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HEARING  
BEFORE THE  
SUBCOMMITTEE ON TACTICAL AIR POWER  
OF THE  
COMMITTEE ON ARMED SERVICES  
UNITED STATES SENATE  
NINETY-THIRD CONGRESS

SECOND SESSION

JULY 24, 1974

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# NAVY DEPARTMENT F-14/GRUMMAN FINANCING

WEDNESDAY, JULY 24, 1974

U. S. SENATE,  
SUBCOMMITTEE ON TACTICAL AIR POWER  
OF THE COMMITTEE ON ARMED SERVICES,  
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 224, Richard B. Russell Senate Office Building, Hon. Howard W. Cannon (chairman).

Present: Senators Cannon (presiding), Symington, and Goldwater.

Also present: Charles Cromwell and George Foster, professional staff members.

## CHAIRMAN'S OPENING STATEMENT

Senator CANNON. The committee will come to order.

Today the Tactical Air Power Subcommittee will review with the Navy their request to continue making "advance payments" to Grumman on Navy airplane contracts and to increase the maximum allowable amount of such payments up to \$100 million.

A year ago this subcommittee held extensive hearings on the F-14 program, and at that time we covered in depth the Navy's advanced payments financing arrangement with Grumman. Testimony then, by Navy witnesses, was that Grumman's line of commercial credit with their banks had been withdrawn in the summer of 1972 when the company's large potential loss in the F-14 fixed price contract was revealed. The Navy had stepped in and arranged to provide advance payments on all of the Navy airplane contracts with Grumman in order to prevent the company from going into bankruptcy and to allow the company to continue to build the airplanes needed by the Navy: the F-14 fighter, the E-2C radar warning airplane, the A-6E attack bomber, and the EA-6B electronic jamming airplane. The testimony of a year ago was that up to \$90 million in advance payments was required to finance Grumman until the 134 airplanes up through lot 5 of the F-14 program (the "loss" airplanes) were delivered.

Also last year, the Navy and Grumman broke the old total package contract for F-14s and agreed to a new fixed price contract for the 50 F-14 airplanes in the fiscal year 1974 program. This contract was signed in September 1973.

This committee had recommended last July authorizing only \$192.7 million toward the total request of \$703 million for those 50 F-14s in what could be termed "lot 6" of the F-14 program. This would have provided partial funds to continue the program only through December 1973, and the committee took the position that,

before the Congress approved full funding, the Navy and Grumman should resolve their differences over the contract price for F-14s in fiscal year 1974. Also, the committee directed that the Navy should settle the remaining contract issues in the old total package F-14 contract which had been closed out by the Secretary of the Navy. The major unresolved issue there was the production schedule for the 134 F-14As purchased under the old fixed-price contract, the one which caused a \$200 million loss to Grumman.

Because of this position taken by the committee, the Navy and Grumman last August negotiated a fixed-price contract for the 50 F-14s in the fiscal year 1974 request. Because of the existence of this fixed-price contract for 50 F-14s, signed by both the Navy and Grumman, I sponsored a floor amendment to the fiscal year 1974 authorization bill, which restored full funding to the F-14 program for that year. This amendment was accepted by the Senate, and the F-14 program received full appropriations in January of this year.

That fixed-price contract contained several contingency clauses. One was that appropriations had to be provided for the 50 airplanes. Another was that the Navy would continue to guarantee availability of financing. When the Navy presented the contract to Grumman for final execution in February 1974, apparently Grumman told the Navy they believed that the "Byrd-Proxmire" amendment to the fiscal year 1974 authorization bill raised a legal question on the ability of the Navy to provide such a guarantee to continue advance payments without prior congressional approval.

The Byrd-Proxmire amendment that was added to the bill last year requires that, on all future contracts subsequent to enactment of last year's bill, congressional approval must be obtained before advance payments in excess of \$25 million can be provided. This amendment was added to the fiscal year 1974 authorization bill after the F-14 fixed price contract had been negotiated between Grumman and the Navy. Grumman apparently took the position that the spirit of the amendment was such that specific congressional approval probably would be required to continue the advancement payments program. Therefore, Grumman refused to execute the contract to put it in force until the Navy could guarantee this assistance would be continued, and the Navy had Grumman proceed with the long lead production items for the planes under an amendment to the prior contract (the usual practice) while this latest contract dispute was being resolved.

Now, I must add that the Tac Air Subcommittee had testimony on the F-14A program on March 21, 1974, and not one word was mentioned by the Navy witnesses about the fact that the company had refused to go ahead with the fiscal year 1974 contract. I know of no instance when Navy or Defense Department officials were over here to testify on the fiscal year 1975 budget request where they informed any congressional committee of this situation until this May, after it was discovered by this committee's staff.

The Byrd-Proxmire amendment also required, after the Congress was informed of the Defense Department's intention to provide advance payments of over \$25 million to a contractor, that there be a wait for 60 days of continuous session of Congress. If a resolution that specifically rejects authorization for these advance payments is

not forthcoming from either House of the Congress within the 60 days, then the permission to make the payments is considered to be granted. In other words, it takes a specific act of rejection by the Congress to disapprove the advance payments requested.

The purpose of today's hearing will be to cover certain specific areas. We want to determine how much advance payment authority is required and what would happen if the advance payment is denied. Also, we will examine the terms and conditions of the proposed new advance payments agreement, and we will review how the Navy has administered the current advance payment agreement which has been in effect since August 1972. We also want to determine the present situation with respect to Grumman's resuming a line of credit with the banks and find out what incentives there are for Grumman to return to normal bank financing.

Our principal witness today is Vice Adm. Kent Lee, Commander of the Naval Air Systems Command. He will be supported by Rear Adm. S. J. Evans, Deputy Commander for Contracts, plus others who have been associated with the administration of the advance payments now being made to Grumman.

Admiral Lee, will you proceed with your statement.

**STATEMENT OF VICE ADM. K. L. LEE, USN, COMMANDER, NAVAL AIR SYSTEMS COMMAND, ACCOMPANIED BY REAR ADM. S. J. EVANS, USN, NAVAL AIR SYSTEMS COMMAND; REAR ADM. J. H. ALVIS, USN, PROJECT MANAGER, F-14, NAVAL AIR SYSTEMS COMMAND; J. C. CRUDEN, ASSISTANT DEPUTY CHIEF OF NAVAL MATERIAL (PROCUREMENT AND PRODUCTION); V. J. SZAREK, OFFICE OF NAVY COMPTROLLER; HARVEY J. WILCOX, COUNSEL, NAVAL AIR SYSTEMS COMMAND; AND JAMES SANDRIDGE, OFFICE OF NAVY CONTROLLER**

Admiral LEE. Thank you, Mr. Chairman.

I am grateful for this opportunity to appear before your committee to discuss the current status of the F-14A procurement.

I am mindful that both the members of this committee and its staff are thoroughly conversant with the history of this aircraft program and our contracts with Grumman Aerospace Corp. for the procurement of the F-14. However, I seek your indulgence in a brief review of some of the salient facts relating to the contractual status of this program.

In particular, I would like to address the status of the fiscal year 1974 contract, Grumman's current and projected financial requirements, the available financing alternatives to meet such requirements and the deliberations involved in addressing them; the impact of the Iranian procurement on such deliberations, and the associated delays leading to our recent decision and notification to the Armed Services Committees of our intention to enter into a \$100 million advance payment agreement with Grumman for U.S. Navy aircraft.

Last year, due to an originally projected date of December 31, 1973, for completion of negotiations with Grumman, the Senate Armed Services Committee recommended authorization of \$197.6 million toward the total fiscal year 1974 request of \$703 million for 50 F-14s,

thereby funding the program only through December 31, 1973. The committee took the position that prior to its consideration of full funding the Navy and Grumman should settle outstanding schedule and pricing issues under the original contract for deliveries through lot V and complete fiscal year 1974 contract negotiations, after which the Navy should return to the Congress with full justification for the remaining fiscal year 1974 funding requirement and present for this committee's review a copy of the proposed fiscal year 1974 contract.

On August 31, 1973, a copy of the proposed F-14 contract was presented to this committee's staff for review. In submitting this contract we did our utmost to comply with the instructions that this committee gave us after long and extensive hearings in the spring of 1973, and to provide you with assistance in your review of the fiscal year 1974 contract. As you recall, careful review and considerable discussion took place before this committee regarding the March 8, 1973, agreement between the Secretary of the Navy and Grumman Corp., relating to completing performance through lot V of the original contract, conducting separate annual contract negotiations for subsequent F-14A procurements and the extent and cause of Grumman's financing needs.

During those hearings, it was pointed out by Department of Defense witnesses that until the resumption of bank financing, \$80 to \$90 million in advance payments would be needed to support Grumman's production of lots III, IV, and V. Further, Department of Defense witnesses expressed the desire and objective for a return to commercial financing at the earliest opportunity. This continues to be one of our primary objectives.

In its performance of lots I through V of the basic F-14 contract Grumman suffered losses in the approximate amount of \$220 million. Those losses resulted in negative Grumman Corp. earnings in 1971 and 1972. We also recognized that the \$220 million loss sustained by Grumman would continue to have a substantial adverse impact on corporate cash flows until the remainder of the 134 aircraft produced under lots I through V were delivered. The impact of this loss on Grumman's financing requirement would increase until delivery of the profitable fiscal year 1974 F-14 buy. It was for these reasons that the contract submitted to your committee on August 31, 1973, for review and consideration during congressional deliberation of the fiscal year 1974 Defense Authorization Act contained a provision (J-32) for advance payment as follows:

The payment provisions of this contract are subject to the terms and conditions of a certain advance payment pool agreement between the Government and the contractor entered into as of 8 August 1972 and this contract shall be deemed as a "Pool Contract" for the purpose of said agreement.

Since the fiscal year 1974 contract was to be signed prior to the passage of the Defense Authorization and Appropriation Acts it was deemed necessary, as you know, to include a special clause (J-34) providing that the contract would become effective only if the authorization and appropriation acts were passed without any restriction inconsistent with the contract terms.

Paragraph (C) of section 807 of the Authorization Act, passed 2 months after this committee had reviewed the terms of the fiscal year 1974 contract, created, in our view, a potential restriction on our ability to carry out the advance payment provision of the contract. Section

807(C) limited the amount of advance payments that could be made without prior congressional notification to \$25 million. The prior negotiation and conditional execution of the contract, plus its review by this committee even before the introduction of the amendment which resulted in section 807, suggested that this contract might come within the exception of section 807(E) for prior commitments. At the outset there was, in any event, sufficient doubt in our minds concerning the applicability of these new provisions to a situation as unusual as ours to cause very careful consideration of the matter.

In January, upon passage of the fiscal year 1974 Appropriations Act, a modification to the fiscal year 1974 contract was issued to Grumman containing full funding and establishing an effective contract date of January 25, 1974. Discussions with Grumman ensued regarding the applicability of section 807. The Navy concluded that while some ambiguity existed regarding this new amendment, to avoid any misunderstanding or the possible assumption of congressional prerogatives, the proper course was to consider section 807 as applying to the fiscal year 1974 F-14 contract and to give notice to the Congress should advance payments in excess of \$25 million be necessary. This interpretation by the Navy, coupled with Grumman's acceptance of the contract conditioned upon availability of, adequate financing, made it possible to execute the contract until such time as Grumman financing requirements could be clearly established and appropriate means of financing determined. Notwithstanding this dilemma, Grumman continued work under long leadtime funding, applies to the basic contract N00019-69C-0422, in order to protect the schedules cited in the fiscal year 1974 contract.

On January 7, 1974, a letter of offer was accepted by the Government of Iran for 30 F-14 aircraft. Grumman subsequently proposed incorporating a partial payment schedule in the Iranian contract which would approximate the company's termination liability for production of the 30 Iranian aircraft. In many respects, Grumman's proposed payment schedule was similar to terms found in many contracts executed by U.S. companies when contracting directly with foreign countries. The proposed payment schedule would have substantially alleviated Grumman's overall cash flow problems, and offered a possible basis upon which commercial credit would again become available, and obviate the need for advance payments by the Navy.

Analysis of Grumman's projected funding requirements for U.S. Navy programs established a peak need of approximately \$95 to \$100 million and an additional funding requirement of approximately \$31 million associated with the Iranian procurement of 30 aircraft.

During discussions with Grumman, the Navy requested that Grumman again test the financial markets to determine the availability of commercial credit in light of this new development. Grumman officials agreed to pursue this possibility.

In March, a memorandum was sent forward from the Naval Air Systems Command to the Navy Comptroller identifying Grumman's funding requirements and essentially two financing alternatives; either seeking \$100 million in advance payments for the U.S. Navy buy, or using an Iranian payment schedule which would reduce the balance of Grumman financing below the \$25 million threshold cited in section 807. While these alternatives were being pursued, Grumman

tested the availability of bank financing and found a willingness among a number of banks to offer lines of credit subject to three conditions; first, that the Grumman proposed payment schedule under the Iranian contract, closely approximating termination liability, be incorporated in the Iranian contract; second, no requests for borrowing under the line of credit offered would be made while the Navy advance payment agreement remained in effect; and third, the Department of Defense obtained assurances from Congress that U.S. advance payments would be resumed, if necessary, following any complete or partial termination of the contract by the Government of Iran. However, since the arrangement had no precedent and involved the U.S. Government in an unusual financial plan with the Government of Iran, the sensitivity of this matter demanded lengthy deliberation at the various levels of review with the Department of Defense.

The final decision regarding the selected alternatives for financing Grumman was not made until June 3, 1974. On June 4, 1974, Secretary Middendorf signed notification letters to the Armed Services Committees advising of the Navy's intent to enter into advance payment agreement with Grumman for \$100 million for U.S. Navy programs and, on behalf of the Iranian Government, to enter into an advance payment agreement using Iranian funds, with terms equivalent to that of the U.S. Navy's agreement, for only the Iranian portion of Grumman's financing needs.

In the final analysis, the decision to forgo the financing benefits of employing a special Iranian payment schedule was based on a policy decision to avoid establishing such a precedent for other FMS cases.

In order to protect the fiscal year 1974 deliveries of F-14 aircraft, an initial increment of \$6.4 million in long-lead moneys was provided on June 7, 1973, funded by fiscal year 1973 appropriations. At the time of enactment of the Defense Appropriations Act in January 1974, \$81 million in long-lead funds has been provided to Grumman for the fiscal year 1974 F-14 effort. Grumman has continued working on the fiscal year 1974 buy in order to protect schedules and as of this date a total of \$161 million has been provided to them for this purpose. As authorized in the fiscal year 1974 act, about \$24 million in long-lead moneys have also been provided to Grumman to protect the fiscal year 1975 deliveries. I would like to emphasize that such funds have been provided only for long-lead items and efforts, and have not been drawn on for advance payments.

Senator CANNON. Are you referring there to the \$24 million?

Admiral LEE. By drawing on advance payments we mean that the value of this fiscal year 1974 and 1975 contract has not been added to the value of the fiscal year 1969 contract which determines the amount of advance payments that can be made to Grumman.

Senator CANNON. I am referring to what you relate back to—are you relating back to that \$24 million in long-lead moneys as authorized in the fiscal year 1974 act?

Admiral LEE. 1975, yes, sir, the 1975 long-lead money and the 1974 act, yes, sir.

Regarding the performance of Grumman and the F-14, deliveries now being made under lot IV are, as of July 10 on schedule. Of the total 79—

Senator SYMINGTON. Your statement shows 81, and you said 79; which is correct?

Admiral LEE. The correct number is 79 aircraft, and we have accepted delivery of 84. I rechecked that number this morning, and it is 79 in flight status. The aircraft are serially numbered and we have accepted delivery of number 84. Fifty-eight are engaged in training and squadron operations. In excess of 14,000 flight hours have been flown. Carrier qualifications aboard the U.S.S. *Enterprise* have gone well. The Carrier Air Wing commander has reported no noteworthy maintenance or support problems. Onboard observers have indicated that the F-14 is experiencing the smoothest introduction to the attack carrier environment of any fleet aircraft in recent history.

In retrospect, the Navy regrets our underestimation of the time required to reach a final decision on a financing plan. An earlier resolution of these questions would have made possible a more timely notification of Congress. Further, I would like to assure this committee that there never was any intent by the Department of Defense to circumvent the provisions of section 807. Indeed, as I have already stated, despite our uncertainty as to its application under the unusual circumstances of this contract, we made the decision early in the deliberative process to adopt a conservative interpretation of section 807 and to notify the Armed Services Committees in accordance with its provisions once it was determined that advance payments in excess of \$25 million would be required.

For the future, I would like to assure this committee that the Navy will continue to pursue every opportunity with Grumman for the earliest possible reentry of bank financing as a substitute for Government advance payment financing. The return of Grumman Aerospace Corp. to profitable operations and the success being experienced during fleet introduction of the F-14 aircraft are providing a growing basis for normal financial arrangements.

Mr. Chairman, this concludes my formal statement. I will now be pleased to answer any questions the committee may have.

#### NAVY WITNESSES

Senator CANNON. Perhaps before we start on the questioning you could have the various backup witnesses identify themselves, Admiral, so that we will have the information for the record.

Admiral LEE. On my left is Rear Adm. John Alvis, he is the F-14 program manager. On my right is Mr. Harvey Wilcox, General Counsel of the Naval Air Systems Command. And on the far right is Rear Admiral Evans, who is contracting officer for the Naval Air Systems Command and then in the back row we have some additional back-up witnesses.

Senator CANNON. When these people are called will you have them state their names and identify themselves?

Admiral LEE. Yes, sir.

#### DEFINITION OF ADVANCE PAYMENTS

Senator CANNON. First, let us start off with the basic question of definition. Would you describe exactly what "advance payments" are and how they differ from progress payments?

Admiral LEE. Yes, sir. May I start with progress payments?

Senator CANNON. Certainly.

Admiral LEE. Our normal way of doing business in Aerospace and the Naval Air Systems Command is to write a contract with an aerospace company which provides 80-percent progress payments to that company. That means the following: that for every dollar spent by the company in fulfillment of this contract, we give them progress payments of 80 cents. That means for every dollar they spend we give them 80 cents. The remaining 20 cents is expected to be supplied by the company either from their internal assets or from a line of credit with various banks.

So that defines progress payments. And that is the way we normally do business in the Naval Air Systems Command.

That brings me to the advance payment agreement. In April 1972 Grumman had a line of credit with a number of banks. They lost that line of credit. The Navy then, using this procedure of advance payments, and based on a decision by the Secretary of the Navy, agreed to serve as Grumman's banker. An advance payment really means that we serve as Grumman's banker, and we loan them money in the form of advance payments on which they pay interest. We have advance payment agreements with Grumman which sets forth the terms and conditions of this banking procedure. Also there are rules and regulations on how this advance payment agreement is written, the interest charged, and how it will be amended.

The advance payment agreement is essentially a banking agreement with the corporation.

Senator CANNON. Does that represent advance payment, a portion of that added 20 cents out of each dollar that has been put into performance of the contract?

Admiral LEE. Yes sir. I should have stated that normally a company uses its own assets or a line of credit to supply that additional 20 cents for the work they perform. This advance payment supplies that additional 20 cents, at least a part or all of it.

#### LIMITATIONS ON AMOUNT OF PAYMENTS

Senator CANNON. That is my next question. Does an advance payment on occasion supply all of it, or does it supply only a portion of that 20 cents?

Admiral LEE. Normally only a portion of it, not all of it, although in theory, I believe, it can supply all of it.

Senator CANNON. How do you make the determination of what portion of the 20 cents, or when all of the 20 cents should be advanced.

Admiral LEE. We have advance payment agreements with Grumman, as I stated earlier. There are several limits in this advance payment agreement. Limit No. 1 is the total amount that we can loan Grumman. The current total agreement is for \$54 million.

No. 2, the agreement states that we can loan them money to carry on their business only for costs incurred, so that under this pool contract, and in the administration of it, the way it is set up, we should not get to the point when we are loaning Grumman or any corporation with this type of agreement, more money than they need to pay for cost incurred and operate their business.

Senator CANNON. Can you loan them more money than they have actually expended in the performance of the contract, in advance

payments? In other words, can you advance them payment for work that has not yet been performed.

Admiral LEE. The agreement states that for costs incurred, it is not necessarily bills paid by Grumman on that particular date, it is for cost incurred. As they incur costs we can provide them money from this bank account. So cost incurred would normally include work performed, and it would include materials ordered, and it would include various overhead, and it would include various other operations of the company. In addition, as a matter of policy, we have agreed that Grumman could, under an informal agreement, maintain 6 days working capital in the company. This 6 days working capital roughly amounts to \$13 million.

Senator CANNON. Could these advance payments at any time exceed the total prospective obligations of the Government on that contract?

Admiral LEE. No sir. The reason is that in the advance payment agreement as written there was another limitation which I did not describe. This limitation states the following: That the sum of progress payments and advance payments and final payments under this arrangement cannot exceed 95 percent of the total value of the contract. So that when the sum of advance payments, progress payments, and other final payments reach 95 percent, then as they deliver their product, namely, the aircraft in this case, the final payments for that product goes to pay off the loan. So the value of advance payments, progress payments, and final payments cannot exceed the total value of the contract at any time.

Senator CANNON. I thought a minute ago you said it could not exceed 95 percent?

Admiral LEE. Ninety-five percent of the value of this contract at any time.

Senator CANNON. You have given us two figures, No. 1, 100 percent and No. 2, 95 percent.

Admiral LEE. The 95 percent is written in the agreement.

Senator CANNON. You cannot exceed 95 percent of the value of the contract at any one time, is that correct?

Admiral LEE. Yes, sir, that is correct.

#### DIFFERENCE BETWEEN FIXED PRICE AND COST CONTRACTS

Senator CANNON. How does payment differ on fixed price contracts and on cost-type contracts, such as are usually used on R. & D. items.

Admiral LEE. I do not think there is any real difference.

May I ask Admiral Evans to speak to that?

Senator CANNON. Let me put it in the form of a question. Is it a fact that, on cost-type contracts, they are reimbursed 100 percent for costs incurred as the contract goes on?

Admiral EVANS. Yes, they can be. However, we do not have any cost-type contracts of that nature involved in this advance payment agreement.

Senator CANNON. I understand you do not. But I am just trying to get a comparison here. In other words, this could be considered to compare with a cost-type R. & D. contract where you would advance

100 percent of the costs as they are incurred, and here you could advance up to 100 percent of the costs incurred, but not to exceed 95 percent of the total value of the contract, is that correct?

Admiral EVANS. Yes, sir.

#### NORMAL FINANCING METHODS

Senator CANNON. How does a contractor who is working on a fixed price contract normally finance the difference between the 80-percent progress payments and the 100-percent cost incurred?

Admiral LEE. Normally he has a line of credit with banks. He uses money from this line of credit to finance his work.

Senator CANNON. Then can advance payments be considered to be a Government loan, since they are payments made to a contractor in lieu of his own normal financing?

Admiral LEE. Yes sir, we would consider it a loan.

#### INTEREST CHARGES ON ADVANCE PAYMENTS

Senator CANNON. You said in your statement that the Government charges interest on these advance payments. Is there a provision for the rate of interest, or how the interest rate is to be determined?

Admiral LEE. The interest rate is determined in accordance with Armed Services Procurement Regulations. It states that the interest rate in such advance payment agreements—this advance payment agreement is a separate document; as I understand it, from the contracts we have with Grumman for F-14s, E-2Cs, and other aircraft, but in our procurement regulations it states that in advance payment agreements, interest will be charged as determined by the Treasury Department under Public Law 92-41, provisions for interest. I would just briefly read this, if I may, how such interest rates are determined for advance payments. It says: "Interest shall accrue and be paid at a rate which the Secretary of the Treasury shall specify as practicable to the period beginning on" this happens to be for some other agreement—"July 1 1971, and ending on December, 31, 1971, and on each 6-month period thereafter. Such rate shall be determined by the Secretary of the Treasury taking into consideration current private commercial rates of interest for new loans maturing in approximately 5 years."

So in accordance with procurement regulations, we use this Treasury Department interest determination to set the interest in any one of these advance payment agreements.

Senator CANNON. Under that prescription would it be possible for you to use an interest rate that was less than the rate currently charged the U.S. Government on Treasury bills.

Admiral LEE. Yes, sir. As a matter of fact, that exception is in this case, in the old agreement.

Senator CANNON. Under that prescription is there any requirement that the Treasury take into account the current prime rate?

Admiral LEE. No, sir.

If I could quickly review it, in 1972 when the original advance payment agreement was signed, prime rates were 5½ percent. This Treasury rate which was to be used for the advance payment agree-

ment was determined to be 6½ percent. Treasury bill rates were less than that at that particular time. As you know, since that time we have had very turbulent financial times with prime rates going up to 11½ percent. There was no provision made in this advance payment agreement, the original one, for changing that interest rate. However, in the new advance payment agreement, copies of which we have provided your staff, we have gotten concurrence with the procurement regulation group down in the Office of the Secretary of Defense to use the new interest rate that the Treasury Department provides each 6 months, so that we will have in effect a floating interest rate in this new agreement.

Senator CANNON. Would that floating rate, then, specify that you could either charge the rate charged the U.S. Government or charge the prime rate, whichever is higher?

Admiral LEE. The floating interest rate is that that will be determined by the Treasury Department based on the interest for new loans maturing in approximately 5 years, commercial loans. It turns out that that rate for the 6-month period we are now in is 9½ percent. Treasury bills, I might add, as I noted in yesterday's paper for the latest period were 7.6 percent. So that this particular rate would be considerably higher than Treasury bills current.

Senator CANNON. That would be the new rate under your proposed agreement?

Admiral LEE. Yes, sir. But the old rate is, as you see, less than the Treasury bill rate currently.

Senator CANNON. So that it truly is costing the Government money at the present time to make these advance payments to Grumman, because it is costing the Government more to borrow the money than they are receiving back in interest payments for the money that they advance to Grumman?

Admiral LEE. Yes, sir.

#### INVESTMENTS IN SHORT-TERM SECURITIES

Senator CANNON. Would it be possible for Grumman in this case to secure advance payments and reinvest them in short-term notes and make money on this proposition?

Admiral LEE. Mr. Chairman, may I comment on that general subject and put it in context as we proceed?

Senator CANNON. Yes. That question was, "Would it be possible," and my next question is going to be, "Did they do that?"

Admiral LEE. You know, most businesses have a certain amount of cash to operate their businesses. We have allowed Grumman to have, as I said earlier, 6 days operating money, roughly \$13 million. Also most businesses of any size use cash that they have on a daily basis to operate their business in the short-term security market. I think Grumman does it, Southern Railroad does it. I was president of the Navy Federal Credit Union, and we did it, we invested our cash which was in the till on a 1-, 2-, 3-day basis in Treasury bills and FNMA series and the like. When this original document was signed, there was certainly no incentive, with Treasury bills going for less than 5½ percent and Grumman paying 6½ percent, for them to take additional advance payments and try to make money in the short-term market. With the turbulent financial times of the past few

months, and especially in 1974, of course Grumman has been getting 6½ percent money, and then this cash that they have kept in the till, they have, since the beginning of the advance payment agreement, kept invested in short-term securities, as is standard practice for businesses. They were getting roughly the Treasury bill rate or the FNMA certificate rate for this cash. With the new agreement of 9½ percent, and with Treasury bill rates, as I said a moment ago that I noted in yesterday's paper of 7.6 percent, it seems to me that that incentive would be taken away from them. But in the advance payment agreement there is nothing in the agreement which prohibits Grumman from following these normal business practices of keeping itself—whatever they have in the till—invested on a very short-term basis.

Senator CANNON. Do you not think it was incumbent to have in the agreement a provision for that, so that Grumman or any other contractor could not receive advance payments from the Government and lend them out on short-term notes to make a profit on the transaction?

Admiral LEE. I do not think we should penalize Grumman by not allowing them to follow the normal business practices. I think when we can improve our advance payment—

Senator CANNON. Wait a minute. Penalize them by not letting them follow normal business practice? We are already giving them an advantage by letting them have low-cost money loaned from the Government, and giving them an unfair competitive advantage over their competitors. Do not their competitors have to go out on the open market and borrow money at the prime rate, or whatever discount they can get on the prime rate?

Admiral LEE. Yes, sir.

Senator CANNON. Then does that not put Grumman in a preferred competitive position vis-a-vis their competitors in this business?

Admiral LEE. I would think so, yes sir.

#### LACK OF INCENTIVE TO OBTAIN BANK CREDIT

Senator CANNON. Would not that be an incentive for them not to go to the banks for a line of credit, so long as they can get advance payments under these favorable terms?

Admiral LEE. I think that certainly could be one incentive, looked at in that light. But I think there are other incentives for them to go to the bank. But in our advance payment agreement we have initially planned, and now we have 2 years' experience with it, to let them have advances on about a monthly basis, and they would have enough cash to operate. In looking at what has happened in the financial market, it is very possible that what we should do is advance to Grumman only what we believe will cut down their cash balances below that \$13 million or 6-day figure, and instead of having a medium-term loan with them which is about what this is, have a shorter term loan and more nearly a line of credit, because as we have done business on this monthly basis, this has allowed Grumman to have a reasonable amount of cash in the till. As I stated a moment ago, we have considered 6 days and \$13 million reasonable. But we think that we probably ought to go—and we have been discussing this within the Navy, and we discussed it with Grumman—to a weekly accounting with them in this advance payments area.

## NAVY AUDIT CONTROLS

Senator CANNON. How close an accounting check does the Navy keep on Grumman in this situation?

Admiral LEE. I would describe it as reasonably close, Mr. Chairman. We have a procurement office on site at Grumman. We have Defense auditors to spot check what goes on at Grumman in this area on a periodic basis, and quarterly. You know the administrator for advance payments in banking and finance in the Navy is Assistant Secretary for Financial Management. He has a section that handles this. Quarterly, Grumman sends down a great package of financial statements, and so forth, which our people study and look at and make sure that the terms of the agreement are being carried out.

## GRUMMAN PROFITS ON SHORT-TERM INVESTMENTS

Senator CANNON. Then if you have that close an accounting check, would you state for the record the amount of profit that Grumman has made as a result of borrowing the money from the Government at a low interest rate and then reinvesting in short-term notes and receiving a higher rate of interest?

Admiral LEE. May I supply those for the record, sir?

Senator SYMINGTON. Could you identify the gentleman behind you that you talked to?

Mr. CRUDEN. J. C. Cruden, Assistant Deputy Chief of Naval Material.

Admiral LEE. What we should like to supply for the record is the interest Grumman has received on short-term securities for the years 1972, 1973 and to date in 1974.

Senator SYMINGTON. And the other gentleman next to him?

Admiral LEE. Mr. Val Szarek, General Counsel for the Controller of the Navy Department, is almost directly behind me.

Senator CANNON. I think I can supply that for the record right now, as long as we are on it.

The question propounded to the Navy was, "How much interest has been earned on temporary investment since the advance payment pool agreement was signed as of August 8, 1972." And the answer supplied to the staff is this, "Since there are both temporary cash peaks and valleys throughout the course of the month, irrespective of the source of financing, overnight, or possibly longer, investments of cash are made in Government obligations. Income from such investments since August 1972 was as follows: August 1972 to December 1972, \$300,000. For the year 1973, \$1.7 million. January 1 of 1974 through May 31, 1974, \$800,000." So that would be \$2,800,000 over that period of time.

Admiral LEE. Yes, sir. I believe we supplied that to your staff.

Senator CANNON. Yes; this is from your supplied information. So if I have that correctly, then, Grumman made a profit of \$2,800,000 over that period on the money that they received in advance payments from the Navy and reinvested in short term investments.

Admiral LEE. That, I believe, is the Grumman Corp. Grumman Corp. includes several subsidiaries, Grumman Aerospace being one of them. They make up about 85 percent of Grumman. Two of those subsidiaries in Grumman Corp. have lines of credit of their

own, one \$13 million and one \$10 million. I do not know what assets Grumman Corp. has. But I believe those numbers you read were for Grumman Corp. rather than for Grumman Aerospace.

Senator CANNON. The issue, it seems to me, is rather clear cut. If the other subsidiaries were not receiving advance payments, then it would be to their interest as they received money, to pay off their bank obligations because the bank obligations are at a higher rate than is paid to the Government here?

Admiral LEE. Yes, sir.

Senator CANNON. So truly during this period of time this one subsidiary at least received advance payments money that they loaned out on short-term notes, is that not correct?

Admiral LEE. They had extra cash which they put out on short-term notes, yes.

Senator CANNON. The cash which they put out on short terms was less than the amount of advance payments that they received from the Government?

Admiral LEE. Yes, sir.

Senator CANNON. So that the money that they made on short terms would in fact have been a profit on money that they got in advances from the Federal Government?

Admiral LEE. Yes, sir. But as I said earlier, Senator, we have allowed Grumman to keep working cash on hand in the amount of about \$13 million as a minimum.

Senator SYMINGTON. Will the chair yield there?

Senator CANNON. Yes, sir.

Senator SYMINGTON. In other words, are you saying that this has been a consistent policy of the Navy over a period of years, that they allow the contractor to make money on advance payments? Or is this a unique case?

Admiral LEE. This is a unique case, Senator Symington.

Senator SYMINGTON. Thank you.

Admiral LEE. We do not have a precedent like this in our record for advance payments.

Senator SYMINGTON. This is the first time to the best of your knowledge that you have advanced payments beyond the agreement that you made with the Congress, and the contractor reinvested that money and made money because of the difference in the interest rates, is that a fact?

Admiral LEE. Senator, we did not advance payments to Grumman over and beyond, over and above and beyond our agreement with Grumman.

Senator SYMINGTON. You did not?

Admiral LEE. No, sir. We made advance payment to Grumman strictly in accordance with our agreement to Grumman.

#### ADVANCES AND DEPOSITS IN 1973 ANNUAL REPORT

Senator CANNON. I have here the Grumman Corp. 44th Annual Report, for the year 1973. On long-term debt it shows for 1973, Advances from the Government, \$24 million. And at the same time, Marketable Securities at Cost for 1973, \$31,358,273. So that would

indicate that \$24 million of that amount that was invested in marketable securities was on loan from the Government, is that it?

Admiral LEE. The advances to Grumman Aerospace were \$24 million, the advances to Grumman Aerospace on that date were \$24 million. That is a subsidiary of Grumman. I believe that the \$31 million—

Senator CANNON. Wait a minute now. The financial statement here is for the Grumman Corp. and subsidiaries, their consolidated report, and it shows \$24 million in advances from the Government, and at the same time investments in marketable securities at cost of \$31,385,273.

Admiral LEE. Yes, sir. Of that amount, I believe, \$14 million was from Grumman Aerospace.

#### EFFECT OF DISAPPROVAL OF ADVANCE PAYMENTS

Senator CANNON. Admiral Lee, what would be the effect if your request to continue advance payments to Grumman on the fiscal year 1974 and fiscal year 1975 Navy contracts was disapproved?

Admiral LEE. Mr. Chairman, I think Grumman would have a very difficult time paying bills. They would not be able to meet their payroll. I think they would not be able to deliver the airplanes, the F-14s, the E-2Cs, the A-6Es and the EA-6Bs that we have contracted for with them.

Senator CANNON. At what point in time would Grumman be unable to continue?

Admiral Lee. The current advance payment agreement with Grumman will reach the 95 percent point sometime after August 15. At that time, for each aircraft they deliver, the final payment for that aircraft would go to pay off the advance payments that we have now given to them. So that when we reach that 95 percent point sometime after August 15, then we would not be able to serve as their banker any longer.

Senator CANNON. So that in effect they would not be able to pay their September bills, is that correct, or payrolls in September.

Admiral LEE. Yes, sir, starting in September.

#### OTHER POSSIBLE FINANCING ALTERNATIVES

Senator CANNON. What alternatives would be available to Grumman if advance payments were not continued?

Admiral LEE. The alternatives—I think perhaps this is a question that Grumman ought to answer, but I suppose the alternatives would be to seek commercial financing, which they have tried, and possibly make an attempt to issue equity securities of some type. But I think all of these would be very difficult choices for Grumman.

Senator CANNON. Or title XI bankruptcy?

Admiral LEE. Or title XI.

Senator CANNON. Do you know whether or not Grumman has explored these other alternatives?

Admiral LEE. I do not know the details that they have gone into with these other alternatives, Mr. Chairman.

Senator CANNON. Senator Goldwater?

## CURRENT GRUMMAN ASSETS

Senator GOLDWATER. Does Grumman have any assets on hand that can be converted into the required cash?

Admiral LEE. I am not all that familiar with Grumman's assets on a detailed basis, Senator. But I know their net worth is around a \$100 million. Their net worth when they signed this contract was pretty close to \$300 million. It went down to roughly \$72 million. As I said a moment ago, their net worth now is \$100 million. They have some land and other assets around their company there, some buildings and machinery, and other equipment. We do not think they have many assets that could be converted into cash at the moment.

Senator GOLDWATER. Does Grumman Aerospace own these assets, or are these assets owned by the other companies that are in Grumman?

## OTHER GRUMMAN CORPORATE SUBSIDIARIES

And by the way, how many companies are in Grumman?

Admiral LEE. There is Grumman Corp., and then they have a half dozen subsidiaries. I have a copy of their report here which lists each subsidiary and their total securities last year and profit, and so forth.

May I put that in the record, Senator? Because I do not know the details of each one of these subsidiaries, Grumman Aerospace being one of them, the company we do business with, and the company we have advance payment agreements with—

Senator GOLDWATER. What I am getting at is, where would the assets be carried, such as land and buildings and so forth? Would they be carried under the other companies or carried under Grumman Aerospace.

Admiral LEE. I think the assets for certainly all the military work and the work that we do with Grumman would be carried under Grumman Aerospace. I would think that assets for Grumman American Corp., another subsidiary which builds their Gulfstream and some other planes, would be carried under Grumman American Corp.

Senator GOLDWATER. The other companies make money, do they not?

Admiral LEE. In their annual report at least three of the other companies make money, from my reading of it last night.

Senator GOLDWATER. Do you think that there is some way that Grumman could reorganize to present a better financial picture to the financial fraternity so that they might be able to finance this through banks and not through the Federal Government?

Admiral LEE. We hope so.

Senator GOLDWATER. We have been hoping so for a long time.

Admiral LEE. Yes, sir.

Senator GOLDWATER. I do not mind telling you that here is one Senator that has hoped for the last time, they either put their house in order or they are not going to get any help from me, I do not care whether they build the F-14 or not. I am getting tired of this one big company consistently being unable to meet its financial needs when it has such a lucrative set of contracts with our Government, and now the Government of Iran. That is the whole purpose of my

question. I do not expect that you can give me the answers that are close to the heart of the Grumman executives. But I would hope that we could get at this.

Admiral LEE. Yes, sir.

Senator GOLDWATER. I have no other questions, Mr. Chairman. I would hope that we might be able to get some indication from Grumman of what they propose to do about changing their corporate structure, if it can be done, to a point that their other assets can be used instead of relying on us.

Senator CANNON. Senator Symington?

Senator SYMINGTON. Thank you, Mr. Chairman.

Admiral, I will make my questions as short as possible, and I would appreciate your answers being as short as possible, to get the story.

#### NAVY AUDITS AND CONTROLS OVER ADVANCE PAYMENTS

Does the Navy determine whether the contractor has immediate excess cash prior to approving advance payments?

Admiral LEE. May I ask the gentlemen from the Navy Controller's Office who administers this contract. He has a very difficult name.

Mr. SANDIDGE. My name is James Sandidge, from the Navy Controller's Office, the Office of Banking and Contract Financing.

We do not make immediate determination that there is a cash requirement. We do a continuing review of the cash requirements and we receive monthly cash reports. So it is done on a monthly basis, but not immediately before an advance payment.

Senator SYMINGTON. Since you do not know whether there is excess cash prior to approving the advance payment, what justification do you have for using the taxpayers' money for advance payments?

Mr. SANDIDGE. We approve the advances on a monthly basis, and we know there is a requirement during that month for these funds.

Senator SYMINGTON. When did you start reviewing it on a monthly basis?

Mr. SANDIDGE. We have been doing it on a monthly basis since the inception of the advance payment arrangement.

Senator SYMINGTON. When was that?

Mr. SANDIDGE. August of 1972, I believe.

Senator SYMINGTON. The staff feels that you did not make this change to a monthly review until the beginning of this year. Are they incorrect on that, in your opinion?

Mr. SANDIDGE. Yes, sir, I believe so, because we have been getting monthly statements.

Mr. CROMWELL. Is it not correct that the Navy in 1972 made three advances to Grumman and had a \$54 million advance to them by December, and they did not change that \$54 million balance, they left that advance outstanding, until July of 1973?

Mr. SANDIDGE. But we did not advance any additional funds.

Mr. CROMWELL. But did you audit at any time in that 6 months to determine whether they needed all of that \$54 million?

Mr. SANDIDGE. Yes, sir, we checked the cash balance monthly. Those balances averaged somewhere around \$13 million.

Mr. CROMWELL. We have been told in preparing for these hearings that the only audits that ever were made were made in January and May this year.

Mr. SANDIDGE. Audits, yes. But we were receiving monthly financial statements and reports. We were receiving them monthly up until June of 1973, and since then we have been receiving them quarterly, plus periodic cash flow statements.

Mr. CROMWELL. I think, to back this point up, let us have the Navy supply for the record at this point a list month by month of when advances were made and when repayments were made. I think that the records will show that during all of 1973, when Grumman made \$2 million profit on their turnover on short-term notes, that there were only three changes in that position, is that not correct?

Mr. SANDIDGE. That is correct.

Mr. CROMWELL. But you were checking it on a monthly basis?

Mr. SANDIDGE. Yes, sir, it was a cash account, and we were checking it monthly.

Admiral LEE. We would be happy to supply that for the record. [The information follows:]

CHRONOLOGY OF ADVANCES TO GRUMMAN UNDER 1972 ADVANCE PAYMENT AGREEMENT

	Date	Amount
Original agreement.....	Aug. 8, 1972	\$20,000,000
Amendment No. 1.....	Sept. 14, 1972	36,000,000
Amendment No. 2.....	Dec. 12, 1972	54,000,000
	Advances (repayments)	Balance
August 1972.....	\$20,000,000	\$20,000,000
September 1972.....	16,000,000	36,000,000
December 1972.....	18,000,000	54,000,000
June 1973.....	(40,100,000)	13,900,000
August 1973.....	10,100,000	24,000,000
February 1974.....	11,000,000	35,000,000
May 1974.....	7,000,000	42,000,000
June 1974.....	4,000,000	46,000,000
July 1974.....	6,000,000	52,000,000

Mr. CROMWELL. Thank you.

Senator SYMINGTON. Thank you, Mr. Cromwell.

GRUMMAN INVESTMENTS OF CASH BALANCES

The allowance for a cash balance of \$13 million is an unwritten agreement between Grumman and the Navy, and it is not stated in the advance payment agreement, is that not correct?

Admiral LEE. Yes, sir.

Senator SYMINGTON. How do you justify that?

Admiral LEE. It is justified on the basis that Grumman needed about 6 working days cash to operate.

Senator SYMINGTON. Does the Navy confirm that advance payments are invested by the contractor in marketable securities?

Admiral LEE. Yes, sir, we believe that they are investing their excess cash in marketable securities.

Senator SYMINGTON. How much interest does Grumman receive from the investment of marketable securities.

Admiral LEE. I believe these numbers were previously supplied for the record for the years 1972, 1973, and 1974.

Senator SYMINGTON. How much of the cash in marketable securities identified in the 1973 Grumman corporate report are for the Grumman Aerospace Corp., and how much would belong to the parent corporation and other subsidiaries?

Admiral LEE. I believe of that \$31 million, \$14 million was Aerospace money, and I believe the rest was Grumman Corp., and subsidiaries.

Correct that. It is \$14 million of Grumman Aerospace of the \$31 million and the \$17 million was from Grumman Corp., and other subsidiaries.

Senator SYMINGTON. Admiral, you are not under oath. But we presume that you feel you are under oath when you make these statements. I am correct on that, am I not?

Admiral LEE. I have looked at these numbers, and I am giving them from memory.

Senator SYMINGTON. Will you correct the record as soon as you can?

Admiral LEE. Yes, sir.

[The information follows:]

BALANCES OF CASH AND MARKETABLE SECURITIES (AT COST) AT DEC. 31, 1973

[In millions of dollars]

	Grumman Aerospace Corp.	Grumman Corp. and all other subsidiaries except Grumman Aerospace Corp.	Total Grumman Corp. and all subsidiaries
Cash.....	7.8	4.6	12.4
Marketable securities (at cost).....	14.4	17.0	31.4
Total.....	22.2	21.6	43.8

Senator SYMINGTON. Because this matter will have to be settled before any appropriations are discussed.

Admiral LEE. Yes, sir.

Senator SYMINGTON. Where is the contractor depositing the interest earned from the investment in marketable securities?

Admiral LEE. It would be deposited in the general cash account of Grumman, I would assume.

Senator SYMINGTON. Why would they not use it to repay the Navy?

Admiral LEE. If Grumman had sufficient cash to repay the Navy, we believe it would be used to repay the Navy.

Senator SYMINGTON. But I think you just said that they had several million dollars profit. Do you not consider that sufficient cash?

Admiral LEE. I think they owe the Navy at the moment \$52 million in advance payments.

Senator SYMINGTON. In other words, one of the ways that you advance payment to Grumman is by letting them make a profit on this financial deal on the market, correct?

Admiral LEE. I do not believe—in our advance payment agreement there was no prohibition against Grumman's using their ready cash, their daily cash balances, for investment in short-term securities.

#### USE OF SPECIAL POOL BANK ACCOUNT

Senator SYMINGTON. Does the Navy make any audit of payments that Grumman makes out of their general fund account?

Admiral LEE. No, sir.

Senator SYMINGTON. The advance payment agreement gives the Government a lien on funds in the special pool bank account. If these funds are being immediately withdrawn, what lien does the Government have, and what value is this lien?

Admiral LEE. The value of the lien would only be, of course, the value of the bank account.

Senator SYMINGTON. But if they withdraw the funds from the bank account the lien really does not mean anything, does it?

Admiral LEE. No, sir. It only means that we have a lien on the amount of money in that bank account.

Mr. CROMWELL. Admiral, could you have your controller people explain the special pool bank account and how it is administered and operated, at this point in the record. Could we get some help on that?

Admiral LEE. Mr. Jim Sandidge will explain the special pool bank account at First National City Bank.

Mr. SANDIDGE. To get an advance payment in the bank account Grumman submits an invoice to the Navy Comptrollers Office. After reviewing the cash flows and determining that there is a need for such an advance payment, the invoice is approved and forwarded to the disbursing office for payment. They pay the invoice by Treasury check, made payable to the special bank account. It is turned over to Grumman and then deposited in the account.

To make a withdrawal from that account, Grumman submits a request in the form of a check, drawn on the account for countersignature by a Government representative. Supporting this request for withdrawal, they should have substantiating documents, such as payment. The countersigning agent countersigns the check, and they make a withdrawal from that account and then it goes into the general cash accounts.

From that point on there is no separate identity of the dollars in the account.

Mr. CROMWELL. What is the purpose of that special pool account, then?

Mr. SANDIDGE. The purpose of that account is to insure that all payments under the contract, advance payments, progress payments, and delivery payments, flow through that account, and that the moneys are used only for the performance of those pool contracts. The withdrawals from this account are to be used for the performance of the contracts.

## DCAA MEMORANDUM ABOUT SPECIAL POOL ACCOUNT

Senator SYMINGTON. Mr. Chairman, I ask unanimous consent for the record that the memorandums of September 20, 1972, from the Defense Contract Audit Agency, New York region, from the Aerospace Corp., plant 30, be inserted at this point in the record.

Senator CANNON. Without objection.

Senator SYMINGTON. I quote one sentence from there:

It is not possible to determine that funds withdrawn are used solely for the purpose of making payments for the required pool contracts. Accordingly we are unable to validate the strict application of paragraph 2 of the Agreement under the contractors interpretation.

[The document follows:]

DEFENSE CONTRACT AUDIT AGENCY,  
NEW YORK REGION,  
September 20, 1972.

CAR-5.17

Memorandum for naval plant representative, NASC, Grumman.

Subject: Request for clarification pertaining to advance payment pool agreement dated August 8, 1972 between the Government and Grumman Aerospace Corp. (GAC).

Our review of the subject Advance Agreement has revealed that the following paragraphs require interpretation and clarification:

(a) Paragraph 2 of the Advance Agreement states that, "No part of the funds in the Navy Special Pool Bank Account shall be mingled with other funds of the Contractor prior to withdrawal . . ." The contractor interprets this to mean that withdrawals can be made from the Special Fund in any amounts desired (subject only to any remaining balance) to reduce the aggregate costs incurred, but not billed, under the pool contracts. The monies actually withdrawn are deposited and mingled with the contractor's general funds. Thus, it is not possible to determine that funds withdrawn are used *solely* for the purpose of making payments required for the pool contracts. Accordingly, we are unable to validate the strict application of Paragraph 2 of the Agreement under the contractor's interpretation.

(b) Paragraph 3 states that the funds may be withdrawn ". . . solely for purposes of making *payments* for direct material, direct labor, and administrative and overhead expenses required for the purposes of Pool Contracts . . ." (underlined for emphasis). Question raised is whether "payments" for this purpose include the following:

1. *Accruals.*

(a) *Short Term* (paid within normal monthly business cycle, e.g., payroll, vendor invoices).

(b) *Long Term* (paid outside the normal monthly business cycle, e.g., year-end bonuses (excluding those defined in Paragraph 18(a) of the Agreement), franchise taxes, pension, unused sick pay, holiday pay, etc.).

2. *Depreciation and Amortization* (accounting write-offs as opposed to "payments" per se).

3. *Contract Losses* (costs incurred which include allocable loss).

(c) Paragraph 5 states that the unliquidated payments, plus unpaid interest charges, combined with the sum of all payments under the Designated Pool Contract (N00019-69-C-0422, F-14), shall not exceed ". . . 95% of the stated contract price. . ." Question raised is whether this applies to the contract as a whole, individual lots, or specific lot(s). Contractor has interpreted this to be only Lot IV at this time.

(d) Propriety of contractor's withdrawal of funds from the Navy Special Pool Account to its general cash account without documentation other than to "zero" the special account down to monthly level of approximately \$200,000 or less. Moreover, what is the effect of a Government lien as set forth in Paragraph 8

when the special pool account will contain only a minimal value due to the aforementioned procedure now being employed? The contractor has verbally stated that unbilled costs incurred for the pooled contracts will serve as security for such undocumented special cash withdrawals. However, it should be noted that such "security" contains considerable F-14 losses which have not been eliminated.

(e) In connection with Paragraph 21(h), does the term "compensation of" \$40,000 or more include fringe benefits (pension, group insurance, paid holidays and vacations, bonuses, etc.)?

(f) Availability of information (Paragraph 22) to this office required to be submitted by the contractor to the Comptroller of the Navy.

It should be noted that the above are our initial observations and may not be all inclusive since questions may arise from time to time during the operation of the subject agreement.

F. J. ZABOROWSKI,  
*Resident Auditor.*

Mr. CROMWELL. If we could follow up on this point, then, these memorandums from the Defense Contract Audit Agency are referring to that special pool account. He is saying that it is impossible to determine that the funds withdrawn are used solely for the purpose of making payments required by the pool account. He says: "We are unable to validate the strict application of paragraph 2 of the advance payment agreement." Paragraph 2, I believe, is the one that says that the purpose of these advance payments is to pay the bills that Gruman is incurring in building these airplanes.

These memorandums were sent to the Navy plant representative in September 1972. Were you ever aware of this, or was anyone in the Navy?

Mr. SANDIDGE. Yes, sir, we were aware of it. We were aware that the investments in this contract by Grumman and the other contracts embraced in the agreement at all times exceeded by more than \$50 million the moneys that had been paid by the Government under such contracts. Every 2 weeks Grumman certifies that these costs on these contracts are right, in their request for progress payments. According to the provisions incorporated in the agreement, they can use the advances to reimburse the contractor for their cost; as I say, at all times these costs were in excess of \$50 million over and above all payments.

Mr. CROMWELL. I believe they used money in the general fund for other purposes also, did they not?

Mr. SANDIDGE. In the general fund, yes, sir; it was used for everything.

Mr. CROMWELL. The Navy is allowing them to pass the money out of the pool account and into the general fund as soon as the money is put in the pool account. Therefore, the pool account in essence is meaningless.

Admiral LEE. May I add another statement to Mr. Cromwell's question, Mr. Chairman.

Senator CANNON. Yes, sir.

Admiral LEE. In a memorandum from the Naval Plant Representative at Bethpage to the Controller of the Navy of October 20, 1972, he comments on this, having to do with Mr. Cromwell's question. He says:

With assistance from the Resident Auditor DCAA, the countersigning agent can assure that the basis is for withdrawals from the Navy Special Pool Account is costs incurred for and properly allocable to the pool contracts rather than actual payments on account of such costs. Arrangements to do this have already

been made as evidenced by reference (b). Since the total corporate payroll is paid out of the contractors general funds and the pool contractors general funds and the pool contractors constitute a substantial portion of the present GAC business base, it can be assumed that withdrawals from the Navy Special Pool Bank Account are being used after merger with the GAC general funds, to finance labor costs both direct and indirect, applicable to the pool contractors. In addition, by copy of this letter, the Resident DCAA Auditor is hereby requested to make monthly test checks.

Senator SYMINGTON. Mr. Chairman, we are all interested in time. May I ask that that be included in the record. The one I read is September 20.

Admiral LEE. This is October 27.

With the chair's permission, I would include that in the record.

Senator CANNON. I think there is one point that the admiral ought to read in that letter, starting near subparagraph 1, because it is very pertinent on this issue.

Admiral LEE. This is what I was reading there.

Senator CANNON. Where you say "The GAC practice," just read that portion into the record, paragraph 2.a.(1) on the first page.

Admiral LEE. It says:

The GAC practice just described above doesn't violate the advance payment pool agreement, which only prohibits mingling of funds prior to withdrawal from the Navy special pool bank account.

And the other paragraph I was reading says that we were going to do spot audits.

Senator CANNON. Read that next sentence also.

Admiral LEE. It says:

However, it makes the tracing through of payments to specific contract costs just about impossible. This, the countersigning agent cannot assure that, after withdrawal from the Navy special pool account, the withdrawn funds are devoted exclusively to financing the cost of performing the pool contracts.

Senator CANNON. The balance will be put in the record.

[Document follows:]

OCTOBER 27, 1972.

From: Naval Plant Representative, Bethpage

To: Comptroller of the Navy (NCD4), Washington, D.C.

Subject: Advance payment pool agreement entered into as of August 8, 1972, by and between the Navy and Grumman Aerospace Corp., Bethpage, N.Y.

Reference: (a) Ltr from NAVCOMPT NCD4 to NAVPRO, Bethpage of 8 Aug 1972, Same Subj

(b) Ltr from NAVPRO, Bethpage to RA, DCAA, Bethpage of 5 Sep 1972, Subj: Audit of GAC data submitted to support withdrawals from the Navy Special Pool Bank Account

1. The gist of the subject Advance Payment Pool Agreement is set forth in reference (a), which transmitted copies of the Pool Agreement and its ancillary supporting agreements. In addition, reference (a) designated the undersigned, "or such other person or persons as he may designate in writing, as Countersigning Agent for all checks drawn against the Navy Special Bank Account".

2. As a result of our initial experience with the advance payment agreement, certain matters have emerged for consideration. They are as follows:

(a) The Countersigning Agent is authorized by reference (a) to approve withdrawals from the Navy Special Pool Bank Account solely for the purpose of making payments for direct and indirect costs properly allocable to pool contracts in accordance with Section XV of the ASPR, and as specified in stipulation (3) of the Advance Payment Pool Agreement. However, immediately following withdrawal from the Navy Special Pool Bank Account, the amounts withdrawn are mingled with the Grumman Aerospace Corporation's general funds, and it is from these general funds that payments of the costs applicable to the pool contracts are made.

(1) The GAC practice just described above doesn't violate the Advance Payment Pool Agreement, which only prohibits mingling of funds *prior to* withdrawal from the Navy Special Pool Bank Account. However, it makes the tracing through of payments to specific contract costs just about impossible. Thus, the Countersigning Agent cannot assure that, after withdrawal from the Navy Special Pool Bank Account, the withdrawn funds are devoted exclusively to financing the costs of performing the pool contracts.

(2) With assistance from the Resident Auditor, DCAA, the Countersigning Agent can assure that the basis for withdrawals from the Navy Special Pool Bank Account is costs incurred for and properly allocable to the pool contracts rather than actual payments on account of such costs. Arrangements to do this have already been made, as evidenced by reference (b). Since the total corporate payroll is paid out of the contractor's general funds and the pool contracts constitute a substantial portion of the present GAC business base, it can be assumed that withdrawals from the Navy Special Pool Bank Account are being used, after merger with the GAC general funds, to finance labor costs both direct and indirect, applicable to the pool contracts. In addition, by copy of this letter, the Resident DCAA Auditor is hereby requested to make monthly test checks, tracing withdrawals from the Navy Special Pool Bank Account through their deposit into the GAC general funds bank account and thence to the payment of selected subcontractors' invoices for work performed under the pool contracts, and to report the results of these tests to the Countersigning Agent.

(3) The procedure outlined in paragraph 2.a.(2), above should provide the most adequate assurance available within the provisions of the Advance Payment Pool Agreement, that withdrawals from the Navy Special Pool Bank Account are made to finance the costs of performing the Pool contracts.

(b) We think that the "stated contract price" of contract N00019-69-C-0422 referred to in stipulation (5) of the Advance Payment Pool Agreement is the sum of all the currently definitized prices of all items of Lot I and all subsequent lots of the contract for which the Government has exercised its option, and not the definitized prices of any single lot by itself. However, this does not prevent the contractor from liquidating the advance against progress payments or product billings due under any one or several lots of the contract, as he sees fit.

(c) In connection with covenant (21)(h) of the Advance Payment Pool Agreement, which covers key employee salaries, bonuses, commissions, etc., we think that the term "compensation", for the purpose of identifying "key employees", is the total of the salaries, commissions, and fringe benefits, such as bonuses, pension plan contributions, stock options, and group life and health insurance contributions, etc., paid to or credited to the account of an employee annually, and is not limited to amounts paid directly to the employee in the form of salaries, bonuses, or commissions.

3. The advice of the Administering Office concerning the validity of our understanding of the subject Advance Payment Pool Agreement with regard to the matters described above is solicited.

R. H. BELTER.

#### GRUMMAN INVESTMENTS IN SHORT TERM SECURITIES

Senator SYMINGTON. Has the Navy been aware of the contractor investing these advance payments in marketable securities since August 1972?

Admiral LEE. I can only speak for myself. I only became aware of this when I read Grumman's annual report for 1973.

Senator SYMINGTON. Who was in your position prior to you?

Admiral LEE. Admiral McClellan. But as I stated earlier, the Assistant Secretary for Financial Management administers this advance payment agreement.

Senator SYMINGTON. Why was the contractor not making investments in marketable securities prior to the advance payment agreements.

Admiral LEE. I think the contractor at that time had a line of credit. He withdrew money from that line of credit on a daily basis and paid it back on a daily basis, whereas our advance payment

agreement is more or less a monthly agreement withdrawal plan, it is more like a midterm to long term loan than a line of Audit agreement.

Senator SYMINGTON. When informed by the Defense Credit Agency and the Navy plant representative that they could not certify the purpose of the funds withdrawn from the special pool bank account, why did the Navy not take steps to tighten control and verification of the use of those funds?

Admiral LEE. In this paragraph that I was reading earlier it stated that what we would do is take spot audits periodically and trace through to Grumman what happened to this money. It was determined by the auditors and by the people managing this account that this would be sufficient. This was in that paragraph that I was reading which will be in the record.

Senator SYMINGTON. How, in the Navy's opinion, does the advance payment agreement give authority for the contractor to invest the funds in marketable securities?

Admiral LEE. There is no authority in the advance payment agreement for them to make investments in short-term marketable securities. However, there is no prohibition against doing this either.

Senator SYMINGTON. You knew they were doing it?

Admiral LEE. I did not personally know until I read their annual statement for 1973.

Senator SYMINGTON. But the people in the Navy must have known if they were auditing their books, or if there was any auditing going on at all?

Admiral LEE. I think the people managing the payment—

Senator SYMINGTON. Did they not think anything about it? Let's get the facts. I am not accusing anybody at least at this time of any fraud in the transaction, but we want the facts. If you were auditing the books and you were paying the taxpayers' money out on the basis of auditing the books you knew when you audited the books that somebody in the Navy must have known, whoever did the audit, that they were using this money in the securities market; is that not a fair statement?

Admiral LEE. Yes sir. Our auditors obviously knew.

Senator SYMINGTON. That is all I was asking.

How, in the Navy's opinion does the advance payment agreement give authority for the contractor to invest the funds in marketable securities?

Admiral LEE. It does not give authority, but it does not deny them the right to do this.

Senator SYMINGTON. Would you plan to continue to allow them to do this?

Admiral LEE. I think we have to allow Grumman a certain amount of cash to operate on a daily basis.

Senator SYMINGTON. With that cash to take advantage of any marketable security position?

Admiral LEE. I think as a matter of running their business they should be allowed to invest this small amount of cash that they operate on in market securities.

Senator SYMINGTON. This market suddenly switched after they did that, to the point where their estimated profit on the basis of that operation turned into a loss, which is very possible, as the rates

vary, would you consider it proper for the Navy to advance additional taxpayers' money in order to handle that operational loss?

Admiral LEE. They are investing this money in Treasury securities and in U.S. Government-backed securities such as FNMA's, and it is on a short-term basis, so I do not see how they could lose money in these U.S. Government—

Senator SYMINGTON. But suppose they did lose money?

Admiral LEE. I do not know what the Government action would be in that case.

Senator SYMINGTON. What would be your thought in the matter? Should it be made up or not?

Admiral LEE. I think that would be Grumman's loss that they would have to make up.

Senator SYMINGTON. Thank you, Admiral.

#### PROPOSED NEW CONTROLS

Does the Navy proposed new advance payment agreement place any further or better control over the use of funds?

Admiral LEE. The Navy's new advance payment agreement at the time it was signed contemplated about the same type of controls on the funds that we have used in the past. However, as I stated earlier, we have been discussing making these statements on a weekly basis rather than monthly. This would cut down Grumman's cash needs.

Senator SYMINGTON. Do you know of any other uses being made of the advance payments?

Admiral LEE. I know of no other uses.

Senator SYMINGTON. Is the contractor's use of these advance payment funds for investment in marketable securities within the terms of the covenants that place restrictions on the use of these funds?

Admiral LEE. Yes, sir. There are no covenants in the advance payment agreement which restrict the use of Grumman's daily cash.

Senator SYMINGTON. So if the Navy decided, as I follow the question—having myself had some business experience—you could advance them a hundred million dollars, or any figure up to what is permissible by Congress, and they could have invested all their marketable securities and thereby have made a large profit regardless of the contract itself; correct?

Admiral LEE. We are only allowed to advance them enough money to pay costs incurred and to have a small amount of operating cash.

Senator SYMINGTON. A small amount of operating cash is the money that they have made investing in the market?

Admiral LEE. Yes, sir. The \$13 million that we have allowed them is the minimum.

Senator SYMINGTON. \$13 million at the year end 1973?

Admiral LEE. For a total of Grumman Aerospace Corp., yes, sir.

Senator SYMINGTON. Why is the advance payment fund not reduced when excess cash is available rather than allow those funds to be invested in marketable securities?

Admiral LEE. Under a monthly basis we have not required this in the past, Senator, in our administration of this advance payment fund. If we go to a weekly basis we would have to cut down their cash allowance, the cash that they have available on a daily basis, to the point where they would have very little to invest.

Senator SYMINGTON. Mr. Chairman, I would ask unanimous consent that some staff statements made incident to these questions be included at this point in the record.

Senator CANNON. Without objection.  
[The statements follow:]

#### GRUMMAN USE OF ADVANCE PAYMENTS FUNDS

The advance payment agreement states that the advance payments will be deposited in a Navy Special Pool Bank Account and that the funds may be withdrawn by the contractor solely for the purposes of making payments for direct materials, direct labor, administrative and overhead expenses required for purposes of pool contracts and for such other purposes as the administering office may approve in writing.

The Grumman Corporation 1973 financial report shows that, as of December 31, 1973, Grumman had \$12.4 million in cash and \$31.4 million in marketable securities on hand, while at the same time Grumman had advance payments from the Government amounting to \$24 million.

1. The Navy has acknowledged to the staff that advance payments are being used to purchase marketable securities when cash is not immediately required. The interest rate on short term investments from December 1973 through June 1974 was in a range of 8-10 percent, compared to the 6½ percent interest charged to Grumman for advance payments.

2. The Navy has not specifically approved, in writing, that the contractor could make this use of advance payments.

3. The interest earned from this investment in marketable securities is not returned to the pool contract bank account for payment of bills on the pool contracts.

4. The findings of the Department of the Navy, in support of further advance payments, stated that "the proposed advance payments will be prudently limited to the immediate needs of Grumman Aerospace Corporation at any given time".

5. Records show that the contractor withdraws the funds from the Special Pool Bank Account immediately after they are deposited and then redeposits these funds in their general funds account, which are used for many purposes.

6. The Defense Contract Audit Agency reviewing the advance payment agreement advised the Navy in September 1972 that it was not possible to determine that funds withdrawn from the Special Pool Bank Account are used solely for the purpose of making payments required for pool contracts.

7. The Navy Plant Representative at Grumman, in October 1972, advised the Comptroller of the Navy that assurance could not be given that withdrawn funds are devoted exclusively to financing the costs of performing the pool contracts.

8. The Navy Plant Representative stated a procedure whereby they would assume that, since the funds were comingled with Grumman's other general funds and that all bills were paid out of Grumman's general fund account, the funds withdrawn from the Special Pool Bank Account must be used to pay the cost incurred on pool contracts.

9. The Navy Comptroller's Office approved this procedure of assuming that funds were being used to pay costs of pool contracts as stated in the advance payment agreement.

10. There were no procedures planned or approved whereby the Navy would determine what other uses were made of funds withdrawn from the special pool bank account.

11. Investment of available cash in marketable securities would be a prudent business practice under normal circumstances where the contractor would have commercial credit. The use of funds under the advance payment agreement for this purpose is subject to question. Grumman financial reports indicate that Grumman has only made these investments in marketable securities since the advance payments agreement became effective.

#### COMPARISON OF F-14 AND F-15 COSTS

Senator SYMINGTON. I would like to ask, is Mr. Malachowski of Admiral Peet's staff here today?

Admiral LEE. No, sir.

Senator SYMINGTON. On June 11, 1974, I received a letter from Dr. Currie, the Director of Defense Research and Engineering, in which he said the program unit cost of the F-14 was \$19.8 million and the program unit cost of the F-15 was \$11.1 million. He breaks it down into program quantity, which was 334 for the F-14 and 749 for the F-15, and research and development, flyaway, and support.

Then it was our understanding that when a Government quotation, not a corporate quotation, was made to the Iranian Government, that the prices of both planes were submitted on a program cost basis at between \$13 and \$14 million each for the F-14 and the F-15, which would be a reduction of \$6 million on the F-14 and an increase of \$2 million on the F-15.

As a result of that, I asked for an explanation, naturally, because it was a letter that came to me a month ago as a result of a letter that I had written to the Secretary of Defense asking for the relative costs. I wrote on July 22, to the Deputy Secretary of Defense.

During the meeting last week with you, Dr. Currie and Vice Admiral Peet re pricing of the F-14 and F-15, it was agreed a member of Admiral Peet's staff would meet with Kathie Smith of my staff to go over the details re the letter sent me by Dr. Currie and its relationship to the offers made to Iran.

On Friday, July 19, Mrs. Smith met with Mr. Ronald Malachowski of Admiral Peet's staff and Mr. Donald Floyd of Legislative Affairs.

Is Mr. Floyd here today?

Admiral LEE. No, sir.

Senator SYMINGTON [reading]:

At that time they showed here a three-page chart entitled "How to Transit from Data of Currie Letter of Symington to Officers to Iran re F-14 and F-15."

That chart showed the various costs which made up the first and second officers of Iran for both the F-14 and the F-15; also the rationale for the specific computations.

In order to accurately relay all this detailed material, Mrs. Smith requested a copy of the chart in question. Mr. Malachowski said, however, that he had orders from Admiral Peet not to leave said chart with my staff without an official letter of request for specific data from me.

All we want are the facts.

[Continuing with the letter]:

In effort to confirm if this was indeed the required procedure, Mr. Floyd called Admiral Peet, who said that it was all right to leave the data on the F-14, but not on the F-15.

So now we have half a chart.

It is pretty difficult to understand all this business. Why must we go to such great lengths to obtain information Defense said they were willing to supply in the first place.

We have not yet received the other half of the chart.

Do you know anything about this?

Admiral LEE. No, sir.

Senator SYMINGTON. Is there anybody here who knows anything about it?

Admiral LEE. No, sir.

We did the pricing for F-14.

Senator CANNON. How do you know that there is nobody here who knows anything about it?

Does anybody else here know anything about that, any of your backup witnesses?

[No response.]

Senator SYMINGTON. Thank you, Mr. Chairman.

It was their offer and we accepted it, and then they gave us half the information and refused to give us the other half.

## SENATOR PROXMIRE'S STATEMENT ON ADVANCE PAYMENTS

This statement has been made, and it will come up certainly on the floor because it has been released by the senior Senator from Wisconsin. In it he says:

I oppose the Navy's request to increase the advance payments agreement with Grumman for the following reasons:

1. There is evidence that previous advance payments have enabled Grumman to make millions of dollars in profits through short-term high yield investments.

Is that correct?

Admiral LEE. They have made some profits in short-term high yield investments.

Senator SYMINGTON. I have never discussed this and I never saw this until this morning, but it has just been released to the press.

2. It is wrong to reward a company that has such a poor record for managing governmental programs with a new Government subsidy.

Can you comment on that?

Admiral LEE. We do not think this new advance payment agreement is a Government subsidy. They are going to pay 9½ percent interest on this loan. We think Grumman is building a very good airplane.

Senator SYMINGTON [reading].

3. The new advance payments agreement, if approved, will add to the cost-overrun on the F-14 and other Grumman contracts and add to the burden of the taxpayer.

What are your comments on that?

Admiral LEE. The advance payment agreement will not have any effect on Grumman's cost in that sense.

Senator SYMINGTON. The next point:

4. The current advance payments agreement is, in effect, a below-market interest rate loan and the new agreement apparently will also provide Grumman with low interest money.

Is that correct?

Admiral LEE. The previous advance payment agreement had an interest rate of 6½ percent. It is below the current market price..

Senator SYMINGTON. So this statement of the Senator is incorrect, is that it?

Admiral LEE. The current agreement is 9½ percent, which is higher than the Treasury bill rate.

Senator SYMINGTON. Then the statement is incorrect?

Admiral LEE. Would you reread the statement, please, Senator?

Senator SYMINGTON [reading].

The current advance payments agreement is, in effect, a below-market interest rate loan and the new agreement apparently will also provide Grumman with low interest money.

Admiral LEE. The current advance payment agreement is below current market interest rates. For the new agreement the interest rate has been provided by the Treasury Department in accordance with Public Law 9241.

Senator SYMINGTON. Would that provide Grumman with low-interest money?

Admiral LEE. It will provide relatively low-interest money.

Senator SYMINGTON. As against the prime rate?

Admiral LEE. Yes, sir.

Senator SYMINGTON. Then the statement is correct, is it not?

Admiral LEE. Essentially correct.

Senator SYMINGTON. The next statement:

5. The new advance payments agreement, if approved, will establish a precedent for 100 percent government financing of defense contracts.

Do you agree with that?

Admiral LEE. We do not think that this new advance payment agreement will establish a precedent of that nature, Senator.

Senator SYMINGTON. But if it were followed out, based on what has happened it would be a precedent that would be carried out on other contracts, would it not?

Admiral LEE. This agreement is unique in our contracting system. We do not think that it will provide a precedent for 100-percent financing of Government contracts.

Senator SYMINGTON. The next observation:

6. The practice of bailing out defense contractors discourages efforts to control costs and is inflationary.

Would you agree with that?

Admiral LEE. We do not agree that we are bailing out Grumman in this sense. We are serving as Grumman's banker.

Senator SYMINGTON. Having borrowed a good deal of money in private business, Admiral, if you ask for a loan and you need it and you go broke if you do not get it, you are being bailed out if you do get it, are you not?

Admiral LEE. You are certainly being helped, yes, sir.

Senator SYMINGTON. I do not want to get into any semantic square dance about it, but I want to make the record, because I think that the request of the Senator from Wisconsin is that this subcommittee, under the able chairmanship of my distinguished colleague from Nevada, explore the decision. I am sure this will come up again, and the more information we get now the better it will be in the future. Senator Proxmire further states:

I have seen nothing in the statements made to adequately explain why the taxpayer should be forced to provide additional financial aid to this private corporation.

By the way, when the Lockheed loan of \$250 million was made, one of the reasons that I voted against the loan was that one of the companies in my State had \$750 million from the banks at the time the \$250 million loan was made.

Back to the statement.

According to my information, Grumman appears to have profited from the earlier advance payments by putting funds made available into short-term investments. I question the propriety of this action on the part of Grumman and wonder whether increasing the advance payments will allow it to continue, in effect, to borrow money from the Government at low interest rates so that it can invest at least some of it at higher rates.

I imagine you feel that we have covered that.

Admiral LEE. Yes, sir.

Senator SYMINGTON. Is it going to continue?

Admiral LEE. Senator, as we stated earlier, the advance payment agreement does not prohibit Grumman from investing their cash in short-term securities. We had not contemplated denying Grumman this way of doing business. We had contemplated going to a weekly

basis of advance funding for Grumman, and in addition, with a 9½-percent interest rate, it certainly would not be to their interest to withdraw the money and pay 9½ and buy Treasury bills at 7.6, which was yesterday's rate. Unfortunately, the agreement did allow this. The financial times of today and the financial conditions in 1972 I think allowed this to happen, due to a very turbulent money market.

Senator SYMINGTON [reading].

It is not at all clear from the facts that Grumman needs the amount requested and that it has exhausted all possibilities of borrowing whatever it needs from private sources.

Would you agree with that?

Admiral LEE. No, sir. We believe that Grumman's financial needs for U.S. Government programs will be in the order of in the low nineties of millions of dollars in the next year or so. We believe Grumman has essentially exhausted commercial credit sources at the moment.

Senator SYMINGTON. Would you say that if they had not been allowed to make this additional money in the securities market that they would have been in financial insolvency or deep trouble with the banks?

Admiral LEE. No, sir, I don't think that this has any bearing on their needs, that is, this amount of money, the \$2.4 million that they made on the security market.

Senator CANNON. \$2.8 million.

Senator SYMINGTON [reading].

As you know—

The statement continues—one government bail-out often leads to another. We have already seen this pattern in the Grumman case. The problem is that companies like Grumman get used to coming to the government for financial aid once they know it is possible to do so.

From all the evidence I have seen, Grumman's problems have resulted from its inability to improve the efficiency of its operations and control the costs on the F-14 and other defense contracts. The burden of paying for the huge cost overruns have been shifted to the taxpayer.

Do you think that that is true, or do you dispute the statement?

Admiral LEE. We think Grumman has made great progress in the last 2 years in improving cost controls and in improving their management procedures.

Senator SYMINGTON [reading].

The constant shifting of responsibility for the costs of Grumman's poor management is unjust to the taxpayer, unfair to Grumman's competitors, and unhealthy for the economy.

You dispute that, as I understand your last statement.

Admiral LEE. Yes, sir.

Senator SYMINGTON [reading].

The advance payments agreement is a backdoor subsidy designed, in this case, to provide Grumman with 100 percent of its cash requirements. Indeed, I have reason to believe that the Navy has been providing Grumman with more than 100 percent of its cash requirements.

The Navy's actions amount to a policy of corporate favoritism and handouts.

Would you agree that that would be corporate favoritism by allowing them to use that money in the market?

Admiral LEE. No, sir, we certainly don't agree with that statement.

Senator SYMINGTON [reading].

I am convinced that a thorough airing of the application for the new Grumman bailout will demonstrate the need to turn it down.

The reason I am asking these questions is, it is clear that it is going to come up.

Admiral LEE. Yes, sir.

Senator SYMINGTON [reading].

Grumman and the Navy have already compiled a dismal record of financial mismanagement on the F-14 program. Cost overruns, largely caused wasteful practices, have already increased the unit cost estimates for the F-14 from \$12.6 million to \$17.9 million.

Are these figures correct?

Admiral LEE. I believe those figures are correct, Senator. However, I hasten to add that a significant portion of that cost increase is attributable to reductions in procurement quantity and reduction in procurement rate and associated stretchout of the production period.

Senator SYMINGTON [reading].

There are rumors that Grumman is indirectly threatening to stop work on the F-14 if it does not get this additional subsidy.

Is that correct?

Admiral LEE. Grumman hasn't threatened to stop work. They have stated that unless they get adequate financing, they won't be able to pay their bills, and so forth, which is, of course, saying that they won't be able to produce the airplane.

Senator SYMINGTON. You see, this is a public statement.

Admiral LEE. Yes, sir.

Senator SYMINGTON [reading].

These rumors which, if true, amount to a kind of political extortion, are reinforced by statements from the company that it will not be able to continue the program beyond a certain date unless it gets increased advanced payments.

Is that correct?

Admiral LEE. We believe that to be true; that is, that they won't be able to continue the program.

Senator SYMINGTON. They have so told you?

Admiral LEE. Yes, sir.

Senator SYMINGTON. He says to this committee, and to its chairman:

I urge you to consider the implications of capitulating to these sorts of demands. Congress should not consider itself too weak to resist unjust demands for bailouts from defense contractors.

The Grumman case is too important to be decided by default or inaction. For this reason, I am happy to note that the committee took the initiative to call this hearing.

As coauthor of the antibailout law which set up the procedure, the Navy is now following, I would like to say that it was my intent that the Senate would have an opportunity to vote on any request for new bailouts such as this one in excess of \$25 million.

I am hopeful that the committee, whatever its decision, will give the full Senate an opportunity to vote on the Navy's request.

What is the Navy's request that he is referring to at that point?

Admiral LEE. The Navy's request is a letter dated June 4 from the Secretary of the Navy to the chairmen of the four committees of Congress that deal with military matters. It states that the Navy intends to go forward with an advance payment agreement with Grumman in the amount of \$100 million unless either House of Congress votes against this plan.

Senator SYMINGTON. Thank you.

Mr. Chairman, I have no further questions or comments.

## EXPECTED END OF REQUIREMENT FOR ADVANCE PAYMENTS

Senator CANNON. While we are on the subject that Senator Symington has been discussing, when does the Navy project that advance payments would no longer be required; in other words, that the Grumman profits would permit them to finance their own operation?

Admiral LEE. In 1977, Mr. Chairman.

Senator CANNON. So that we would have to act as the banker until 1977 unless they secured a private line of credit from commercial banks.

Admiral LEE. Yes, sir.

Senator CANNON. Or other funds?

Admiral LEE. Yes, sir.

## ESTIMATED AMOUNT REQUIRED

Senator CANNON. Has the Navy actually determined that Grumman will need exactly \$100 million in advance payments or is the current Navy estimate less than \$100 million?

Admiral LEE. The current Navy estimate is somewhere in the low 90's, Mr. Chairman. We ask for \$100 million to cover possible errors in our estimates.

Senator CANNON. Is the contractor's cash flow data based on projected expenditures that are higher than Navy's own estimates of cost?

Admiral LEE. I think the contractor's projected estimates of expenditures were examined by our finance people and our auditors, and have changed somewhat, we have changed them somewhat, but we think that their estimates are reasonable by and large.

Senator CANNON. Are you saying, then, that their cost projections for the fiscal years 1974 and 1975 F-14 programs are not in excess of the Navy's estimate for those programs?

Admiral LEE. I believe their cost projections—we concur with their cost projections for those two programs in general, except for—those two contracts have not been negotiated, Mr. Chairman. We have to negotiate many items in there such as profit, such as items which they are not allowed to put in the contract, and so forth.

## SEPARATION OF NAVY AND IRANIAN FUNDS

Senator CANNON. Since the contractor comingles funds in a general fund account, one that is not audited, immediately after withdrawal from the special pool bank account, how will the Navy determine that the U.S. advance payment funds will not be used to pay for the Iranian program, or part of it?

Admiral LEE. May I ask Mr. Sandidge to answer that question.

Mr. SANDIDGE. You would have to set up adequate controls to determine that at no time would funds be advanced in excess of the expenditures under the contracts.

Senator CANNON. You do intend to set up such controls if this authority is granted?

Mr. SANDIDGE. It will be considered by the Navy, yes, sir.

Admiral LEE. Mr. Chairman, we will set up controls to audit Grumman books to assure that the Iranian money is used for the Iranian program and U.S. advance payments are used for U.S. programs only.

Senator CANNON. How much in advance payments is projected for the 80 Iranian aircraft?

Admiral LEE. Thus far we have only signed an agreement for the 30 aircraft buy. That agreement with Grumman covering that Iranian buy is for \$31 million. We think, but we haven't negotiated yet for the 50 aircraft buy, that that will go up to some higher figure than \$31 million. We haven't sorted that out yet.

Senator CANNON. What are the terms and conditions, for example, with respect to the \$31 million?

Admiral LEE. The terms and conditions of the advance payment for the 31 aircraft, \$31 million, are almost identical with the terms and conditions of the U.S. advance payment.

Senator CANNON. Will the Iranian advance payment funds be comingled, or will they be accounted for separately?

Admiral LEE. They will be accounted for separately on a separate bank account, is our present plan.

Senator CANNON. Will the Iranian F-14 contract be added to the Navy pool contracts?

Admiral LEE. It will be a separate contract, Mr. Chairman, to cover that advance payment agreement which we have negotiated with Grumman having to do with Iranian purchases.

#### REQUESTED AGREEMENT COVERS ONLY FISCAL YEAR 1974-75

Senator CANNON. Does the Navy intend for this proposed new advance payment agreement to go beyond the fiscal year 1975 programs and include long-lead funding for fiscal year 1976?

Admiral LEE. The Navy's present plans are to have this advance payment agreement cover fiscal year 1974 and fiscal year 1975. It

would not cover the fiscal year 1976 program. In terms of advance payments, if the Congress authorizes advance payments to Grumman for a fiscal year 1976 buy, those advance payments would be made to Grumman, but it would not be part of this advance payment agreement.

#### EFFECTIVE INTEREST RATE TO GRUMMAN

Senator CANNON. If I can just sort of recap some of this interest rate thing that we have gone over, I understand that Grumman has paid the Navy about \$4 million in interest on advance payments since August of 1972; is that correct?

Admiral LEE. About \$4 million, yes, sir.

Senator CANNON. Of which amount Grumman has recovered \$2.8 million in the short-term security market.

Admiral LEE. Yes, sir.

Senator CANNON. For a net money cost to them of those advance payments of about \$2.2 million.

Admiral LEE. Yes, sir.

Senator CANNON. What is the effective rate of interest that Grumman is paying for those advance payments, if you apply the \$2.8 million recovered in short-term notes against the \$4 million in interest that they pay?

Admiral LEE. I haven't done that computation, Mr. Chairman.

Senator CANNON. Will you have your people compute that and furnish it for the record?

Admiral LEE. Yes, sir.

Senator CANNON. But in any event, it would be somewhere along 2-plus or 3 percent, somewhere in that range, would it not?

Admiral LEE. It would be a low-interest rate.

[The information follows:]

The effective interest rate would be 2.3%. This interest rate does not recognize that some of the temporary investments in Government securities were made from monies received by GAC for aircraft deliveries and from progress payments. It is not practicable to separate the delivery payments and progress payment monies from advance payments for purposes of the above interest computation.

Senator CANNON. A very low interest rate. And the proposed interest rate for the new agreement, then, is 9% percent?

Admiral LEE. Yes, sir.

#### POSSIBLE COMPETITIVE ADVANTAGE OF LOW RATE

Senator CANNON. Wouldn't this put the contractors at a competitive advantage in bidding on Government work because of this financial support, the current and proposed rate of interest, which is lower than the general commercial credit rate?

Admiral LEE. It seems to me it would give him a competitive advantage in terms of a contractor who has to pay the prime rate.

Senator CANNON. It not only seems to me, it certainly would, wouldn't it, if another contractor has to pay the prime rate, which is now roughly 12 percent, or thereabouts, and he is going to get the new contract agreement at 9%, it right off the bat would give him 2% percent advantage, would it not?

Admiral LEE. Yes, sir.

Senator CANNON. Under these advance payments that have been made in the past where he paid \$4 million for the money and received \$2.8 million in return on short-term investments, for an effective rate of in the neighborhood of 3 percent, at that period of time I guess the prime was fluctuating from 6 to 12. So he obviously would have had a substantial advantage there; is that correct?

Admiral LEE. The prime during that period went from 5½ to 12, I believe.

Senator CANNON. 5½ to 12?

Admiral LEE. Yes, sir.

Senator CANNON. Would the Navy consider requesting the Defense Department to give authority to increase the interest rate above that allowed in the Armed Services Procurement Regulations? Has the Navy considered that?

Admiral LEE. We have debated it among ourselves. And we decided to go with the Treasury rates, Mr. Chairman, of 9% percent, and to change this each 6 months, as the new Treasury rate changes.

Senator SYMINGTON. Will the chair yield for a question in context?

Senator CANNON. Yes, sir.

Senator SYMINGTON. Isn't the concept of the Navy's purchasing procurement one of competition?

Admiral LEE. Yes, sir.

Senator SYMINGTON. If you do something like this aren't you arbitrarily violating your concept of true competition? I am not at this point saying that there is fraud in this case, but I don't see how you can legally state, if the law says that you have to be competitive

when you purchase, I don't see how you can give an advantage, and a big advantage, of this character to a competitor without breaking the law, unless you admit that it is not a competitive situation, that is, one where, regardless of price, you are going to get the produce you want in spite of the law. Would you comment on that.

Admiral LEE. Of course, all of our procurements are competitive, Senator.

Senator SYMINGTON. But the chairman has just pointed out, in this case it was not competitive.

Admiral LEE. In this particular case it was a continuing buy that resulted from competition in 1968 and 1969 which Grumman won. So that it is not competitive in that sense, that we are running a competition each year.

Senator SYMINGTON. I see. But did you feel that you could pay the higher prices incident to allowing these interests rates because they won a competition, is that correct?

Admiral LEE. No, sir, We didn't set the interest rates. We have followed the rules of establishing these interest rates for the advance payment agreement which I cited earlier; namely, the procurement regulations and then the public law for setting interest rates for this type of advance payment agreement. If some other interest rate is proposed, say the prime rate. I suppose this could be negotiated through the Department of Defense and other places to make sure that Grumman pays the prime rate. But let me say again, in this advance payment agreement and our agreements with Grumman we followed the procurement regulations and the public laws having to do with this, not setting our own rates.

Senator SYMINGTON. So you don't think there are anything in any way unethical or illegal in letting them use this money in the market to increase their profits?

Admiral LEE. I was talking about interest rates. But in 1972, when this initial agreement was signed, the prime rate was 5½ percent. The interest rates charged in that initial agreement where 6⅞ percent. The prime rate stayed below this interest rate up until I think May 1973. So the times have changed since that agreement was signed.

Senator SYMINGTON. I only ask these questions for clarification, because the statement was made by the present chairman of the Joint Economic Committee—and the next chairman of the Banking and Currency Committee—he said here that he intended to pursue it.

Thank you, Mr. Chairman.

#### POSSIBILITY OF REQUIRING PRIME RATE

Senator CANNON. Is there any reason that Grumman should not be required to pay interest similar to what they would be required to pay for commercial credit?

Admiral LEE. Mr. Chairman, we could certainly require Grumman to pay the prime rate provided it is approved by the Procurement Board in the Office of the Secretary of Defense.

Senator CANNON. Is there any reason that they should not be required to pay that rate that you know of?

Admiral LEE. I can't think of any good reason why they should not be required to pay the prime rate, Mr. Chairman.

## INCENTIVE FOR GRUMMAN TO OBTAIN BANK CREDIT

Senator CANNON. I think I requested this before. But does the contractor have an incentive to obtain commercial credit when the contractor has a favorable interest rate on advance payments?

Admiral LEE. We think there are many incentives for Grumman to attempt to attain commercial credit. We have debated this among ourselves. I have a list of reasons why we think Grumman has incentives to go to commercial credit.

Senator CANNON. I would like to hear those. Would you mind giving them to us.

Admiral LEE. We think the company status in the financial community—for instance, bankers and investors do not look with favor on a company whose financial condition forces them to be dependent on Government financing due to its essential defense products.

Senator CANNON. Because of this Government financing they have been able to pay dividends, have they not?

Admiral LEE. Yes, sir, they pay dividends.

Senator CANNON. So that should make them look pretty good instead of making them look bad when they have to respond to their stockholders.

## PARENT CORPORATION FUNDS NOT APPLIED

And in that connection, I would like to ask you, is the contractor required to apply all of their corporate funds in cash to assist in producing the programs of the Grumman Aerospace Corp., or are there some available funds that are not and cannot be applied to these programs?

Admiral LEE. Our agreement is with Grumman Aerospace Corp. I believe the corporation and its other subsidiaries have funds which are not applied to the aerospace business.

Senator CANNON. Grumman Aerospace, is it not a fact, has reported profits to the parent corporation enabling them to pay dividends, is that correct?

Admiral LEE. Yes, sir.

Senator CANNON. They pay dividends in fact to the parent corporation?

Admiral LEE. They pay dividends to the parent corporation.

Senator CANNON. Give us the rest of those.

Admiral LEE. Our restrictions in the advance payment agreement, all three assets of the company, are under the control of the Navy. The company cannot market or acquire stock in any other company without specific Navy approval.

The capital expenditures are limited in amount.

Salaries, commissions and bonuses of officers and key employees are controlled.

Grumman Aerospace Corp. cannot pay dividends to the parent corporation in excess of 50 percent of its after-tax profit.

Then insufficiency of continued financing.

The advance payment financing in excess of \$25 million is subject to congressional review.

The proposed agreement provides for financing of only fiscal year 1974 and fiscal year 1975 programs. After that, provided that agreement

is approved by the houses of Congress, Grumman would be in financial trouble unless they can arrange commercial financing or some other type of solution to this problem.

#### OTHER SUBSIDIARIES HAVE BANK CREDIT

Senator CANNON. Do the other Grumman subsidiaries have a commercial line of credit with banks?

Admiral LEE. Two of the subsidiaries have commercial lines of credit with banks, Grumman American and Grumman Allied have their own lines of credit with banks, I think in the amount together of about \$23 million.

Senator CANNON. So this is basically the only subsidiary that doesn't have a commercial line of credit, it relies on the Government for financing, and in turn pays dividends to the parent corporation?

Admiral LEE. There are more than two other subsidiaries. And I don't know what their status is. But I think the two that I named are the only two with their own lines of credit. Of course, Grumman Aerospace has no line of credit. They do pay dividends to the parent corporation.

#### USE OF DIVIDENDS

Senator CANNON. As a matter of fact, it would be possible for Aerospace to use those dividends to reduce the amount of advance payments required from the Government, wouldn't it?

Admiral LEE. Yes, sir.

Senator CANNON. How much did they pay the parent company in dividends last year?

Admiral LEE. I don't know.

May we provide that for the record?

Senator CANNON. If you know it, tell us.

Mr. SANDIDGE. It is approximately \$7 million, but approximately \$6 million of that was for firm commitments, service of debt and things such as that. The dividends were about \$1 million which they declared to stockholders in 1973.

#### SUMMARY OF ADVANCE PAYMENTS SITUATION

Senator CANNON. If I may, Admiral, let me see if I can recap very briefly some of the issues that we have been exploring here today.

First, the present payment agreement with Grumman provides funds to the company at an interest rate of 6½ percent, which is way below the commercial prime rate and indeed is lower than the current cost to the Government to borrow the money the Navy is lending to Grumman.

Second, the Navy has been extremely lax in its audit controls over Grumman's actual cash needs for these advance payments, and as a result Grumman has had large cash balances on hand which it has used to invest in short-term securities for its own profits, rather than repaying the Government's loan.

Third, the Navy's special contract pool bank account is used to deposit payments to Grumman, but the Navy exercises no controls over payments from that account to Grumman, as withdrawals are made by the company for deposit into the company's general fund account. Once the funds are deposited in that account, they cannot

be audited and traced as to what specific purpose they will be used for. Therefore, the Navy does not know specifically whether the advance payment funds will be used for their stated purpose.

This suggests to me that if the Congress does not disapprove the Navy's request to continue advance payments to Grumman, then certain changes should be made to correct present deficiencies with the Navy's terms, conditions, arrangements, and financial controls for providing these advance payments. Specifically, I believe that all companies receiving advance payments should be charged the commercial prime rate or the Government's borrowing rate (whichever is higher) so that they do not have a lower borrowing cost than their corporate competitors who are financially solvent and successful. Second, I believe that the Navy should increase the frequency of their audits of cash requirements and specifically audit each request by Grumman for additional advance payments. Third, I believe that the funds in the contract pool account should be withdrawn only to pay the legitimate bills accrued to pool contracts and that they should not be allowed to comingle with the company's general funds. This could be easily accomplished by either paying bills out of the special pool bank account or establishing a separate Grumman bank account for these pool contracts only.

Admiral Lee, I would like you to comment on my synopsis of these conclusions from this hearing and also on my beliefs of where changes should be made in the advance payment agreements, controls, and procedures.

Admiral LEE. Mr. Chairman, that is a very long statement, and I can't remember all the statements that I would comment on. Could we supply the comment for the record? It seems to me that most of those things that you recommended or suggested are reasonable, and that we could accomplish them. But may I provide specific comments on that?

Senator CANNON. You may supply a detailed statement for the record.

[See p. 40.]

Senator CANNON. Senator Symington, did you have any further questions?

Senator SYMINGTON. No, Mr. Chairman, I think we have covered this situation.

I just regret that there seems to be such a discrepancy between the way some contractors are handled as against the way others are handled. I have expressed my opinions to the Deputy Secretary of Defense and to the Secretary also. I would hope that we could get this matter cleared up. If we don't get it cleared up, we are liable to have some babies thrown out with the bath water, in my opinion, when this comes up. I am grateful for these hearings and for the thoroughness with which they have been handled.

Senator CANNON. Thank you, Senator.

#### CHAIRMAN'S PROCEDURE AND SCHEDULE

In closing this hearing, I would like to discuss my intentions for handling this matter on a procedural basis.

After the subcommittee members have had a few days to study the information that we have gathered here today, the subcommittee will issue a report to the full Senate Armed Services Committee, along with our recommendation on whether to approve or disapprove the Navy's request to continue making advance payments to Grum-

man. If our decision is to continue these payments, I am sure we will include some very specific additional recommendations on changes which should be made to the Navy's terms and conditions for making such payments and to the Navy's administrative procedures for controlling these funds.

After our report is given to the full committee, I would anticipate that the committee will report to the Senate shortly thereafter with a final recommendation on this question.

[The following questions were submitted by Senator Thurmond to be answered for the record:]

Senator THURMOND. Admiral Lee, describe for the subcommittee the proposal involving the Iranian Government which if consummated would have made extension of the U.S. Advance Payments unnecessary?

Admiral LEE. The proposal would have provided for payments according to a schedule which would closely approximate the Iran termination liability. These payments would have provided monies, in excess of cash needs for the Iranian items, sufficient to reduce the cash deficiency existing on U.S. Navy programs below the level requiring congressional notification.

Senator THURMOND. Did the Iranian government agree to this plan?

Admiral LEE. The proposal for use of the Iranian payment schedule was never discussed with the Government of Iran.

Senator THURMOND. What is the position of the Grumman Corporation reference this plan?

Admiral LEE. Grumman proposed this plan and agreed to language incorporating the plan.

Senator THURMOND. What is the position of the Navy reference this plan?

Admiral LEE. The Navy's position to use the Advance Payment plan rather than the Iranian payment schedule was set forth in the Secretary of the Navy's letter to the House and Senate Armed Services Committees on 4 June 1974.

Senator THURMOND. Would the Navy plan be necessary if the Iran plan had been accepted?

Admiral LEE. The Iran plan required assurance from Congress that U.S. Advance Payments would be resumed, if necessary, following any complete or partial termination of the contract by the Government of Iran.

Senator THURMOND. Why was this plan dropped?

Admiral LEE. The plan was dropped based on a policy decision to avoid establishing such a precedent for other FMS cases.

Senator THURMOND. What interest charges would commercial banks probably require of the Grumman Corporation?

Admiral LEE. At least the commercial prime rate which is in the 12% range.

[The following statement and material was submitted by the Navy for the record subsequent to the hearing:]

The Navy testimony confirms generally the synopsis of conclusions.

The restated and amended advance payment agreement covering the U.S. buys of the F-14 and other U.S. aircraft and the new advance payment agreement covering the Iranian buy of the F-14 have been further modified to accomplish the following:

1. Establish and ensure positive control of cash from the Navy Special Pool Bank Account to ultimate disbursement for authorized or approved purposes. Control of cash designed to provide audit trail.

2. Reduce advance payments from monthly cash flow cycle to weekly or lesser period.

3. Revise interest rate to prime plus  $\frac{1}{2}\%$  or Treasury rate, whichever is the higher.

Revised NAVPRO and DCAA procedures are being established to assure that these advance payment controls are effective.

The first restated and amended Advance Payment Pool Agreement entered into 29 July 1974 is printed below.

DEPARTMENT OF THE NAVY,  
OFFICE OF THE SECRETARY,  
Washington, D.C., July 29, 1974.

Hon. HOWARD W. CANNON,  
Chairman, Subcommittee on Tactical Air Power of the Committee on Armed Services,  
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: During the course of recent hearings before your Subcommittee on the Department of the Navy's proposed increase of advance payments to the Grumman Aerospace Corporation (GAC), you stated that if the Congress is not to disapprove the Navy's request, certain changes should be made to correct present deficiencies with the Navy's terms, conditions, arrangements, and financial controls for providing these advance payments. Particularly, you emphasized: (a) that the interest rate be established at the commercial prime rate or the Treasury rate, whichever is the higher; (b) a need for a more frequent audit of cash requirements; and (c) that funds withdrawn from the Special Pool Bank Account be used only to pay bills accrued to Pool Contracts either directly out of the Special Pool Bank Account or by the establishment of a separate GAC account for these Pool Contracts.

The Department of the Navy and GAC have now agreed to revised terms and conditions governing the extension of advance payments. These revisions have been negotiated to meet the desires of your Committee. I am attaching hereto a copy of the new agreement, together with a point paper summarizing the significant changes and a letter of understanding from the President of Grumman Corporation.

In addition to the expressed control provisions in the Agreement, I intend to create an oversight Committee, chaired by the Assistant Secretary of the Navy (Financial Management), to supervise the administration and operation of the Agreement.

Please do not hesitate to call upon me for any additional information you may desire on this matter.

Sincerely,

J. WILLIAM MIDDENDORF II,  
Secretary of the Navy.

ANALYSIS OF SIGNIFICANT CHANGES BETWEEN ADVANCE PAYMENT POOL AGREEMENT OF AUGUST 8, 1972, AND THE FIRST RESTATED AND AMENDED ADVANCE PAYMENT POOL AGREEMENT OF JULY 28, 1974

1. The 8 August 1972 Advance Payment Agreement as amended 14 September 1972, 12 December 1972, and 8 March 1973 (referred to as the "1972 Agreement"), provides for advances up to \$54 million for the purpose of financing designated Navy Pool Contracts. The First Restated and Amended Advance Payment Pool Agreement of 29 July 1974 (referred to as the "1974 Agreement") would increase the advance payment ceiling to \$100 million. This ceiling amount has been determined to be sufficient to finance all Navy Pool Contracts, including the FY 1974 and FY 1975 F-14 programs.

2. Paragraph (3), Use of Funds clause in the 1974 Agreement, has been substantially amended to provide for a readily auditable system of examining the flow of funds to Grumman Aerospace Corporation (GAC). This control of funds procedure includes not only advances made by the Navy, but also all progress and delivery payments earned by GAC and deposited into the Navy Special Pool Bank Account.

(a) Under the new arrangement, GAC will have to document any requested withdrawal of funds from the Special Pool Account. (All withdrawals from this Account under the 1972 and 1974 Agreements must be countersigned by an authorized Navy official.) Cash required for: vendors bills will be supported by a print-out of vendors by name and dollar amount properly allocable to Pool Contracts; direct labor costs will be supported by job order allocation to Pool Contracts; indirect labor costs will be properly allocated to Pool Contracts; and overhead and General and Administrative (G&A) cash requirements will be properly allocated to Pool Contracts. Emphasized here is that requests for withdrawals will be countersigned only for supported cash requirements, not accrued costs.

(b) For audit visibility, GAC is required to establish a new cash account entitled "Pool Cash Account". Checks drawn on the Special Pool Bank Account (and countersigned by the Navy) for supported vendors bills and overhead and G&A will be deposited directly into the Pool Cash Account. As GAC pays these vendors bills and overhead and G&A costs, auditors will have a clear trail in reviewing transactions in the Pool Cash Account as against the supporting documentation for which these funds were drawn from the Special Pool Account.

(c) Checks drawn on the Special Pool Account for payroll will be deposited directly into GAC's present payroll account. Since this latter account is strictly for payroll, audit is readily accomplished.

(d) Under the 1972 Agreement, advances were made on a monthly cash flow projection. This caused wide cash balance variations in the GAC operating cash account. To overcome this situation, the 1974 Agreement prohibits advances beyond 5 working days. The 1974 Agreement provides for daily advances and liquidations. With the new interest rate and restriction on any investment including governments (discussed below), GAC will, as a practical matter, operate essentially on a daily financing basis.

3. The Interest rate under the 1974 Agreement will be a floating prime plus  $\frac{1}{2}$  percent or the current Treasury rate established under Public Law 92-41, whichever is the higher.

4. The 1974 Agreement prohibits investment by GAC in any stock or other securities of any corporation, municipality, or Governmental authority. Investments in U.S. securities can be made only when no advances under the Agreement are outstanding, and any such investments must be liquidated before any advances can be made.

5. In addition to the above, the Secretary of the Navy will establish an oversight Committee to supervise the administration and operation of the advance payment agreement. The Assistant Secretary of the Navy (Financial Management) or his superior will chair the Committee.

GRUMMAN CORP.,

Bethpage, N.Y. 11714 July 29, 1974.

HON. DAVID S. POTTER,  
Assistant Secretary of the Navy,  
Department of the Navy,  
The Pentagon, Washington, D.C.

DEAR MR. SECRETARY: It was a pleasure to be able to participate in a full discussion with you and your associates this past Saturday regarding the financial agreements and other obligations that have followed from the settlement agreement which we signed with the Secretary of the Navy on March 8, 1973.

The amended advance payment pool agreement which has been signed by the Navy and Grumman Aerospace Corporation today is an improvement over the predecessor agreement. The changes that have occurred in the past months in the money markets have made a fixed rate of interest less viable than the floating rate which has now been agreed to. The new permission to Grumman Aerospace Corporation to request or repay advances on a daily basis is an improvement over the old "periodic" provision and removes the need to use other procedures to manage its daily cash position. I believe the improved accounting approach which we have discussed with the Navy will satisfy the Navy's needs for more segregated accounts. Specifically, these three changes are the three points emphasized by Senator Cannon in his summation at the end of the recent hearings before his committee.

The Navy and all of us at Grumman are agreed that the earliest possible return by Grumman to regular commercial credit (and the concurrent cancellation of the advance payments pool agreement) is highly desired. We have felt that this was possible, and as a matter of fact, we believed that it was essentially at hand this spring. Unfortunately, due to various events and policies, our plans had to be cancelled, as explained by the Navy at the recent Congressional hearings. Even so, we have hopes that our expected debenture exchange will be followed by a new and more successful approach. An advance payments pool agreement was a necessary part of the settlement agreement with the Secretary of the Navy but we would like to return to commercial credits as soon as possible.

The June 28, 1974 agreement between the Navy and ourselves will continue for the life of the advance payment pool agreement. There are some additional assurances we would like to add, and which we understand will be helpful to the Navy in its relationship with and understanding of all parts of the Grumman Corporation during this period.

As agreed, we will be sending the Navy our regular monthly consolidated and consolidating financial statements. We will be pleased to meet with you at any reasonable time to explain or discuss any of the parts or the whole. We will also consult and advise with you prior to any event known to us which would result in a material change in these statements. As I mentioned Saturday, we need to continue Grumman's historically conservative dividend policy, and we are not now contemplating a merger or acquisition or any consequence.

Most importantly, we feel that there is a growing recognition in the financial communities of Grumman performance in both the military and the commercial arenas.

We believe this recognition has come primarily from the consistency of Grumman's performance, or as contemplated in the financial planning done at the time of the agreement with the Secretary of the Navy. Further, this recognition and our continued success are, in our opinion, the best criteria of our return to commercial credits.

If this letter reflects our understanding, would you please sign the enclosed copy and return it to me.

Sincerely,

JOHN C. BIERWIRTH,  
*President.*

DEPARTMENT OF THE NAVY,  
OFFICE OF THE COMPTROLLER,  
*Washington, D.C.*

#### FIRST RESTATED AND AMENDED ADVANCE PAYMENT POOL AGREEMENT

This Agreement entered into as of this 29th day of July 1974 by and between the United States of America (hereinafter called the "Government"), represented by the Office of the Comptroller, Department of the Navy (hereinafter called the "Administering Office"), and Grumman Aerospace Corporation (hereinafter called the "Contractor"), a corporation having a principal office at Bethpage, Long Island, New York.

The Government and the Contractor are parties to a certain Advance Payment Pool Agreement dated as of 8 August 1972, as amended 14 September 1972, 12 December 1972, and 8 March 1973, and the Restated and Amended Advance Payment Pool Agreement dated 28 June 1974. The Government and the Contractor now wish to further amend and restate the 28 June 1974 Agreement.

Now, therefore, the parties hereto mutually agree as follows:

(1) *Amount of Advances.*—At the request of the Contractor, and subject to the conditions hereinafter set forth, the Government shall make advance payments as frequently as daily, to the Contractor under the Pool Contract or Contracts which are, or may hereafter by amendment be designated by the Administering Office in paragraph (18)(a) below. Such contracts shall hereinafter be called "Designated Pool Contracts". No advance payments shall be made in an amount which together with all advance payment theretofore made, shall exceed either the amount stated in paragraph (18)(b) below or as to each contract designated, the amount due under such contract.

(2) *Special Pool Bank Account.*—Until all advance payments made hereunder, and interest charges, are liquidated and the Administering Office approves in writing the release of any funds due and payable to the Contractor, all advance payments and all other payments under all Pool Contracts (including Designated Pool Contracts) subject to this Agreement shall be made by check payable to the Contractor and be marked for deposit only in a Navy Special Pool Bank Account with the bank designated in paragraph (18)(c) below. No part of the funds in the Navy Special Pool Bank Account shall be mingled with other funds of the Contractor prior to withdrawal thereof from the Navy Special Pool Bank Account as hereinafter provided. Except as hereinafter provided, each withdrawal shall be made only by check of the Contractor countersigned on behalf of the Government by the official designated in paragraph (18)(e) below, or such other person or persons as he may designate in writing (hereinafter called the "Countersigning Agent").

(3) *Use of Funds.*—

(a) The funds in the Navy Special Pool Bank Account may be withdrawn by the Contractor, under terms and conditions specified below, for the purpose of making payments for direct materials, direct labor, and administrative and overhead expenses required for the purpose of Pool Contracts (including, without

limitation, payments incident to termination for the convenience of the Government) and properly allocable thereto in accordance with generally accepted accounting principles and for such other purposes as the Administering Office may approve in writing. Any interpretation required as to the proper use of funds shall be made in writing by the Administering Office.

(b) All withdrawals from the Navy Special Pool Bank Account requested by the Contractor shall be supported in writing in a manner and form prescribed by the Administering Office. Without limitation, this supporting documentation will identify:

- (i) material costs by name of vendors and amounts to be paid;
- (ii) direct labor costs by job order allocation to Pool Contracts;
- (iii) indirect labor costs properly allocable to Pool Contracts; and
- (iv) overhead and General and Administrative (G&A) cash requirements properly allocable to Pool Contracts.

(c) Checks drawn on the Navy Special Pool Bank Account for payroll shall be deposited only into the Contractor's payroll account.

(d) The Contractor will establish a new cash account with its bank entitled "Pool Cash Account". Deposited into this new account shall be all checks drawn on the Navy Special Pool Bank Account for the payment of vendor's bills, overhead and G&A expenses for other than indirect labor costs, and for such other expenses as directed by the Administering Office.

(e) Withdrawals from the Navy Special Pool Bank Account for deposit into the Pool Cash Account and/or Payroll Account shall be disbursed in accordance with documentation supporting such withdrawals.

(f) No withdrawals will be authorized from the Navy Special Pool Bank Account which shall exceed cash requirements for the five succeeding working days.

(4) *Return of Funds.*—The Contractor may at any time repay all or any part of the funds advanced hereunder. Whenever so requested in writing by the Administering Office, the Contractor shall repay to the Government within thirty (30) days such part of the unliquidated balance of advance payments as shall in the opinion of the Administering Office be in excess of current requirements, or in excess of the amount specified in paragraph (18) (b). In the event the Contractor fails to repay such part of the unliquidated balance of advance payments when so requested by the Administering Office, all or any part thereof may be withdrawn from the Navy Special Pool Bank Account by checks payable to the Treasurer of the United States signed solely by the Countersigning Agent and applied in reduction of advance payments then outstanding hereunder.

(5) *Liquidating.*—If not otherwise liquidated, the advance payments made hereunder and interest charges shall be liquidated as herein provided. When the sum of all payments under the Designated Pool Contract N00019-74-C-0073, including the unliquidated amount of advance payments made thereunder (plus any unpaid interest charges on such advance payments), are equal to 95% of the stated contract price, the Government shall thereafter withhold further payments to the Contractor under the Designated Pool Contract or Contracts and apply the amounts so withheld against the Contractor's obligation to repay such advance payments made hereunder and interest charges until such advance payments and interest charges shall have been fully liquidated. If, upon the completion of each Designated Pool Contract or Contracts, or the termination thereof, the advance payments made to the Contractor hereunder have not been fully liquidated, the balances thereof shall be deducted from any payments otherwise due or which may become due to the Contractor from the Government, and, if the sum or sums due or which may become due to the Contractor from the Government are insufficient to cover such balances, the deficiency shall be paid by the Contractor to the Government upon demand.

(6) *Interest Charge.*—As required in paragraph (18) (f) below and at the rate therein specified, the Contractor shall pay interest to the Government upon the daily unliquidated balance of advance payments made under this Agreement. If the full amount of such interest is not paid by deduction or otherwise upon the completion or termination of Pool Contracts, the deficiency shall be paid by the Contractor to the Government upon demand. Interest at the rate specified in paragraph (18) (f) shall be computed at the end of each calendar month in the manner herein specified on the daily balances of the principal of the advance payments outstanding. Notwithstanding monthly computation, interest shall be computed for the actual number of days involved, on the basis of a 365 or 366 day year as the case may be. As soon as such monthly computations shall have been made, the interest charge so determined shall be deducted from any payments otherwise due to the Contractor under the contracts on which advance payments

have been made. In the event the accrued interest exceeds any such payment, the excess of such interest shall be carried forward and deducted from subsequent payments. The interest shall not be compounded, and shall, subject to the provisions of paragraph (11) hereof, cease to accrue with respect to each contract upon which advance payments are outstanding hereunder upon termination of such contract for other than the fault of the Contractor.

(7) *Bank Agreement.*— Before an advance payment is made hereunder, the Contractor shall transmit to the Administering Office, in the form prescribed by such office, an Agreement in triplicate from the bank in which the Navy Special Pool Bank Account is established, clearly setting forth the special character of the account and the responsibilities of the bank thereunder. Wherever possible, such bank shall be a member of the Federal Reserve System, or an "insured" bank within the meaning of the Act creating the Federal Deposit Insurance Corporation (Act of August 23, 1935, 29 Stat. 684, as amended: 12 U.S.C. 264).

(8) *Lien on Navy Special Pool Bank Account.*—The Government shall have a lien upon any balance in the Navy Special Pool Bank Account, paramount to all other liens, which lien shall secure the repayment of any advance payment made hereunder together with interest charges thereon. When all such advance payments, together with interest charges thereon, have been liquidated, any funds remaining in the Navy Special Pool Bank Account shall, upon notification in writing to the depository bank by the Administering Office, be free and clear of any lien or claim of the Government whatsoever and may be withdrawn by the Contractor without any restrictions.

(9) *Lien on Property under Contracts.*—Any and all advance payments made under this Pool Agreement, together with interest charges thereon, shall be secured, when made, by a lien in favor of the Government, paramount to all other liens, upon the supplies or other things covered by Pool Contracts and on all material and other property acquired for or allocated to the performance of Pool Contracts, except to the extent that the Government, by virtue of any other provision of Pool Contracts or otherwise, shall have valid title to such supplies, materials, or other property as against other creditors of the Contractor. The Contractor shall identify by marking or segregating all property which is subject to a lien in favor of the Government by virtue of any provision of Pool Contracts in such a way as to indicate that it is subject to such lien and that it has been acquired for or allocated to the performance of Pool Contracts. If for any reason such supplies, materials, or other property are not identified by marking or segregating, the Government shall be deemed to have a lien to the extent of the Government's interest under Pool Contracts on any mass of property with which such supplies, materials, or other property are commingled. The Contractor shall maintain adequate accounting control over such property on its books and records. If at any time during the progress of the work on Pool Contracts it becomes necessary to deliver any item or items and materials upon which the Government has a lien as aforesaid to a third person, the Contractor shall notify such third person of the lien herein provided and shall obtain from such third person a receipt, in duplicate, acknowledging, inter alia, the existence of such lien. A copy of each receipt shall be delivered by the Contractor to the Contracting Officer. If any Pool Contract is terminated in whole or in part and the Contractor is authorized to sell or retain termination inventory acquired for or allocated to such contract, such sale or retention shall be made only if approved by the Contracting Officer, which approval shall constitute a release of the Government's lien hereunder to the extent that such termination inventory is sold or retained, and to the extent that the proceeds of the sale, or the credit allowed for such retention of the Contractor's termination claim, is applied in reduction of advance payments then outstanding hereunder.

(10) *Insurance.*—The Contractor represents and warrants that it is now maintaining with responsible insurance carriers, (i) insurance upon its own plant and equipment against fire and other hazards to the extent that like properties are usually insured by others operating plants and properties of similar character in the same general locality; (ii) adequate insurance against liability on account of damage to persons or property; and (iii) adequate insurance under all applicable workmen's compensation laws. The Contractor agreed that, until work under Pool Contracts has been completed and all advance payments made hereunder have been liquidated, it will (i) maintain such insurances; (ii) maintain adequate insurance upon any materials, parts, assemblies, subassemblies, supplies, equipment and other property acquired for or allocable to Pool Contracts and subject to the Government lien hereunder; and (iii) furnish such certificates with respect to its insurance as the Administering Office may from time to time required.

(11) *Default Provisions.*—Upon the happening of any of the following events of default, (i) termination of any Pool Contract by reason of fault of the Contractor; (ii) failure of the Contractor to observe any of the covenants, conditions or warranties of these provisions; (iii) appointment of a trustee, receiver or liquidator for all or a substantial part of the Contractor's property, or institution of bankruptcy, reorganization, arrangement or liquidation proceeding by or against the Contractor; (iv) service of any writ of attachment, levy of execution, or commencement of garnishment proceedings with respect to the Navy Special Pool Bank Account; or (v) the commission of an act of bankruptcy; the Government, without limiting any rights which it may otherwise have, may, in its discretion and upon written notice to the Contractor, withhold further withdrawals from the Navy Special Pool Bank Account. The events of default enumerated above shall constitute such events immediately upon their occurrence, but the Contractor shall have ten (10) days in which to cure the events of default enumerated in (ii) and (iv) above before the Government may exercise the rights granted to it herein. Upon the continuance of any such events of default for a period of thirty (30) days after such written notice to the Contractor, the Government may, in its discretion, and without limiting any other rights which the Government may have, take the following additional actions as it may deem appropriate in the circumstances: (a) withdraw all of any part of the balance in the Navy Special Pool Bank Account by checks payable to the Treasury of the United States signed solely by the Countersigning Agent and apply such amounts in reduction of advance payments then outstanding hereunder; (b) charge interest on advance payments outstanding during the period of any such event of default at the rate specified in paragraph (18) (f), below; (c) demand immediate repayment of the unliquidated balance of advance payments made hereunder; or (d) take possession of and, with or without advertisement, sell at public sale at which the Government may be the purchaser, or at a private sale, all or any part of the property on which the Government has a lien or any security interest as provided for herein, and, after deducting any expenses incident to such sale, apply the net proceeds of such sale in reduction of the unliquidated balance of advance Government against the Contractor.

(12) *Prohibition Against Assignment.*—Notwithstanding any other provisions of the Pool Contracts, the Contractor shall not transfer, pledge, or otherwise assign any Pool Contract subject to this Agreement, or any interest therein, or any claim arising thereunder, to any party or parties, bank, trust company or other financing institution until all advance payments made hereunder have been fully liquidated.

(13) *Access to Records.*—The Contractor shall afford to authorized representatives of the Government proper facilities for inspection and audit of the Contractor's books, records, and accounts.

(14) *Disputes.*—

(a) Except as otherwise provided in this Agreement, any dispute concerning a question of fact arising hereunder which is not disposed of by agreement shall be decided by the Administering Office, who shall reduce its decision to writing and mail or otherwise furnish a copy thereof to the Contractor. Within thirty (30) days from the date of receipt of such copy, the Contractor may appeal by mailing or otherwise furnishing to the Administering Office a written appeal addressed to the Secretary of the Navy and the decision of the Secretary or his duly authorized representative for the hearing of such appeals shall, unless determined by a court of competent jurisdiction to have been fraudulent, arbitrary, capricious, or so grossly erroneous as necessarily to imply bad faith, be final and conclusive; provided that, if no such appeal is taken, the decision of the Administering Office shall be final and conclusive. In connection with any appeal under this clause, the Contractor shall be afforded an opportunity to be heard and to offer evidence in support of its appeal. Pending final decision of a dispute hereunder, the Contractor shall proceed diligently with the performance of the contracts financed under the terms of this Agreement and in accordance with the decision of the Administering Office.

(b) This "Disputes" clause does not preclude consideration of law questions in connection with decisions provided for in paragraph (a) above; provided, that nothing in this contract shall be construed as making final the decision of any administrative official, representative, or board on a question of law.

(15) *Officials Not to Benefit.*—No member of or delegate to Congress, or resident commissioner, shall be admitted to any share or part of this Agreement, or to any benefit that may arise therefrom; but this provision shall not be construed to extend to this Agreement if made with a corporation for its general benefit.

(16) *Convenants Against Contingent Fees.*—The Contractor warrants that no person or selling agency has been employed or retained to solicit or secure this Agreement upon an agreement or understanding for a commission, percentage, brokerage, or contingent fee, excepting bona fide employees or bona fide established commercial or selling agencies maintained by the Contractor for the purpose of securing business. For breach of violation of this warranty, the Government shall have the right to annul this Agreement without liability or in its discretion to deduct from any Pool Contract price or consideration the full amount of such commission, percentage, brokerage, or contingent fee.

(17) *Examination of Records.*—The Contractor agrees that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of three (3) years after final payment hereunder, have access to and the right to examine any pertinent books, documents, and records of the Contractor involving transactions related to this Agreement and all Pool Contracts as defined herein.

(18) *Designations and Determinations.*—

(a) *Designated Pool Contract.* The following contract is a "Designated Pool Contract" under this Agreement: N00019-74-C-0073

This designation shall take effect on the effective date of said contract.

(b) *Amount.* The aggregate amount of advance payments to be made hereunder shall not exceed \$100,000,000.

(c) *Depository.* The bank designated for the deposit of advances and all other payments made hereunder shall be the First National City Bank, New York, New York.

(d) *Special Pool Bank Account.* This account referred to throughout the terms of this Agreement shall be designated the "Grumman Aerospace Corporation, Navy Special Pool Bank Account" and shall be maintained in the Depository named in paragraph (18)(c) above.

(e) *Countersigning Agent.* The person designated as Countersigning Agent shall be the Navy Plant Representative, Bethpage, New York, or such other person or persons as he may designate in writing.

(f) *Interest Charge.* Interest shall be charged in the manner provided herein at either (i) the rate established semi-annually (January and July) by the Secretary of the Treasury pursuant to Public Law 92-41; or (ii) the prime rate of the Depository (as designated in paragraph (18)(c) above) plus one-half of one percent (0.5%); whichever is greater.

(g) *Administrative Office.* The office administering advance payments is the Office of the Navy Comptroller.

(h) *Requests for Advance Payments.* Requests for advance payments pursuant to paragraph (1) hereunder will be submitted by the Contractor to the Disbursing and Accounting Branch of the Navy Plant Representative Office, Bethpage, New York, to make payment of advances as authorized by the Administering Office.

(19) *Other Security.*—The terms of the Agreement shall be considered adequate security for advance payments hereunder, except that, if at any time the Administering Office, in its discretion, deems the security furnished by the Contractor to be inadequate, the Contractor shall furnish such additional security as may be satisfactory to the Administering Office.

(20) *Representations and Warranties.*—To induce the making of the advance payments, the Contractor represents and warrants that:

(a) The balance sheet, the profit and loss statement and any other supporting financial statements, heretofore furnished to the Administering Office, fairly reflect the financial condition of the Contractor at the date shown on said balance sheet and the results of the operation for the period covered by the profit and loss statement, and since said date there has been no materially adverse change in the financial condition of the Contractor.

(b) No material litigation or proceedings are presently pending or threatened against the Contractor, except as shown in the above statements.

(c) The Contractor, apart from liability resulting from the renegotiation of defense production contracts, has no contingent liabilities not provided for or disclosed in the financial statements furnished to the Administering Office.

(d) None of the provisions herein contravenes or is in conflict with the authority under which the Contractor is doing business or with the provision of any existing indenture or agreement of the Contractor.

(e) The Contractor has the power to enter into this Agreement and accept advance payments hereunder and has taken all necessary action to authorize such acceptance under the terms and conditions of this Agreement.

(f) None of the assets of the Contractor is subject to any lien or encumbrance of any character except for current taxes not delinquent, and except as shown in the financial statements or other data furnished by the Contractor to the Administering Office. There has been no assignment of claims under any contract affected by these advance payment provisions, or, if there has been any assignment, such assignments have been terminated.

(g) The Contractor has sufficient working capital to perform all of its Government and other contractual obligations for all presently held contracts, other than the contracts embraced in this financing arrangement and the FMS Advance Payment Pool Agreement.

(h) Grumman Corporation, which holds all of the common stock of the Contractor, has agreed that Grumman Corporation will not, during the time this Advance Payment Pool Agreement remains in force, (a) declare or pay any dividends, except (1) dividends payable in stock of the Corporation or (2) dividends in an amount not to exceed fifty percent (50%) of its consolidated after-tax earnings in each year, (b) make any other distribution on account of any shares of its capital stock.

(i) These representations and warranties shall be continuing and shall be deemed to have been repeated by the submission of each request for advance payments.

(21) *Additional Covenants.*—During the period of time that advance payments may be made hereunder and so long as any such advance payments remain unliquidated, the Contractor shall not without the prior written consent of the Administering Office:

(a) Mortgage, pledge, or otherwise encumber, or suffer to be encumbered, any of the assets of the Contractor now owned or hereafter acquired by it, or permit any pre-existing mortgages, liens, or other encumbrances to remain on or attach to any assets of the Contractor which are allocated to the performance of the Pool Contracts; except such liens as presently exist, a listing of which has been furnished the Administering Office;

(b) Sell, assign, transfer, or otherwise dispose of accounts receivable, notes or claims for money due or to become due;

(c) Sell, convey, or lease more than ten percent (10%) of the book value of its property or assets; provided, however, that the foregoing limitation shall not apply to any sales, conveyances or leases prior to the effective date of Amendment No. 3 to the Advance Payment Pool Agreement dated 8 August 1972;

(d) Acquire for value the stock or other securities of any corporation, municipality, or Governmental authority. Investments in U.S. securities may be made only during periods that no advance payments are outstanding hereunder, and such investments must be liquidated before any additional advances are made under this Agreement;

(e) Make any advance or loan to or incur any liability as guarantor, surety, or accommodation endorser for any other firm, person, or corporation in excess of \$500,000;

(f) Make prepayment of any notes, debentures or other evidences of indebtedness payable by the Contractor;

(g) Permit a writ of attachment or any similar process to be issued against its property without procuring release thereof or bonding the same within thirty (30) days after the entry of the writ of attachment or any similar process;

(h) Pay any salaries, commissions, bonuses, or other remuneration in any form or manner to its officers, directors, or key employees in excess of rates of payment existing on 8 August 1972 or of rates provided in agreements or pay practices existing on 8 August 1972 in connection with which notice has been given to the Administering Office, or accrue such remuneration, however, salaries of such officers, directors and key employees may be adjusted upwards at an effective rate of no more than five percent (5%) in total per annum. Any employee whose compensation exceeds \$40,000 annually shall be deemed a key employee;

(i) Make any substantial change in ownership or control of the corporation;

(j) Merge or consolidate with any other firm or corporation, change the type of its business or engage in any transaction outside the ordinary course of its business as presently conducted;

(k) Deposit any of its funds except in a bank or trust company insured by the Federal Deposit Insurance Corporation;

(l) Create or incur indebtedness for borrowed money or advances other than advances to be made hereunder and the FMS Advance Payment Pool Agreement other than as shown in the financial statements furnished in connection with this advance payment;

(m) Make capital expenditures for fixed assets in excess of \$12,000,000 in calendar year 1974 and \$18,000,000 in any calendar year thereafter;

(n) Declare or pay any dividends, except dividends payable in stock of the Corporation, or make any other distribution on account of any share of its Capital stock, except (a) that sufficient cash dividends may be paid by the Contractor to Grumman Corporation to enable the latter to (i) meet its interest obligations on its presently outstanding subordinated debentures, (ii) meet its interest and annual installments on its Notes under an existing Credit Agreement with Marine Midland Trust Company, and (iii) meet its interest and installment payments on its Renegotiation Settlement with the Government in the following amounts: (A) \$500,000 in December 1974, (B) the balance of the Renegotiation Settlement in December 1975, and (C) accrued interest in the amounts and during the month it is payable by Grumman Corporation, (iv) in an amount not to exceed \$1,250,000 annually to support development of the Grumman Corporation's Health Systems, or (b) an amount not to exceed fifty percent (50%) of the Contractor's after-tax earnings in each year, whichever of (a) or (b) is greater; and it is further provided that Contractor will give notice to the Administering Office of its intention to declare any such dividends at least ten (10) days prior to the declaration and payment of any such dividend.

(22) *Furnishings of Information.*—The Contractor agrees to provide the Comptroller of the Navy each month, within 30 days after the last day of the month with the following information:

(a) Balance sheet and profit and loss statement of Grumman Aerospace Corporation on a corporate basis and Grumman Corporation and subsidiaries on a consolidated basis (consolidated statements will be furnished within forty (40) days after the last day of the month);

(b) A statement showing the total monthly expenditures for the following program categories: EA6B, A6E, E2C, F14, other programs and raw materials and standard parts including aluminum sheet, stock, etc.;

(c) Statement of accounts payable showing total amount of accounts payable outstanding for (i) 30 days or less, (ii) for 31 to 60 days, and (iii) over 60 days.

(d) A statement showing contract awards of \$1 million or more and, within forty-five (45) days after the end of each quarter, a statement of backlog by major programs;

(e) A cash flow statement showing beginning balance, receipts, disbursements, forty-five (45) days after the end of each quarter, a statement of backlog by

(e) A cash flow statement showing beginning balance, receipts, disbursements, and ending balance with necessary details to support the cash flow including indicated disbursements for payroll, accounts payable, taxes, plant property and equipment, payments on long term debt, payments to parent company, and other payments with an explanation of any of the "other" payments which exceed \$250,000 in any one month;

(f) A statement with regard to any problems raised by major subcontractors requiring material change in delivery dates or any substantial change in price;

(g) Principal Contractual Documents to be received (loss of cash);

(h) A statement indicating compliance with or any slippage in delivery schedules with regard to each major aircraft program; and

(i) A report on the operation of the Navy Special Pool Bank Account in the form prescribed by the Administering Office.

(23) *Authority.*—The making of advance payments under this Agreement is made pursuant to the authority of Title 10 U.S.C. 2307, and all liens created hereunder are statutory liens, superior to all other liens, as provided by said statute.

(24) *Limiting Date.*—Advance payments made hereunder are to finance all Pool Contracts subject to this Agreement, including any amendments issued thereunder which result in increasing the contract price, and which are executed as of a date on or before 31 December 1975. Upon repayment of all funds advanced hereunder and notice from the Contractor to the Administering Office that advance payments are no longer required, this Agreement and all terms hereof shall terminate forthwith.

(25) *Effective Date.*—This First Restated and Amended Agreement is subject to the provisions and conditions of 10 U.S.C. 2307(d), (Section 807(c) of Public Law 93-155). Notification to the Committees on Armed Services of the Senate and House of Representatives of advance payments proposed under this First Restated and Amended Agreement was made by the Secretary of the Navy on 4 June 1974. Upon expiration of the period prescribed by the said Section 2307(d) of

Title 10, United States Code, if neither House of Congress has adopted a resolution disapproving payments proposed by this First Restated and Amended Agreement, the Administering Office and the Contractor shall agree, in writing, to the effective date of this First Restated and Amended Agreement.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

THE UNITED STATES OF AMERICA,  
By J. B. SANDIDGE,  
*Acting Director of Banking and Contract Financing, Office of the Comptroller,  
Department of the Navy.*

GRUMMAN AEROSPACE CORP.,  
By JOHN O'BRIEN,  
*Administrative Vice President.*

Attest:

RAPHAEL MUR.

[Letter submitted by Senator Javits for the record:]

U. S. SENATE,  
*Washington, D.C., July 18, 1974.*

HON. HOWARD W. CANNON,  
*Chairman, Tactical Airpower Subcommittee, Senate Armed Services Committee,  
Washington, D.C.*

DEAR SENATOR CANNON: The Tactical Airpower Subcommittee of the Senate Armed Services Committee will shortly be considering a communication from the Secretary of the Navy dated June 4, 1974 which notifies the Committee that "the Department of the Navy intends to increase advance payments to the Grumman Aerospace Corporation from the presently authorized amount of \$54 million to \$100 million under contracts placed with Grumman for the Navy's FY 1974 requirements for Models F-14, E-2C, A-6 and EA-6B aircraft." This notice is provided in conformance with the statutory requirements of Section 2307(d) of Title 10, U.S. Code, also incorporated in the FY 1974 Department of Defense Appropriation Authorization Act (P.L. 93-155, Sec. 807(c)), which states that "Payments . . . may not exceed \$25,000,000 unless the Committee on Armed Services of the Senate and House have been notified in writing of such proposed payments and 60 days of continuous session of Congress have expired following the date on which such notice was transmitted to such Committees and neither House of Congress has adopted, within such 60-day period, a resolution disapproving such payments."

During the House Committee consideration of this matter, several points were raised by Vice Admiral Lee, the Commander of the Naval Air System Command, which are very supportive of the Navy's request which I would like to bring to your attention.

First is, the fact that the advance funding will not cost the government more money because Grumman will be paying interest on the advance at a rate set by the Department of the Treasury.

Next, Admiral Lee made the point that it is Grumman's desire, and also clearly in Grumman's best interest, to get back on commercial credit as soon as possible. The reasons cited include: restrictions in Advance Payment Agreement which place all free assets of the Company under control of the Navy; the Company cannot merge or acquire stock in any other company without specific Navy approval; capital expenditures are limited in amount; salaries, commissions and bonuses of officers and key employees are controlled; Grumman Aerospace Corporation cannot pay dividends to its parent corporation in excess of 50% of its after-tax profit; and uncertainties of continuing financing.

However, a key factor in Grumman's ability to return to commercial credit hinges on an agreement with the Government of Iran to purchase 30 F-14's, and the U.S. Government's agreement to step in if the Iranian Government completely or partially terminates the agreement. Since the Department of Defense has been reluctant to enter into this unprecedented agreement with Iran without further study, and since banks are unwilling to extend credit to a company totally dependent on Government contracts for its financial stability, Grumman is not yet able to return to commercial credit.

Finally, the Navy position, which is based on a daily scrutiny of Grumman's business procedures, is that without the advance payments of \$90-\$100 million, the Company will be forced out of business. Admiral Lee emphasized at this point, that the "pool agreement" with Grumman under which these advance payments are made is such that it applies not only to the F-14, but also the A-6E, the EA-6B, and the E-2C, so that every plane which the Government procures from Grumman is involved in this situation. Admiral Lee also pointed out that Grumman is on schedule with regard to all these planes.

These facts point up the seriousness of this situation as it is permitting the Government to procure essential military weapons and serves also to support the need for giving every consideration to the request for these advance payments.

Accordingly, I urge you to consider this matter most thoughtfully in your hearings on July 24, 1974.

In order for the Committee to be apprised of my support of this request, I would like to have this letter made part of the official hearing record.

With best wishes,

Sincerely,

JACOB K. JAVITS.

#### STATEMENT SUBMITTED BY SENATOR PROXMIRE FOR THE RECORD

I oppose the Navy's request to increase the advance payments agreement with Grumman for the following reasons:

1. There is evidence that previous advance payments have enabled Grumman to make millions of dollars in profits through short-term high yield investments.
2. It is wrong to reward a company that has such a poor record for managing government programs with a new government subsidy.
3. The new advance payments agreement, if approved, will add to the cost-overrun on the F-14 and other Grumman contracts and add to the burden on the taxpayer.
4. The current advance payments agreement is, in effect, a below-market interest rate loan and the new agreement apparently will also provide Grumman with low interest money.
5. The new advance payments agreement, if approved, will establish a precedent for 100% government financing of defense contracts.
6. The practice of bailing out defense contractors discourages efforts to control costs and is inflationary.

Because of the improper way the Navy and Grumman have handled this request, I am confident that your Subcommittee will want to fully explore the Navy's decision and Grumman's need for this additional government subsidy.

I have seen nothing in the statements made to adequately explain why the taxpayer should be forced to provide additional financial aid to this private corporation.

According to my information, Grumman appears to have profited from the earlier advance payments by putting funds made available into short-term investments. I question the propriety of this action on the part of Grumman and wonder whether increasing the advance payments will allow it to continue, in effect, to borrow money from the government at low interest rates so that it can invest at least some of it at higher rates.

You are well aware, I am sure, that the Navy has been advancing cash to Grumman at below market interest.

It is not at all clear from the facts that Grumman needs the amount requested and that it has exhausted all possibilities of borrowing whatever it needs from private sources.

As you know, one government bail out often leads to another. We have already seen this pattern in the Grumman case. The problem is that companies like Grumman get used to coming to the government for financial aid once they know it is possible to do so.

From all the evidence I have seen, Grumman's problems have resulted from its inability to improve the efficiency of its operations and control the costs on the F-14 and other defense contracts. The burden of paying for the huge cost-overruns has been shifted to the taxpayer.

The constant shifting of responsibility for the costs of Grumman's poor management is unjust to the taxpayer, unfair to Grumman's competitors, and unhealthy for the economy.

The advance payments agreement is a backdoor subsidy designed, in this case, to provide Grumman with 100% of its cash requirements. Indeed, I have reason to believe that the Navy has been providing Grumman with more than 100% of its cash requirements.

The Navy's actions amount to a policy of corporate favoritism and handouts. I am convinced that a thorough airing of the application for the new Grumman bail out will demonstrate the need to turn it down.

Grumman and the Navy have already compiled a dismal record of financial mismanagement on the F-14 program. Cost-overruns, largely caused wasteful practices, have already increased the unit cost estimates for the F-14 from \$12.6 million to \$17.9 million.

There are rumors that Grumman is indirectly threatening to stop work on the F-14 if it does not get this additional subsidy. These rumors which, if true, amount to a kind of political extortion, are reinforced by statements from the company that it will not be able to continue the program beyond a certain date unless it gets increased advanced payments.

I urge you to consider the implications of capitulating to these sorts of demands. Congress should not consider itself too weak to resist unjust demands for bail outs from defense contractors.

The Grumman case is too important to be decided by default or inaction. For this reason, I am happy to note that the Committee took the initiative to call this hearing.

As co-author of the Anti-bailout Law which set up the procedure, the Navy is now following, I would like to say that it was my intent that the Senate would have an opportunity to vote on any request for new bailouts such as this one in excess of \$25 million.

I am hopeful that the Committee, whatever its decision, will give the full Senate an opportunity to vote on the Navy's request.

Senator CANNON. Thank you very much. The hearings will now be adjourned.

Admiral LEE. Thank you, Mr. Chairman.

[Whereupon, at 12:05 p.m., the subcommittee was adjourned.]

