that if this amount is considered, then the Board has not resulted in recouping more excess profits than the cost of the Act for both Government and industry. Maintains that a large portion of the so-called "voluntary refunds" claimed by the Board are not attributable to renegotiation, but to a variety of procurement and audit techniques—especially the Truth-in-Negotiations Act which empowers an agency to unilaterally impose a contract price reduction where a contractor is held to have submitted faulty cost or pricing data.

Recommends that if Congress decides to further extend renegotiation, it should be limited to a two-year extension. Urges that this period be used to complete a new study of the renegotiation process and the role, if any, that renegotiation should play in the total procurement picture. Feels that previous congressional studies as well as the recent report of the Government Procurement Commission have not included adequate analysis of the relationships between renegotiation and defense procurement. Suggests that Congress consider appointing some other group to conduct such a study.

Urges that the study give consideration to the following proposals, if renegotiation is to be continued further:

(1) *Remove certain civilian agencies from the Act*, such as the General Services Administration, civil works functions of the Army Corps of Engineers and nonmilitary procurements of the Atomic Energy Commission.

(2) *Increase the $1 million "floor,"* such as to $5 million or 5 percent of the contractor's total sales.

(3) *Provide a three-year loss carryback*, plus some means of a carryforward and carryback of "inadequate profits."

(4) *Repeal Vinson-Trammell Act* limitation on profits.

(5) *Allow revoking of any excessive profit determinations* if such sums are employed by the company for reconversion planning to undertake new commercial product research and development.

National Security Industrial Association, J. M. Lyle, President (written statement).—Expresses opposition to extension of the Renegotiation Act. Contends that the Act fails to encourage efficient production and is inconsistent with procurement techniques which recognize the benefits that can be achieved through utilization of the profit motive to encourage cost reductions.

Maintains that, contrary to assertions of high profits, defense profits are not high enough to attract adequate industrial capabilities to defense contracts. Notes that of the 4,227 contractors whose filings were reviewed by the Board in fiscal 1972, only 2,618 showed a profit while the remaining 1,609 showed a loss. Questions whether there is justification for the costs to both the Government and industry in complying with the Act.

Recommends that if any extension is found necessary, it be limited to a period of no more than two years. Suggests that as soon as possible prompt consideration be given to termination of the Act as well as the profit limitation provisions of the Merchant Marine Act and the Vinson-Trammell Act.

Herbert H. Adise, President, Computer Instruments Corporation (written statement).—Endorses a strong Renegotiation Act. Indicates, however, that the present act is deficient in two respects.

Believes that section 103(f) of the Act, which grants to the Board the sole right to determine the accounting method by which costs are assigned to renegotiable sales, has resulted in allowing some excessive profits to escape recapture because of the Board's use of the "sales ratio" method of allocating profits between renegotiable and nonrenegotiable sales. Maintains that this is arbitrary since profits are not necessarily the same on renegotiable and nonrenegotiable sales. Considers the "sales ratio" method to ignore the factor of the year-to-year impact of production volume on costs and profits. Suggests that consideration of the year-to-year impact be added to section 103(f).

Suggests that the Board also pay closer attention to return on net worth as well as profit as a percentage of sales in making determinations of excessive profits.

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