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Highway Revenue Act of 1956

Renegotiation Act of 1951 Amended

REPORT OF THE JOINT COMMITTEE  
ON INTERNAL REVENUE TAXATION  
RELATING TO RENEGOTIATION

PRINTED PURSUANT TO PUBLIC LAW 216  
SECTION 6, 84TH CONGRESS, 1ST SESSION  
APPROVED AUGUST 3, 1955



MAY 31 (legislative day, MAY 24), 1956.—Ordered to be printed

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CONGRESS OF THE UNITED STATES  
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION  
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## LETTERS OF TRANSMITTAL

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JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,  
*Washington, D. C., May 31, 1956.*

The PRESIDENT OF THE SENATE.

SIR: Pursuant to section 6 of Public Law 216, 84th Congress, 1st session, I have the honor to submit the report of the Joint Committee on Internal Revenue Taxation dated May 31, 1956, relating to the Renegotiation Act of 1951. Attached thereto is a study prepared by the staff of the committee. Part I of the study has been adopted and approved by the committee and constitutes the report of the committee. The other parts contain historical data and material in support of part I, and are submitted for the information of the Congress without action being taken thereon by the committee.

Very respectfully,

HARRY F. BYRD, *Chairman.*

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JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,  
*Washington, D. C., May 31, 1956.*

The SPEAKER OF THE HOUSE OF REPRESENTATIVES.

SIR: Pursuant to section 6 of Public Law 216, 84th Congress, 1st session, I have the honor to submit the report of the Joint Committee on Internal Revenue Taxation dated May 31, 1956, relating to the Renegotiation Act of 1951. Attached thereto is a study prepared by the staff of the committee. Part I of the study has been adopted and approved by the committee and constitutes the report of the committee. The other parts contain historical data and material in support of part I, and are submitted for the information of the Congress without action being taken thereon by the committee.

Very respectfully,

HARRY F. BYRD, *Chairman*

## REPORT OF THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

(Pursuant to Public Law 216, 84th Cong., 1st sess.)

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WASHINGTON, D. C., *May 31, 1956.*

In connection with the study of the Renegotiation Act of 1951, section 6 of Public Law 216 provides as follows:

SEC. 6. (a) The Joint Committee on Internal Revenue Taxation, or any duly authorized subcommittee thereof, is hereby authorized and directed to make a complete study in order to determine—

(1) whether there is any necessity of extending the Renegotiation Act of 1951 beyond December 31, 1956; and

(2) if any such further extension is found necessary, the extent to which renegotiation of Government contracts should apply after such date.

(b) The joint committee shall, not later than May 31, 1956, report to the Senate and the House of Representatives the results of the study conducted pursuant to this section, together with such recommendations as it deems necessary or desirable.

(c) For the purpose of making the study and report required by this section, the joint committee, and the chief of staff of the joint committee, may exercise any of the powers conferred upon the joint committee and the chief of staff of the joint committee by sections 8021 and 8023 of the Internal Revenue Code of 1954. The provisions of section 8023 (b) of such code shall apply to requests made under the authority of this subsection to the same extent as in the case of other requests made under the authority of section 8023 (a) of such code.

In accordance with the above provisions of law the joint committee has caused its staff to make a study of renegotiation and to submit the results thereof. This study was made with the cooperation of the Department of Defense and the Renegotiation Board.

Part I of the study contains the recommendations relating to the extension and improvement of the 1951 Renegotiation Act. The committee adopts and unanimously approves part I, except that the Honorable Wilbur D. Mills does not wish to commit himself on the merits of recommendations 2, 3, 4, 5, and 6 until he can give further study to them.

Part II is a general discussion of the present defense procurement and renegotiation procedures.

Part III is, in general, a discussion of the case for and the case against the continuation of renegotiation.

Part IV is a detailed discussion of the reasons for the suggested improvements in the act.

In addition appendix I outlines the Renegotiation Act of 1951, as amended, and appendix II discusses the development of price and profit limitation.

Both the Department of Defense and the Renegotiation Board approve of all of the recommendations in this report.

HARRY F. BYRD, *Chairman.*

## LETTER OF SUBMITTAL

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CONGRESS OF THE UNITED STATES,  
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,  
*Washington, D. C., May 31, 1956.*

HON. HARRY F. BYRD,  
*Chairman, Joint Committee on Internal Revenue Taxation,  
Washington, D. C.*

MY DEAR MR. CHAIRMAN: There is submitted herewith a study by the staff of the Joint Committee on Internal Revenue Taxation relating to the Renegotiation Act of 1951.

In preparing this study the staff has had the cooperation of the Department of Defense and the Renegotiation Board, both of which approve the recommendations made for changes in the act as shown in part I. Also, in connection with the preparation of the study, suggestions were received from various industry groups.

Respectfully submitted.

COLIN F. STAM, *Chief of Staff.*

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# STUDY BY THE STAFF OF THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION RELATING TO RENEGOTIATION

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## PART I. GENERAL DISCUSSION

### (A) BACKGROUND IN BRIEF

The purpose of the Renegotiation Act of 1951, as declared in the opening section of that act, is to eliminate excessive profits from contracts made with the United States, and from related subcontracts, in the course of the national-defense program. To accomplish this purpose the act prescribes certain factors which are to be taken into consideration in determining the excessiveness of profits, and directs that all excessive profits so determined be eliminated.

Three points in the history of renegotiation are particularly pertinent to an understanding of the present situation. First, renegotiation is an after-the-fact examination of the contractor's profit and performance on all renegotiable business in a fiscal year. Renegotiation was established in the Renegotiation Act of 1942 as a method of lowering excessive prices on a contract-by-contract basis. Renegotiation of individual contracts and subcontracts involved serious practical difficulties and also proved unfair to contractors who were not able to offset losses against profits. Overall renegotiation of profits on a fiscal-year basis was provided by the Revenue Act of 1942. It has been on that pattern ever since.

Secondly renegotiation was first proposed as a wartime measure and was terminated at the end of 1945. It was in effect again during the war in Korea. The Congress has in the past, however, considered it an appropriate measure in a semimobilization period. Thus, renegotiation was applied on a limited scale from 1948 to 1951 and the broad 1951 act was extended by the Congress in 1954 and again in 1955. Presently the act will expire December 31, 1956.

Finally, renegotiation is one of several defense profit-control measures. The formula profit limitations of the Vinson-Trammell provisions were first enacted in 1934. These provisions, now inoperative, would come into effect if renegotiation were terminated. Various price redetermination provisions used in defense contracts also serve to recapture profits.<sup>1</sup>

At the present time all contracts with departments named in the act, and related subcontracts, are subject to renegotiation, except those contracts which are specifically exempt.<sup>2</sup> Sales on contracts so subject must be reported to the Renegotiation Board in Washington. Such reports showing renegotiable sales under \$500,000 are auto-

<sup>1</sup> More detailed historical information on profit limitation and renegotiation is contained in appendix II.

<sup>2</sup> The exemptions are listed on p. 41.

matically exempt. Firms with over \$500,000 of renegotiable sales must file a detailed information return. These returns are screened and those that are found to have no excessive profits are eliminated, and the contractor is so notified. The remaining filings are sent to the regional boards where either a specific determination of excessive profits is made or a clearance granted. These boards take into account the efficiency of the contractor, reasonableness of costs and profits, net worth, risk assumed, contribution to the defense effort, and the nature of the contractor's business.

A contractor may have a determination of a regional board reviewed by the central board in Washington. A complete review is also available in the Tax Court. The determination by the Tax Court is final insofar as it relates to the amount of the excessive profits.

#### (B) RECOMMENDATIONS

1. Evaluation of renegotiation in its operation and results, leads to the conclusion that renegotiation should not become a permanent part of the law. We are now, however, in a period of semi-mobilization, with defense procurement running as high as \$17 billion a year. The emphasis in the current defense program on rapid technological improvement in weapons makes pricing difficult. For these reasons it is believed that a temporary extension of renegotiation is necessary.

*It is recommended that the Renegotiation Act of 1951 be extended to apply to receipts and accruals after December 31, 1956, and before January 1, 1959.*

2. Renegotiation creates serious, expensive compliance problems, which are particularly burdensome to small business. Furthermore, the present floor prevents the Board from concentrating on the large cases where the amounts involved justify the complicated procedure. *It is, therefore, recommended that the statutory floor beneath which sales cannot be renegotiated be increased from \$500,000 of sales to \$1,000,000 effective for fiscal years ending after June 30, 1956.*

3. The operation of the standard commercial article exemption has been seriously criticized both by the Board and by industry. Under present law an article is exempted only where the Board finds that competition for the particular article is such as may reasonably be expected to prevent excessive profits. Each year the Board must make such a finding on each article for which application for exemption is made. This is a great burden on the Board and an inordinate expense to industry.

*It is recommended that the standard commercial article exemption provision be amended by eliminating the test that competitive conditions must be such as will reasonably prevent excessive profits.*

In addition, substantial changes should be made in the definition of a standard commercial article. Under the present law the contractor must file an application with the Board in order to obtain the benefit of the standard commercial article exemption. In deciding whether or not to grant the exemption the Board must often examine the circumstances of other contractors, or of an entire industry, in determining if the supply of the article is used to meet a significant civilian demand as well as to fill defense orders.

*It is recommended that a standard commercial article be defined as an article either customarily maintained in stock or covered by estab-*

lished price quotations, but in either case, at least 35 percent of the dollar amount of the sales of such article by the contractor himself during the fiscal year must be for general civilian industrial or commercial use. If this definition is met the article would automatically qualify as a standard commercial article without the requirement that the contractor file an application and obtain the approval of the Board.

Present law provides that an item which is "identical in every material respect" with a standard commercial article is also a standard commercial article. In general, "identical in every material respect" is defined in the present act to mean of the same kind, content and use, without necessarily being of the same specifications. In applying these tests the Board examines articles produced by other manufacturers as well as those produced by the contractor claiming the exemption. The word "use" in the present act, although relevant, has proved to be too flexible a concept and therefore not very helpful as a test of identity, and comparisons with similar articles produced by other contractors have made the provision difficult to apply.

*It is recommended that "reasonably comparable price" be substituted for "same use" in the present act and that comparisons be made only with other articles produced or sold by the contractor claiming the exemption. Contractors claiming exemption under this provision should still be required to file applications and obtain Board approval.*

Under the above changes the contractor need only file an application for the standard commercial article exemption with the Board where his claim is for an article which is "identical in every material respect" with a standard commercial article. *It is recommended that the action of the Board on this application be taken within 3 months of filing instead of 6 months as under present law.*

It is recommended that these changes in the standard commercial article exemption be effective for fiscal years ending after June 30, 1956. These changes are proposed on the basis of present conditions. In the event of a future national emergency declared by the Congress there should be no mandatory standard commercial article exemption.

4. Under present law contracts with 21 Government agencies are subject to renegotiation. Renegotiable sales to many of these agencies are at relatively low levels. Also many of the agencies confine the bulk of their purchases to articles of standard specifications. *It is recommended that with respect to receipts and accruals after December 31, 1956, renegotiation be confined to contracts with the Departments of Defense, Army, Navy, and Air Force, the Atomic Energy Commission, the Maritime Administration, and the General Services Administration.* The President should have the authority to designate contracts with other agencies as subject to renegotiation in the event of a future national emergency declared by the Congress.

5. *It is recommended that the net worth factor contained in section 103 (e) (2) of the act be retained on the assumption that in determining excessive profits no special emphasis is given to net worth and capital employed as contrasted with the other statutory factors, and that in determining excessive profits no ceiling is placed on the rate of return on net worth or capital employed.* The Board has announced publicly that this is its present practice (see p. 30).

6. The present act provides a 1-year carry forward of losses on renegotiable contracts. Thus, the only loss which may be taken into account in a profit year is the loss sustained in the immediately pre-

ceding fiscal year. *It is recommended that in determining profits on renegotiable sales with respect to any fiscal year ending on or after December 31, 1956, losses sustained on renegotiable business in the two preceding fiscal years should be allowed as a carry forward.*

7. Under present law business firms having renegotiable sales below \$500,000, although not subject to renegotiation, are required to file a statement to the effect that their renegotiable sales are under this figure. *It is recommended that in the case of contractors below the statutory floor of \$1 million, the filing of this statement of nonapplicability be optional with respect to any fiscal year ending after June 30, 1956.* As under present law, if the Board takes no action on the filing within one year, the renegotiation is permanently foreclosed in the absence of fraud or malfeasance, or misrepresentation of a material fact. A contractor could file the statement in order to obtain a final settlement of his renegotiation status.

8. The present procedure for appealing renegotiation cases to the Tax Court, and from the Tax Court to higher courts, should not be changed. *It is recommended that it be made clear that section 108 means that an order of the Board is stayed during review by the Tax Court only if adequate bond is posted.*

9. In general, Government agencies are required to make an annual report to Congress. This is not true of the Renegotiation Board. *It is recommended that the Renegotiation Board make an annual report of its activities for each Government fiscal year beginning with the fiscal year 1956. This report should be made by January 1, following the close of the fiscal year.*

10. Various minor technical amendments are recommended as follows:

(a) *Subcontracts made after June 30, 1956, under a contract with a tax-exempt organization should not be automatically exempt from renegotiation.*

(b) *Provision should be made, as in the World War II renegotiation law, that receipts and accruals after termination of the act attributable to performance before termination should be considered to have been received or accrued prior to the termination date.*

(c) *The present permissive exemption from renegotiation for contracts and subcontracts to be wholly performed abroad by foreign contractors should be made mandatory with respect to receipts or accruals after June 30, 1956. This would not apply to a foreign corporation which is a subsidiary of a domestic corporation.*

(d) Section 113 of the act now relieves persons employed by the Board through December 31, 1953, from the usual conflict of interest restrictions upon former Government employees. In view of the proposed extension of the act, *it is recommended that this provision be amended to apply to persons employed by the Board at any time.* Any such employee will be barred permanently, of course, from handling any renegotiation case which he handled for the Board during his employment.

(e) The act provides a floor of \$500,000 for renegotiable sales generally, but a separate floor of \$25,000 is provided for subcontracts for brokerage fees or commissions. In determining

## ERRATA SHEET

S. Doc. 126—84/2

Substitute for letter of Dudley C. Sharp, Assistant Secretary of the Air Force, on page 5

### (C) LETTERS FROM THE DEPARTMENT OF THE AIR FORCE AND THE RENEGOTIATION BOARD

DEPARTMENT OF THE AIR FORCE,  
OFFICE OF THE ASSISTANT SECRETARY,  
*Washington, D. C., May 31, 1956.*

HON. HARRY F. BYRD,  
*Chairman, Joint Committee on Internal Revenue Taxation,  
Congress of the United States.*

DEAR MR. CHAIRMAN: This is in response to your request of May 24, 1956, to the Department of the Air Force for the views of the Department of Defense with respect to recommendations 1 through 11 which are contained in pages 3TU to 5TU of the galley print as revised. of Report of the Joint Committee on Internal Revenue Taxation Relating to Renegotiation. The Department of the Air Force has been designated to present the views of the Department of Defense with respect to these recommendations.

The Department of Defense has carefully reviewed the recommendations and strongly concurs in a 2-year extension of the Renegotiation Act of 1951, as amended. Further, the Department of Defense approves the other recommendations.

The Department of Defense would like to suggest that the implementing legislation grant the President as well as the Congress the authority to declare a state of national emergency, which will affect certain of these recommendations. In addition, the Department of Defense understands that it will be given an opportunity to comment upon the implementing legislation. It is our further understanding that the Renegotiation Board has indicated that the proposed amendments with respect to the definition of standard commercial articles will assist the administration of the act.

This report has been coordinated within the Department of Defense in accordance with procedures prescribed by the Department of Defense.

The Bureau of the Budget has advised that it has no objection to the submission of this report.

Sincerely yours,

DUDLEY C. SHARP,  
*Assistant Secretary of the Air Force.*



whether companies under common control have renegotiable sales in excess of the floor, transactions between members of the group are not counted as sales. This has an unintended result where brokerage commissions of more than \$25,000 are received by one such member from another. *It is recommended, therefore, that in determining for any fiscal ending on or after June 30, 1956, whether a group of commonly controlled contractors has exceeded the \$25,000 floor, commissions received by one member of the group from any other member thereof should not be eliminated.*

11. Industry and Government representatives expressed a general preference for renegotiation as compared with the type of profit-control provisions provided by the Vinson-Trammell and Merchant Marine Acts. The provisions of these acts will, however, come into operation automatically if renegotiation is allowed to terminate.

Before renegotiation is finally terminated, *it is recommended that the appropriate committees of the Congress review the entire profit limitation area, including the profit limitation provisions of the Vinson-Trammell and Merchant Marine Acts, for the purpose of determining whether these provisions are adequate, necessary, or workable. Such review should also include the scope and effect of price-redetermination provisions incorporated in procurement contracts.*

(C) LETTERS FROM THE DEPARTMENT OF THE AIR FORCE AND THE  
RENEGOTIATION BOARD

DEPARTMENT OF THE AIR FORCE,  
OFFICE OF THE ASSISTANT SECRETARY,  
Washington, D. C., May 31, 1956.

HON. HARRY F. BYRD,  
*Chairman, Joint Committee on Internal Revenue Taxation,  
Congress of the United States.*

DEAR MR. CHAIRMAN: This is in response to your request of May 24, 1956, to the Department of the Air Force for the views of the Department of Defense with respect to recommendations 1 through 11 which are contained in pages 3TU to 5TU of the galley print as revised, of Report of the Joint Committee on Internal Revenue Taxation Relating to Renegotiation. The Department of the Air Force has been designated to present the views of the Department of Defense with respect to these recommendations.

The Department of Defense has carefully reviewed the recommendations and strongly concurs in a 2-year extension of the Renegotiation Act of 1951, as amended.

The Department of Defense would like to suggest that the implementing legislation grant the President as well as the Congress the authority to declare a state of national emergency, which will affect certain of these recommendations. In addition, the Department of Defense understands that it will be given an opportunity to comment upon the implementing legislation. It is our further understanding that the Renegotiation Board has indicated that the proposed amendments with respect to the definition of standard commercial articles will assist the administration of the act.

This report has been coordinated within the Department of Defense in accordance with procedures prescribed by the Department of Defense.

The Bureau of the Budget has advised that it has no objection to the submission of this report.

Sincerely yours,

DUDLEY C. SHARP,  
*Assistant Secretary of the Air Force.*

THE RENEGOTIATION BOARD,  
Washington, D. C., May 31, 1956.

HON. HARRY F. BYRD,  
Chairman, Joint Committee on Internal Revenue Taxation,  
Senate Office Building, Washington, D. C.

DEAR SENATOR BYRD: You have requested a statement of the views of the Renegotiation Board on the recommendations proposed to be included in the report on renegotiation about to be submitted to the Congress by the Joint Committee on Internal Revenue Taxation, pursuant to Public Law 216, section 6, 84th Congress, 1st session, approved August 3, 1955.

As you know, the Renegotiation Board has cooperated closely with the staff of the joint committee by rendering technical assistance in the course of the study leading to this report. Certain of the recommendations reflect suggestions made by the Board itself for needed improvements in the Renegotiation Act of 1951, as amended.

The Board approves the recommendations 1 to 11, inclusive, in that the Board believes they would improve the administration of the Act within the areas in which renegotiation may be desired.

The Bureau of the Budget has advised that it has no objection to the submission of this letter.

Sincerely yours,

THOMAS COGGESHALL, *Chairman.*

## PART II. PRESENT LAW DEFENSE PROCUREMENT AND RENEGOTIATION

### (A) PROCUREMENT PRICING AND RENEGOTIATION

A defense procurement program at current levels involves serious pricing problems. In many areas the Government takes such a large part of the output of a product that it completely disrupts civilian market prices. In other areas the Government must purchase new articles which have no free market prices. In still other areas, in the interest of long-run economy, the Government makes purchases at something other than the lowest price available in the market, for example, to bring small business into defense production, to deal with a firm that can meet an early delivery schedule, or to place contracts in a labor surplus area.

A question about the ability of the normal competitive market to meet the needs of military procurement is recognized in the extension of numerous grounds for purchases through negotiated contracts under the Armed Services Procurement Act. Some 88 percent, by dollar volume, of procurement contracts by the Defense Department is done through negotiated contracts. The calculation for a negotiated price must cover, of course, the estimated accounting costs, and, also, must make allowance for a return on capital to be employed, a return for the risks to be incurred, and a return for the amount of management services that will be required. These latter returns, to the extent they exceed payments to outsiders, are called profits in the accounting sense. It may be seen, however, that the negotiated price must provide for such profits because there would be little reason to expect contractors to undertake Government business if the Government purchase price does not provide a return for these services comparable to what they could earn elsewhere. Thus, the initial Government procurement process, in fixing reasonable negotiated prices, must anticipate and provide reasonable profit.

The proposed Armed Services Procurement Regulation, section III, part 7, dealing with price negotiation policies and techniques, discusses the matter as follows:

*3-708.3 Profit.* As previously stated, there is no fixed formula for the establishment of a fair and reasonable estimate for profit. Where competition is adequate and effective and proposals are on a firm price basis, the Contracting Officer should concern himself with the amount of estimated profit included in a price only in the unusual case. However, when considered in the light of an individual procurement and the lack of competition or other knowledge does not permit acceptance of the initial quotations, there are certain factors which may affect the amount of the estimate of a fair and reasonable profit when negotiation of a price is necessary.

The factors cited in the regulation include: (1) degree of risk, (2) extent of Government assistance, (3) contribution to the defense effort, (4) character of contractor's business, and (5) contractor's performance.

Looking at the supplier's profit position is not different in essence from the procurement policy of a large-scale business firm. The firm attempts to purchase at market price or if the market price is considered too high then the firm expects to get the product at a price that covers cost and a reasonable profit. The weapon of the private firm to assure such a price is the prospect of producing the article itself. Large retail outlets have established their own brands and large manufacturing establishments have created their own sources of supply.

Even granting that the pricing of the bulk of defense procurement must be on the basis of making allowance for reasonable costs and reasonable profits it is still obvious that at the time of entering contracts these things are clouded in uncertainty. To deal with this the services have adopted a variety of contracting techniques. A fixed price contract may provide an escalation clause, a formula price adjustment for raw material price changes, wage rate changes, etc. The contract may provide for one or several price redeterminations. These may relate to future deliveries only or they may change the price for deliveries already made as well. The contract may provide a target cost and profit with provision for paying the contractor a certain percentage of cost savings from the target.

The renegotiation statute in the present law assumes that contract pricing alone, however careful, is not adequate to assure procurement at reasonable profit. There are two reasons for this assumption.

The first is that the contractor's entire operation, rather than merely the separate contracts, must be examined. A reasonable price for article A may be \$100 if this is the only article produced in a plant. If, later, a contract is placed for article B in the same plant it may develop that only very little extra labor, materials and management time are required, indicating a possible price for B of \$50. Although not all of the plant overhead should be carried by article A, the appropriate allocation may be a very difficult question. The renegotiation process does not attempt to recalculate the price of each contract, of which there may have been hundreds, but seeks to deter-

mine whether or not the total receipts and total profits were reasonable for the services performed.

The second reason is that the extreme contingencies involved in continual changes in design call for a look at the whole operation of a contractor, after the contingencies have materialized. With respect to these contingencies renegotiation attempts the very difficult task of evaluating the resulting profit in terms of what the contractor did to make the contingencies come out as they did. High quality performance should justify higher profits than routine performance.

Turning to the mechanics of renegotiation, every firm with renegotiable business must file an information return with the Renegotiation Board annually. The essence of this return for firms whose sales exceed the statutory minimum is a segregation of sales and costs between renegotiable business and other business. This is a cost problem not required for income tax accounting but is generally the sort of analysis that must be available for ordinary internal management, including Government contract negotiations.

The Renegotiation Act provides that contractors be reviewed for evidence of excessive profits on renegotiable business. Cases are screened by the Washington Board to eliminate those which can readily be dismissed as not having excessive profits. This takes from 6 to 8 weeks. About 12 percent are referred to regional boards for further processing.

The first step of the further processing is an accounting review. Segregation of renegotiable sales and allocation of costs between renegotiable and other sales are examined. Certain tests of allowable costs on renegotiable business are applied and various ratios are calculated which are later used to evaluate the contractor's performance.

On the basis of the reviewed accounting statement the regional board conducts a review of the contractor's profit following the guidelines of the factors relating to excessiveness of profits stated in the renegotiation statute. In practice much of this involves a review of performance, with evaluation of internal cost controls, rate of return, contribution to the defense effort and risk borne by the contractor. In addition to analysis of the accounting statement reliance is placed on the following techniques:

- (1) Cost comparison with other firms where the same product is involved.

- (2) Relative profit to sales ratios of similar firms where there is no identical product.

- (3) Performance reports by the procuring department on direct contracts, and reports from the prime contractor on subcontracts. In all of this analysis various special circumstances are taken into account.

The regional board may determine a clearance or a refund. In 78 percent of the cases completed by the end of 1955, the decisions of the regional boards were final. Under present Board regulations all regional board determinations involving profits of over \$800,000 are subject to approval by the Washington Board. It is estimated that these cases involve renegotiable sales of \$10 million or more. Any refund determination made by the regional board may be appealed to Washington by the contractor. A decision of the Washington Board may be appealed to the Tax Court. On the question of excessiveness of profits the Tax Court decision is final.

## (B) SUMMARY OF RESULTS OF RENEGOTIATION

*1. Departments named in the act or designated by the President*

Section 103 of the Renegotiation Act provides that contracts with certain agencies shall be subject to renegotiation, and that contracts with other agencies may be made subject to renegotiation if so designated by the President. The named and designated departments together with the respective applicable dates are as follows:

## Named in the act:

- Department of Defense
- Department of the Army
- Department of the Navy
- Department of the Air Force
- Department of Commerce
- Panama Canal Company
- Canal Zone Government
- General Services Administration
- Atomic Energy Commission
- Reconstruction Finance Corporation
- Housing and Home Finance Agency

## Designated by the President:

## July 1, 1951:

- Federal Civil Defense Administration
- National Advisory Committee for Aeronautics
- Tennessee Valley Authority
- Treasury Department
- United States Coast Guard

## October 1, 1951:

- Defense Materials Procurement Agency
- Interior Department
- Bureau of Mines
- United States Geological Survey

## November 1, 1951:

- Interior Department
- Bonneville Power Administration

## July 1, 1952:

- Interior Department
- Bureau of Reclamation

## October 1, 1954:

- Federal Facilities Corporation

*2. Financial results*

Table 1 is a compilation of the number of contracts entered into and the amount of such contracts for the fiscal years 1951 through 1955. This table includes all of the departments and agencies covered by the act with the exception of the Reconstruction Finance Corporation and the Federal Facilities Corporation for which there are no available data and the Defense Materials Procurement Agency which entered into no contracts subject to renegotiation.

TABLE 1.—Number of contracts and amount thereof entered into by departments and agencies as provided by the 1951 Renegotiation Act or Executive order

[Dollar figures in thousands]

	Fiscal years—					Total 1951-55
	1951	1952	1953	1954	1955	
Department of Defense (Army, Navy and Air Force):						
Number of contracts.....		114,993	93,125	75,596	76,589	860,303
Total value of contracts...	\$30,785,000	\$41,248,000	\$28,394,000	\$11,563,000	\$14,752,000	\$126,742,000
United States Atomic Energy Commission:						
Number of contracts.....	1,020	17,906	21,975	15,418	15,068	71,387
Total value of contracts...	\$1,242,292	\$1,101,797	\$2,739,515	\$1,700,191	\$904,377	\$7,688,172
Department of Commerce <sup>2</sup> ...	799	792	565	260	259	2,468
	162,994	239,164	120,859	65,526	72,244	664,754
Tennessee Valley Authority:						
Number of contracts.....	36,900	40,000	40,500	39,154	31,823	187,477
Total value of contracts...	\$200,771	\$233,642	\$103,512	\$39,282	\$25,159	\$602,467
Bonneville Power Admin- istration (Interior Depart- ment):						
Number of contracts.....	125	494	350	254	348	1,571
Total value of contracts...	\$12,749	\$30,318	\$24,340	\$14,240	\$16,556	\$98,203
National Advisory Commit- tee for Aeronautics:						
Number of contracts.....		25,616	17,358	2,338	2,580	47,892
Total value of contracts...		\$37,067	\$36,943	\$13,144	\$16,198	\$103,352
Bureau of Reclamation (In- terior Department):						
Number of contracts.....	5,008	7,196	8,875	7,705	8,161	36,945
Total value of contracts...	\$73,752	\$72,216	\$20,531	\$20,186	\$13,967	\$200,652
General Services Administra- tion:						
Number of contracts.....	1,498	209	376	29	34	2,056
Total value of contracts...	<sup>1</sup> \$263,767	<sup>1</sup> \$41,524	\$32,550	\$4,796	\$8,573	\$351,210
United States Coast Guard <sup>2</sup> (Treasury Department):						
Number of contracts.....	337	420	260	213	229	1,459
Total value of contracts...	\$21,192	\$21,464	\$10,640	\$22,288	\$8,162	\$83,746
The Panama Canal Company and Canal Zone Govern- ment:						
Number of contracts.....	7	15	20	29	71	142
Total value of contracts...	\$2,523	\$12,279	\$2,560	\$7,011	\$2,972	\$27,345
Housing and Home Finance Agency:						
Number of contracts.....	247	194	234	126	32	833
Total value of contracts...	\$14,356	\$36,505	\$34,105	\$8,667	\$2,659	\$96,292
Bureau of Mines (Interior Department):						
Number of contracts.....	93	85	83	132	109	502
Total value of contracts...	\$3,749	\$4,930	\$3,685	\$4,243	\$2,086	\$18,693
Geological Survey (Interior Department):						
Number of contracts.....	90	97	100	125	64	476
Total value of contracts...	\$3,875	\$4,348	\$2,907	\$2,614	\$1,259	\$15,003
Federal Civil Defense Admin- istration.....	5	41	23	31	47	147
	124	288	74	116	248	851
Number of contracts.....						713,658
Total value of contracts.....						\$136,692,740

<sup>1</sup> Includes only those contracts estimated to have a total cost in excess of \$25,000.<sup>2</sup> Does not include contracts under the amount of \$10,000.

Source: Departments and agencies covered.

Table 2 shows the total number of filings by contractors under the 1951 act through December 31, 1955. A filing can cover the results from one or hundreds of contracts. The table shows that there were filed with the Renegotiation Board a total of 144,161 cases. Of these 127,841, or 88.7 percent, were eliminated from consideration because they were either under the statutory minimum or they were screened out because the report showed no excessive profits. There were 17,187 cases, or 11.9 percent, of the total actually assigned to the regional boards for examination. Of this number 3,215 had not been completed as of December 31, 1955; 11,667 had been cleared; and 2,305, or 1.6 percent of the original filings, had been found to have excessive profits.

TABLE 2.—Total filings and their disposition through Dec. 31, 1955

	Number	Percent
Total filings received by the Board through Dec. 31, 1955.....	144,161	100.00
Less:		
(1) Number below \$500,000 statutory minimum.....	103,441	
(2) Number screened out (obviously no excessive profits)---	24,400	
	127,841	88.7
Number remaining for assignment to the Regional Boards.....	16,320	11.3
Assignments made without filings and other special cases.....	867	
Total assignments to the Regional Boards.....	17,187	11.9
Assignments:		
(1) Not completed as of Dec. 31, 1955.....	3,215	2.2
(2) Completed as of Dec. 31, 1955.....	13,972	9.7
(3) Cleared or otherwise disposed of.....	11,667	8.1
(4) Resulting in determination of excessive profits.....	2,305	1.6

Source: Renegotiation Board.

Table 3 shows the disposition of the assignments through December 31, 1955, in which the boards actually found excessive profits. Of the 2,305 cases, the renegotiable sales amounted to \$11,278 million, and \$380 million of excessive profits were determined. Subsection (B) of this table is an attempt to determine as far as possible the net recoveries to the Government made by the Renegotiation Board and from voluntary refunds and price reductions made to the Government. The table shows that net recoveries by the Board were \$115 million, and that net recoveries from voluntary refunds and price reductions amounted to \$92 million, a total of \$207 million. The voluntary refunds and price reductions recorded here are only those made in cases where the contractor has actually been renegotiated. The amount of voluntary refunds in cases where the contractors were screened out of renegotiation is not known. It should also be pointed out that these figures cannot be taken as absolute net recoveries because no allowance has been made for the tax deductible expenses incurred by the contractors in keeping records, segregating sales, and the like, in connection with renegotiation.

TABLE 3.—Disposition of assignments through Dec. 31, 1955, resulting in excessive profits and the net effect of voluntary refunds and recoveries by the Renegotiation Board since enactment of the 1951 act.

A. NUMBER OF DISPOSITIONS, THEIR SALES AND EXCESSIVE PROFITS DETERMINED BY THE BOARD <sup>1</sup>

Type	Number	Renegotiable sales involved (in millions)	Excessive profits determined (in millions)
By agreement.....	2, 195	\$10, 051	\$352
By order.....	110	1, 226	28
Total.....	2, 305	11, 278	380

B. NET RECOVERIES BY THE RENEGOTIATION BOARD AND NET RECOVERIES THROUGH VOLUNTARY REFUNDS AND PRICE REDUCTIONS TO THE GOVERNMENT <sup>2</sup>

	<i>In millions</i>
(1) Gross recoveries by Renegotiation Board.....	\$380
(a) Less: Tax effect <sup>3</sup> .....	\$247
(b) Administrative expenses.....	18
(2) Total offsets on gross recoveries.....	265
(3) Net recoveries by the Board.....	115
(4) Gross recoveries from voluntary refunds and price reductions to the Government.....	263
(a) Less: Tax effect <sup>3</sup> .....	171
(5) Net recoveries from voluntary refunds and price reductions.....	92
(6) Total net recoveries by the Board and from voluntary refunds and price reductions to the Government (3)+(5).....	207

<sup>1</sup> Source: Renegotiation Board.<sup>2</sup> Source: Data on gross sales and recoveries, Renegotiation Board.<sup>3</sup> Based on analysis by Internal Revenue Service.

Table 4 was prepared from material furnished by the Department of Defense. This table shows the Department of Defense expenditures for the years 1951 through 1955 and estimates for 1956 and 1957. The data are segregated between estimated renegotiable and nonrenegotiable expenditures.

TABLE 4.—Estimated breakdown of renegotiable status of Department of Defense expenditures 1951-57

[In millions]

	Fiscal years—						
	1951	1952	1953	1954	1955	1956, estimate	1957, estimate
Extent to which renegotiation applied.....	\$8, 039	\$20, 293	\$29, 938	\$22, 213	\$17, 546	\$16, 500	\$16, 500
Extent to which renegotiation did not apply.....	12, 004	18, 529	13, 775	18, 271	17, 993	18, 075	19, 047
Total expenditures.....	20, 043	38, 822	43, 713	40, 484	35, 539	34, 575	35, 547

Source: Constructed from data furnished by the Department of Defense.

## PART III. CONTINUATION OF RENEGOTIATION

## (A) CASE FOR CONTINUATION OF RENEGOTIATION

The message of President Eisenhower dated March 7, 1955, stated:

In spite of major improvements which we have achieved in our contracting and price redetermination operations, there nevertheless remains an area in which only renegotiation can be effective to assure that the United States gets what it needs for defense at fair prices.

If all prime contracts and subcontracts could be made at prices that were fair, not only in the light of the facts and circumstances then existing, but also in relation to all pertinent developments occurring later in the fiscal year of the contractor, principally additional production volume, and if all such present and future facts could be known by the procurement officer negotiating each individual prime contract, and by each industry purchasing agent negotiating each individual subcontract, there would be no need or justification for renegotiation at any time. Since this is not possible, it follows that an individual price that has been soundly negotiated and is honestly believed to be fair and proper at the time of the negotiation may prove, in relation to subsequent developments, to be unfair and improper in the sense that it yields excessive profits to the contractor. To the extent that renegotiation eliminates such excessive profits, it may be said to adjust the prices of the contractor to a level that is, once again, fair and proper in relation to all of the facts and circumstances surrounding the procurement.

In explaining the necessity for the continuation of renegotiation the Secretary of the Air Force, as spokesman for the Defense Department, in a letter dated May 2, 1956, to the Speaker of the House, recommending a 2-year extension, stated:

Essentially the same reasons which existed for the passage of the original act, and the extensions thereof, continue to exist. The estimate of expenditures subject to renegotiation for fiscal year 1956 will approximate \$16.5 billion, and the same order of magnitude is forecast for fiscal years 1957 and 1958. It seems clear that this sustained high rate of spending over the next 2 years, as compared to any so-called peacetime period, is a compelling factor in favor of extension.

While we have achieved major improvements in our pricing policies and contracting techniques, there nevertheless remains an area in which only renegotiation can be effective to assure that the United States gets what it needs for defense without paying excessive profits. In the changing technology of the defense effort, new equipment becomes more complex and past production and cost experience is not necessarily satisfactory for forecasting and avoiding unconscionable profits. This factor has increased dramatically in importance with the new urgency which has centered on the guided-missile and supersonic-aircraft programs. The problem is further complicated by the numerous changes and improvements which are necessarily introduced into production to achieve better performance, safety in flight, and producibility. Under such circumstances price redetermination and other pricing techniques cannot be considered a complete solution. Other factors also preclude close pricing to the extent desired. These arise principally in situations where the Government is unable to obtain the benefits accruing from extensive competition because of limited sources or proprietary situations.

Experience has proved that statutory renegotiation is an effective method of insuring against excessive profits, particularly where volume is abnormal. It has a salutary effect in contract pricing and has proved particularly effective in the subcontracting areas where maintenance of controls to prevent excessive profits is extremely difficult. In consideration of the very large percentage of dollars involved in subcontracting, renegotiation is particularly desirable and necessary.

Although this country is at peace, we recognize that the country is in a state of semimobilization and that, so long as defense expenditures continue at the present rate, we must do everything in our power to see to it that the maximum return is received for each dollar spent. Extension of the Renegotiation Act of 1951 is an important step in achieving this objective.

#### (B) CASE AGAINST CONTINUING RENEGOTIATION

The following is a summary of the arguments received against the continuation of renegotiation:

Since the Korean war competition has reemerged in a vast number of markets, and in these areas competition is adequate protection against excessive prices and profits. In the area of highly specialized production where competition may not be significant the best protection against "excessive profits" is the use of the technical skill of the procurement personnel because they have had adequate time to acquire expert skills with which to deal with this problem. As long as Government buyers know that there will be a "second look" at the profits under the contracts they will continue to "lean on the crutch" of renegotiation instead of relying on their own adequate training and skill.

An examination of the Renegotiation Act and a study of its operation reveal its obvious unfairness and capriciousness. After a contract price has been agreed upon a contractor making a profit may later find that a large portion of his profit is eliminated by the imposition of a 100 percent tax on what the Board deems excessive profits. If the contractor had suffered a loss, he would have had no remedy at all. Furthermore, the manner in which the act attempts to eliminate excessive profits is capricious. Although the act sets out certain factors to be considered by the Board in determining the amount of excessive profits, these factors are so vague that their application by the Board amounts to no more than an arbitrary judgment, as evidenced by differences of very substantial amounts between determinations of the Washington and regional boards.

Renegotiation discourages efficiency and incentive by reducing profits of contractors engaged in defense work. One unfortunate result of this policy is that more and more efficient producers are avoiding renegotiable business and entering the commercial field where their efficiency will be rewarded. Also within the renegotiation field itself efficiency is not properly rewarded. An efficient producer may manufacture an item and sell it for \$950, making a profit of 25 percent. An inefficient producer sells the same item for \$1,000 and makes a profit of only 10 percent on the same volume. In spite of the fact that the efficient contractor sold the item at a considerably lower price, it is that contractor and not his inefficient competitor who will be renegotiated. This tendency to discourage efficiency causes contractors to be less interested in efficiency when engaged in renegotiable business.

The recordkeeping required and the dealings with the Board are time-consuming and burdensome, particularly on small businesses who do not, as a general rule, have regular full-time accountants and attorneys.<sup>3</sup>

<sup>3</sup> One industry group presented the following data as to compliance cost within its industry:

"While the expenses of operating the Renegotiation Board and the amount of tax refund arising from recoveries on renegotiable business can both be ascertained with reasonable accuracy, the question of how to measure the cost of industry compliance is understandably difficult. In our prior statement, we estimated the cost to be in the neighborhood of one-tenth of 1 percent of renegotiable sales. This figure, how-

Delay in processing renegotiation cases also creates a dilemma for contractors, especially in the case of small business. Although contractors might personally feel that their profits from defense contracts were entirely reasonable, they are very reluctant to invest their liquid assets in expansion or improvement of plant and facilities or distribute profits as long as there is a possibility that they may be renegotiated at a later date.

#### (C) PROCUREMENT PROCEDURES AS A SUBSTITUTE FOR RENEGOTIATION

It has been asserted that careful defense procurement policy should result in such close pricing as to substantially eliminate excessive profits and thus the need for renegotiation. A number of aspects of this contention deserve separate comment.

(1) It is often argued that greater reliance on formal advertised competitive bidding will make greater use of competitive forces in the economy and reduce the need for renegotiation. Successful use of this technique requires a large number of suppliers effectively bidding against each other on a product with definitive specifications. It is readily seen that this is substantially the situation referred to in the discussion of the standard commercial article exemption. Recommendations are made for considerably liberalizing the standard commercial article exemption in present law. With this more liberal exemption it will be seen that in fact there will not be a great deal of

ever, was based on experience of companies in our industries during the peak of military procurement. In order to bring this up to date and make it more meaningful to the committee in terms of specific situations, a recent sample check was undertaken of company experience within the various capital goods industries which comprise our membership. The results reveal a number of significant facts and trends which the committee might wish to take into consideration.

*Increased administrative costs.*—The first of these is the almost universal experience among companies polled of sharply rising administrative costs of compliance with renegotiation when measured in terms of a percentage of renegotiable sales. One of the unfortunate phenomena of renegotiation is the tendency for industry costs of salary and overhead directly attributable to the renegotiation process to remain almost constant regardless of the recent decline in volume of renegotiable business occasioned in large part by a shift in the type of procurement and to some extent by the various statutory and administrative exemptions.

Thus, with most companies in the capital goods and allied industrial equipment industries having experienced a sharp decline in renegotiable business and currently devoting only a small portion of their industrial capacity to Government business, the ratio of costs to renegotiable business has soared. The result has been to reduce, in most instances, the net recovery to the Government on refunds which reasonably can be anticipated for 1954, 1955, and 1956 to a minus figure.

While our study confirmed our previous assumption that the cost to medium and small business would be appreciably greater than that for the larger companies, it was significant that for the year 1954—and thereafter—a number of the larger companies have indicated that their costs are running higher than the one-tenth of 1 percent. In no instance did the survey reveal that this figure was higher than the experience of the reporting company.

Admittedly, military procurement represents only a small portion of capital goods industries' production. Those few companies in our economy whose productive capacity is currently devoted in large part to present and future military weapons and systems might possibly experience a smaller cost-of-compliance ratio than that prevailing in our industries. The cost in dollars, however, even in these situations, undoubtedly remains exceedingly high.

*The effect of amendments.*—While various statutory amendments have reduced the amount of receipts and accruals subject to renegotiation, the administrative costs for most of those companies which remain under the act on some part of their sales continue at their former level. In the case of the standard commercial article exemption—which has been so narrowly construed as to make it practically inapplicable to any of our growth industries—the cost of additional filing and substantiating a SCAR each year has actually added to the administrative burden for most companies without corresponding benefits to anyone.

#### *Drain on management*

While the acute shortage of scientists and engineers has been widely publicized, the business community and the Government are also keenly aware of the growing shortage of well-trained management personnel. As the complexities of business administration increase, not only in production and research but in such areas as human relations, finance, taxation, etc., every company—and particularly a smaller one—finds it increasingly difficult to keep adequately staffed. It is not uncommon for the comptroller, the financial vice president, or even the president of a company to devote a significant amount of time to a renegotiation case which, based on current experience, is apt to take some 3 years to process unless an inordinate amount of time is spent to try to speed it through.

In this situation, the diversion of professional manpower to the complex and time-consuming task of renegotiation represents more than an item of cost to the taxpayer; it constitutes a drain on our economy of an already scarce commodity—professional manpower. The benefits to be obtained from continued renegotiation must be carefully evaluated, and the findings would have to be very favorable indeed to justify the inherent waste. In our judgment, the case has not been made in the present situation."

renegotiation in those areas where advertised competitive bids are used.

(2) Within the area of negotiated contracts a number of contract techniques have been employed that deal with many of the contingencies which could cause a reasonable procurement price to produce an unreasonable profit. These are summarized below:

(a) Firm fixed-price contract: Suitable where there is little uncertainty.

(b) Fixed-price contract with escalation: Escalation clauses deal with contingencies beyond the control of the contractor, such as material prices. Generally, escalation may be up or down, but a ceiling is provided. Actually such clauses are used rarely.

(c) Fixed-price redeterminable: A procurement contract may provide a tentative price with provision for redetermination of price at one or more later points in time. The redetermination may go to fix prices on future delivery only or it may provide price adjustment for both past and future deliveries. Redetermination can result in upward or downward price adjustment. Generally the redetermination is set before 20 percent of deliveries are made or 30 percent of cost of performance is incurred. Redetermination upon completion of the contract is rare.

(d) Fixed-price incentive contract: A target price is set as the sum of target costs plus target profit. As experience shows a different cost the price is adjusted according to an agreed formula. Most commonly 80 percent of the cost saving goes to the Government and 20 percent to the contractor. A ceiling price is provided. Actually, this technique is sometimes combined with redetermination by not adopting a firm target price until some production is under way.

(e) Cost reimbursement type contracts: Two forms of cost reimbursement type contract are important. The cost-plus-a-fixed-fee is used in cases where very great uncertainty is involved in the production operation. Ordinarily the fee must not exceed 10 percent of the initially estimated cost. A cost-plus-incentive-fee contract is also used which provides for increasing the fee if the contractor operates below a target cost or decreasing it if above.

In terms of dollar value, 40 percent of Defense Department procurements in fiscal year 1955 was under firm fixed-price contracts (this includes the 15 percent of procurement under advertised competitive bids); 24 percent was under incentive contracts; 20 percent were under cost-plus-fixed-fee; 13 percent under contracts providing for price redetermination; and the remaining 3 percent were no-fee contracts and cost reimbursement contracts based on time and materials. The principal change in contract forms since fiscal year 1951 has been a declining use of contracts with price redetermination. This form accounted for about one-third of Government procurement in fiscal years 1951 and 1952. Detailed figures are contained in table 1 in the appendix.

Potentially, the contracting officers have considerable means of dealing with cost uncertainties even in the cases of new and experimental products, major changes in design and specifications, and major changes in the scale of procurement. A difficulty arises, however, in trying to work all of this out on a contract by contract basis.

The most difficult problem in accounting for costs is the allocation to separate products of a cost incurred to turn out two or more products. For example, a firm buys a machine and trains a crew of operators to turn out a product for the Navy. The reasonable price, say \$100, agreed to by the Navy must cover the training costs, and the depreciation and maintenance on the machine. For relatively little extra cost, say \$30, the company may be able to turn out, at the same time, a product for the Army. How should the overhead now be divided to establish reasonable prices for the two products? Price redetermination on a separate contract basis would involve almost endless disagreement over the proper cost allocation to each product.

This situation is clearly recognized in one system of cost accounting, the direct cost method. Under this method no effort is made to calculate an arbitrary allocation of the part of overhead cost which does not vary directly with the output of each product. Instead, the variable costs of the product are computed and together with the price of each product, provide a calculation of contribution that each product makes toward meeting overhead cost and profit.<sup>4</sup>

It is apparent from this that renegotiation on the basis of the contractor's overall business is preferable to extensive repricing on each contract.

A further limit to reliance upon flexible contracting techniques is the variety of changing circumstances encountered. Because of the developmental nature of much military procurement there must be a fairly continuous interchange of information between contractor and purchaser. Some design improvements will begin with the contractors, some design improvements may begin with the Government. It can be argued that adequate rewards for changes reflecting good management can only be made on the basis of a review after the fact.

(3) The foregoing material deals with the ability to make reasonably accurate forecasts to implement a procurement "bargain," worked out between equals. It is not necessarily true that bargaining positions will be equal. Once the services have adopted a general requirements program their needs become fairly rigid and substitutions are often difficult. This is reflected in the fact that they have often gone to extra expense to develop alternative sources. The departments might also find themselves at a bargaining disadvantage in purchasing proprietary items. The Government does not have the same ability in this situation as a large business firm to bargain through the threat of making the product itself. The services do have a limited bargaining ability in some of these situations arising from the prospect of extending loans to help establish a new business to make the product.

In essence the Departments must, in a large procurement program, put themselves in a number of inflexible positions from which they cannot bargain effectively.

(4) There is no reason to expect that the experience of service procurement personnel will match the experience of business representatives. Business firms will pay to hire the best people available. Contracting officers in the services are rotated in the career development program, and capable civilian employees are often recruited by industry.

<sup>4</sup> R. P. Márple, *Direct Costing and the Uses of Cost Data*, *The Accounting Review*, July 1955.

(5) It has been argued that as long as Government buyers know that there will be a "second look" at the profits under the contracts they will continue to "lean on the crutch of renegotiation" instead of relying on their own training and skill. It is noted that in the Department of Defense, notwithstanding its endorsement of renegotiation, procurement personnel are instructed that no reliance whatever is to be placed upon renegotiation in the negotiation or redetermination of contract prices. This is desirable to economize the Department's appropriation since renegotiation refunds go to miscellaneous receipts of the Treasury and are not available for reexpenditure.

(D) VINSON-TRAMMELL PROVISIONS AS A SUBSTITUTE FOR  
RENEGOTIATION

Certain profit limitations under what are commonly known as the Vinson-Trammell provisions are suspended during the effective operation of the Renegotiation Act of 1951 by section 102 (d) of the act. These provisions<sup>5</sup> limit profits on contracts and subcontracts thereunder for naval vessels and for ships for the Maritime Administration to 10 percent of the contract price, and in the case of Army and Navy aircraft to 12 percent of the contract price. These provisions were suspended during the effective period of the World War II excess-profits tax, and through the effective period of the 1948 renegotiation statute.

Upon discontinuance of the Renegotiation Act of 1951 the Vinson-Trammell profit limitations that would come into effect would be as follows:

1. Profits on contracts and subcontracts thereunder in excess of \$10,000 would be limited to 10 percent of the contract price in the case of naval vessels and ships for the Maritime Administration, and to 12 percent in the case of military aircraft.

2. Computation of the excess of profit above the percentage limitation would be made on the basis of all of the contracts with each individual department completed by the contractor within an income taxable year.

3. A net loss, or a net deficiency in the allowable profit, would be allowable as a credit in determining excess, if any, during the next succeeding 4 income-taxable years. However, since these provisions are applicable to Army and Navy contracts separately, the net loss, or deficiency in profit carryover, would not be applicable interchangeably in the case of such contracts. For example, net loss or deficiency in profit in the case of contracts for naval aircraft could not be offset against excess profits computed in the case of contracts for Army aircraft.

4. Under the amendments of 1936 an exemption was provided for certain categories of naval scientific equipment if designated as exempt by the Secretary of the Navy. This is in contrast to the arguments used by the Department of Defense in urging the continuation of renegotiation that it is in the field of new production that it is most difficult to negotiate reasonable contract prices.

5. If any receipts or accruals under a long-term contract were subject to renegotiation, then the Vinson-Trammell provisions would

<sup>5</sup> Act of March 27, 1934 (48 Stat. 503, 505), as amended and supplemented, and sec. 505 (b) of the Merchant Marine Act of 1936 (49 Stat. 1998), as amended and supplemented (46 U. S. C. 1155 (b)).

never apply to any part of that contract including amounts received or accrued after the termination of renegotiation.

It is the position of the industry groups which opposed extension of the renegotiation statute that the continuation of the Vinson-Trammell provisions would be less desirable than the renegotiation provisions.

It is the position of the Treasury that the Vinson-Trammell provisions urgently require review and clarifying amendment.

This uniform flat percentage profit limitation legislation was opposed by the military departments and the War Production Board just prior to the adoption of renegotiation in World War II. Included in the arguments against it were: that it places contracts on a cost-plus basis; that the rate of profit should be related to the contribution and performance of the contractor instead of to a flat statutory percentage; that allowing a uniform percent of profit on gross sales is unfair as applied to different types of business, where the same volume of sales may involve widely different amounts of capital, skill, and work, levels of subcontracting, and other differences; and that it is unfair in treating alike those contractors who use Government facilities, those who are financed by the Government either through advance payments, direct loans or cost-plus-fixed-fee contracts, and others who use their own facilities and capital.

The present Vinson-Trammell provisions do not seem to be an appropriate substitute for renegotiation.

#### (E) CONCLUSIONS ON CONTINUATION OF RENEGOTIATION

Under normal conditions contractors and the Government should have definiteness and finality in their relationship which are not obtainable under renegotiation. For this reason renegotiation should not become permanent. However, during the next 2 years there will be a need for some form of profit control in the defense procurement area. At the present time there is no ready substitute for renegotiation. It is, therefore, recommended that the Renegotiation Act of 1951 be extended to apply to receipts and accruals after December 31, 1956, and before January 1, 1959.

It might be pointed out that legislative and other delays and resulting uncertainties have beset the Board from the outset. The act, although effective from January 1, 1951, was not enacted until March 23, 1951. The Board was not appointed and organized until October of that year. The first extension of the act, which continued its coverage from 1953 through December 31, 1954, was not enacted until September 1, 1954. The second extension of the act, through December 31, 1956, was not enacted until August 3, 1955. Each of these delays necessarily compelled the Board to grant substantial blanket extensions of time for all contractors to file renegotiation reports for the affected years, until the act could be renewed and filings prepared to reflect the effect of the substantive amendments made with each extension. Beginning with 1954 fiscal years, further delay has been occasioned by the standard commercial article exemption made applicable to such years. The cases of contractors who claim that exemption for only a part of their renegotiable sales, or whose exemption claims are denied, obviously cannot be completed or even satisfactorily processed until Board action on their exemption claims has been concluded.

In view of the foregoing, it is evident that if renegotiation is to be continued beyond 1956, extension legislation should be enacted in the current session of the Congress. A retroactive extension of the act enacted in a later session would cause similar uncertainties and administrative delays.

It is very important to take note that the Vinson-Trammell provisions will automatically come into effect if renegotiation is not continued. It is recommended, therefore, that before discontinuation of renegotiation, the whole subject of profit limitation on defense business, including the Vinson-Trammell provisions, be given thorough study and review by the appropriate committees of the Congress.

#### PART IV. IMPROVEMENTS OF RENEGOTIATION

##### (A) MINIMUM AMOUNT SUBJECT TO RENEGOTIATION

The act provides that renegotiation will not apply to contractors or subcontractors whose receipts or accruals from renegotiable contracts for fiscal years ending before June 30, 1953, are not more than \$250,000.<sup>6</sup> This amount was raised to \$500,000 for fiscal years ending on or after June 30, 1953.<sup>7</sup>

Under the present law the holder of any contract entered into with one of the designated departments or agencies, or of any related subcontract, must file a report with the Renegotiation Board, although if his renegotiable sales aggregate less than \$500,000 in his fiscal year he cannot be renegotiated. The following table shows the number of refund cases and the amount of refunds in the sales categories under \$500,000, \$500,000 to \$1 million, and \$1 million and over, under the 1951 act, through December 31, 1955:

Renegotiable sales	Cases		Refunds	
	Number	Percent of total	Amount	Percent of total
Under \$500,000.....	696	30.19	\$21,243,000	5.59
\$500,000 to \$1,000,000.....	599	25.99	32,340,000	8.51
Over \$1,000,000.....	1,010	43.82	326,449,000	85.90
Total.....	2,305	100.00	380,032,000	100.00

The table shows that, if the statutory floor had been \$500,000 at the outset, 696 cases, or about 30 percent of the total, would have been eliminated and that these cases involved gross refunds amounting to about \$21 million. Had the floor been \$1 million at the outset, there would have been eliminated 599 additional cases, involving gross refunds of approximately \$32 million. At the present about 80 percent of the annual filings represent sales of less than \$500,000. An increase in the floor to \$1 million will substantially increase the percentage of filings below the floor.

Various recommendations have been made to aid small business insofar as renegotiation is concerned. It has been pointed out that increasing the floor to \$1 million and eliminating or making optional the filing where renegotiable sales are less than this amount would be of tremendous value and aid to small business. In addition, it

<sup>6</sup> Sec. 105 (f) of the Renegotiation Act of 1951.

<sup>7</sup> Sec. 2 (a) of Public Law 764, 83d Cong., approved September 1, 1954.

would enable the Board to concentrate on the larger cases. It is, therefore, recommended that the statutory floor of \$500,000 be increased to \$1 million effective for fiscal years ending after June 30, 1956.

(B) STANDARD COMMERCIAL ARTICLE EXEMPTION

1. *Present situation*

An amendment approved September 1, 1954, added to the mandatory exemptions from renegotiation, contracts and subcontracts for standard commercial articles. By an amendment approved August 3, 1955, standard commercial services were also exempted. The exemption applies only if the contractor files a report and, within 6 months thereafter, the Board makes a specific finding "that the competitive conditions are such as will reasonably prevent excessive profits," or fails to make a contrary finding. The determination by the Board on the allowability of this exemption is effective for only 1 year, and the exemption, if desired, must be claimed annually by a contractor. The terms "standard commercial article" and "standard commercial service" are defined in the act in detail. Nevertheless, these definitions are broad enough to raise very complex problems. This is particularly true of the expression "standard commercial article," which, in general, is defined as an article which is customarily maintained in stock, or which is (or is "identical in every material respect" with) an article sold by two or more persons for general civilian use.

Pursuant to this provision, 1,485 contractors filed applications with the Board through December 31, 1955, for exemption of more than 4,000 separate classes of products. Represented in these claims were a great many segments of American industry, including contractors who compete only in local areas as well as those who compete in larger areas. Of the applications filed, 1,265 were processed by December 31, 1955. These totaled \$2,035 million of sales, as estimated by the claimants, and involved hundreds of thousands of different products, ranging widely in usage and complexity. Most applications involved a number of products; some involved hundreds of products. Some products, of course, appeared many times, in separate applications.

Of the 1,265 applications processed, over half or 720 were granted in full and 330 were denied in full. The remainder, 215, were granted in part and denied in part.

In terms of sales dollars, however, exemption was granted to approximately \$680 million of the total of \$2,035 million claimed, or only 33 percent. More than half of the denials were for 1 or the other of 2 reasons:

(1) The items failed to qualify under the statutory definition of standard commercial articles or services (many involved jet fuel and other special military fuels, and numerous other items of purely military character); or

(2) The Federal Trade Commission or the Department of Justice advised the Board that the contractor was charged with violating one or more of the antitrust laws in the sale of the articles for which exemption was claimed. The Board considered itself obliged in such cases to make specific findings that the competitive conditions were not such as would reasonably prevent excessive profits.<sup>8</sup>

<sup>8</sup> With respect to the claims denied on the ground of competitive conditions, the Board's analysis has been limited to those cases which involved sales in excess of \$5 million each.

A tabulation of the foregoing results follows:

	Number	Amount (thousands of dollars)
(a) Number of exemption applications filed through Dec. 31, 1955.....	1,485	
(b) Number and dollar volume granted.....	720	\$500,000
(c) Number and dollar volume denied:		
1. Denials on ground of definition.....	70	100,000
2. Denials on ground of competition.....	260	290,000
(d) Number granted in part and denied in part, indicating dollar volumes and grounds of denials.....	215	
1. Granted.....		180,000
2. Denials on ground of definition.....		355,000
3. Denials on ground of competition.....		610,000
Total.....	1,265	2,035,000

If no charges are pending against the contractor in connection with the article for which exemption is claimed, then to determine whether competition was reasonably sufficient to prevent excessive profits, the Board directs its attention to such factors as these:

1. Individual industry conditions, the supply and demand situation and profits.
2. The customary level of industry profits for the product classes involved.
3. The proprietary or nonproprietary character of the product, including the significance of patents or trademarks.
4. The sources of demand for the articles as related to and affecting sales.
5. The influence of marketing and pricing practices and number of competitors on the effectiveness of competition.

In considering these matters, the Board endeavors to place itself at the threshold of the transaction and to appraise, prospectively, the likelihood of excessive profits resulting from the competitive conditions then prevailing. The determination is made on the basis of the competitive situation found to exist at the time of sale. The Board may find the contractor's original filing of application for this exemption to be inadequate and may ask for more information. The Board need not make its decision until 6 months after an acceptable application is filed, which almost always is after the close of the year in question. Even then a new filing is required for the next year.

When the standard commercial article exemption is denied, this does not mean that the Board has thereby decided that the contractor has made excessive profits. It only means that the Board will treat these contracts as renegotiable. If the Board later decides that the contracts claimed to be exempt did produce excessive profits, the Tax Court may review the Board's finding on the right to the exemption in its de novo consideration of the whole question of excessive profits.

## 2. *Proposals and analysis*

Generally industry complaint over the standard commercial article exemption is directed toward: the complexity of filings required to cover information on competitive conditions; the arbitrariness of the decision which the law forces on the Board about effectiveness of competition; and the arbitrariness of the decision forced on the Board as to whether a given article is "identical in every material

respect with" another article which qualifies as a standard commercial article.

Any exemption for a category called standard commercial articles or services will, of necessity, involve some complexity and judgment factors. To improve the operation of the exemption within its present broad objective, the following proposals are pertinent:

(a) It has been proposed that the language in the present statute, which requires a test of competitive conditions which may "reasonably" be expected to prevent excessive profits, be eliminated. There are three reasons for urging this proposal:

(i) The elimination of the competitive conditions test is especially desirable at the present time in standard commercial fields. High profits in these areas today are more likely to be due to quality performance rather than limited supply or lack of competition.

(ii) The administration of the "competitive conditions" test requires the contractor to furnish complex and expensive information regarding competition in his business. Even after this information is furnished the judgment of the Board on the question of what is adequate competition is often necessarily arbitrary. Furthermore, the Board is required to spend a great deal of time administering this provision. To a large extent this effort may be pointless since the determination that competition is inadequate does not necessarily mean excessive profits are present and will be refunded to the Government.

(iii) The test could also be opposed on the grounds that as long as the Government was buying on the same terms as the civilian economy (i. e., getting the same quantity discounts, and so forth, as civilians) there should be no renegotiation. If there are monopolistic practices that affect both civilians and Government, these should only be dealt with by effective proceedings by the Department of Justice or the Federal Trade Commission.

The first two of these reasons are sufficiently persuasive so that it is unnecessary to pass judgment on the third. Thus it is recommended that the competitive conditions test be abandoned. It is recommended, however, that the broad exemption for all standard commercial articles not be applicable in a period which has been declared by the Congress to be a national emergency. It would be in such periods in particular that we could expect to find shortages and lack of competition at numerous points throughout the economy.

(b) Substantial changes should be made in the definition of a standard commercial article. The tests now contained in the statutory definition are not easily administrable. Among other things, they are not limited to the situation of the particular contractor claiming the exemption, but require examination of the circumstances of other contractors, or of an entire industry. Thus, an article cannot properly qualify as one that is "customarily maintained in stock" by manufacturers or dealers, within the meaning of the exemption provision, unless a sufficient supply is used to meet a significant commercial demand as well as to fill defense orders. Only a determination of the proportion of the total industry output of the article that is customarily sold to fill commercial orders could furnish a complete solution of the problem. Neither the contractor nor the Board has such information, nor can they ascertain it with reasonable accuracy. Similar

difficulties are inherent in the other tests embodied in the present statutory definition.

The following proposals are recommended:

1. If an article is customarily maintained in stock by the contractor and if sufficient sales are made by him for general civilian industrial or commercial use, it should automatically qualify as a standard commercial article without requiring the contractor to file an application and obtain the approval of the Board.

The stock test in the statutory definition was devised on the theory that when an article passes freely in commerce, a supply of the article is likely to be maintained by the manufacturer or its dealers or distributors. This type of stock maintenance is ordinarily accomplished on a maximum-minimum inventory basis, and is to be distinguished from the production of particular quantities of the article to fill specific orders. That such stock maintenance is the usual criterion of a standard commercial article is borne out by the fact that a preponderance of the articles which have qualified as standard commercial articles under the present statute have done so under this stock test.

In order to make the stock test workable, it is believed necessary to provide that a prescribed percentage of his sales of a stock item must be sold in the particular year for general civilian industrial or commercial use by the particular contractor who claims the exemption. With rare exceptions, every contractor who has applied for the exemption on the basis of the stock test under present law has claimed it on the ground that he, himself, stocks and sells the article. Only in a few unusual cases has a contractor claimed exemption on the ground that, although he does not stock the item himself, other manufacturers do. Therefore, no substantial change in operation of the exemption would be brought about if the act were to state expressly that the stock basis of exemption is limited to contractors who stock and sell the article themselves. For purposes of the stock test, it is suggested that at least 35 percent of the dollar amount of the contractor's sales of the particular item, in the fiscal year, must be for general civilian industrial or commercial use.

The stock test has the virtue of being simple and understandable. As such it may easily be applied by contractors themselves under proper regulations, without further Board participation unless it should appear in the renegotiation of other sales of the contractor that the exemption has been abused or misapplied. Such a provision could be readily applied by the contractor because all of the facts pertinent to the determination would be within his knowledge. It substitutes company standard for industry standard in the exemption of commercial articles.

In applying this test, contractors should not be permitted to group articles, however similar they may be, and to take the exemption for the entire group where only some of the articles are stocked and sold commercially in the prescribed percentage. The stock test is intended to apply to individual articles, not groups or classes of articles. The other articles in the group may still be exempted under the substantial identity test, by application to the Board, as described below.

The operation of the proposed stock test may be illustrated by the following example: Assume that a company manufactures and stocks typewriters of various models which it sells to military departments as

well as to civilian purchasers. If at least 35 percent of the dollar amount of sales of a particular model in a particular year is made to civilian purchasers on nonrenegotiable orders, such item will qualify under the stock test, and the sales of typewriters of that model to military departments during that year may be excluded from negotiable sales without the necessity of filing an application and obtaining the approval of the Board.

2. Although an article is not maintained in stock, if it is listed in price schedules regularly maintained by the contractor, and if sufficient sales are made by him for general civilian industrial or commercial use, it should similarly qualify as a standard commercial article without requiring the contractor to obtain the approval of the Board.

A number of producers find that the articles they produce are required in a wide variety of sizes, forms, and shapes with varying degrees of thickness, hardness, and strength. As a consequence, these producers find it impossible to manufacture for stock to any substantial extent. Instead they manufacture to the customers' specifications, only after orders for particular articles are received. Although these articles are not carried in stock, they are priced and sold from regularly maintained catalogs or price schedules which are available to all purchasers, Government and civilian alike. While orders for certain specifications may be more frequent than orders for others, the number of possible product varieties is limited only by the capacity of the manufacturers' productive equipment. Such catalogs or price schedules commonly specify price variations corresponding with product variations or with the quantity of the order or the terms of the sale.

Part of the manufacturer's articles may be sold to commercial buyers and the remainder to Government departments. Where the articles are sold at the same prices and terms, from regularly established price schedules, on both negotiable and nonnegotiable orders, no distinction should be made between the manufacturer who produces for stock and the manufacturer who produces to customer specification. The only essential difference between the two is that one manufacturer can anticipate his customers' requirements and the other cannot.

Here again it would be necessary to provide that a certain percentage of the dollar sales of the article must be made by the contractor himself for general civilian industrial or commercial use during the fiscal year in order for the article to qualify for exemption under the catalog test. As in the stock test it is recommended that the percentage be fixed at 35 percent. This test should not apply to groups or classes of articles. Each model of each product is considered a separate article and must qualify separately under this requirement of 35 percent civilian sales if it is to qualify under the catalog test.

3. The "substantial identity" test should be clarified and Board control over its application should be retained.

Under the present act the term "standard commercial article" includes an article which is "identical in every material respect" with an article manufactured and sold by more than two persons for general civilian industrial or commercial use. "Identical in every material respect" is defined to mean "of the same kind, manufactured of the same or substitute materials, and having the same industrial or commercial use or uses, without necessarily being of identical specifica-

tions." Experience has demonstrated that it is virtually impossible to establish fixed and precise meanings, of uniform and universal applicability, for the phrases "of the same kind" and "having the same use." Since these terms can have such a variety of meanings it is obvious that widespread abuse could result if they were thrown open to contractors to apply as they saw fit. It is recommended, therefore, that the requirement of a filing be retained in the case of any contractor who makes his claim for exemption on the basis of the substantial identity test.

The test itself can be considerably improved, however. The requirement of sameness of kind seems proper, even though the concept defies precision, since no two articles of different kinds could possibly qualify as identical in every material respect. But "use," except insofar as it helps to establish kind, is not a determinant of identity. Even identical articles may be applied to different uses. The problem is compounded by the present statutory requirement that the two articles under comparison must have the same industrial or commercial use. Under this language even the slightest variation imposed by the military on an item of wide commercial usage might suffice to disqualify it from the exemption because the argument could be made that the military item, since it has no commercial use, cannot possibly be said to have the same commercial use as another article.

Before attempting to rephrase the substantial identity test it may be well to review the purpose of Congress in establishing such a test. Commercial articles manufactured and sold by more than two persons were exempted on the theory that the prices of such articles were established and tested by competitive pressures in the market place, and that this circumstance furnished adequate assurance against excessive profits. It was recognized, however, that an exemption so limited would not cover articles which, although not themselves articles that could boast competitively established prices, were yet so similar to such articles that the same assurance against excessive profits could reasonably be expected to prevail. The substantial identity test was, therefore, written into the law. The test takes cognizance of the fact that a Government procurement officer or an industry purchasing agent, knowing or ascertaining the established market price of an article, would be in a secure position when negotiating a prime contract or subcontract price for a substantially similar article. Presumably, he would be able to obtain a price that presented no greater likelihood of excessive profits than the price of the competitively tested article used for comparison.

Instead of same use, therefore, it is recommended that reasonably comparable price be included as an element of the substantial identity test. Comparable prices are usually found with comparable articles. If prices are not comparable there is a greater likelihood that the articles are not sufficiently similar to afford protection against excessive profits.

If the factors of kind, content, and price were substituted for the kind, content, and use factors of the present act, a satisfactory three-fold criterion should be available for exempting an article on the ground of its similarity to another article.

It is believed that the substantial identity test must be applied on a company basis rather than an industry basis. Therefore it is recommended that exemption under this test be limited to articles which

are identical in every material respect with articles which the contractor himself maintains in stock or in a price schedule for general civilian industrial or commercial use. Such a provision can be readily administered because all of the facts pertinent to the determination are within the knowledge of the contractor and may be fully presented to the Board. The issue would become considerably more involved, and would go beyond proper control, if comparisons were required to be undertaken with articles produced by other manufacturers, involving consideration of physical differences, price differences, and the extent of the commercial sales of such other articles. To make such comparisons would require information relating to an entire industry which is not available to the contractor or the Board.

The phrase "of the same kind" in the substantial identity test should be fairly narrowly construed to exclude unreasonable deviations from the article offered for comparison. For example, an ultra-precision bearing manufactured to extremely close tolerances is not considered to be an article of the same kind as a bearing manufactured to much wider tolerances. Also, a capacitor for an aircraft electronic assembly, having an estimated reliability ratio of 1 unit in 20,000 units and requiring 40 hours to manufacture, is not considered to be an article of the same kind as a capacitor for a commercial radio, having an estimated reliability ratio of 1 unit in only 200 units and requiring only 2 hours to manufacture. The term should also be construed to exclude obviously unlike articles which, for accounting or other purposes of the contractor, may be grouped together by him in a single general classification. Ordinary commercial plate and armor plate, for example, are not considered to be articles of the same kind although both may be carried by the contractor under the single accounting classification of "plate."

In the case of similar articles that differ only by a measurable characteristic, it is still possible under the substantial identity test that all such articles will be exempt as standard commercial articles if any one of them is a standard commercial article. Thus, if a contractor sells 50 percent of his output of 3-inch pipe and 50 percent of his output of 1-inch pipe to the public, he may be able to obtain the standard commercial article exemption for his output of 2-inch pipe which may be sold exclusively under renegotiable contracts. It would be necessary, however, to file an application with the Board and establish that the 2-inch pipe is of the same kind and content as the other pipe sizes and that the price of the 2-inch pipe is reasonably comparable with the other prices; that is, that it varies from the other prices in a manner consistent with the contractor's pattern of prices for various sizes of pipe.

Like the stock and catalog tests, the substantial identity test is intended to apply to individual articles, not groups or classes of articles. It is understood that under present law the Board in its regulations, as a convenience to contractors in the filing of exemption applications, permits the grouping of comparable articles in accordance with the accounting classifications regularly used by the contractor. The Board advises that this has created problems. Whether it should be done under the proposed new provision, or with what restrictions, should not be prescribed in the statute but should be left to the judgment of the Board. It should not be permitted, however, under the self-executing stock and catalog tests.

An article may qualify for exemption under the substantial identity test herein proposed even though the contractor's entire production of such article is sold under renegotiable contracts or subcontracts. For example, the exemption could embrace a rivet or other fastening device sold exclusively for military consumption, provided that it is identical in every material respect with other fastening devices which are stocked or cataloged and sold commercially by the contractor in the required percentage. The primary function of the rivet is to secure two pieces of metal. The fact that the rivet purchased under a renegotiable contract is ultimately used to achieve this result in an instrument of war should not of itself disqualify such article from the exemption.

The standard commercial article exemption is not intended to extend to an article which does not itself meet any of the tests contained in the statutory definition, even though its component materials or ingredients do or may qualify for exemption under such tests. Jet fuel, for example, would not qualify for exemption even though it is composed of ingredients which may qualify. Similarly, a complicated fire-control system used in conjunction with anti-aircraft guns would not qualify for exemption even though its components, such as relays, wires, and other electrical parts, might so qualify.

(c) The above recommended changes in the definition of a standard commercial article should to the extent appropriate be made in the definition of a "standard commercial service." However, the requirement of a filing should be retained for all contractors seeking exemption of service contracts or subcontracts.

It is not intended that the exemption of services should be limited to those performed on standard commercial articles. It should be available to any contractor who performs a service within the definition of a "standard commercial service," even though he performs it on an article which does not itself qualify for exemption. For example, if a contractor who produces aircraft parts furnishes them to a subcontractor for plating the subcontractor is not precluded from obtaining the exemption merely because the aircraft parts are not exempt.

#### (C) STATUTORY FACTORS FOR DETERMINING EXCESSIVENESS OF PROFITS

In determining excessive profits the 1951 act requires that favorable recognition be given to the efficiency of the contractor. In addition, consideration must be given to the following factors, namely: (1) reasonableness of costs and profits, (2) net worth, (3) extent of risk assumed, (4) contribution to the defense effort, (5) character of business, (6) such other factors the consideration of which the public interest and fair and equitable dealing may require.<sup>10</sup>

There is not much merit in debating the fine points of the wording in the statutory factors which the Renegotiation Act requires to be taken into account in determining excessive profits. The one factor of net worth, however, requires special attention in view of the extensive criticism from industry groups about the way in which the Board has used that factor.

<sup>10</sup> Sec. 103 (c) of the Renegotiation Act of 1951.

*The net-worth factor under present law*

With respect to net worth the act provides:

There shall be taken into consideration \* \* \* the net worth, with particular regard to the amount and source of public and private capital employed.<sup>11</sup>

The corresponding provision of the 1943 act required consideration to be given to the—

amount and source of public and private capital employed and net worth.<sup>12</sup>

The 1951 act, as it passed the House, provided that consideration be given to the—

reasonableness of return on net worth, with particular regard to the amount and source of public and private capital employed.<sup>13</sup>

The Senate Finance Committee deleted the words "reasonableness of return on" stating that, under the House provision, the Board was required to consider only the reasonableness of return on net worth. This provision was considered to be too restrictive since the reasonableness of return on net worth might not, in many cases, be an adequate measure of fair profits.<sup>14</sup>

Under regulations promulgated by the Board, capital employed is the total of net worth, debt, and any assets furnished by the Government or customers not contained in the contractor's records. The source of capital is required to be established in order that a determination may be made of the extent to which capital employed in renegotiable business came from public sources or from customers, or was furnished by the contractor. The amount of net worth employed, as well as the amount and source of capital employed, is generally that existing at the beginning of the year, although significant changes in either capital or net worth during the year are to be taken into account. Whenever possible an estimate is made of the amount of net worth employed in renegotiable business.

The regulations also provide that the relationship of profit realized on renegotiable business to the capital and net worth employed in renegotiable business will be used as one of the considerations in the final determination of excessive profits. A contractor who is not dependent upon Government or customer financing of any type is entitled to more favorable consideration than a contractor who is largely dependent upon these sources of capital.<sup>15</sup>

Industry representatives have expressed concern over the application of the net worth factor by the Renegotiation Board. While this factor is only one of several factors to be taken into account in determining the reasonableness of profits, the contention has been made that return on net worth has been overemphasized and applied in such a manner as to place an arbitrary ceiling limitation on the amount of allowable profits. It has been suggested that this factor be eliminated from the act.

It is pertinent to these industry arguments that the Board under date of February 14, 1956, issued the following press release elaborating on its use of the net worth factor.

<sup>11</sup> Sec. 103 (e) (2) of the Renegotiation Act of 1951.

<sup>12</sup> Sec. 403 (a) (4) (A) (iii) of the Renegotiation Act of 1943.

<sup>13</sup> H. R. 1724, 82d Cong., 1st sess.

<sup>14</sup> S. Rept. No. 92, 82d Cong., 1st sess., p. 11.

<sup>15</sup> 32 C. F. R. 1460.11.

## THE RENEGOTIATION BOARD

Washington, D. C.

For immediate release  
February 14, 1956Release No. 1-56  
Republic 7-7500, Ext. 4131

## STATEMENT ON NET WORTH FACTOR

Because some misunderstanding apparently exists in certain quarters respecting the Renegotiation Board's interpretation and application of the so-called net worth factor (sec. 103 (e) (2) of the Renegotiation Act of 1951, as amended), the Board today issued the following statement.

Section 103 (e) (2) of the act provides that the Renegotiation Board shall, in determining excessive profits, take into consideration: "The net worth, with particular regard to the amount and source of public and private capital employed \* \* \*." In discharging its responsibility under this section, the Board does not regard any particular rate of return on net worth or capital employed as excessive per se. The Board does not attempt to equalize its determinations respecting the members of any given industry from the standpoint of return on net worth or capital employed, inasmuch as renegotiation obviously is not a ratemaking process. The Board does not place special emphasis on the net worth and capital-employed factor as distinguished from the other statutory factors.

The Board desires to reemphasize the fact that reasonable profits are determined in every case by an overall evaluation of all the statutory factors, and not by the application of any fixed formula with respect to rate of profit on sales or rate of return on net worth or capital employed, or any other formula. That is not to say, however, that the return on net worth can properly be ignored in an appropriate case. Excluding those industries where capital is not a significant income-producing factor, the relationship of profit realized on renegotiable business to the capital and net worth employed in renegotiable business is, and properly should be, one of the considerations (though not the sole consideration) in the final determination of excessive profits. The Board's determinations must permit the retention of profits sufficient to provide a proper incentive for the investment of equity capital. Where borrowed capital is involved, the retained profits must reflect the additional risk to which equity capital is thereby subjected.

With respect to contractors who receive Government financial assistance, the regulation under the 1951 act [RBR 1460.11(4)] expresses a basic policy which was first enunciated under the 1943 Renegotiation Act (RR 412.2) and again under the 1948 Act [MRR 424.412-2(d)(1)]: "A contractor who is not dependent upon Government or customer financing of any type is entitled to more favorable consideration than a contractor who is largely dependent upon these sources of capital. When a large part of the capital employed is supplied by the Government or by customers, the contractor's contribution tends to become one of management only and the profit will be considered accordingly."

An example of the application of the foregoing policy is to be found in a case where an increase in Government-furnished facilities enables a contractor to achieve substantially expanded volume for defense purposes. In such a case there will often be a significant increase in contractor's rate of return on net worth over the immediately preceding years, which generally will evidence in a concrete way the effect of increased volume and increased Government assistance. Certainly the Board must consider this fact, together with all other relevant factors, in determining whether contractor's profit on the expanded renegotiable sales bears a reasonable relationship to the expanded volume. End Release.

The staff believes that this is a reasonable approach to the application of the net worth factor under the law.

Two fundamental principles must be observed in the application of this factor: (1) It should not be given special emphasis in relation to the other statutory factors in determining excessive profits, and (2) no ceiling should be placed on the rate of return on net worth or capital employed. The net worth factor should be retained in the act, with proper regard for these principles. The staff believes that the net worth factor should not operate unfavorably against a firm, particularly a small firm, that must make long-term commitments to private lenders in order to raise the capital necessary to its operations. The special advantages realized by a contractor with Government

financing or interest free customer financing should be taken into account.

It has been suggested that if net worth is considered to be the book value of the contractor's net investment in property, it is simply an accounting residual which has been influenced to a great degree by decisions and events having no relationship to renegotiation. Among these are the depreciation and amortization policies of the contractor, arbitrary writeups, writedowns, or writeoffs of property, decisions to capitalize or charge off certain expenditures, and any prior reorganizations or recapitalizations of the company. Any attempt to inquire into the present fair market value of the contractor's investment would convert renegotiation into a long, drawn out public utility type of rate proceeding. It is understood, however, that in cases where the difference between present and book value is important the information is brought to the attention of the Board.

#### (D) ELIMINATION OF "FRINGE" AGENCIES

Under the present law contracts entered into by a number of departments or agencies are subject to the provisions of the Renegotiation Act. These agencies have been listed above along with their volume of renegotiable business. See page 9.

With the exception of the Departments of Defense, (Army, Navy, and Air Force), Commerce (Maritime Administration only), the Atomic Energy Commission, and the General Services Administration, most of the contracts entered into are for articles of standard specifications. Since these agencies have adequate cost and price experience, it would seem desirable to eliminate them from the provisions of the act. Furthermore, the number of defense contracts entered into by these agencies and the dollar value involved has been steadily decreasing. These data can be seen in table 1 on page 10.

In a period of national emergency it may be desirable to cover departments and agencies other than those recommended. It is, therefore, recommended that a provision be adopted whereby in a future national emergency as declared by the Congress the President would be authorized to designate any department or agency that he considers should be covered by the renegotiation statute.

#### (E) 2-YEAR LOSS CARRY FORWARD

The present act provides a 1-year carry forward of losses on renegotiable contracts. Therefore, in determining whether the profits on renegotiable business for any year are excessive, the contractor is permitted to deduct any loss sustained on renegotiable business in the preceding year.

Complaints have been received that this 1-year carry forward provision is too limited. Inadequate pricing information, production difficulties, or other unforeseen contingencies may cause contractors to sustain losses for more than 1 year before realizing a profit on renegotiable business. Under present law, however, the only loss which may be taken into account in the profit year is the loss sustained in the year immediately preceding the profit year. A part of the remaining profits may be recovered by the Government as excessive even though the contractor has not recouped the losses sustained in earlier years on renegotiable business.

In other situations the loss sustained in a particular year may be greater in amount than the profit realized in the next year. Because of the 1-year limitation on the carry forward of losses the unabsorbed portion of the loss is not available to the contractor as an offset in any later year in which he may realize excessive profits.

It is recommended, therefore, that losses be allowed to be carried forward to the next 2 succeeding years. Under this recommendation, if a contractor sustains losses for 2 consecutive years, the losses of both years may be offset against the profits of the third year. Likewise, if a loss for any year is so large that it is not absorbed in the first succeeding profit year, the unrecovered portion of the loss may be carried forward and offset against the profits of the next succeeding year.

In applying the loss carry forward it is recommended that the loss on renegotiable business in a particular year be taken into account as an item of cost in the first and second succeeding years, in that order, to the extent of the profits realized on renegotiable business in these years. This application of the carry forward is consistent with the application of the 1-year carry forward under the present act. Therefore, if a contractor has a loss in 1 year, nonexcessive profits in the second year, and excessive profits in the third year, the loss would first be reduced by the nonexcessive profits of the second year, before being carried forward and applied against the excessive profits of the third year.

Losses sustained on renegotiable business after the fiscal year under review may not be carried back to that year under the provisions of the act. In the opinion of the staff, this is proper. A provision for the allowance of subsequent losses would only produce delay and administrative difficulties.

#### (F) APPEALS FROM THE RENEGOTIATION BOARD

##### 1. *Appeal to the Tax Court under present law*

Appeals from the Renegotiation Board to the courts are handled quite differently from appeals from other administrative boards. In most instances the appeal to the courts is limited to questions of law, to the question of whether there was evidence to support the finding, or whether there was bias or capriciousness on the part of the board.

In the case of appeals from the Renegotiation Board, however, a complete review of facts and merits is granted to a contractor who feels aggrieved by an order of the Board.

Under section 108 of the Renegotiation Act of 1951 a contractor or subcontractor aggrieved by an order of the Renegotiation Board may petition the Tax Court for a review of its case. This provision is similar to section 403 (e) (1) of the World War II Renegotiation Act. If a good and sufficient bond is filed with the court within 10 days after filing the petition the execution of the order of the Board will be stayed. The staff is informed, however, that a Federal district court in Michigan has recently held, in effect, that even though a bond is not filed with the Tax Court, the Government may not execute the order of the Board once the petition is filed in the Tax Court.

Where an appeal is taken to the Tax Court, that court may determine a lesser amount of excessive profits, a greater amount, or the same amount. The Tax Court hearing is a de novo proceeding. The burden of proof, however, is placed on the party (or parties) seeking

to alter the original determination. *Nathan Cohen v. Secretary of War*, 7 TC 1002. In 41 of the 112 opinion cases the Tax Court held that this burden had not been overcome.

Table 5 shows that 931 renegotiation cases have been filed with the Tax Court, and that 846 of these cases have been disposed of by the court. Of the 85 cases pending before the Tax Court 65 were filed under the World War II renegotiation laws, which indicates that the time required by the Tax Court to dispose of a renegotiation case is quite lengthy.

The time required to dispose of the average renegotiation case in the Tax Court is approximately 66 months, whereas the time required to dispose of the average case is only about 2 years. The lengthy period required to handle a renegotiation case is apparently due to the complexity of this type of case, which in turn necessitates continued requests for extension of time, either by the contractor or the Government, after issue has been reached and the case is ready for hearing.

The largest percentage of renegotiation cases are disposed of by dismissal upon agreement of both parties. Of the 846 closed cases 524 were disposed of in this manner. In this category only very small adjustments were made.

Only 112 cases were disposed of by opinion. In 55 of these cases the Tax Court lowered the determination of excessive profits from a total of \$16.4 million to \$9 million. Actually over half of this reduction was attributable to a determination in favor of one corporation where the court held on procedural grounds that a large contract was not subject to renegotiation.

A fairly large percentage of the opinion cases deal with the question of reasonable salaries. In some instances the Tax Court has raised the amount of salaries allowed by the Board and hence reduced excessive profits in that manner. Generally speaking, however, the large reduction of excessive profits which has been made in the opinion cases is not attributable to decisions on questions of fact but is primarily attributable to determinations in the contractor's favor of purely legal questions such as: (1) whether there was a renegotiable contract at all, (2) whether the Board processed the case within the period of limitations, (3) whether through common control the contractor's renegotiable receipts exceeded the statutory minimum, and (4) whether certain deductions such as amortization and State income taxes were allowable.

In 112 of the 135 cases decided upon stipulation a lower amount of excessive profits was determined. The amount originally determined, \$102 million, was lowered to \$76 million. Cases involving only seven corporations account for over half of the difference.

The overall results of renegotiation in the Tax Court show that determinations by the court lowered the originally determined figure by 5.8 percent. Cases dismissed for lack of jurisdiction are excluded from the calculations.

Of the 247 cases decided by opinion and stipulation, the table shows that the contractor in 167 cases (67.6 percent) was successful in having the amount of excessive profits lowered.

The results reached in the Tax Court thus far are not necessarily an accurate indication of future results. The cases reflected in the figures in the table were brought almost without exception under renegotiation acts prior to the 1951 act.

## 2. *Appeal from the Tax Court*

Under the 1948 Renegotiation Act an appeal from the Tax Court to the Courts of Appeal on the question of excessive profits was permitted. However, under the World War II and 1951 renegotiation laws no appeal could be taken from the Tax Court on the question of excessive profits.

Twenty-four renegotiation cases have been appealed from the Tax Court. Of these cases 2 are now pending on appeal. In 7 cases the Tax Court was affirmed, in 2 reversed, and 13 were dismissed for lack of jurisdiction.

In five cases certiorari to the Supreme Court was applied for. In only one case was certiorari granted, *U. S. v. California Eastern Line, Inc.*, 348 U. S. 351 (March 7, 1955). This case held that the question of whether there was a renegotiable contract was a question which could be reviewed by the appellate courts in spite of the fact that the Tax Court is the final arbiter on the question of excessive profits.

There is now pending before the Senate Finance Committee S. 2282. This bill would amend the present law to allow appeals from the Tax Court to United States Courts of Appeal and to the United States Supreme Court on the question of excessive profits. Thus, the application of the statutory factors for determining excessive profits would become an appealable question.

Appeals could be taken from the Tax Court in the same manner as appeals from district courts in civil cases tried without a jury. If the appellate courts found that there was no evidence to support the decision on excessive profits, the case would be reversed.

Under present law venue of an appeal from the Tax Court, where permitted, is only in the United States Court of Appeals for the District of Columbia. S. 2282 would amend the law to change the venue of an appeal from the Tax Court to the Court of Appeals for the circuit in which the contractor or subcontractor resides.

## 3. *Recommendations*

It is believed that the present appellate procedure in renegotiation cases is adequate. S. 2282, which would permit appeals from the Tax Court in all cases, might unduly prolong the already lengthy appellate process. The Tax Court should remain the final authority on the question of excessive profits, and its judgment on this point should not be reviewed by the appellate courts on the question of whether there was evidence to support the decision.

It is felt that an order of the Renegotiation Board should be stayed only where a bond is filed with the Tax Court. Accordingly, it is recommended that section 108 of the act be amended so as to remove any doubt on this point.

TABLE 5.—Renegotiation cases in the Tax Court of the United States—Statement as of Jan. 31, 1956

Number of cases filed with the court.....	931
Number of cases closed by court.....	846
Number of cases pending Jan. 31, 1956.....	85

	Number	Amount determined	Amount redetermined by court
<b>By opinion:</b>			
Amounts redetermined same as determined.....	41	\$17,083,577.00	\$17,083,577.00
Amounts redetermined less than determined.....	55	16,419,258.50	<sup>1</sup> 9,029,426.59
Amounts redetermined greater than determined.....	16	13,482,333.00	14,442,971.64
Total.....	112	46,985,168.50	40,555,975.23
<b>By stipulation:</b>			
Amounts redetermined same as determined.....	3	818,960.16	818,960.16
Amounts redetermined less than determined.....	112	102,227,726.16	<sup>2</sup> 76,021,354.35
Amounts redetermined greater than determined.....	20	10,434,717.00	11,290,165.63
Total.....	135	113,481,403.32	88,130,480.14
<b>By dismissal:</b>			
Lack of jurisdiction.....	72	22,622,761.08	
Agreement of parties or lack of prosecution.....	524	388,781,646.00	388,646,646.00
Total.....	596	411,404,407.08	388,646,646.00
<b>By mandate:</b>			
Total.....	3	975,000.00	975,000.00
Total.....	846	572,845,978.90	<sup>3</sup> 518,308,101.37
Closed cases under 1951 act, agreement of parties.....	3	586,314.00	586,314.00

<b>Pending cases:</b>	
Under 1943 and prior acts (4 under submission to judges).....	65
Under 1948 act.....	1
Under 1951 act.....	19
Pending Jan. 1, 1956.....	85

<sup>1</sup> The table shows that in 55 opinion cases the Tax Court determined a lesser amount of excessive profits to the extent of \$7,389,531.91. Of this figure 3 cases represent \$5,070,659:

No. 520 R, Martin Wunderlich Co.....	\$1,910,000.00
No. 521 R, Martin Wunderlich Co.....	2,610,659.00
No. 87 R, Bibb Manufacturing Co.....	550,000.00
Total.....	5,070,659.00

<sup>2</sup> The table shows that in 112 stipulated cases the Tax Court determined that the excessive profits were less than the amount originally determined to the extent of \$26,206,371.81. Of this figure 12 cases represent \$16,254,116:

No. 735 R, Brevets Aero-Mechaniques S. A. Co.....	\$6,486,010.00
No. 405 R, Brevets Aero-Mechaniques S. A. Co.....	1,431,525.00
No. 361 R, Brevets Aero-Mechaniques S. A. Co.....	679,570.00
No. 104 R, The Austin Co.....	900,000.00
No. 487 R, Panama Contractors, Inc.....	985,000.00
No. 142 R, National Pneumatic Co.....	674,866.00
No. 688 R, Bibb Manufacturing Co.....	1,109,891.00
No. 790 R, Bibb Manufacturing Co.....	1,087,254.00
No. 874 R, Simpson Steel Co.....	900,000.00
No. 861 R, Simpson Steel Co.....	700,000.00
No. 794 R, Simpson Steel Co., Aircraft Division.....	600,000.00
No. 749 R, The Timken Detroit Axle Co.....	700,000.00
Total.....	16,254,116.00

<sup>3</sup> This amount does not include the excessive profits involved in 72 cases dismissed for lack of jurisdiction. Source: Tax Court of the United States.

### (G) ANNUAL REPORT BY THE RENEGOTIATION BOARD

Under present law the Renegotiation Board is not required to make an annual report to Congress. The staff feels that an annual report should be made by the Board. This report should include the following:

1. The personnel of the Central Board and each regional board.
2. The administrative expenses.

3. The number of filings by sales volume during the year for--
  - (a) Those screened out.
  - (b) Cases renegotiated.
  - (c) Number and amount of refunds.
4. The number of pending cases.
5. The changes made in the regulations.
6. Improvements made in procedure.
7. The renegotiation cases in the Tax Court and higher courts and their disposition.

Most of the matters listed above could be readily furnished by the Board under its present recordkeeping system. Such a report would be of great aid to Congress in examining the operation of renegotiation under the recommended extension, particularly the effect of the proposed amendments.

It is recommended that this report should cover activities for the fiscal year ended June 30, 1956, and be filed by January 1, 1957. Thereafter the report should be filed by January 1 of each succeeding year covering the activities for the preceding fiscal year.

#### (H) REPORTING REQUIREMENTS

##### 1. *Present situation*

Financial reporting requirements for renegotiable sales and profits are a costly matter for business firms and a frequent source of complaint.

The present reporting system may be summarized as follows:

(i) Statement of Nonapplicability (RB form 90). This form requires the contractor to state, if applicable, that his renegotiable business was under the floor (\$500,000 sales or \$25,000 commissions, etc.). The contractor need not show his actual figure of renegotiable sales. He is required to name other firms which either he controls, or control him or are under common control with him. Finally, the form calls for the firm's gross receipts and the status of its standard commercial article exemption claims, if any.

(ii) All firms above the renegotiable floor must file the Standard Form of Contractor's Report, forms RB1 and RB1B. From this data the Board decides to screen out the contractor or assign his case to the field. Adequate information at this point saves work overall by reducing the number of field assignments.

RB1 calls for renegotiable sales under each type of prime contract (fixed price, cost plus, and redeterminable) and under subcontract and non-renegotiable sales. This separation has problems. Sales invoices must be classified and tabulated. Subcontractors must often find out from the next higher tier firm how much of the deliveries to it was used in renegotiable, and how much in nonrenegotiable end products. In other cases the product must be tracked through a number of tiers of higher subcontractors to find out if the final product is renegotiable. Application of some of the exemptions is complicated. On this form the contractor must describe his method of segregating sales. In some cases sampling procedures are permitted.

The form also requires some simpler factual information covering accounting method, nature of product, etc.

The other difficult part of this filing is the form RB1B, an income statement with cost breakdowns. Sales and a number of cost break-

downs are shown separately for fixed price, cost plus, and redeterminable contracts on renegotiable business and for other business. This cost separation is a fairly complicated accounting procedure that might not be undertaken, except for renegotiation especially by small business.

(iii) When actual renegotiation starts in the field the report forms used are essentially work sheets on which the renegotiators record such data as under the circumstances appears significant.

## 2. *Proposals and analysis*

(i) It has been proposed that the Statement of Nonapplicability be eliminated. There is no objection to this from the Renegotiation Board. Actually no such statement was required in World War II. There is, however, an advantage to the contractor in filing this statement. If no action has been taken by the Board within 1 year of the filing, then renegotiation is foreclosed for the year involved in the absence of fraud or malfeasance, or misrepresentation of a material fact. It would be a better solution to make this filing optional with the contractor.

(ii) It has been proposed that the Standard Form of Contractor's Report could be shortened in various ways. Realizing the complexity of this form the staff is satisfied that no major simplification is consistent with renegotiation even as it would be continued under the recommendations in this report. Actually the Renegotiation Board has allowed considerable leeway in taking such cost and sales breakdowns as the contractor can reasonably provide without imposing unnecessary standards of precision. The separation of renegotiable costs into those under fixed cost, cost plus and redeterminable contracts would seem to be of limited use in the screening process, but this is less burdensome than would appear since under the terms of cost plus and redeterminable contracts the contractor must keep cost data for contract price adjustment. Some simplification might be achieved if the Board permitted lumping of redeterminable contracts with fixed-price contracts if prior to the year in question the price has been finally redetermined.

(iii) There has been some criticism from industry groups of the amount of information called for by the renegotiation authorities during the actual renegotiation, especially the repeated calls for extra information after a presumably full hearing has been held.

The informality of this stage of renegotiation, plus the broad nature of the factors which must be considered, makes it singularly inappropriate for the staff to recommend specific changes. It is expected, however, that the Board itself can improve this situation. The accumulation of data on 1951, 1952, and 1953 cases should help reduce future information problems.

## (I) MISCELLANEOUS TECHNICAL AMENDMENTS

1. Under the present act any contract or subcontract with a tax-exempt organization is exempt from renegotiation. The exemption of subcontracts under such contracts or subcontracts affords an undue advantage to commercial enterprises which supply materials or services to tax-exempt institutions. It is recommended, therefore, that the exemption to the subcontractors be removed effective as to such subcontracts made after June 30, 1956.

2. The present act does not prescribe treatment for the receipt or accrual of amounts attributable to performance prior to the termination date of the act although such amounts are renegotiable. It should be provided that receipts and accruals attributable to performance before the termination date be considered to have been received or accrued not later than the termination date. The alternative to this would require a separate renegotiation proceeding for these amounts for years after the termination date. These amounts were treated as received prior to the termination date under the World War II renegotiation law.

3. The present law provides a permissive exemption to contracts or subcontracts to be performed outside the continental limits of the United States or in Alaska. The Board has generally granted the exemption to contracts to be performed by a foreign contractor since it does not have the facilities and may not have the essential legal authority to enforce the renegotiation of foreign contracts. The exemption of such a large volume of procurement might more properly be a responsibility of Congress than of the Board. It is recommended therefore, that a mandatory exemption be provided for contracts and subcontracts to be performed abroad by foreign contractors to the extent of receipts or accruals after June 30, 1956. This exemption should not extend to any contract or subcontract for sea or air transportation or cargo carriage from any point in the United States to a point outside the United States or vice versa. Also, the exemption should not apply to any foreign corporation 80 percent or more of the stock of which is owned by a domestic corporation.

4. Under section 113 of the act, employees of the Board through December 31, 1953, the original termination date of the act, were relieved from certain conflict of interest provisions applicable to Government employees generally. The provisions in question preclude employees, during their employment, from agreeing to act or acting as agent or attorney, or otherwise assisting, in the prosecution of claims against the Government, and also preclude such employees, for a period of 2 years following the termination of their employment, from so acting with respect to any such claims pending during their employment. When the act was first adopted it was considered necessary to exempt Board personnel from these restrictions in order to make it possible for the Board to obtain employees of the caliber required to administer the act. This is still true. Accordingly, it is recommended that this provision be extended to cover employment by the Board at any time. Section 113 contains a further provision which, in effect, permanently bars any person employed by the Board through December 31, 1953, from handling for a contractor any renegotiation case which he handled for the Board during his employment. The change recommended above would have the effect of imposing this prohibition upon persons employed by the Board at any time. Without this provision, Board employees would be barred for only 2 years (by another provision of law) from handling any such case. It is also noted that section 113 covers not only employees of the Board, but employees of the departments as well. The section was so framed at the time of its original enactment to allow for the possibility, then under consideration, that the Board might delegate renegotiation authority to the departments. Since this was not done and the Board created instead its own system of regional boards,

consideration should be given to the elimination of the present reference to departments.

5. It is recommended that section 105 (f) (3) be amended to provide that fees or commissions received by an agent or broker from principals under common control with him are not to be eliminated in determining whether the group has exceeded the \$25,000 floor prescribed in section 105 (f) (2) for any fiscal year ending on or after June 30, 1956. At the present time, such amounts must be eliminated and thus often escape renegotiation, leaving the Board with the sole and unsatisfactory alternative, where renegotiation is not conducted on a consolidated basis, of evaluating such commissions in the renegotiation of the principal and possibly disallowing some portion thereof as unreasonable costs.

# APPENDIXES

## APPENDIX I

### OUTLINE OF THE RENEGOTIATION ACT OF 1951 AS AMENDED

#### 1. *Purpose of the act; section 101*

The declared purpose of the Renegotiation Act of 1951 is to eliminate, as provided in the act, excessive profits from contracts made with the United States, and from related subcontracts, in the course of the national defense program.

#### 2. *Coverage of the act; sections 102, 103 (a)*

Except for the specific exemptions provided by section 106 all contracts with the departments named in the act and related subcontracts are subject to renegotiation on receipts or accruals after December 31, 1950, and before January 1, 1957. Contracts with other departments designated by the President under the act and related subcontracts are subject to renegotiation on receipts or accruals starting with the month following designation.

#### 3. *Basis for determining excessive profits; section 103.*

A. *Overall fiscal year review.*—Excessive profits are determined with respect to the receipts or accruals of the contractor under all renegotiable contracts and subcontracts in an entire fiscal year of the contractor.

B. *Application of statutory factors.*—Renegotiable profits are determined by charging against renegotiable receipts or accruals (usually referred to as “renegotiable sales”) all costs and expenses incurred by the contractor and allocable to the performance of renegotiable business. Excessive profits are that portion of such renegotiable profits which is determined in accordance with the act to be excessive. In making these determinations, the Board is required by the act to observe certain prescribed factors. Briefly stated these factors are: efficiency, reasonableness of costs and profits, net worth, risk, contribution to defense effort, character of the business, and any other factor which the Board deems equitable.

C. *Costs.*—All allowable deductions for Federal income tax purposes, to the extent allocable to renegotiable business, are required to be allowed as costs.

#### 4. *Renegotiation clause in contracts; section 104*

The Secretary of each named department is directed to insert in each contract made by his department a provision under which the contractor agrees to eliminate excessive profits, and under which the contractor agrees to insert the same provision in each subcontract thereunder. The inclusion of such a provision in a contract or subcontract does not necessarily mean that the contract is renegotiable.

Nor does the omission of such a clause from a renegotiable contract deprive the Board of jurisdiction.

#### 5. *Renegotiation proceedings; section 105*

Every contractor is required to file an annual report with respect to its receipts or accruals from renegotiable contracts and subcontracts during its fiscal year. This duty is imposed by the act upon every person who holds any such contracts or subcontracts (section 105 (e) (1)), irrespective of the amounts received or accrued therefrom during the fiscal year.

Section 105 (f) (1) of the act, as originally enacted, provided that renegotiation would not be conducted with respect to the renegotiable receipts or accruals of a contractor or subcontractor unless (with the exception noted below) such receipts or accruals of the contractor or subcontractor, and all persons under control of or controlling or under common control with the contractor or subcontractor, exceeded \$250,000 in a fiscal year. By amendment approved September 1, 1954, this minimum amount was increased to \$500,000 with respect to any fiscal year ending on or after June 30, 1953.

For particular subcontractors (agents, brokers, etc., whose renegotiable compensation usually is derived in the form of commissions), the statutory floor is \$25,000.

Section 105 provides that the proceedings shall be commenced by mailing a notice to the contractor or subcontractor. The proceeding must be commenced within 1 year after the statement is filed by the contractor or subcontractor and must be completed within 2 years after commencement. The Board is directed to reach an agreement, whenever possible, with the contractor or subcontractor with regard to the elimination of excessive profits. Where an agreement cannot be reached the Board is directed to enter an order determining the amount of excessive profits. This order is final unless an appeal is taken to the Tax Court in the manner set forth in section 108.

#### 6. *Exemptions; section 106*

Exemptions are either mandatory, by force of the statute itself, or permissive, granted by the Board pursuant to authority vested in it by the act.

A. *Mandatory exemptions.*—The mandatory exemptions are briefly as follows:

(a) Contracts with political units or their subdivisions and contracts with foreign governments.

(b) Contracts and subcontracts for raw agricultural commodities.

(c) Contracts and subcontracts for minerals and timber not processed beyond the first form or state suitable for industrial use.

(d) Contracts and subcontracts with regulated common carriers or public utilities.

(e) Contracts and subcontracts with tax-exempt organizations.

(f) Contracts and subcontracts which the Board deems not directly connected with national defense.

(g) Competitive bid construction contracts and subcontracts.

(h) Subcontracts under the above exempt contracts or subcontracts.

(i) Contracts and subcontracts for standard commercial articles or services under certain conditions.

B. *Partial mandatory exemption.*—Section 106 (c) of the act exempts contracts and subcontracts for new durable productive equipment, except to the extent of that part of the sales price which bears the same ratio to the total price as 5 years bears to the average useful life of such equipment. Thus if a machine has an expected useful life of 10 years, five-tenths of the sale price would be renegotiable.

C. *Permissive exemptions.*—Section 106 (d) of the act authorizes the Board, in its discretion, to exempt the following:

(a) Contracts and subcontracts to be performed outside the continental United States or in Alaska.

(b) Contracts and subcontracts under which the profits can be reasonably determined when the contract price is established.

(c) Contracts and subcontracts with provisions which the Board considers otherwise adequate to prevent excessive profits.

(d) Contracts and subcontracts of a secret nature.

(e) Subcontracts as to which the Board considers it not administratively feasible to segregate the profits attributable thereto from the profits attributable to nonrenegotiable activities of the contractor.

#### 7. *The Board; section 107*

The Renegotiation Board is created as an independent establishment in the executive branch of the Government.

The Board is composed of five members. Each is appointed by the President, by and with the advice and consent of the Senate. The Secretaries of the Army, the Navy and the Air Force, subject to the approval of the Secretary of Defense, and the Administrator of General Services each recommend to the President for his consideration one person from civilian life to serve as a member of the Board. The President designates one member to serve as Chairman.

No member of the Board may actively engage in any business, vocation, or employment other than as a member of the Board.

#### 8. *Review by the Tax Court; section 108*

Any contractor aggrieved by an order of the Board determining an amount of excessive profits may file a petition with the Tax Court of the United States for a redetermination thereof. Such a petition must be filed within 90 days after notice of the final action of the Board. The court may determine as the amount of excessive profits an amount less than, equal to, or greater than that determined by the Board. The proceeding in the Tax Court is a proceeding *de novo*, and the determination made by that court of the amount, if any, of excessive profits is final. The filing of a petition with the court does not stay the execution of the order of the Board unless, within 10 days, the petitioner files a good and sufficient bond.

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## APPENDIX 2

### DEVELOPMENT OF PRICE AND PROFIT LIMITATION ON CONTRACTS FOR FURNISHING DEFENSE MATERIALS AND SERVICES

Although a complete history of profit limitation is not attempted for this report, an outline of the development of price and profit limitation is included in connection with the study for its bearing on

the questions required to be considered under section 6 of Public Law 216.

The fundamental problem has been one of getting a fair return for each dollar spent for defense material, eliminating profiteering and strengthening the industrial mobilization base on which defense depends. War profit limitations do not reflect a stigma on the bulk of private industry, but it has been used to deal with the great price and cost uncertainties of war.

The problem of prices and profits realized from sales of defense materials to the Government is as old as the history of the Nation. General Washington in letters to the Continental Congress complained of prices and profits being charged for materials which he regarded as unfair and as jeopardizing the outcome of the Revolution, and similar complaints were made in wars preceding World War I. But the modern limitation movement assumed huge proportions as a result of that war.

Charges were made that 23,000 new millionaires were created, and the word "profiteer" came to be applied to many defense suppliers. This it appears was in part because of the failure of cost plus a percentage of cost contracting, and of the war controls and tax techniques employed in that period. At any rate, the 25 years following World War I witnessed a nationwide movement for the prevention of inordinate profits by war suppliers at unfair cost to the Government, a few instances of which should be noted.

The American Legion assumed great influence. In convention in 1922 it adopted a program of preventing profiteering in future wars and of attaining a reasonable degree of equality between the treatment of people and the treatment of capital.

Both major political parties in 1924 adopted planks relative to the use of capital, management, and facilities, in time of war, and the control of profits realized from war production.

Between the end of World War I and 1940 hundreds of bills were introduced in Congress for the elimination and control of war profits.

In 1930 the Congress authorized a Senate investigation of the munitions industry, for which the reason was given in these words:

Whereas the 71st Congress, by Public Resolution Numbered 98 approved June 27, 1930, responding to the longstanding demands of American war veterans speaking through the American Legion are for legislation to take the profit out of war.

The War Policies Commission, of which Mr. Bernard Baruch was Chairman, concluded that restrictions such as price-fixing, higher taxes, and priorities were not sufficient to prevent inordinate profits.

#### VINSON-TRAMMELL PROVISIONS

The movement described had its influence in the series of acts and amendments, known as the Vinson-Trammell provisions, to limit profits on the construction of naval vessels and Navy and Army aircraft. Although now suspended during the effective period of the Renegotiation Act of 1951, they would come into effect again if the Renegotiation Act of 1951 is discontinued unless action should be taken by the Congress to the contrary.

The first law after World War I relative to control of profits on armament was the act approved March 27, 1934 (48 Stat. 504; U. S. C. title 34, sec. 496).

Under this law, profits on contracts for naval vessels and aircraft were limited to 10 percent of the contract price. On June 25, 1936 (Public Law 804, 74th Cong.), it was amended to permit offsetting of losses on one contract against profits on another contract. This was done by applying the 10 percent profit limitation to the aggregate of the contract prices for all contracts completed by a prime contractor within the income taxable year. Also, the amendment permitted net losses of 1 taxable year to be offset against net profits of the succeeding taxable year, a carryforward of 1 year. This was later made a 4-year carryforward.

In 1936 the Merchant Marine Act provided a 10 percent limitation on profits from contracts for ships built for the Maritime Commission.

In 1939 the Vinson-Trammell Act was amended to apply the 10 percent profit limitation to contracts for naval vessels, and to apply a 12 percent limitation on contracts for Army and Navy aircraft.

All of the foregoing related to peacetime procurement. The defense period preceding World War II began in 1940. On June 28, 1940, an amendment to the Vinson-Trammell Act changed the limitation on contracts for naval vessels and for Army and Navy aircraft to 8 percent of the contract price; and applied the provisions of the Vinson-Trammell Act to subcontractors. It was also provided that profits in excess of 8.7 percent of the cost of performance would be regarded as in excess of the 8 percent limitation, except in the case of prime contracts made on a cost-plus-fixed-fee basis.

The Second Revenue Act of 1940 imposed an excess-profits tax and suspended as of December 31, 1939, the profit limitation statutes applicable to Army and Navy contracts whenever the contractor or subcontractor was subject to excess-profits tax. By reason of this suspension and the fact that the act of June 28, 1940, provided that its amendments were to terminate June 30, 1942, the 8 percent and the 8.7 percent provisions never came into operation and are not now a part of the existing Vinson-Trammell provisions.

A little noted fact was an effort at price and profit control just preceding the adoption of the first renegotiation statute in April 1942. Pursuant to the Second War Powers Act, approved March 27, 1942, the President by Executive Order 9217, issued April 10, 1942, designated the War Production Board, the War, Navy, and Treasury Departments, the Reconstruction Finance Corporation, and the Maritime Commission, as governmental agencies to inspect the plants and audit the books of any contractor or subcontractor with whom a contract had been placed, to prevent the accumulation of unreasonable profits. Under this authority on April 25, 1942, cost-analysis sections and price-adjustment boards were established. The cost analysis sections were to conduct surveys of costs and profits incident to war contracts, and to act as fact finding agencies for the price-adjustment boards. The price adjustment boards were to assist the departments in securing voluntary adjustments or refunds whenever costs or profits were deemed excessive. It was the stated purpose of this administrative action to provide incentives to control costs, to promote efficiency, and to eliminate undue profits from contracts hastily made.

In the meantime, on March 28, 1942, the day after the enactment of the Second War Powers Act, but before the Executive order and the establishment of the machinery for cost analysis and obtaining

adjustments or voluntary refunds, the Case amendment was adopted by the House of Representatives to the Sixth Supplemental National Defense Appropriation Act of 1942 to limit profits on any war contract to 6 percent of the contract price. In March 1942 the War Production Board and the War Department opposed this flat percentage profit limitation on the ground that it would impede production and would be unfair to many contractors and too generous to others.

#### WORLD WAR II RENEGOTIATION

The Case amendment to limit profits of war contracts to a flat 6 percent of the contract price was passed by the House without debate in the Sixth Supplemental National Defense Appropriations Act of 1942. The Senate Committee on Appropriations rejected a plan offered by the Government departments embodying the voluntary system of administrative renegotiation and price redetermination under which voluntary refunds were sought. Instead the Congress by enacting section 403 of the Sixth Supplemental National Defense Appropriation Act adopted the form of renegotiation,<sup>1</sup> under which refunds of undue profits were to be obtained by agreement with the contractors where possible but authorizing the departments to issue orders for refund where bilateral agreements with contractors could not be made, thus rejecting a flat percentage limitation on profits from war contracts proposed in the Case amendment which had passed the House.

In its original form, section 403 referred to in subsection (b) authorized and directed—

the renegotiation of the contract price at a period or periods when, in the judgment of the Secretary, the profits can be determined with reasonable certainty—

and in subsection (c) the withholding from the contractor or subcontractor of—

any amount of the contract price which is found as a result of such renegotiation to represent excessive profits.

In this form, renegotiation was made to operate on the individual contract price.<sup>2</sup>

The Revenue Act of 1942 amended the original act to implement administrative practices of the departments and amended section 403 (c) (1) to provide that—

When the contractor or subcontractor holds two or more contracts or subcontracts the Secretary in his discretion may renegotiate to eliminate excessive profits

<sup>1</sup> Sec. 403, 6th Supplemental National Defense Appropriation Act, 1942, approved April 28, 1942 (56 Stat. 226, 245-246), frequently referred to as the First Renegotiation Act. Title VIII—Renegotiation of War Contracts, Revenue Act of 1942, approved October 21, 1942 (56 Stat. 798, 982-985). Title VII—Renegotiation of War Contracts, and Title VIII—Repricing of War Contracts, Revenue Act of 1943, passed over the veto of the President February 25, 1944 (58 Stat. 21, 78-93), frequently referred to as the Renegotiation Act of 1943. Both the Revenue Act of 1942 and the Revenue Act of 1943 renegotiation legislation was by amendment of sec. 403 of the 6th Supplemental National Defense Appropriation Act of 1942, and there was added to the latter by the Revenue Act of 1943, sec. 701 (b) a subsec. (1), which provided "(1) This section may be cited as the Renegotiation Act" (58 Stat. 90). The termination date of the act was extended through December 31, 1945, by an act approved June 30, 1943 (59 Stat. 294-295).

<sup>2</sup> That the Renegotiation Act of 1942 came in as a war measure was universally recognized and is too clear to need documentation. Justice Burton in delivering the opinion in the *Lichter* case, holding the Renegotiation Act constitutional (*Lichter v. United States*, 334 U. S. 742), stated:

"The Renegotiation Act was developed as a major wartime policy of Congress comparable to that of the Selective Service Act. The authority of Congress to authorize each of them sprang from its war powers. Each was a part of a national policy adopted in time of crisis in the conduct of total global warfare by a nation dedicated to the preservation, practice, and development of the maximum measure of individual freedom consistent with the unity of effort essential to success. \* \* \* Both acts were a form of mobilization. \* \* \* The act always has been limited in duration to a period during and shortly following the war" (*Lichter v. U. S.*, supra, pp. 754, 755, 771).

on some or all of such contracts and subcontracts as a group without separately renegotiating the contract price of each contract or subcontract.

Thus renegotiation was made to operate on the basis of the aggregate of the receipts and accruals of all the contracts and subcontracts of the contractor.

Also, in determining the amount of the contract prices which was found as the result of renegotiation to represent excessive profits, subsection (c) (3) of section 403 provided that there should be allowed—

the properly applicable exclusions and deductions of the character which the contractor or subcontractor is allowed \* \* \* under the Internal Revenue Code, and a credit against any excessive profits to be eliminated for Federal income and excess profits taxes as provided in \* \* \* the Internal Revenue Code.

The Revenue Act of 1943 by section 701 amended section 403 to provide in subsection (a) (4) (A) that—

The term "excessive profits" means the portion of the profits derived from contracts with the departments and subcontracts which is determined in accordance with this section to be excessive—

and provided for the first time seven factors to be specifically taken into consideration.

#### RESULTS UNDER WORLD WAR II RENEGOTIATION

Various analyses of results under the World War II law have been made, including data presented in the "Brewster Report,"<sup>3</sup> and figures set forth in the Government's brief in the Lichter case. The latter reported results which afford a basis for approximating the impact of World War II renegotiation in respect of the dollar volume of contracts subject to, and the gross and net recoveries under, the World War II law. The figures were reported as of June 30, 1947, and cover the fiscal years 1942 through 1946.

The dollar amount of contracts subject to renegotiation for these years was reported as \$190 billion, excluding contractors eliminated because of exemption or noncoverage.

Gross recoveries from renegotiation cases assigned were reported as \$10,434,637,000. The dollar amount of contracts subject to renegotiation left after reduction by \$10,434,637,000 of gross recoveries was \$179,565,363,000.

The net recoveries, after deduction of the Federal tax credit of \$7,304,246,000, representative of the amount which would have been recovered by taxes, was \$3,130,391,000.

The total cost of administering the law for salaries and other expense was estimated by the War Contracts Price Adjustment Board as \$41,476,000, making the net recovery amount, after deducting the administrative cost, \$3,088,915,000.

Of the total gross recoveries of \$10,434,637,000, recoveries by agreement with contractors amounted to \$9,539,144,000, or 91.4 percent of gross recoveries, and recoveries by unilateral order for refund amounted to \$895,493,000, or 8.6 percent.

<sup>3</sup> Special Committee Investigating the National Defense Program, Rept. No. 440, 80th Cong., 2d sess.

## THE RENEGOTIATION ACT OF 1948

Between the expiration of the World War II statute, December 31, 1945, and 1948, no renegotiation statute was in effect, but the Vinson-Trammell limitation provisions again came into operation January 1, 1946.

However, effective as to fiscal years ending June 30, 1948, the Renegotiation Act of 1948 was passed in an act making supplemental appropriations for the national defense for the fiscal year ending June 30, 1948, and for other purposes (Public No. 547, 80th Cong., 2d sess., H. R. 6226).

The Renegotiation Act of 1948 was made applicable to contracts and subcontracts of the military departments, and its administration was placed under the Secretary of Defense. In the area of its operation it was based on the World War II statute and procedures. As amended it was in effect with respect to such contracts and subcontracts through 1950.

A renegotiation board was established by the Secretary of Defense for each of the military departments—the Department of the Army, Department of the Navy, and the Department of the Air Force. The determinations of these departmental boards were subject to the approval of the Military Renegotiation and Review Board.

With respect to the work of these boards not completed, the Renegotiation Act of 1951 placed the administration of this act under the independent Renegotiation Board established in the 1951 act.

No separate data as to the volume of its operation is available as of the time of printing of this report.

With the beginning of Korean hostilities, the Congress again established a system of price controls similar to those of World War II, including the excess-profits tax of 1950 and the Renegotiation Act of 1951, both of which were originated by the Committee on Ways and Means of the House and passed by the Congress.

## THE RENEGOTIATION ACT OF 1951

The Renegotiation Act of 1951 is based almost entirely upon the World War II statute. However, instead of putting the administration of renegotiation under the departments whose contracts and subcontracts are subject to renegotiation, the 1951 act established an independent Renegotiation Board, which carries out the provisions of the act through regional boards.

The 1951 act differed from previous statutes in another respect; namely, it specifically spelled out the policy on which the act was based. Its first section reads as follows:

## TITLE I—RENEGOTIATION OF CONTRACTS

## SEC. 101. DECLARATION OF POLICY.

It is hereby recognized and declared that the Congress has made available for the execution of the national defense program extensive funds, by appropriation and otherwise, for the procurement of property, processes, and services, and the construction of facilities necessary for the national defense; that sound execution of the national defense program requires the elimination of excessive profits from contracts made with the United States, and from related subcontracts, in the course of said program; and that the considered policy of the Congress, in the interests of the national defense and the general welfare of the Nation, requires that such excessive profits be eliminated as provided in this title.

The act was extended by the Congress for 1 year in 1954, and for 2 years in 1955, or through December 31, 1956.

A statement on the volume of contracts and subcontracts subject to renegotiation under the 1951 act, and data as to recoveries under the act, are included in the main body of this report.

#### SUMMARY

By way of summary, it may be observed that jurisdiction of the committees of Congress dealing with profit limitation has been divided. The Vinson-Trammell profit-limitation provisions were originated and developed in the committees of the Congress having jurisdiction of the military departments. The original Renegotiation Act of 1942 originated with the Case amendment in the Committee on Appropriations of the House of Representatives and in the Committee on Appropriations of the Senate, where section 403 of the Sixth Supplemental National Defense Appropriations Act was substituted for the House provision and became the original Renegotiation Act of 1942. This act was amended and expanded in the Committee on Finance of the Senate in October 1942. In 1943 extensive hearings were held by the Committee on Naval Affairs of the House, the Committee on Ways and Means of the House, and the Committee on Finance of the Senate. The Revenue Act of 1943 made extensive amendments, originating with the Committee on Ways and Means and the Committee on Finance, which committees also originated amendments providing for termination of the World War II statute. The renegotiation statute in effect from 1948 through 1950 originated in the Committee on Appropriations of the House, and was never considered or amended as such by the tax committees of the Congress. For the first time, the tax committees in 1950 originated a renegotiation statute in the Renegotiation Act of 1951.

This review of committee development of profit limitation on contracts and subcontracts for the materials of defense by the United States may serve to point up the difficulties arising from the provisions of the various statutes, and also whether the Congress should, in a study of the whole subject of profit limitation involved in a policy of obtaining the materials of defense at a cost reasonable to the Government, review the question of the procedures of Congress for carrying out such a policy, either in war or in a semimobilization period, as well as the profit limitation provisions themselves.

APPENDIX 3

TABLE 1.—Net value of military procurement actions by type of contract pricing provision, fiscal years 1951-55

[Dollar value in millions]

	Amount					Percent						
	5-year total	Fiscal year 1951	Fiscal year 1952	Fiscal year 1953	Fiscal year 1954	Fiscal year 1955	5-year total	Fiscal year 1951	Fiscal year 1952	Fiscal year 1953	Fiscal year 1954	Fiscal year 1955
Total contracts.....	\$109,374	\$21,458	\$34,028	\$29,285	\$10,942	\$13,661	100.0	100.0	100.0	100.0	100.0	100.0
Fixed price type, total.....	88,122	18,736	27,954	23,358	7,708	10,366	80.6	87.3	82.1	79.8	70.5	75.9
Firm.....	38,439	9,426	10,129	9,308	4,158	5,419	35.2	43.9	29.8	31.8	38.0	39.7
Flexible <sup>2</sup> .....	27,360	7,192	12,677	5,771	270	1,449	25.0	33.5	37.2	19.7	2.5	10.6
Maximum <sup>3</sup> .....	1,692	14	446	598	368	266	1.6	.1	1.3	2.1	3.4	1.9
Incentive.....	18,941	1,951	4,080	7,030	2,756	3,124	17.3	9.1	12.0	24.0	25.2	22.9
Escalation.....	1,689	1,152	622	652	155	107	1.5	.7	1.8	2.2	1.4	.8
Cost reimbursement type, total.....	21,253	2,722	6,074	5,927	3,234	3,295	19.4	12.7	17.9	20.2	29.5	24.1
No fee.....	3,512	855	1,523	482	289	363	3.2	4.0	4.5	1.6	2.6	2.7
Fixed fee.....	16,442	1,862	4,510	4,780	2,607	2,693	15.0	8.6	13.3	16.3	23.8	19.7
Incentive fee.....	1,102	15	42	631	277	193	1.0	.1	.1	2.2	2.5	1.4
Time and materials.....	197			34	62	45	.2			.1	.6	.3

<sup>1</sup> Excludes intragovernmental procurement; excludes Armed Services Petroleum Purchasing Agency procurement; includes overseas procurement. For the fiscal years 1952-55 excludes all procurement actions under \$10,000. For fiscal year 1951; for Army, excludes actions under \$100,000, for the Air Force, actions under \$10,000, and for Navy, actions under \$5,000. Also, for the Navy Department, some letters of intent (on which pricing provisions had not been determined), during fiscal years 1951 and 1952, have been omitted.

<sup>2</sup> Redetermination upward or downward.  
<sup>3</sup> Redetermination downward only.

Source: Office of the Assistant Secretary of Defense (Supply and Logistics) Statistics Branch, Dec. 2, 1955.