Senate Hearings

Before the Committee on Appropriations

Renegotiation Board

Fiscal Year 1975

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SPECIAL HEARING

RENEGOTIATION BOARD

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE
COMMITTEE ON APPROPRIATIONS
UNITED STATES SENATE

NINETY-THIRD CONGRESS

SECOND SESSION

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DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, SPACE, SCIENCE, VETERANS, AND CERTAIN OTHER INDEPENDENT AGENCIES APPROPRIATIONS FOR FISCAL YEAR 1975

THURSDAY, JULY 25, 1974

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, D.C.

The subcommittee met at 10:04 a.m. in room 1318, Everett McKinley Dirksen Office Building, Hon. William Proxmire (chairman) presiding.

Present: Senators Proxmire, Chiles, and Mathias.

RENEGOTIATION BOARD

TESTIMONY OF WILLIAM S. WHITEHEAD, CHAIRMAN

ACCOMPANIED BY:
REX M. MATTINGLY, BOARD MEMBER
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GOODWIN CHASE, BOARD MEMBER
NORMAN B. HOUSTON, BOARD MEMBER
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FRED G. REED, EXECUTIVE ASSISTANT TO THE CHAIRMAN
JOHN B. DAVIS, SPECIAL ASSISTANT TO MR. CHASE

SUBCOMMITTEE PROCEDURE

Senator PROXMIRE. The subcommittee will come to order.

Serious questions have been raised in recent years about the failure of the Renegotiation Board to diligently and effectively recapture excess profits on defense contracts. This subcommittee has a direct interest in receiving these questions. We appropriate funds to Government agencies in the expectation that the agencies will vigorously and conscientiously implement the programs under their control. We need to know if programs are not being properly implemented and public funds are not being well managed.

Hearings were held on the Renegotiation Board's budget request on March 26 of this year. On that occasion, we were informed by the Chairman of the Board that several cases involving dissents from majority opinion of the Board were about to be issued. We were promised copies of opinions and dissents as soon as they were issued. About a week ago, we received copies of the opinions and dissents in two cases involving the McDonnell Douglas Corp.

M'DONNELL DOUGLAS CASE

Case No. 1 was a review of the firm's renegotiable business for fiscal year 1967. A majority of the Board found that McDonnell Douglas had earned excessive profits in the amount of $5 million. One member of the Board, Mr. Goodwin Chase, dissented from the majority and wrote his own opinion, in which he concluded that the company should have been charged with $15 million in excessive profits.

In case No. 2, a majority of the Board found that the firm made no excessive profits for the fiscal years 1968 and 1969. Mr. Chase dissented and concluded in a separate opinion that McDonnell Douglas should have been charged with $16 million in excessive profits for 1968. Mr. Chase stated, in addition, that he believed there were excessive profits for the year 1969 but there was insufficient information to base this specific amount.

In all, the dissents conclude that total excess profits for 2 of the 3 years reviewed were $31 million rather than the $5 million found by the majority and there were an indeterminate amount of excess profits for 1969.

The grounds for the dissent are similar in the two cases. Mr. Chase asserts that the Board should have pierced the corporate veil of the company so as to examine the profits of the major profit centers and divisions, principally the McDonnell Co. and the Douglas Co.

According to the facts shown, McDonnell made high profits in the years preceding its merger with Douglas in 1967. In fact, McDonnell's profits were ruled excessive by the Board in 1965 and 1966. Douglas, on the other hand, made low profits in those years.

Mr. Chase has stated that the same situation prevailed after the merger. McDonnell continued making high profits; Douglas made low profits. Mr. Chase comes to his conclusions by separating the financial returns of the two divisions after the merger.

The approach of the majority opinion was to average the profits of McDonnell Douglas. Mr. Chase alleges that the Board had the duty under the law and the Board's regulations to separate them.

Mr. Chase further alleges that McDonnell Douglas refused to supply the Board with all of the information it needed in order to arrive at its conclusions. He states that the Board, and I quote, "The Board failed to exercise its obligations to examine the information essential to an accurate determination of excessive profits by contract type for each of the operating divisions and subsidiaries of McDonnell Douglas Corporation."

Mr. Chase further charges that the Board has not exercised its authority under the statute and the regulations to examine the segments separately and then to aggregate the results in arriving at a final determination.

The dissenting opinions also provide details of what appears to be a systematic refusal on the part of the company to provide information requested by the Board, and refusal to comply with the provisions of the Renegotiation Act. The Board apparently acceded to the refusals of the company.

Now, these are serious charges. They go to the heart of some of the questions raised about the effectiveness and diligence of the Board.

We have therefore invited the members of the Board and the General Counsel of the Board to appear before us so that we might attempt to clear up the discrepancies of the majority and dissenting opinions, and so we might get to the bottom of the charges that have been made.

Because of the serious charges, we have also invited McDonnell Douglas to request time to answer the charges before this committee or to supply us with any testimony it wishes to provide.

The procedure this morning will be as follows. First, I want to swear in each of the witnesses, and second, the Chairman, Mr. William S. Whitehead and other members of the Board will have an opportunity to make a brief opening statement or reply to my own remarks, and then I want to direct some questions to the witnesses.

Before I proceed to swear in the witnesses, I should tell you that we are having a conference on the Agricultural appropriations bill, and there is a matter of great importance in that conference on which I must speak, and for that reason it may be necessary—I do not know when that is going to come up. Whenever it comes up we will have to recess the hearing temporarily while I go to the Capitol to appear in the conference. And I am hopeful that we can conclude the hearing this morning before that time.

SWEARING IN OF WITNESSES

I now would ask the witnesses, that includes the members of the Board and the Counsel of the Board, to rise, and I ask each of you, do you solemnly swear that the testimony you will present this morning is the truth, the whole truth and nothing but the truth, so help you God?

Mr. WHITEHEAD. I do.
Mr. MATTINGLY. I do.
Mr. RINEHART. I do.
Mr. CHASE. I do.
Mr. HOUSTON. I do.
Mr. LAMBERT. I do.

INTRODUCTION OF MR. WHITEHEAD

Senator PROXMIRE. Now, Mr. Whitehead, would you like to reply or would other members of the Board like to make any kind of statement in connection with my opening statement, or would you prefer simply to respond to questions?

Mr. WHITEHEAD. Thank you, Mr. Chairman. I have no opening statement. I caught several prominent points made in your remarks. We would be pleased at this time to answer any questions fully and fairly and to the best of our ability.

Senator PROXMIRE. All right, sir, fine. I think maybe that is a good way to handle it.

And supposing I go ahead with the questions, and then at the conclusion of the question and answer period, either you or other members of the Board might like to make some kind of a statement that would help us clarify the situation or understand it more thoroughly, and maybe that would be a better time for such a statement rather than do it now, all right?

Mr. WHITEHEAD. Mr. Chairman, may I get into the record the names of those from the Board staff who are here other than the Board members?

Is it all right to submit this witness list or do you want me to recite the names?

Senator PROXMIRE. That is fine. I presume that the witness list, that all those on the witness list have taken the oath, is that correct?

Mr. WHITEHEAD. Well, no, I don't know. I could not see in the back. I do believe so.

Senator PROXMIRE. All right.

Supposing you read that list off and anyone who is on the list who is going to testify we will swear.

Mr. WHITEHEAD. All right.

STAFF MEMBERS PRESENT

Mr. Grenough, Director of the Office of Accounting, on my immediate left; Mr. Harold Stone, Director of the Office of Administration, in the rear; David M. F. Lambert, General Counsel who was sworn; George Lenches, Director of the Office of Planning and Analysis, on my immediate right; William H. Harrison, Acting Director of the Office of Review; Mr. Fred G. Reed, Executive Assistant to the Chairman of the Board; Mr. John B. Davis, Special Assistant to Mr. Chase.

Mr. Chairman, if I might make a suggestion——

Senator PROXMIRE. Go right ahead, sir.

Mr. WHITEHEAD. We have prepared some notes here which delineate the method of renegotiating a contractor with renegotiable business in more than one division or subsidiary. It is a statement which is about 3 or 4 pages long, but I really think and believe that if I could read this into the record and provide you and the committee with copies thereof, that it would be helpful in initiating this hearing because it is around this apex of your hearing.

Senator PROXMIRE. That is fine. I wish we had had it in advance. We would have liked to have had it in advance, but why do you not go ahead?

Mr. WHITEHEAD. Actually, it was not prepared until late last night.

Senator PROXMIRE. All right. if it is only three or four pages, it would take about 5 minutes to read it, that would be fine.

Now, before you do that I want to be sure that the people on the witness list whose names you read off have been sworn in.

Mr. WHITEHEAD. All right.

Senator PROXMIRE. All right, fine.

Now, let me ask you gentlemen to raise your right hand.

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

Mr. GRENOUGH. I do.

Mr. STONE. I do.

Mr. LENCHES. I do.

Mr. HARRISON. I do.

Mr. REED. I do.

Mr. DAVIS. I do.

Senator PROXMIRE. All right, sir, go ahead with your statement.

RENEGOTIATION BY PRODUCT LINE

Mr. WHITEHEAD. All right, I will read these notes.

In renegotiating a contractor whose renegotiable business is conducted in more than one division, plant or subsidiary, the procedure is as follows:

The types of major products produced at each plant, division or subsidiary are evaluated to determine the degree of differences, for renegotiation purposes, that may be present in such products. The Board's interest in product differences does not necessarily parallel the existing Federal Trade Commission, Internal Revenue Service, or other standard classification of products. Instead, the differences that concern the Board include such broad areas as technology, manufacturing and engineering techniques, types of contracts and history of products.

Having evaluated the various products to identify significant differences, the Board may conclude that in some cases the products are not sufficiently dissimilar to justify the application of the statutory factors to the individual products. In these cases, the financial and other operating data pertaining to such products are evaluated as a whole, without differentiating the particular division, plant, or subsidiary, where the individual products were produced.

This procedure is consistent with the act, since it permits the Board to apply the statutory factors to appropriately broad segments of the business, and thereby avoid becoming unrealistically finite in the application of the statutory factors to similar phases of the contractor's business. To apply the factors separately to narrow ranges of contractors products would impute a degree of preciseness to the statutory factors which we believe was not intended by the act. To do otherwise would not only be inconsistent with the provisions of the act but would have adverse effects on corporate management and efficiency. Profit equalization among components would be attempted by management that could result only in the loss of efficiency in planning and facility utilization. Attempts of this kind would certainly not be in the best interest of the contractor or the Government.

Where the major products produced at each plant, division or subsidiary are so diverse as to yield substantially different renegotiation results upon application of the statutory factors, every attempt is made to obtain separate financial and other operating data pertaining to such products, to the extent that such information is available. In these circumstances, the statutory factors are applied to each such

diverse product individually, in order to determine the presence or absence of excessive profits. In case of products where excessive profits are determined not to be present, the Board seeks to determine the extent to which profits may be deficient, so as to consider the circumstances which caused the deficient profits to exist. Depending on the nature of such circumstances, the Board may or may not deem it appropriate to offset deficient profits against excessive profits in other products, in order to determine the presence or absence of excessive profits for the contractor as a whole.

There is a wide range of circumstances which give lead to a determination of deficient profits upon the application of the statutory factors to the products. For example, the degree of risk undertaken by the contractor may have resulted in low profits or losses for a particular product; the contractor may have made a significant contribution to the defense effort in case of a particular product, but the low profit or losses does not adequately compensate him for such contribution. Under circumstances of these types it is appropriate, and entirely consistent with the provisions of the act, to offset a portion or all of the low profits on such products against excessive profits on other products, since the contractor's business, as a whole, is being renegotiated.

RENEGOTIATION OF MC DONNELL DOUGLAS CORP.

In the opinion of the majority of the Board, in the renegotiation of McDonnell Douglas Corp. for fiscal years 1967, 1968, 1969, the procedure described above was followed. The pertinent historical financial and operating data for the McDonnell and Douglas entities, that is, when they were separate corporations, were considered by the Board in relation to the proceedings for fiscal years 1967, 1968, and 1969. Because of this knowledge of McDonnell's and Douglas' prior independent operations, gained through many years of renegotiation, coupled with knowledge of review years products, the Board did not believe it appropriate to apply the statutory factors separately to the Douglas and McDonnell components. Therefore, the question of deficient profits was not considered germane to the proceedings. In other words, Mr. Chairman, the Board did not believe the products to be sufficiently dissimilar to yield substantially different results for renegotiation purposes and it did not seek out, and evaluate separately, the financial and operating data on the Douglas and McDonnell divisions beyond the point that permitted it to apply the statutory factors to the corporation as a whole.

Now, that concludes the statement, Mr. Chairman. I apologize first of all that we do not have copies, but it does show, I think, rather distinctly the two different approaches which the Board, not only this Board but every predecessor Board has taken, that where the products are not dissimilar, the company is renegotiated as a whole. Where a corporation has a number of operating subsidiaries and they have dissimilar products, then we take each subsidiary or division or operating unit and we analyze the profits or the losses of each. Generally, when they come in they will file, for the most part, on a consolidated basis under the regulations which have been in force many years.

What we do is to look at the operation as a whole, taking into consideration those profits made by certain subsidiaries or units, operating units, and the losses in others, if any. We try to equate and

evaluate the total return that the corporation has made on the basis of what may or may not be excessive profits.

Thank you very much for permitting me to read this.

Senator PROXMIRE. Thank you, Mr. Whitehead.

Now, Mr. Whitehead, what is your response—I am going to get to Mr. Chase shortly. Obviously he has his viewpoint, and we would like that expressed, too.

What is your response to Mr. Chase's charges that the Board did not obtain all of the information requested from the company, that on one occasion you acceded or backed down when McDonnell Douglas refused to provide what you asked for?

INFORMATION REQUESTED OF CONTRACTOR

Mr. WHITEHEAD. Well, my answer is that the company provided us with every bit of information that we asked for. It is just as simple as that.

Now, we did not take photostatic copies or copies of the information which they gave us, but we did—the books and the records in every instance were made available to us. I understand there was never a time on the part of the McDonnell Douglas Corp. that they did not cooperate fully with us in giving us what we asked for.

Senator PROXMIRE. Let me be specific. It is alleged that the Board requested the contractor to furnish full and complete financial information relating to the McDonnell Co. and full and complete financial information ralating to the Douglas Aircraft Division for the years under review, and thereafter the Board acceded in the contractor's request that such information not be required.

Do you deny that?

Mr. WHITEHEAD. Yes, I do, sir.

Senator PROXMIRE. You deny it?

Mr. WHITEHEAD. Yes, sir. I would like to show for the record a three-page identification of all of the information which was made available to us, and it amounts to 1,907 pages for fiscal years 1967, 1968, and 1969. I would like to put this in the record, sir.

Senator PROXMIRE. You deny?

Well, there were two questions involved here. I want to make sure I understand what you are denying. First, I said it was alleged that the Board requested the contractor to furnish full and complete financial information relating to the McDonnell Co.

Now, is that true?

Mr. WHITEHEAD. From the representative——

Senator PROXMIRE. From the McDonnell Co. first, the McDonnell Co. first. It is alleged that the Board requested the contractor to furnish full financial information relating to the McDonnell Co. I am not talking about the McDonnell Douglas Co. or the Douglas Co., but the McDonnell Co.

Do you deny that?

Mr. WHITEHEAD. Yes, we deny that.

Senator PROXMIRE. Now, second, did you request complete financial information relating to the Douglas Division, relating to the years under review?

Mr. WHITEHEAD. With regard to the Board's Notice of Points dated November 27, 1973, the Division, consisting of all of the Board members, considered the request made by the contractor on December 12, 1973, and decided that the information already furnished and summarized in the accounting reports was sufficient enough to view the reasonableness of the contractor's profits. Mr. Chase agreed to this decision.

On January 14, 1974, following the meeting held with the contractor, and after the information obtained in this meeting had been studied, the Division met to decide whether the contractor realized excessive profits, and the amounts involved. The Division, again consisting of all the Board members, decided that the contractor realized excessive profits in the amount of $5 million for 1967, and that clearances should be granted for fiscal 1968 and 1969.

Senator PROXMIRE. Mr. Whitehead, let me say, what you are telling me now is that the Board did, I think the year is 1973, accede to the contractor's request that such information not be required.

Is that not what you are saying? You are saying that Mr. Chase agreed with that; you are saying that is what the Board did.

ACTION BY CONTRACTOR

Mr. WHITEHEAD. I would like to have the director of accounting, on my left, answer in part because this was an accounting critique——

Senator PROXMIRE. Well, first, Mr. Whitehead, can you answer this yourself?

Do you know? As chairman——

Mr. WHITEHEAD. I was not on the spot, Senator, but I would like to have Mr. Grenough supplement my——

Senator PROXMIRE. I understand you are saying now you do not know and you are asking for your accounting assistant to tell us. Is that right?

Mr. WHITEHEAD. We got everything we asked for.

Senator MATHIAS. Mr. Chairman, may I make a suggestion at this point?

Senator PROXMIRE. Yes. Senator Mathias.

Senator MATHIAS. First of all, let me inquire whether your request for information was in writing or was it a verbal request?

Mr. WHITEHEAD. The Notice of Points that we send out, according to the regulations, which precedes our visit to the plant for the examination of the material, was in writing and it was acceded to in full.

NOTICE OF POINTS LETTER

Senator MATHIAS. So I would suggest, Mr. Chairman, that we request the Board to give us a copy of the request, the notice of points, I believe, as Mr. Whitehead has called it.

Mr. WHITEHEAD. Do we have a copy of the points letter here?

Senator MATHIAS. If you do not have it with you, supply it for the record, and I think that will make it clear what the nature of the information requested is.

And then we can make some judgment as to whether or not that was adequately complied with.

Mr. WHITEHEAD. We will send to the committee a copy of the—in reply to Senator Mathias—a copy of the letter which we sent to McDonnell Douglas under date of November 27, 1973, in which we asked for this information, and which was provided us.

[The information appears on p. 32.]

EXAMINATION OF BOOKS AND RECORDS

Senator PROXMIRE. All right, now, Mr. Chase states that on or about—in a message, Mr. Whitehead states that on or about April 30, 1974, the contractor agreed to a limited examination of its books and records, but that the examination of costs and profit records was hampered by limited access to the divisional accounting imposed by the officers of McDonnell Douglas Corp.

Is that true or not true, to the best of your knowledge?

Mr. WHITEHEAD. Are you asking me or Mr. Chase?

Senator PROXMIRE. I am asking you, Mr. Whitehead.

Mr. WHITEHEAD. I thought the question was addressed to Mr. Chase. What was it?

Senator PROXMIRE. I said I want you to answer. I said Mr. Chase states and I want you to answer. Mr, Chairman. Mr. Chase states that on or about April 30, 1974, the contractor agreed to a limited reexamination of its books and records, but that the examination of costs and records and profit records was hampered by the limited access to the divisional accounting imposed by the officers of McDonnel Douglas Corp.

Do you deny that?

Mr. WHITEHEAD. I deny it unequivocally.

Senator PROXMIRE. All right.

Mr. Chase further states that the company turned down the request you made for additional d[illegible] in its letter of November 30 of 1973, and stated its refusal on D[illegible]cember 13, 1973, in a meeting with the members of the Board in St. Louis.

Do you deny that?

Mr. WHITEHEAD. As the Division Chairman, Mr. Rinehart, conveyed the Division's findings to the contractor, in an attempt to persuade the contractor to enter into a bilateral agreement. On January 28, 1974, the contractor notified him that it would enter into a bilateral agreement with the Board for the elimination of $5 million of excessive profits calculated with the——

Senator PROXMIRE. If I could interrupt, Mr. Chairman, my question is a very simple question, and it can be answered by whether or not you received a letter. The letter was dated November 30, 1973, and that the company turned down the request you made in that letter dated November 30, 1973, and then restated its refusal on December 13 at a meeting with the members of the Board in St. Louis.

NOTICE OF POINTS LETTER

Mr. WHITEHEAD. Subsequent to this November 30 letter, we received everything that we asked for.

Does that satisfy you?

Senator PROXMIRE. Let me ask you first, what did the letter say? Did the letter say no or did the letter say yes?

Did the letter turn you down in your request or did the letter not turn you down in your request?

Mr. WHITEHEAD. In view of the certain facts that are stated in McDonnell Douglas' letter, they requested that this point be withdrawn. As far as I know, the point was never withdrawn, and I send to the Chair the letter in which we asked for this certain information.

Senator MATHIAS. That is in effect that November 30 letter, is in effect in response to this November 27 letter, which has already been—

Mr. WHITEHEAD. That is right. These letters of points of presentation go before the actual visit to the plant or the meeting with the contractor, and it is my understanding that subsequent to this November 30 letter, we were provided with everything that we asked for.

Senator PROXMIRE. When were you provided with that? Was that in writing? Did they send you a letter in which they said they would provide this, or was it oral?

Mr. WHITEHEAD. In May 1974.

Senator PROXMIRE. In other words, that was following the agreement that I referred to above, on April 30, 1974, for a limited access.

Mr. WHITEHEAD. Yes, sir.

Senator PROXMIRE. So, in the first place, what they did do is to say no, and then they did say yes, but with a limited access, so they turned you down partially, isn't that correct?

Mr. WHITEHEAD. No, there was no limited access, Senator. We did not take pictures or copies of documents, but they did provide us with full disclosure and accessibility to the records, and our representatives took actual notes of whatever they provided us.

So I cannot say there was a denial on their part to provide us with that which we requested.

Senator PROXMIRE. Well, it appears that you made the request in November 1973, and 5 months later, or 6 months later, in May 1974, you did have some kind of access which you regard as complete.

Is that right?

Mr. WHITEHEAD. Apparently, from the record that is correct, yes, sir.

Senator PROXMIRE. Now, is it correct that the company stretched its right of exemption to the provisions of the act requiring it to submit information and that, as Mr. Chase alleges, it, and I quote Mr. Chase now:

> Refused to allow the examination of any details of the costs of goods sold or general administrative expenses in any way related to the divisional or contract breakdown.

Is that true? Or do you deny the allegation?

Shall I repeat that?

Mr. WHITEHEAD. Well, the Director of Accounting tells me, and I am going to rely on him because he is the Board's staff officer, there is nothing that the Board's staff asked for in the way of accounting information, but that we received.

Senator PROXMIRE. Let me repeat the information. I am not sure that that is completely responsive.

I asked whether it is correct that the company stretched its right of exemption to provisions of the act requiring it to submit information and that——

Mr. WHITEHEAD. Senator, I cannot hear you with the bell ringing.

Senator PROXMIRE. And refused to allow the examination of any details of the costs of goods sold or general administrative expense in any way related to the divisional or contract breakdown.

Mr. WHITEHEAD. The answer is "No," Senator.

Senator PROXMIRE. All right, now, I want to get into some other issues, but first I would like to ask Mr. Chase to respond.

It appears that——

Senator MATHIAS. Mr. Chairman, before you do that, in reference to your last question, who was physically present when the books were being examined?

VISIT TO CONTRACTOR'S PLANT

Mr. WHITEHEAD. Two representatives from the Board, one, I think Mr. Perkowski from the Western Regional Board attached to its Accounting Division, and Mr. Moreland, who is an Assistant Director of the Office of Accounting from the Statutory Board.

Would that suffice, Senator Mathias?

Senator MATHIAS. Yes.

I just wondered whether Mr. Chase's comments were——

Mr. WHITEHEAD. I would be happy to provide the names of the people who were there or anything else that you want.

Senator MATHIAS. I was just curious whether Mr. Chase's comments were based on his own experience or whether they were reports which had come in from the field?

Mr. WHITEHEAD. Well, there is a very definite division of opinion here, and he has his opinion and I do not know where he got some of the allegations that he puts in his dissent, but there are a considerable number of refutations, and that is for him to defend and not me.

Senator PROXMIRE. Mr. Chase? You don't have a microphone, but I think in a room of this size, it is possible for you to be heard. Well, I guess you do have a microphone, now. That is fine.

Mr. CHASE. Yes, Mr. Chairman.

Senator PROXMIRE. Let me ask you point by point. You can respond in any way you wish, but I think it may be helpful if we ask the specific questions that we asked Mr. Whitehead, and which he seems to deny. But what I understand to be your position—first, I asked Mr. Whitehead, what is your response to Mr. Chase's charges that the Board did not obtain all of the information requested from the company; and on one occasion, Mr. Whitehead and the Board acceded, or backed down, when McDonnell Douglas refused to provide what was asked for. Mr. Whitehead denied that.

Mr. CHASE. That was his original statement, Senator?

Senator PROXMIRE. That's right.

Mr. CHASE. Well, I will try to answer your questions by reading from my notes, if I may——

Senator PROXMIRE. Very good.

Mr. CHASE. The procedural, explanatory statement presented by the chairman this morning is a viewpoint that I simply cannot concur with. The genesis of his viewpoint, in my opinion, is essentially that the product line of the years under review are indeed similar. I cannot agree with that premise.

It occurs to me, the F–4 Phantom jet is completely unlike the Saturn stage, or the launch support services, produced by the McDonnell Douglas Co., or the manned orbital laboratory. How we can call those similar, I cannot understand. It is aerospace, but then would you say that a truck, a wagon, a fire engine, an automobile, a bicycle, a train is a similar transportation product line?

He then referred to the matter of information the McDonnell Douglas Corp. furnished as being adequate. Well, let me say this; that is a correct statement, for the purpose of consolidated filing, wherein you consider all of the product lines in the consolidation as one, regardless of the excess or high profits of one, and the moderate or low profits of another. But in that regard, the information that we received was not adequate to make a responsible determination of excessive profits of any one segment, or of any one of the product lines, if you wish to use those words.

Mr. Chairman—I would like to have you ask this question: Without regard to the question of the consolidated filings, under the terms of the statute and the regulations by which the Renegotiation Board operates, were the full details of the cost of goods sold examined by segment, product line or contract type? The answer to that question provides the basis of the genesis of my dissent.

Senator PROXMIRE. All right.

That's a much better question than I asked, and I'm asking you to answer that. Were they?

Mr. CHASE. But you did not refer to it, I think, sir, as a segment, as a group. That is different from a consolidated filing. If you take a consolidated filing you may be including all manner of products. The F–4 had been built over 8 or 10 years. At the time of this examination, the F–4 learning curve had flattened. The research and development was behind it, the configuration of the airplane was established. We have evidence to produce later in the testimony, if you wish, to prove this, by our own board's statement in the previous years examined.

Senator PROXMIRE. Let me say, Mr. Chase, that I have a great many questions later getting around to the point you are raising now, and I think it is fine for you to go ahead and answer it in any way you wish. But what I am asking about specifically now, however, is the charges that seem to be in contradiction between you and the chairman with respect to access to the firm's data. Do you want me to repeat the first question?

INFORMATION BY SEGMENTS

Mr. CHASE. I thought I answered that question.

Senator PROXMIRE. Well, I will repeat it, and see if you agree. I hope you will listen carefully to this question. Let me ask the question again.

Mr. CHASE. On the basis of the data used to arrive at the majority opinion, yes. But that data did not give sufficient information to responsibly determine excessive profits on the basis of the segments or the product lines for the year under review.

Senator PROXMIRE. So what you're saying, it's on the basis of the consolidated report?

Mr. CHASE. Yes.

Senator PROXMIRE. They did obtain information that was requested. But on the basis of breaking down, so it would be useful on the basis of your assumptions, you did not.

Mr. CHASE. Yes.

Senator PROXMIRE. Now, let me ask the additional question I had. Is it true that on one occasion, the board acceded or backed down when McDonnell-Douglas refused to provide what was asked for? Is that true or not true?

Mr. CHASE. I did not hear the question.

Senator PROXMIRE. That they, on one occasion—the board acceded or backed down when McDonnell-Douglas refused to provide what was asked for.

Mr. CHASE. Yes, we did back down, and there is documentary evidence to that effect.

Senator PROXMIRE. All right.

Give me the evidence. What was the date? And give me the material.

Mr. CHASE. This is contained, Mr. Chairman, in Mr. Forry's letter of November 30, 1973.

Senator PROXMIRE. Well, that was the letter, I take it, that Mr. Whitehead discussed with us before. Now, will you explain what in that letter, in your view, constitutes refusal on the part of McDonnell Douglas to provide the data requested? Could you read that part and explain why?

Mr. CHASE. Mr. Chairman, Mr. Forry, corporate vice president and comptroller of McDonnell Douglas, on November 30, 1973, said, and I quote from paragraph 3:

> With respect to the first point for presentation, in Reference [a], this Contractor understands the renegotiation statute to require consideration of the renegotiable earnings of the company as a whole, rather than by contracts or by organizational components.

May I ask my assistant to read this? I have difficulty reading, I think it should be read.

Mr. PROXMIRE. All right, fine.

Mr. DAVIS [reading]:

> Furthermore, the renegotiable business of McDonnell Douglas for all years involved has been almost exclusively in aerospace, rather than by a conglomerate engaged in a number of completely different lines of business. In view of the above, the Contractor requests that this point be withdrawn.

Mr. CHASE. And, Mr. Chairman, it was withdrawn.

Senator PROXMIRE. You construe that request that the point be withdrawn as backing down, and question was on what occasion, the Board acceded or backed down; and I take it the Board did accede to that request?

DECISION BY DIVISION OF BOARD

Mr. CHASE. The division of the Board acceded to that request.

Senator PROXMIRE. Mr. Whitehead, would you like to respond to that? That seems to me to be a refutation of your flat denial the Board acceded.

Mr. WHITEHEAD. Indeed I will, sir. Mr. Chase agreed to the decision to forego this information, and later on, in May of this year, we obtained sales, costs and profits by McDonnell separately and by Douglas separately. Now, I cannot state it any more clearly.

Senator PROXMIRE. I think you've made it very clear now. I think we all understand what happened. What happened was——

Mr. WHITEHEAD. No. That is the opinion of the staff, that's the opinion of the Board members, and I am just——

Senator PROXMIRE. What you are just—what you are telling me is, you acceded, and 5 months later, Mr. Chase agreed with that accession. My question was whether you acceded a request of the McDonnell Douglas Corp., and you are saying yes, you did.

Isn't that correct?

Mr. WHITEHEAD. No, sir. We agreed on January 14 of 1974 that we would forego this.

CORRESPONDENCE

Senator MATHIAS. Mr. Chairman, I think we've got a missing link here. We have the Board's request for information on the 27th of November 1973. We have McDonnell Douglas' response, which Mr. Chase cites as support for his position, which was on the 30th, and which he has just read, and which I suggest be put into the record in its entirety at this point.

Senator PROXMIRE. Without objection, it will be done.

[The information appears on p. 34.]

BOARD AGREEMENT ON MCDONNELL DOUGLAS POSITION

Senator MATHIAS. Now, what we don't have is any evidence that the Board agreed to that position of McDonnell Douglas on the 30th. We do not have any evidence other than Mr. Whitehead's statement that by April, they had gotten all they wanted. Now, how did you get all that you wanted by April? I think that is the critical point.

Mr. WHITEHEAD. May I answer, Mr. Chairman? Let me read you a note here. "In regard to the Board's Notice of Points, dated November 27, 1973"—a copy of which you have—"the division"—that is the division Mr. Rinehart was Chairman and the five Board members constituted the division—"the Division considered the request made by the contractor on December 12, 1973, and decided that the information already furnished, and summarized in the accounting reports, was sufficient enough to view the reasonableness of the contractor's profits." And Mr. Chase agreed to this decision.

Senator MATHIAS. From what are you reading now?

Mr. WHITEHEAD. I'm reading a summation of what the facts are, in connection with certain allegations that have been made in the dissent.

Senator PROXMIRE. May I say, with great respect for my good friend and colleague Senator Mathias, that what happened was that the Board made the request on November 27. On November 30, in very clear and unequivocal language, McDonnell Douglas said that they were requesting that the Board not press for this information, and then by May, the Board, including Mr. Chase, acceded in that request. But it did accede, it did accede, it did back down. It didn't make the request that was initially made in the letter of November 27, and you never got the information that was requested. You never got it.

Mr. WHITEHEAD. We have all the——

Senator PROXMIRE. Not by product line, or by division, or by contract.

Mr. WHITEHEAD. Yes; we have. We have all of the sales, costs, and profits by both the McDonnell and the Douglas divisions, and we got that in May of 1974.

Now, let me say for the record, Senator, that this is not the first time that a contractor has asked us to waive a point in the Notice of Points of Presentation; and after due consideration, we went after this information, and we obtained it.

Senator PROXMIRE. As I understand it, Mr. Chase, you say they only got limited access. Would you go ahead and explain that?

Mr. CHASE. Mr. Chairman, I wish to respectfully deny the allegation that the chairman has made concerning my consent to the withdrawal of this point. I opposed it vigorously, but had I consented to that, I would never have dissented. Now, I have before me a document which is evidence of my position here. This is a letter dated December 6, 1973, that was written after the Letter of Points to the contractor stating that item 1 of Letter of Points be answered. The coordination sheet has on it a statement, "Mr. Rinehart says, No reply necessary." Signed by the Director of the Office of Accounting.

Senator PROXMIRE. Explain what that means, "no reply necessary."

Mr. CHASE. It means that the letter did not go out requesting the information; and Mr. Harrison, in the Office of Review, was so concerned about that answer that he went to Mr. Rinehart's office and said, do you really mean that? And Mr. Rinehart said yes, and the document reads: "Orally confirmed with Mr. Rinehart by W. H. Harrison, 12/6/73."

Senator PROXMIRE. Mr. Rinehart, what did you mean by that?

Mr. RINEHART. Perhaps there is a missing link here on which I can be helpful. We visited the McDonnell Douglas plant on our inspection, and held the hearing. The notice of points, which seems to be in contention here—on the one point, McDonnell Douglas advised us it would not have sufficient time to provide all of the information necessary. That is the time that we agreed, on this particular point, to withdraw that, and allow McDonnell Douglas to supply the information after the hearing.

Later on, I reviewed the question to which Mr. Chase is referring to, and the information which he required; and we had a meeting of the minds as to information which was necessary. And at that time, after we were in accord as to what information was needed, we asked our accountants to go back to McDonnell Douglas and get the information which Mr. Chase had requested. To my knowledge—from the accountant from the Western Board, and from our staff under the direction of Mr. Grenough—we got all the information we ever requested. There is a missing link here, but in the first place, McDonnell Douglas asked us to withdraw the point due to lack of time, and after we reviewed the case and heard McDonnell Douglas' presentation, it was decided we needed additional information. We sent our accountants out, and to my knowledge we got all of the information that we originally requested.

Senator PROXMIRE. What do you mean lack of time?

Mr. RINEHART. We had set up a hearing.

Senator PROXMIRE. You are talking about the fiscal year 1967, right?

Mr. RINEHART. Right.

Senator PROXMIRE. Why would it take so much time to get that information?

Seven years ago, it ought to be a historical record. They could go back, any well done company would know, I would think.

Mr. RINEHART. No; this information was asked of McDonnell Douglas perhaps 30 days prior to the hearing. I do not have those documents here. Perhaps 30 days, and the information which we requested they could not supply in 30 days' time, but agreed to supply at a later date.

Senator PROXMIRE. Mr. Chase, do you agree with Mr. Rinehart that the Board got all it asked for?

Mr. CHASE. I think substantially that became eventually a correct statement. However, he has overlooked the fact of the chronology of the thing. What happened was that I made the strenuous objection, and at a subsequent date, they did send someone out there to get information, but it was on the basis of a consolidated filing and did not include examining the product lines, and I think I can support this statement.

Here is a statement from the Region of the Renegotiation Board in Los Angeles which says—would you read it for me, please?

REGIONAL BOARD ACCOUNTING REPORT

Mr. DAVIS. This is contained in the body of the 1967 Western Regional Accounting Report to the Board on the subject of cost of goods sold. In summary, the accountant stated: "The Contractor's accounting system did not readily provide for the determination of cost of goods sold by elements for the several types of renegotiable contracts performed by the contractor. A comparative summary of input costs for total business is as follows:" and the summary then takes the contractor's total consolidated business of the $2.2 billion of both the Douglas and McDonnell as a consolidation without a breakdown of any cost information.

Senator PROXMIRE. So you never got information by contract type, which is part of the essence of your dissent, is that right, Mr. Chase?

Mr. CHASE. That is right. There was insufficient detail.

Senator PROXMIRE. Now, Mr. Whitehead denied that the following was true. The company stressed its right of exemption to provisions of the act requiring it to submit information and that as you, and I quoted you, alleged, it refused to allow the examination of any details of the cost of goods sold, or general and administrative expenses in any way related to the divisional or contract breakdown.

Now, he denied that that was the case.

Mr. CHASE. Well, I stand on my original statement, Senator.

Mr. WHITEHEAD. May I read into the record right at this point a statement, sir?

Senator PROXMIRE. Yes, sir.

Mr. WHITEHEAD. "At no time during the course of the subsequent review——"

Senator PROXMIRE. Who are you quoting, sir?

Mr. WHITEHEAD. These are notes prepared by myself and the staff which are refutations to certain allegations.

Senator PROXMIRE. I just wanted you to identify who prepared those notes, the date of those notes, and we will put those notes in the record; but you read that, please.

Mr. WHITEHEAD. When the black book goes up, Senator, that means that these are notes of denials of certain allegations. I'm sorry. I didn't explain the source of my testimony.

Senator PROXMIRE. All right, sir.

Mr. WHITEHEAD. "At no time during the course of the subsequent review in May 1974 did the contractor stress that it was exempt from the provisions of the act, nor did the contractor refuse to allow the examination of any requested detailed records. The contractor's position was that it felt that it had provided to the Board all necessary information for processing of the case, and it was not obligated to provide additional data. However, in an effort to help further the processing of the case, the contractor did offer to assist the Board and its staff in any way it could in reviewing, interpreting and evaluating the large amount of data previously furnished."

There was complete cooperation on the part of the contractor and I again, for the third time, say to you, Senator, for the record, that we have obtained the necessary sales, costs, and profit data by both McDonnell and Douglas operations.

Senator PROXMIRE. All right. I just wanted to make sure that what you have just read into the record, because this is important evidence we have available to us, identified by was it minutes that were kept that related to this? Was this your notes, your memory of what happened? What was it?

MEMORANDUM

Mr. WHITEHEAD. This is an extract, Senator, contained in a memorandum addressed to me by Mr. Grenough, the director of accounting.

Senator PROXMIRE. All right, that is fine.

We want that, we want the date of it, and we want to put it in the record.

Mr. WHITEHEAD. Sir, do you want the date of his memorandum? Or do you want the memorandum of Mr. Grenough put in the record?

Senator PROXMIRE. That is right, what you just read to us.

Mr. WHITEHEAD. All right. We will be glad to give such information to you, sir.

[The information follows:]

THE RENEGOTIATION BOARD

DATE : JUL 18 1974

TO : Mr. Goodwin Chase
Board Member

FROM : Donald S. Grenough, Director
Office of Accounting (Signed) D. S. Grenough

SUBJECT: McDonnell Douglas Corporation
Fiscal Year Ended December 31, 1967
Comments on Dissent to Final Opinion

As requested by the Board, we offer the following observations on questions of fact, both narrative and numerical, on your recently issued dissent in the above case.

1. Dissent, Page 1, Paragraph 1 - "As a result of the 1967 purchase of Douglas Aircraft Company by McDonnell Aircraft Company forming a new corporate entity....."

   Comments: This transaction was not a purchase; instead Douglas Aircraft Company, Inc. was merged into McDonnell Company (surviving corporation) and its name was changed to McDonnell Douglas Corporation.

2. Dissent, Page 1, Paragraph 2 - "In the initial development of data necessary to the renegotiation process, The Renegotiation Board requested the contractor to furnish full and complete financial information relating to the McDonnell Company and full and complete financial information relating to the Douglas Aircraft Division for the years under review. Thereafter, the Board acceded to the contractor's request that such information not be required."

   Comments: We have searched the available files at the Board to determine at what stage in the processing of the case the above "full and complete financial information" was requested, and have been unable to locate the information. Similarily we have been unable to locate the contractors request that such "full and complete financial information" not be required, and the Boards agreement to this request.

3. Dissent, Page 2, Paragraph 1 - ...."By not lifting the veil of the conglomerate...."

   Comments: About 70% of corporate sales are aircraft, and aircraft related, and slightly over 25% of corporate sales can be identified as space equipment. Under our historical classification system on McDonnell Douglas, activities are classified as SIC 3721 - aircraft, with the knowledge that a substantial minority fits SIC Code 3769 - guided missile and space, etc. However, both of these categories are within the major SIC 37. Therefore, to label these activities as "conglomerate" with its implied diversity of products, may be somewhat misleading.

4. Dissent, Page 2, Paragraph 2 - "The Board renegotiated the contractor on a consolidated basis and combined McDonnell Company, its five subsidiaries and Douglas Aircraft Division in their evaluation of McDonnell Douglas Corporation."

Comments: The Douglas and McDonnell entities are part of the same corporation and, were not combined by the Board but, rather the financial activities were reported for the entire corporate entity after the merger.

5. Dissent Page 3. Paragraph 2 (Table)			Comments	
McDonnell FYE 6/30/66	Sales	$1,011	Should read	$1,014
	Profit	107	" "	109
	% of Sales	10.5%	" "	10.8%
	% of Sales after Board Action	8.1%	" "	8.3%
McDonnell (6 mo. ended 12/31/66)	Sales	$ 567	" "	$ 568
	Profit	54	" "	56
	% of Sales	9.6%	" "	9.8%
	% of Sales after Board Action	8.5%	" "	8.7%
Douglas FYE 12/31/65			" "	FYE 11/30/65
	Sales	$ 510	" "	$ 515
Douglas FYE 12/31/66			" "	FYE 11/30/66
	Sales	$ 560	" "	$ 564
Douglas (5 mo. ended 4/28/67)	Sales	$ 245	" "	$ 247
Douglas FYE 12/31/67			" "	(8 mo. ended 12/31/67)
	Sales	$ 495	" "	$ 495*
McDonnell FYE 12/31/67	Sales	$1,124	" "	$1,124*

*Excludes sales between Douglas and McDonnell; however, these type sales were not eliminated in the prior years included above, because each company was a separate, unrelated corporation.

6. Dissent, Page 4, Second Full Paragraph - "The fact that the contractor reported for renegotiation (RB Form 1) for the review year by averaging the sales, costs and profits of the product lines of its various divisions and subsidiaries in a consolidated report is not based on the language of the Renegotiation Act, expressed or implied."

   Comments: The term "averaging" denotes the addition of some numbers, the total of which is divided by some other number. The RB-1 as filed by the contractor represents the simple arithmetic total of appropriate financial data the corporations included in the consolidated filing, in accordance with Board Regulations.

7. Dissent, Page 5, Paragraph 5 - "The contractor again stressed its right of exemption to the provisions of the Act, but even more pointedly refused to allow the examination of any details of the cost of goods sold or general and administrative exepnses in any way related to divisional or contract breakdown."

   Comments: At no time during the course of the subsequent review in May 1974 did the contractor stress that it was exempt from the provisions of the Act, nor did the contractor refuse to allow the examination of any requested detailed records. The contractor's position was that it felt that it had provided to the Board all necessary information for the processing of the case and it was not obligated to provide additional data. However, in an effort to help further the processing of the case, the contractor did offer to assist the Board and the staff in any way it could in reviewing, interpreting and evaluating the large amount of data previously furnished.

During the course of the subsequent review in May 1974 the contractor was never asked to allow the staff to examine the details of the cost of goods sold or general and administrative expenses. The whole purpose of the subsequent review in May 1974 was to satisfy the requirement set out in point No. 1 of the Notice of Points letter dated November 27, 1973 which is included at the top of page 5 of the dissent. This information was obtained during the course of the subsequent review, the results of which were set out in a review memorandum dated June 7, 1974. Included in the additional information reviewed and extracted was a breakdown, by the Douglas and McDonnell components and by contract-type within each component, of sales, costs and profit, and the total cost of goods sold and administrative expenses for Douglas as distinct from McDonnell.

8. Dissent, Page 6, Paragraph 2 - "The significance of this shift in contract type in the review year is that these F-4 phantom sales account for $906 million of the McDonnell Company's review sales on which a profit of $80.3 million, or 8.9% on sales, was realized."

   Comments: The figures reflected in this paragraph pertain to total McDonnell Aircraft Company fixed-price incentive contract sales and profits not just F-4 sales and profits. However, it is true that the F-4 sales make up a substantial portion (at least 92%) of the McDonnell Aircraft Company's 1967 fixed-price incentive contract sales.

9. Dissent, Page 7, Paragraph 3 "....does not lead to the conclusion reached in the Board's majority opinion that returns on assets employed by McDonnell Douglas "although high are acceptable."

   Comment: The words "although high are acceptable" could not be found in the Board's majority opinion.

10.

Dissent, Page 9, (Table)		Comment	
Return on Capital	27.2%	Should read	26.9%
Return on Net Worth	54.8%	" "	54.1%

Senator PROXMIRE. And I want to yield to Senator Mathias for just a minute, but first may I ask Mr. Chase to respond to that.

Mr. CHASE. Well, Senator, the response that is given here again gets back to the treatment of a consolidated filing. If you notice, he says enough information was furnished to determine the excessive profits, that we received the information for both the McDonnell sector and the Douglas sector of one of the consolidated filings but what about the details of that data? That is wherein lies the problem, and I would like for my assistant to read to you from the same document that the chairman has referred to.

Senator PROXMIRE. All right, sir, go ahead.

Mr. DAVIS. This information is a field trip report of the examination of the contractor's records, subsequent to the final dissent of Mr. Chase. This was a field trip made by members of the staff to the Board, as the chairman has pointed out, to reexamine the accounting records. This field trip report is dated June 7, 1974 and states, in part, "At your request I have undertaken a review of the above subject cases in a further effort to attempt to break out divisional or product line profit and loss information. This attempt was made fully realizing that the contractor's currently stated position is that it feels that it has already provided the Board with sufficient data on which an evaluation can be made for each of the 3 fiscal years, 1967, 1968 and 1969—and does not at this time choose to provide any further data. The contractor stated that it is its position that it should be renegotiated in total and not on a contract by contract, product line, or divisional basis."

This field report, breaks out the sales, costs, and profits in totals for the McDonnell component and the Douglas component. This in effect is exactly what Mr. Chase has pointed out. The information is on a consolidated basis without the supportive details of the elements of the costs of goods sold by segment or product line.

So you are looking at combined financial statements. When we talk of the cost of goods sold, broken out by elements, we are saying that we want to see the labor, the materials and the subcontracting and other expenses that the contractor incurred on these contracts that he says was in his product lines for the 1967, 1968 and 1969 years.

Most of thes contracts, incidentally, and most of the dollar revenue that was generated on these contracts by the McDonnell Co. was under negotiated firm fixed price incentive fee contract. Those types of contracts are very specifically covered under the regulations of the Renegotiation Board, setting forth the procedure to be followed for the examination of FPI contracting.

Mr. WHITEHEAD. Mr. Chairman, may I make a statement?

Senator PROXMIRE. Senator Mathias would like to ask a question.

Senator MATHIAS. Let me interject at this point a question because it becomes somewhat fundamental.

First of all, I would support the right of the Renegotiation Board to get any information from any contractor that is brought by the statute within its jurisdiction in order to do its job, and I would salute Mr. Chase or any other member of the Board who tried to dig out the necessary information.

But I have been reading over this, the points of November 27, I am reading for example from profit figures which you furnished the regional boards with respect to the 1967 fiscal year it would appear that on one basis of evaluation, the ratio of profits to sales, the Douglas component operated at about 5 percent while the McDonnell component realized about 9.5 percent of sales.

Now, that is the extent of the detail to which that request goes. It only talks about the McDonnell and the Douglas components. There has been no demand on the part of the Board for a product line breakdown or no demand for greater breakdown than that.

Now, Mr. Chairman, I do not want to interrupt your line of questioning more than this. I would like to talk to Mr. Chase a little bit about what he feels is really necessary in this regard. But I do not see how on the basis of that demand you can talk about getting into product lines and other areas in such fine detail.

Mr. CHASE. Senator——

Senator PROXMIRE. Mr. Chase, go right ahead.

Would you like your assistant to respond, too?

Mr. CHASE. Yes. That is a technical question which I am acquainted with, but I think in more detail Mr. Davis could answer that.

Senator PROXMIRE. All right, sir.

Mr. Davis.

COST-ACCOUNTING INFORMATION

Mr. DAVIS. Senator, I do not have the Notice of Points in front of me.

If you will start on page 1, at the bottom of that page, in the last paragraph, the words in effect state, be prepared to furnish in sufficient detail, or words to that effect, the reasonableness of profits.

I believe that any accountant will readily subscribe to the fact that you do not arrive at profit without knowing cost and sales, and if you want to know the reasonableness of a profit, you have to know the reasonableness of the cost, and the crux of the entire point that we have raised in this dissent deals with the subject that there does not appear in the record the details of the cost in order to establish reasonableness of profit.

Senator MATHIAS. Now you sent this demand on November 27 of 1973 and you got a response on the 30th of November of 1973. Then, as I understand it, the Board met in early December, around the 12th of December, and at that time reviewed the information which was already accumulated as a result of the prior investigation.

Is that correct?

Mr. CHASE. Yes, that is correct, Senator.

Senator MATHIAS. And was there any dissent at that point on the part of Mr. Chase to the information that was then in hand?

Mr. CHASE. Well, Senator Mathias, I was a rookie in this business. I came with the Board on the 10th of October. I was advised at a division meeting of the Board that it was a requirement of the Board that we give consideration in a consolidated filing to all these statutory factors, to which certainly I agree. I was told that it was not possible for me to make a judgment on any other basis than that of the majority of the Board. It wasn't until later when I came back to the office in Washington that I became suspicious of what I was told in St. Louis where we had the meeting. I began to make inquiries about it,

and then came the paper from the staff study group, that said indeed we could look at the product lines separately, and then came the legal opinion that said, indeed not only was this permissible, we have been doing it. I went to the division of the Board, and I said that I could not in conscience continue to uphold the policy applied here and withdrew my support for a clearance in 1968 and 1969 and a $5 million determination in 1967. Had I known when I was in St. Louis on December 12th and 13th what I knew a month or so later, I would never have consented to the decision to limit our review to the McDonnell Douglas activities in our combination.

Senator MATHIAS. Now, you had a meeting in January, about a month later, about the 14th of January?

Mr. CHASE. Right.

Senator MATHIAS. And you again reviewed the information that was on hand, right?

STAFF PAPERS ON PRODUCT LINE RENEGOTIATION

Mr. CHASE. But that was again prior to the time that I had the legal opinion and the proposed policy paper from staff stating that it could be done. And I notified the Board that sat en banc in that case of this fact. I appealed to the Board to obtain more detailed information, to take the case off the clearance agenda and the determination agenda. I was unsuccessful, and I was therefore required to dissent.

Mr. WHITEHEAD. Mr. Chairman——

Senator MATHIAS. But, that January the 14th meeting, just to get the sequence of events clear, the January 14th meeting, there was a decision by the division which did include all of the Board members.

Mr. CHASE. Yes, but the divisional decision is not final.

Senator MATHIAS. No, but it was the divisional decision and therefore tentative, although the Board members were actually sitting as members of the division.

Mr. CHASE. Right.

Senator MATHIAS. That McDonnell Douglas had generated excess profits in fiscal year 1967 of $5 million, but no excess profits in 1968 and 1969; is that correct?

Mr. CHASE. Yes, that is correct.

Senator, I would like to ask you a question:

If you were reliably advised by sources that you considered authoritative, that something is the case, and later you find out that there is another more authoritative viewpoint or another determination, do you think it is proper that you make an effort to change the minds of the others and change your own decision?

Senator MATHIAS. Mr. Chase, one of the oldest maxims of human wisdom is that the wise man changes his mind and the fool never. So we're not quarreling with you.

But as of the 14th of January, you had not objected to that decision?

Mr. CHASE. No; I was in the process then of getting an education of what, in my view, is the way the renegotiation process should proceed.

Senator MATHIAS. And so it was after that meeting that you began to raise the questions?

STUDY GROUP REPORT ON PRODUCT LINES AND CONGLOMERATES

Mr. CHASE. Yes; it was February 1, to be exact, when the paper was delivered by our professional staff, by the director, office of review, and it was also signed by the acting director of accounting, and I have that paper here. If you wish to, I would be glad to read pertinent excerpts from it.

Senator, would you care to have me do that?

This is the paper that caused me to change my mind.

Senator MATHIAS. Why don't you submit it for the record.

Mr. CHASE. All right, sir.

Senator MATHIAS. So that we can have a complete record before us.

Mr. Chairman, I would ask unanimous consent that that be included at this point.

Senator PROXMIRE. Yes; it will be.

[The information appears on p. 106.]

MATERIAL AND LABOR COSTS

Mr. WHITEHEAD. Mr. Chairman?

Senator PROXMIRE. Mr. Whitehead?

Mr. WHITEHEAD. I don't mean to interrupt Senator Mathias.

Are you through, sir?

Senator MATHIAS. Yes; I just wanted to establish this chronology of events.

Mr. WHITEHEAD. All right.

Mr. Davis referred to the cost of goods sold by material, labor, a breakdown by material, labor, et cetera. We never asked for that in the points of presentation which went out initially. I think that what is involved here, is that Mr. Chase, in all due respect to him, continues to refer to the McDonnell Douglas Corp. as a consolidation. It was never a consolidation. It was a merger, and it is not a conglomerate as we understand the Litton Industries, Inc., for instance, and a number of other companies, and its products are similar, according to classification provided by IRS and by the Federal Trade Commission. And when we begin to talk about going down into the—breaking the cost of goods sold down into various types of products, then we have got to go into a situation where a conglomerate or a consolidated group has one operating division making aircraft and perhaps another division in the communications business.

So we do look at the cost and the profits, by operating unit. The law forbids us from looking at the contracts per se. We have to do it on a fiscal year basis, and we have done everything within reasonable grounds to evaluate the assessment against this company for the years 1967, 1968, and 1969. And I might add parenthetically that over the years from 1967 through 1969, the corporation has been assessed by the Board to the tune of $47 million, which they have paid under agreement with the Board.

Senator PROXMIRE. Now, we want to get into that kind of thing a little later, if you don't mind, Mr. Whitehead.

Mr. WHITEHEAD. All right.

Senator PROXMIRE. I would like to proceed now on the possibility of intimidation of Mr. Chase.

Mr. CHASE. Mr. Chairman.

Senator PROXMIRE. Let me get back to this later, sir. Otherwise we're going to get on this back and forth, and we'll never get into this material that I have here. But reserve what you have, make a note of it so that you don't forget to bring it up later.

Mr. Whitehead, I understand that some time before your final majority opinion was issued, the fact that Mr. Chase intended to dissent was communicated to McDonnell Douglas and that a copy of his proposed dissent was forwarded to the company before the final decision.

Now, is this true; and if it is, could you explain these actions for us?

Mr. WHITEHEAD. I don't know that such was the case. Since Mr. Rinehart was the division chairman, I think it would be appropriate for you to address him, because he was the one who contacted the corporation on all renegotiation matters.

Senator PROXMIRE. Mr. Rinehart?

Mr. RINEHART. Could you repeat the question?

Senator PROXMIRE. The question was, before your final majority opinion was issued publicly, the fact that Mr. Chase intended to dissent was told to McDonnell Douglas, and a copy of his proposed dissent was forwarded by the Renegotiation Board to McDonnell Douglas before the final decision was issued.

Is that true or not?

Mr. RINEHART. To my knowledge, that is not correct.

Senator PROXMIRE. That is not correct?

Is it your understanding that that is correct or incorrect, Mr. Chase?

Mr. CHASE. I have never heard of it before, Senator.

Senator PROXMIRE. When was McDonnell Douglas first advised that one member of the Board intended to dissent from the majority decision?

Mr. Rinehart, can you tell us?

Mr. RINEHART. I would have to refer back to my records on that, Senator. I'm sorry, I don't have my notes with me on that particular point.

Senator PROXMIRE. You don't know?

Mr. RINEHART. To give you an exact date, I do not know.

Senator PROXMIRE. I am surprised that nobody on the Board can tell us whether they were advised that there was going to be a dissent on this.

Mr. WHITEHEAD. May I try to clear this up a little bit, Senator?

Senator PROXMIRE. All right.

Mr. WHITEHEAD. We have only had, in the 5 years I've been a member of the Board, we have only had two dissents. You have both of them in hand and the final opinions in both. Our policy on the first dissent in the *Lykes-Youngstown* case, in which Mr. Chase joined me on the dissent, we sent the final opinion and the dissent to the contractor at the same time. For over several months, we tried and implored to obtain from Mr. Chase a written dissent so that we could send a copy of his dissent together with our final opinion in the 3 years involved. We were not successful in getting a dissent, a written

dissent, from him, and the corporation, as I understand it, was subsequently asking, when can we expect the final opinion? We are in agreement with the assessment of $5 million for 1967. And I believe that Mr. Rinehart at that particular time informed him that we would like to issue the final opinions and the final dissent at the same time.

A little later on, Mr. Forry, it is my understanding, said, well, if you don't have the dissent prepared and ready, is there any objection to providing us with a copy of the final opinion? And Mr. Rinehart——

Senator PROXMIRE. Who is Mr. Forry?

Mr. WHITEHEAD. Mr. Forry is corporate vice president for McDonnell Douglas. They were having their annual meeting, as I understand it. The company's board would be there. The board of directors has to discuss these things.

Senator PROXMIRE. It sounds to me as if you were talking with McDonnell Douglas officials about the Chase dissent before the decision was issued, is that correct—talking with Mr. Forry about it?

INFORMATION REGARDING DISSENT

Mr. WHITEHEAD. He was informed that there would be a dissent I'm not going to say that he was informed what the dissent was.

Senator PROXMIRE. Well, was he or wasn't he informed what the dissent was or given a copy of the dissent?

Mr. WHITEHEAD. I don't think he was given a copy of the dissent, but he may have been—he was informed that there was a dissent coming. And finally——

Senator PROXMIRE. Why?

Why would a contractor be informed?

Mr. WHITEHEAD. Because it has been our policy, I tried to explain to you, Senator, it has been our policy to issue the final opinion and the dissent together at one time, and we had the final opinion prepared and ready to go, but Mr. Chase didn't provide us with his dissent for weeks on end. So finally, Mr. Forry said, why don't we get a final opinion under the regulations and why don't we conclude this?

And Mr. Rinehart informed him that there was a dissent coming, and we waited and we waited and we waited for Mr. Chase——

Senator PROXMIRE. When were the McDonnell Douglas officials informed that a dissent would be coming?

Mr. WHITEHEAD. When was it, Mr. Rinehart?

I can't give the Senator that information.

Mr. RINEHART. What is the date of the opinion?

Senator PROXMIRE. What month was it?

Mr. RINEHART. Mr. Forry had called and stated that the Board of Directors meeting was scheduled for a certain date, and he said he would like to report to the Board the results of the renegotiation liability. At that time I told him the opinion was being formulated and was being mailed to him just as soon as it was ready.

Senator PROXMIRE. Well, I tell you, here is what bothers me. A court of law would not notify a complainant that a dissent was going to be forthcoming. It seems to me to be very irregular, and of course, what really, the suspicion it would arouse in my mind is that there would be pressure brought to bear on Mr. Chase by McDonnell

Douglas or others to withdraw his dissent or to change his mind. That is the kind of interference with the judicial operations of the Board that it seems to me would be quite wrong and dangerous.

Mr. RINEHART. That would be wrong, and that is not the case.

Mr. WHITEHEAD. Let me deny unequivocally that there was any threat made to Mr. Chase, morning, noon, or night, at any time during these proceedings so far as the personnel of the Board itself is concerned, or the staff.

Mr. RINEHART. Senator, the date of the final opinion was June 18. So it was during that week that they were advised that the final opinion would be mailed and there would probably be a dissent. I didn't say there was a dissent. I said there probably would be a dissent.

Senator PROXMIRE. Let me ask you for the record, Mr. Whitehead, by advising the company of Mr. Chase's intent to dissent, was it in any way intended to induce company officials to contact Mr. Chase for the purpose of persuading him not to dissent?

Mr. WHITEHEAD. No, sir; none whatsoever.

Senator PROXMIRE. All right.

Do you know whether in fact officials of McDonnell Douglas did try to persuade Mr. Chase not to dissent or to change his opinion?

Mr. WHITEHEAD. I beg your pardon?

Senator PROXMIRE. Do you know whether in fact officials of McDonnell Douglas did try to persuade Mr. Chase not to dissent?

Mr. WHITEHEAD. No, sir. I cannot talk for officials of McDonnell Douglas. I can only talk for the Board members and the staff of the Board.

Senator PROXMIRE. Mr. Chase, were you contacted by anybody from McDonnell Douglas before your dissent was filed asking you either not to dissent or to change your dissent in any way?

Mr. CHASE. No, I was not.

I would like to comment, Mr. Chairman——

Senator PROXMIRE. Yes, sir.

Mr. CHASE [continuing]. On the statement that Chairman Whitehead just made concerning the length of time which elapsed before my dissent was submitted to the Board is completely and wholly erroneous, and I am sure that he didn't mean to make it, if he was aware of the facts.

FILING OF DISSENT

Senator PROXMIRE. Which statement are you referring to?

Mr. CHASE. His statement about the long delay in the preparation of my dissent.

Senator PROXMIRE. All right.

Mr. CHASE. That just is not the case.

Mr. WHITEHEAD. Well, ask Mr. Rinehart, the Chairman. He dealt with him.

Mr. CHASE. May I answer?

Senator PROXMIRE. Let Mr. Chase answer first.

Mr. WHITEHEAD. Fine.

Mr. CHASE. The original Memorandum of Opinion was a long time in preparation. At that time it was called the Memorandum of Decision. I waited months for that.

Senator PROXMIRE. You're talking about the majority opinion?

Mr. CHASE. The majority opinion, I waited months for that opinion. When that was in my hands, and you can't write a dissent, sir, until you have the opinion—when that was in my hands, I delivered it 2 days later.

Senator PROXMIRE. Two days later?

Mr. CHASE. Yes, sir.

Senator PROXMIRE. Can you give us the date. Can you give us the date, sir?

Mr. CHASE. I can. May I just defer that for a moment?

Senator PROXMIRE. All right.

Mr. CHASE. I submitted it 2 days later. The majority of the Board read my dissent, apparently became concerned about the issues I had raised, and withdrew their Memorandum of Decision. To satisfy me they sent two staff people out to the plant. They came back with, in my opinion, insufficient information to measure up to the responsibilities of developing data on which a good and sufficient determination could be made. The final opinion was prepared later, which I contend was in answer to my original dissent. And 2 days before the Board meeting on the Final Opinion Mr. Rinehart called me to his office and went over the revised opinion. We met at the Board meeting and the majority of the Board approved the second Memorandum of Opinion. I dissented, and at that point, with no adequate notice of what the opinion was, it took me 10 days to file a dissent. And I filed a second dissent 10 days, approximately, after the Final Opinion was approved by the majority of the Board.

Senator PROXMIRE. This sounds extremely unusual. As I understand it, the Board delivered a majority opinion. You wrote a dissent, had the dissent available in 2 days. The Board then took several months in which they formulated a new opinion, a second opinion. And then you wrote a dissent to the second opinion.

Is that correct?

Mr. CHASE. I filed the dissent within 10 days, as my memory serves me.

Mr. WHITEHEAD. Mr. Chairman?

Senator PROXMIRE. This is an extraordinary activity. It would seem to me that any court would reach an opinion and the dissents are written and that is it.

Go right ahead, Mr. Whitehead.

Mr. WHITEHEAD. Mr. Chairman, I cannot sit here and take the insinuations that are being thrown out. Mr. Rinehart was the day-to-day manager of these findings. I know that we had held up the decision of this Board for at least 4 months to get Mr. Chase to sit down and write a dissent so that we could send that with the final opinion to the contractor, and when it was not forthcoming we asked the contractor if he would take the final opinion without the dissent, and they said yes, in order to get it to the Board of Directors because they were coming to St. Louis, and that is precisely what we did. And the minute that it was mailed to the contractor, 2 days later he got a copy of the dissent.

Senator PROXMIRE. This is a matter of simple fact. It's not a matter of anything else.

Is it not true, or is it wrong, that after the original majority opinion was arrived at and made available to Mr. Chase, he responded within about 2 days with his own dissent?

Mr. WHITEHEAD. My information is that that is not a fact, sir.

Mr. Rinehart, could you tell us when it did arrive?

Mr. RINEHART. I would not say that it was 2 days, but it didn't take him—I say he supplied it within a week.

Senator PROXMIRE. All right, he supplied it within a few days.

Mr. RINEHART. Here again, Senator, is the point, the missing link. In Mr. Chase's dissent he again brought up the matter about the notice of points, the lack of information.

Senator PROXMIRE. I'm sorry, could you repeat that?

Mr. RINEHART. In Mr. Chase's dissent, his original dissent, he brought out the question of the type of information which was not provided, and at that time we agreed to send the accountants back to McDonnell-Douglas to get the information which he had requested. Now, that is the reason for the delay between——

Senator PROXMIRE. All right. Then Mr. Chase is substantially correct. What he is saying is, he supplied his dissent promptly, 2 days, 3 or 4 days. At any rate, it was fairly prompt.

In the dissent you say that there was, one of his points was that there was inadequate information. At that point, you held up the majority decision, attempted to get more information from the contractor, and then wrote a subsequent opinion.

Is that correct?

Mr. RINEHART. To get the information which Mr. Chase requested?

Senator PROXMIRE. Yes.

Mr. RINEHART. That is correct.

Mr. CHASE. Mr. Chairman?

Senator PROXMIRE. Yes, sir, Mr. Chase?

Mr. CHASE. Mr. Chairman, I just happen to have some notes here which will verify my position. On April 9, 1974——

Senator PROXMIRE. Give that date again?

Mr. CHASE. April 9, 1974.

The memorandum of decision was submitted.

Senator PROXMIRE. All right.

Mr. CHASE. I may have seen it the day before on a green sheet. My dissent was submitted on April 12, 1974, 3 days later.

MAJORITY OPINION

Senator PROXMIRE. All right.

Mr. CHASE. The majority of the Board withdrew its memorandum of decision and sought additional information, not at my request, but as a means of attempting to satisfy me and the proposition was put to me in that manner, and that is where some of the lapse of time is involved.

My dissent was of record officially all the while that Mr. Whitehead is referring to a delay. It was of record. I did not withdraw my dissent.

Senator PROXMIRE. Give us the date when the opinion, the majority opinion was withdrawn.

Mr. CHASE. All right. On April 29, 1974.

Senator PROXMIRE. The date when the majority opinion was withdrawn?

Mr. CHASE. On April 29, 1974.

Senator PROXMIRE. No, sir. April 10, 1974, the majority opinion was provided. On April 12 you filed your dissent.

Mr. CHASE. Yes.

Senator PROXMIRE. Then you said subsequently, without giving us the date, the majority opinion was withdrawn.

What was the date of that?

Mr. CHASE. April 29.

Senator PROXMIRE. June 18, all right.

Mr. CHASE. No, that's the date of the final opinion. Approximately April 29 the first opinion was withdrawn.

Senator PROXMIRE. All right, on or about May 20 the opinion was withdrawn, the majority opinion was withdrawn. On May 22 or 23, you say the staff visit to the contractor, and then on June 18 a new opinion was provided.

Is that correct?

Mr. CHASE. On June 18, Mr. Chairman, the final opinion was submitted and my revised dissent—I had to answer that particular second opinion—was submitted on July 3. I said approximately 10 days. I was mistaken. It is 11.

Senator PROXMIRE. All right.

NOTES ON REVISED OPINION

Would you give us those notes also for the record?

Mr. CHASE. I beg your pardon?

Senator PROXMIRE. Would you provide a copy of those notes for the record?

Mr. CHASE. Of these?

Senator PROXMIRE. Yes, of those notes that you have just been reading from so we have the documentation in the record.

Mr. CHASE. Yes, I'd be glad to.

Senator PROXMIRE. Fine.

[The information follows:]

1. Notice of Points Letter, dated November 27, 1973.

2. Letter dated November 30, 1973 from McDonnell Douglas Corporation to the Board.

3. Proposed letter to McDonnell Douglas Corporation, dated December 6, 1973, which was not mailed.

4. Memorandum of Decision with Coordination Sheet, dated April 17, 1974, which was held.

5. Memorandum to the Board, dated April 12, 1974, presenting Mr. Chase's dissent.

6. Memorandum to Mr. Chick, Director, Office of Review, dated June 7, 1974, from Mr. R. E. Moreland, Office of Review.

7. Final Opinion for the fiscal year 1967, dated June 18, 1974, mailed to the Contractor attached to the Agreement, on July 1, 1974.

8. Final Opinion for the fiscal years 1968 and 1969, dated June 18, 1974, mailed to the Contractor attached to the Clearances, on June 18, 1974.

9. Letter to McDonnell Douglas Corporation, dated July 9, 1974, enclosing a copy of Mr. Chase's dissent for the fiscal year 1967, dated July 3, 1974.

10. Letter to McDonnell Douglas Corporation, dated July 9, 1974, enclosing copy of Mr. Chase's dissent for the fiscal years 1968 and 1969, dated July 3, 1974.

11. Excerpt from Report of Renegotiation, Western Board, Division of Accounting Report.

12. Source document, Memorandum of Decision of the majority of the Board, dated April 19, 1974, referred to in Hearing of July 25.

13. Source documents, Items 18, 18A and 18B of information furnished at Hearing of July 25, 1974 concerning study of product line renegotiation in response to Brooks Committee Report.

Notice of Points Letter, dated November 27, 1973.

AIR MAIL

McDonnell Douglas Corporation
Post Office Box 516
St. Louis, Missouri 63166

November 27, 1973

Attention: Mr. John E. Forry
Corporate Vice President and Controller

Subject: Renegotiation Proceedings
McDONNELL DOUGLAS CORPORATION (CONSOLIDATED)
Fiscal Years Ended December 31, 1967,
December 31, 1968 and December 31, 1969

Gentlemen:

Reference is made to the Board's letter dated November 12, 1973, advising that a meeting with the Board has been scheduled for December 12, 13 and 14, 1973.

Pursuant to Section 1472.5 of the Renegotiation Board regulations, this Notice of Points for Presentation is provided to enable the contractor to prepare for the meeting with the division and address itself, in particular, to the points or matters on which a presentation is desired. The enumeration is not to be construed to mean that these are the only important points or matters in the case, and any omission is not to be construed to mean, necessarily, that the Board has accepted the contractor's views on any points or matters which may have been raised heretofore.

You are advised to make a full presentation of your case, and your representatives will have the full opportunity at the meeting to present and discuss any and all matters which they consider pertinent. They should, however, be prepared to deal specifically and in appropriate detail with the following:

1. The reasonableness of overall renegotiable profits of the consolidated group for fiscal years 1967, 1968 and 1969, in light of the profits realized individually by Douglas Aircraft Company and McDonnell Aircraft Corporation in the years prior to the acquisition of Douglas by McDonnell. For example, from profit figures which you furnished the Regional Board with respect to the 1967 fiscal year, it would appear that on one basis of evaluation (the ratio of profits to sales) the Douglas component operated at about 5% while the McDonnell component realized about 9.5% of sales.

2. The contractor has disagreed with the Regional Board's 1967 computations of returns on capital and net worth. Although the Board has the contractor's charts and related notes available which outline the reasons for disagreement, a brief oral presentation on this subject would be appreciated.

If you wish to submit any written material in response to this notice, it would be appreciated if you would have the material in our hands not later than December 6, 1973.

Very truly yours,

(Signed) W. H. Harrison

W. H. Harrison
Acting Deputy Director
Office of Review

cc: Bd. Members, Legal, Accounting,
Chairman, Regional Board, Mr. Lieberman
Review, Files

Letter dated November 30, 1973 from McDonnell Douglas Corporation to the Board.

The Renegotiation Board
2000 M St. NW
Washington, D. C. 20446

RB-H330-1499
30 November 1973

Attention: Mr. D. E. Rinehart

Reference: (a) Mr. W. H. Harrison's letter of 27 November 1973
(b) Telecon 29 November 1973 with D. E. Rinehart

Gentlemen:

1. Reference (a) letter, for the first time, advised the Contractor "to make a full presentation" of its case in respect to all three years 1967, 1968 and 1969 during the contemplated visit of the Board members on 12 and 13 December 1973.

2. During Reference (b) telecon, the short time remaining before the contemplated visit and the facts that Statutory Factors for 1968 and 1969 are not now available were discussed. This will confirm the agreement in Reference (b) that, should it prove impossible to reach a mutually acceptable agreement of the 1967, 1968 and 1969 cases, the Contractor will later be given the opportunity more fully to develop and present its case(s) to the Board.

3. With respect to the first Point for Presentation in Reference (a), this Contractor understands the renegotiation statute to require consideration of the renegotiable earnings of the company as a whole rather than by contracts or by organizational components. Furthermore, the renegotiable business of McDonnell Douglas for all years involved has been almost exclusively in aerospace rather than by a conglomerate engaged in a number of completely different lines of business. In view of the above the Contractor requests that this Point be withdrawn.

4. This Contractor has concurred with the accounting principles used by the Regional Board for 1967. Therefore, the return on net worth and capital calculations presented in the 1967 WRRB Memorandum of Decision are not the subject of disagreement. Assuming that the Statutory Board does not challenge the position of the WRRB, the Contractor feels no further presentation of his arguments is required, and the Contractor requests that this Point be withdrawn.

5. Attached is a proposed agenda for the visit of the Board on 12 and 13 December 1973: this tentative schedule can be revised at your convenience. We are looking forward to this opportunity of reviewing the activities of MDC and its St. Louis facilities with both continuing and new members of the Board and its staff.

Sincerely,
MCDONNELL DOUGLAS CORPORATION

John E. Forry
Corporate Vice President
Controller

AGENDA

12 December 1973

0830	Pick up at Sheraton Jefferson Hotel (MDC transportation)
0900	General description of MDC
1000	Commence plant tour
1215	Lunch
1300	Continue plant tour
1500	Review
1530	Depart MDC plant for Sheraton Jefferson Hotel

13 December 1973

0900	Convene at Federal Building for MDC presentation re 1967 case
1200	Break for lunch
1330	Reconvene to discuss 1968 and 1969 data

Proposed letter to McDonnell Douglas Corporation, dated December 6, 1973, which was not mailed.

12-6-73

McDonnell Douglas Corporation
Post Office Box 516
St. Louis, Missouri 63166

Attention: Mr. John E. Barry
Corporate Vice President

Subject: Renegotiation Proceedings
MCDONNELL DOUGLAS CORPORATION (Consolidated)
Fiscal Years Ended December 31, 1967
December 31, 1968 and December 31, 1969

Gentlemen:

By letter dated November 30, 1973, you requested that the first point for presentation included in our November 27, 1973 letter be withdrawn on the basis that The Renegotiation Act requires consideration of renegotiable profits of the company as a whole and not by organizational components. Although the Board determines the reasonableness of overall profits in the performance of its duty, the Board gives separate consideration to different types of contracts (RBR 1460.2 (b)) and takes into account the varied characteristics of different types or classes of business (RBR 1460.10(b)(4)). In your cases where most of the renegotiable business was performed in organizational components which immediately prior to the years under review were separate companies, it would be helpful to review the profits and characteristics of each. Accordingly a presentation on this point would be helpful.

With respect to the second point, it was our understanding, based on information in our files that for 1967 you objected to the Regional Board's exclusion of the amount paid for Douglas stock in January 1967 from beginning capital and net worth. Since you have advised us that there is no such disagreement, we withdraw the point.

Very truly yours,

W. H. Harrison
Deputy Director
Office of Review

THE RENEGOTIATION BOARD
COORDINATION SHEET

This form not for routing mail. Attach firmly to central file (green) copy. This form must accompany all documents for signature of board members, office and division directors, as listed.

TITLE AND DESCRIPTION OF ATTACHED DOCUMENT

McDonnell Douglas Corporation
Fiscal Years Ended December 31, 1967,
December 31, 1968 and December 31, 1969

DATE INITIATED: 12/6/73

INDORSEMENT OF INITIATING OFFICE OR DIVISION

This proposed document is a complete and clear statement of all essential facts, all essential data are accurate, and in my judgment its release is appropriate to the circumstances.

Concurrences of all offices concerned with the subject matter are checked below.

DATE 12/6/73 SIGNATURE WJH W. H. Harrison, Deputy Director, Office of Review
(Director, Initiating Office or Division)

CONCURRENCES OF OTHER OFFICES

(Initiating office must obtain all necessary concurrences and will indicate by check (✓) mark all offices concerned with the subject matter of proposed document.)

CONCURRENCE

✓	OFFICE OR DIVISION	CONCURRING SIGNATURE OF OFFICE OR DIVISION DIRECTOR, OR AUTHORIZED ALTERNATE	DATE RECEIVED	DATE FORWARDED
	BOARD CHAIRMAN			
	BOARD MEMBER (INDICATE NAME)			
	BOARD MEMBER (INDICATE NAME)			
	BOARD MEMBER (INDICATE NAME)			
	BOARD MEMBER (INDICATE NAME)			
	ADMINISTRATION			
	ECONOMIC ADVISOR			
	ASSIGNMENTS			
	SECRETARY TO THE BOARD			
	COUNSEL WJH	Mr. Lambert WJH	12/6/73	12/6/73
	REVIEW			
	SCREENING AND EXEMPTIONS			
	ACCOUNTING			
	PROCUREMENT AFFAIRS			
	RENEGOTIATING			

RETURN TO	BUILDING	ROOM NO.	DATE RETURNED
W. H. Harrison		4103	

ATTACH SECURELY TO CENTRAL FILE (GREEN) COPY

FORM RRB-20
Revised 4-70

GSA DC 70-11[illegible]

COORDINATION SHEET	copy. This form must accompany all documents for signature ... board members, office and division directors, as listed.

TITLE AND DESCRIPTION OF ATTACHED DOCUMENT

McDonnell Douglas Corporation
Fiscal Years Ended December 31, 1967,
December 31, 1968 and December 31, 1969

DATE INITIATED: 12/6/73

INDORSEMENT OF INITIATING OFFICE OR DIVISION

This proposed document is a complete and clear statement of all essential facts, all essential data are accurate, and in my judgment its release is appropriate to the circumstances.

Concurrences of all offices concerned with the subject matter are checked below.

DATE 12/6/73 SIGNATURE WHH. W. H. Harrison, Deputy Director, Office of Rev
(Director, Initiating Office or Division)

CONCURRENCES OF OTHER OFFICES

(Initiating office must obtain all necessary concurrences and will indicate by check (✓) mark all offices concerned with the subjec matter of proposed document.)

CONCURRENCE

✓	OFFICE OR DIVISION	CONCURRING SIGNATURE OF OFFICE OR DIVISION DIRECTOR, OR AUTHORIZED ALTERNATE	DATE RECEIVED	DATE FORWARDED
	BOARD CHAIRMAN			
	BOARD MEMBER (INDICATE NAME)			
	BOARD MEMBER (INDICATE NAME)			
	BOARD MEMBER (INDICATE NAME)			
	BOARD MEMBER (INDICATE NAME)			
	ADMINISTRATION			
	ECONOMIC ADVISOR			
	ASSIGNMENTS			
	SECRETARY TO THE BOARD			
	COUNSEL			
	REVIEW	Orally consulted with Mr. Rinehart by WH Harrison 12/6/73		
	SCREENING AND EXEMPTIONS			
	ACCOUNTING	Mr. Girard		
	PROCUREMENT AFFAIRS	Mr. Rinehart says no reply necessary		
	RENEGOTIATING	RGirard 12/6/73		

RETURN TO	BUILDING	ROOM NO.	DATE RETURNED
W. H. Harrison		4103	

ATTACH SECURELY TO CENTRAL FILE (GREEN) COPY

FORM RBF-28
Revised 4-70

GSA DC 70-1285

Memorandum of Decision with Coordination Sheet, dated April 17, 1974, which was held.

THE RENEGOTIATION BOARD
2000 M Street N. W.
Washington, D. C. 20446

MEMORANDUM OF DECISION

MCDONNELL DOUGLAS CORPORATION (AGENT)
St. Louis, Missouri 63166
Consolidated with:

McDonnell Douglas Corporation, Successor-in-Interest to Conductron Corporation

Actron Industries, Inc., Successor-in-Interest to Tridea Electronics Company
(Wholly owned by Conductron Corporation)

Actron Industries, Inc., Successor-in-Interest to Advanced Communications, Inc.
(Wholly owned by Conductron Corporation)

McDonnell Douglas Corporation, Successor-in-Interest to McDonnell Automation Company of Texas, Inc.

McDonnell Douglas Corporation, Successor-in-Interest to McDonnell Automation Company of Colorado

Fiscal Year Ended December 31, 1967
Assignment No. 10354-67

The renegotiable sales and profits and the returns on capital and net worth considered by the Board in this proceeding were as follows (000's omitted):

Sales	$1,618,566
Profits	130,717
Percent	8.1%
Return on Capital	30 %
Return on Net Worth	61 %

On April 28, 1967, Douglas Aircraft Company was acquired by McDonnell Aircraft Corporation and the company name was changed to McDonnell Douglas Corporation. Thus, the renegotiable business reviewed by the Board, as reflected in the foregoing figures, was the result of the combined efforts of two large companies (8 months' operations of Douglas and a full year's operations of McDonnell), which formerly had played a significant separate and independent role in the aerospace industry. Although five subsidiaries were included in the consolidation, the parent accounted for 99% of the renegotiable sales and all the renegotiable profits.

In view of the fact that the McDonnell and Douglas companies had been engaged in similar work in the same industry, the combination resulted in a valuable interchange of vital information and technical know-how. In addition, the organizational methods adopted by the contractor's management lent themselves, even in the first year of operations, to a smooth and orderly transition and a resulting well functioning corporate structure. To all intent and purpose, the identity of the two individual companies was lost on the date of the merger. Thus, the Board evaluated the contractor's business on the basis of a broad application of the statutory factors to the combined performance of the McDonnell and Douglas segments. However, the Board did give full consideration to the geographic changes in the contractor's business following the Douglas acquisition, the different types of products and contract-mix, and different labor, manufacturing, and other factors with which the contractor was confronted in this first year of combined operations.

Renegotiable business (64% of total business) consisted of the manufacture of highly specialized, advanced military aircraft, spacecraft, missiles, support systems and other products and certain related research, design and development work. The principal items produced in the review year were the Phantom F-4 supersonic fighter aircraft (56% of total renegotiable sales); S-IVB Saturn space vehicles (7%); manned orbiting laboratory spacecraft (7%); A-4 attack aircraft (5%); and the balance consisting of Spartan missiles; Thor and Delta launch vehicles; Gemini spacecraft; and, the F-111 crew-escape systems. There were seven different models of the F-4 manufactured in the review year, which models had varying characteristics. For example, there were five different types of engines involved, seven different radar systems, and various other differences in electronics and other components.

The advanced nature of the aircraft, spacecraft and other products required highly complex manufacturing techniques and a high degree of efficiently applied engineering skills and involved the utilization of substantial manufacturing and engineering facilities, specialized equipment and trained personnel. Combined material and subcontracting costs in the review year ran about 54% of total cost of sales. Many new machining, fabricating, assembly and manufacturing techniques were developed and a large amount of research, development and design operations was conducted.

The Board considered the contractor's operations to be highly complex.

The contractor maintained very good quality and delivery standards and achieved cost reductions in the review year. The contractor also presented documents demonstrating increasingly lower maintenance time for the F-4 aircraft due to continued improvements in the aircraft. On the basis of the favorable performance and other data in the Board's files, the Board considered the contractor to be a highly efficient producer.

Approximately 19% of total renegotiable sales in the review year were under firm fixed price contracts. The comparable percentages for McDonnell Aircraft Corporation in its prior two years were 32% and 75%. For Douglas Aircraft Company the percentages for the prior

two years were 32% and 30%. Fixed price incentive contracts accounted for approximately 67% of renegotiable business with cost-reimbursement type contracts accounting for the remaining 14%. Almost all of the firm fixed price business consisted of the production of F-4 and A-4 aircraft and bomb racks, all of which were procured by the Government on a negotiated sole source basis. Most of the fixed price incentive sales involved the F-4 Phantom aircraft which had been produced in unusually large quantities in previous years, including 1,000 of the Phantom aircraft that had been delivered under firm fixed price contracts in prior years. Although the contractor had gained experience on the F-4 and A-4 in earlier years and enjoyed a favorable cost-sharing curve in its incentive business, the Board considered that the contractor did assume significant pricing risk in the review year particularly because of the number of models manufactured.

The contractor contended that it assumed risk by increasing the production of F-4 aircraft to a peak rate of 71 per month in the review year compared with a monthly rate of only 40 in January 1966. During the production buildup, employment increased by 10,000. Since there were no other aircraft or similar manufacturers in the St. Louis area, the contractor faced a serious shortage of experienced workers. As a result, it had to lower its employment standards and hire many workers who could not qualify even after extensive training. The Board recognized that the contractor assumed some risk in this regard.

At the time of its acquisition by McDonnell Aircraft Corporation, the Douglas Aircraft Company was experiencing severe financial difficulties due to large losses on commercial business. Accordingly, McDonnell assumed a great financial risk in the merger with Douglas Aircraft Company and this redounded to the Government's benefit in that the Douglas productive capabilities still continued in the performance of Government contracts. The Board favorably considered this risk.

During the review year the contractor had the use of Government-owned facilities with a cost value of $236.7 million and was also furnished substantial Government progress payments showing an unliquidated balance of $385.3 million at the end of its fiscal year. The Board recognized that not all of the $236.7 million of Government-owned facilities were utilized since some were not adaptable to the review year renegotiable business. The ratio of the cost of Government facilities to the total cost of Government and contractor facilities ($236.7 million divided by $589.3) is 40.2% of such total.

In evaluating the contractor's performance under the capital-employed factor, the Board, to the extent possible, relied on specific identification of assets in computing returns rather than to follow the customary practice of allocating capital employed to renegotiable business on the cost-of-sales ratio. Such returns are stated on the basis of contractor's books at the beginning of the year and are without regard to the amount of Government-furnished equipment described above. As so computed, the contractor's review year returns on capital and net worth allocated to renegotiable business were 30% and 61%, respectively, and for the reasons cited above, they were not comparable to the prior years' returns.

The Board considered the contractor's returns on capital and net worth in the review year to be high and indicative of excessive profits. Those returns, however, should be considered in light of the following statements made by the Tax Court in the LTV case:

> "First, ...where a contractor risks relatively little of its own capital it is primarily a manager of property, and thus not entitled to as great a return for risk-taking as a contractor which supplies its own assets. Secondly, whereas a contractor which uses its own assets is entitled to an element of return equivalent to the rental value of the assets, a contractor using the assets of others is not. For these reasons, a contractor using largely public capital -- either rented property or Government-furnished property -- is not entitled to as large an absolute amount of profit as a contractor using its own property."

> "It does not follow that the contractor using capital supplied by others is necessarily entitled to a smaller rate of return on its own net worth. Profit is in part a payment to an entrepreneur for the productive use of assets. A contractor is entitled to an appropriate profit for such use based on the total capital it employs in its renegotiable business, whether the capital is owned by it or by others. Cf. sec. 1460.11(b) (3), R. B. Regs. Two companies making the same kind of use of the same amount of capital should be entitled to the same amount of entrepreneurial profit, whatever the source of such capital. However, this entrepreneurial profit will inevitably be a larger percentage of the net worth of a company using primarily public capital than one using primarily its own capital. Therefore, the total profit -- the return on invested capital plus the entrepreneurial profit -- will be a larger percentage of the net worth of the contractor using public capital."

(See LTV vs. the Renegotiation Board, - 51 TC 369, (405) (1968)).

Thus, because of the utilization of a large amount of public capital, i.e., Government-furnished equipment, the returns on capital and net worth in the instant case, after refund, are higher than the Board would consider reasonable were the foregoing facts not present.

Procurement sources largely considered the contractor to be an average cost producer in the review year. The contractor's material and labor costs showed a decline and, in the Board's opinion, on an overall basis, the contractor's costs were reasonable and well controlled.

The following is a comparison of the contractor's review year renegotiable sales, profits, and profit margin, as a percentage of sales, with those of McDonnell and Douglas in prior years (000's omitted):

	Sales	Profits	Percent
Review Year	$1,618,566	$130,717	8.1
McDonnell (6 mos. ended 12/31/66) 1/	~~559,742~~ 561 049	~~47,401~~ 48 729	~~8.5~~ 8.7
FYE 6/30/66 2/	~~984,173~~ 986684	~~79,562~~ 82073	~~8.1~~ 8.3
FYE 6/30/65 3/	990,915	75,420	7.6
Douglas (4 mos. ended 4/28/67)	~~244,752~~ 246563	12,700	5.2
FYE 12/31/66	~~559,861~~ 562998	32,284	5.7
FYE 12/31/65	~~510,046~~ 515,030	17,629	3.4

1/ After refund of $7 million.
2/ After refund of $27 million.
3/ After refund of $8 million.

The Board found that the contractor realized excessive profits in the amount of $5,000,000 (subject to appropriate adjustment for State and Federal income taxes) in the year under review, and the entire amount of excessive profits was allocated to McDonnell Douglas Corporation and the contractor has indicated its willingness to enter into an agreement for the elimination of such excessive profits. The effect of the Board's finding is to leave the contractor with adjusted renegotiable sales and profits as follows (000's omitted):

Sales	$1,613,566
Profits	125,717
Percent	7.8%
Return on Capital	29 %
Return on Net Worth	59 %

GOODWIN CHASE, MEMBER, DISSENTS AS FOLLOWS:

A majority of the Board made the affirmative determination that the McDonnell Douglas Corporation for the Fiscal Year Ending December 31, 1967 had excessive profits in the amount of $5 million and determined that profits for the Fiscal Years Ending December 31, 1968 and 1969, respectively, were not excessive; thus clearances were given in those years. Mr. Chase dissents. In 1967, the two major segments of McDonnell Douglas Company were known as the McDonnell Company and the Douglas Aircraft Division.

The genesis of the dissent concerns:

(1) The Renegotiation Board requested the contractor furnish full and complete financial information relating to the McDonnell Company and full and complete financial information relating to the Douglas Aircraft Division for the years under review. Thereafter, the Board acceded to the contractor's request that such information not be required. By not lifting the veil of the conglomerate, the Board failed to exercise its obligation to examine information essential to an accurate determination of excessive profits, component by component.

(2) The Board renegotiated the contractor on a consolidated basis and combined McDonnell Company and Douglas Aircraft Division

in their evaluation of McDonnell Douglas Corporation. By this procedure the Board has afforded the contractor the substantial benefit of diluting the proven McDonnell Company history of high earnings with the low profit levels generated by the Douglas Aircraft Division: and finally,

(3) the pronounced lack of in-depth probing of the accounting, analysis, and review function in these areas burdens the Board's ability to make an accurate determination of excessive profits.

* * * * *

By combining the two segments, McDonnell Company and Douglas Aircraft Company, the Board has not exercised its authority under the statute* (see General Counsel's Opinion dated February 22, 1974) and the regulations to examine the segments separately and then to aggregate the results in arriving at a final determination.

In order to put into perspective the magnitude of the difference that could result by separate examination, the following schedule of prior years renegotiable sales and profits of the Douglas Aircraft Company and the McDonnell Aircraft Company are set forth:

Douglas Aircraft Co., Inc.

(000's omitted)

	1965 (12/1/64-11/30/65)	1966 (12/1/65-11/30/66)	5 months-1967 (12/1/66-4/28/67)
Renegotiable Sales	$ 515,030	$ 563,998	$ 246,563
Renegotiable Profits	17,629	32,284	12,700
% to Sales	3.4%	5.7%	5.2%
Return on Net Worth	15.5 16 %	36.5 36 %	31.1 37 %
Return on Capital	6 %	11.2 11 %	7.5 8 %
Board Determination	Clearance	Clearance	Clearance

McDonnell Aircraft Corp.

	1965 (7/1/64-6/30/65)	1966 (7/1/65-6/30/66)	(6 months) (7/1/66-12/31/66)
Renegotiable Sales	$ 998,915	$1,013,684	$ ~~568,069~~
Renegotiable Profits	83,420	~~109~~,073	~~55,729~~
% to Sales	8.4%	10.8%	9.8%
Return on Net Worth	71.6 77 %	83.3 %	63 % 63.3
Return on Capital	32.6 33 %	42 %	32 % 31.7
Board Determination	8,000 Refund	27,000 Refund	7,000 Refund
% Profit after Refund	7.6%	8.3%	8.7%
Return on Net Worth	69.2%	63 % 62.7	55 % 55.3%
Return on Capital	29.4% 29.5	32 % 31.6	28 % 27.5%

* (Concluding paragraph of General Counsel's Opinion dated 2/22/74): In summation, it is my opinion that the Act and regulations give the Board authority to examine segments of a contractor's renegotiable business, such as a product line, profit center or division or types of contracts and determine the excessive profits of one without the other provided the profit excesses and deficiencies resulting from such examinations are aggregated in arriving at a final determination. This approach is analogous to the treatment frequently accorded by the Board to individual members of a consolidated group.

Further analysis of the above schedule is evidence that, for the three years prior to the merger, the McDonnell Company's renegotiable earnings were substantial and Douglas Aircraft's renegotiable earnings were significantly lower. Excessive profits were recovered from the McDonnell Aircraft Company in those years. The two components, therefore, should have been examined and evaluated independently. This then would reveal the true excessive profits assessable to the McDonnell Company earnings and with such additional considerations as they may be entitled to collectively, the aggregate of the two components then would reflect the fair level of profits to be retained on a consolidated basis.

Further, in the context of this argument as a segment of Mr. Chase's reasoning for dissent, it is important to note that the McDonnell sales volume in 1966 is relatively at the same level as the year of the merger 1967. The year 1968 is only slightly less, yet a clearance for that year was given.

Mr. Chase is concerned about the extent to which the Board gave consideration to McDonnell Aircraft Company for having rescued the financially distressed Douglas Aircraft Company. The facts are other responsible companies were willing and able to purchase the company. An ad hoc committee of the Douglas board established a high level of criteria that would shape its choice as to who would acquire the Douglas Aircraft Company as follows:

1. The successful candidate would have to provide $100 million of equity capital or subordinated debt, and be prepared to supply more than that if more were needed.

2. The battered Douglas shareholders must get a fair shake in the final proposal.

3. The successful bidder must be able to bring not only capital but management to Douglas. Moreover, the management must be available at all levels, not just at the top.

4. The winner must have a record establishing both an ability to exert tight controls on operations and a promising growth potential of its own.

The following companies made aggressive presentations and formal bids in the interest of acquiring the Douglas Aircraft Company: General Dynamics, North American Aviation, Fairchild Hiller, Garrett Corporation, a wholly owned subsidiary of Signal Oil and Gas Company, and McDonnell Aircraft Company. Each company made its presentation before the Douglas Committee and displayed its ability to meet the criteria in varying proposals. McDonnell Aircraft Company's concern about the considerable interest by its competitors increased its original offering substantially, the result being that the McDonnell Aircraft Company proposal was accepted. This spirited competitive effort to acquire Douglas Aircraft Company would not indicate a rescue operation.

Apart from the advantage of diversification which the commercial sector of Douglas Aircraft Company provides, the motivation could well have been the approximately $56 million in tax carryforward benefits resulting from net operating losses and investment credits of Douglas Aircraft Company operations prior to the merger. Moreover, the contractor's request that the year of merger 1967 and the years 1968 and 1969 be renegotiated without separate evaluation of the costs and profits of the respective McDonnell and Douglas segments resulted in a substantial advantage to McDonnell Douglas Corporation by offsetting the McDonnell Company's excessive profits against the low to marginal profits of the Douglas Aircraft Division.

Finally, for the overwhelming reason that full information was not disclosed, it is not possible to address this dissent to the statutory factors. To appropriately apply them to the two major segments (the McDonnell Company and the Douglas Aircraft Division) would involve factually disputable conjecture.

Richard E. Kapps
Secretary to the Board

c: Board Members
Legal (2)
Accounting
Office of Secretary (3)
Review (3)

THE RENEGOTIATION BOARD
COORDINATION SHEET

This form not for routing mail. Attach firmly to central file (green) copy. This form must accompany all documents for signature of board members, office and division directors, as listed.

TITLE AND DESCRIPTION OF ATTACHED DOCUMENT

MEMORANDUM OF DECISION: MCDONNELL DOUGLAS CORPORATION (AGENT)
(Consolidated)
FYE 12/31/67
IMPASSE - $5,000,000

DATE INITIATED: 4/17/74

INDORSEMENT OF INITIATING OFFICE OR DIVISION

This proposed document is a complete and clear statement of all essential facts, all essential data are accurate, and in my judgment its release is appropriate to the circumstances.

Concurrences of all offices concerned with the subject matter are checked below.

DATE April 17, 1974 SIGNATURE W. H. Harrison
Deputy Director, Office of Review
(Director, Initiating Office or Division)

CONCURRENCES OF OTHER OFFICES

(Initiating office must obtain all necessary concurrences and will indicate by check (✓) mark all offices concerned with the subject matter of proposed document.)

CONCURRENCE

✓	OFFICE OR DIVISION	CONCURRING SIGNATURE OF OFFICE OR DIVISION DIRECTOR, OR AUTHORIZED ALTERNATE	DATE RECEIVED	DATE FORWARDED
4	BOARD CHAIRMAN	Mr. Whitehead		
3	BOARD MEMBER (INDICATE NAME)	Mr. Rinehart, Division Chmn.	4/25/74	4/29/74
5	BOARD MEMBER (INDICATE NAME)	Mr. Mattingly	4/24/74	4/29/74
6	BOARD MEMBER (INDICATE NAME)	Mr. Houston		
7	BOARD MEMBER (INDICATE NAME)	Mr. Chase		
	ADMINISTRATION			
	ECONOMIC ADVISOR			
	ASSIGNMENTS			
	SECRETARY TO THE BOARD			
2	COUNSEL	Mr. Burkhalter	4/25/74	4/29/74
	REVIEW			
	SCREENING AND EXEMPTIONS			
1	ACCOUNTING	Mr. Grenough		
	PROCUREMENT AFFAIRS			
	RENEGOTIATING			

RETURN TO: W. C. Swenson | BUILDING | ROOM NO. | DATE RETURNED

ATTACH SECURELY TO CENTRAL FILE (GREEN) COPY

FORM RBF-28
Revised 4-70

GSA DC 70-12854

Memorandum to the Board, dated April 12, 1974, presenting Mr. Chase's dissent.

April 12, 1974

MEMORANDUM TO THE RENEGOTIATION BOARD

Subject: McDonnell Douglas Corporation
Fiscal Years Ending December 31, 1967, 1968 and 1969

A majority of the Board made the affirmative determination that the McDonnell Douglas Corporation for the Fiscal Year Ending December 31, 1967 had excessive profits in the amount of $5 million and determined that profits for the Fiscal Years Ending December 31, 1968 and 1969, respectively, were not excessive, thus clearances were given in those years. The undersigned dissented. In 1967, the two major segments of McDonnell Douglas Company were known as the McDonnell Company and the Douglas Aircraft Division.

The genesis of the dissent concerns;

(1) the Renegotiation Board requested the contractor furnish full and complete financial information relating to the McDonnell Company and full and complete financial information relating to the Douglas Aircraft Division for the years under review. Thereafter, the Board acceded to the contractor's request that such information not be required. By not lifting the veil of the conglomerate, the Board failed to exercise its obligation to examine information essential to an accurate determination of excessive profits component by component,

(2) the Board renegotiated the contractor on a consolidated basis and combined McDonnell Company and Douglas Aircraft Division in their evaluation of McDonnell Douglas Corporation. By this procedure the Board has afforded the contractor the substantial benefit of diluting the proven McDonnell Company history of high earnings with the low profit levels generated by the Douglas Aircraft Division, and finally,

(3) the pronounced lack of in-depth probing of the accounting, analysis, and review function in these areas burdens the Board's ability to make an accurate determination of excessive profits.

* * * * *

By combining the two segments, McDonnell Company and Douglas Aircraft Company, the Board has not exercised its authority under the statute * (see General Counsel's Opinion dated February 22, 1974) and the regulations to examine the segments separately and then to aggregate the results in arriving at a final determination.

In order to put into perspective the magnitude of the difference that could result by separate examination, the following schedule of prior years renegotiable sales and profits of the Douglas Aircraft Company and the McDonnell Aircraft Company are set forth:

Douglas Aircraft Co., Inc.

(000's omitted)

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Renegotiable Sales	$ 515,030	$ 563,998	$ 246,563
Renegotiable Profits	17,629	32,284	12,700
% to Sales	3.4%	5.7%	5.2%
Return on Net Worth	16 %	36 %	37 %
Return on Capital	6 %	11 %	8 %
Board Determination	Clearance	Clearance	Clearance

	McDonnell Aircraft Corp. (7/1/64-6/30/65)	(7/1/65-6/30/66)	(6 months) (7/1/66-12/31/66)
Renegotiable Sales	$ 998,915	$1,013,684	$ 568,069
Renegotiable Profits	83,420	109,073	55,729
% to Sales	8.4%	10.8%	9.8%
Return on Net Worth	77 %	83 %	63 %
Return on Capital	33 %	42 %	32 %
Board Determination	8,000 Refund	27,000 Refund	7,000 Refund
% Profit after Refund	7.6%	8.3%	8.7%
Return on Net Worth	69.2%	63 %	55 %
Return on Capital	29.4%	32 %	28 %

* (Concluding paragraph of General Counsel's Opinion dated 2/22/74): In summation, it is my opinion that the Act and regulations give the Board authority to examine segments of a contractor's renegotiable business, such as a product line, profit center or division or types of contracts and determine the excessive profits of one without the other provided the profit excesses and deficiencies resulting from such examinations are aggregated in arriving at a final determination. This approach is analogous to the treatment frequently accorded by the Board to individual members of a consolidated group.

Further analysis of the above schedule is evidence that, for the three years prior to the merger, the McDonnell Company's renegotiable earnings were substantial and Douglas Aircraft's renegotiable earnings were significantly lower. Excessive profits were recovered from the McDonnell Aircraft Company in those years. The two components, therefore, should have been examined and evaluated independently. This then would reveal the true excessive profits assessable to the McDonnell Company earnings and with such additional considerations as they may be entitled to collectively, the aggregate of the two components then would reflect the fair level of profits to be retained on a consolidated basis.

Further, in the context of this argument as a segment of my reasoning for dissent, it is important to note that the McDonnell sales volume in 1966 is relatively at the same level as the year of the merger 1967. The year 1968 is only slightly less, yet a clearance for that year was given.

I am concerned about the extent to which the Board gave consideration to McDonnell Aircraft Company for having rescued the financially distressed Douglas Aircraft Company. The facts are other responsible companies were willing and able to purchase the company. An ad hoc committee of the Douglas board established a high level of criteria that would shape its choice as to who would acquire the Douglas Aircraft Company as follows:

1. The successful candidate would have to provide $100 million of equity capital or subordinated debt, and be prepared to supply more than that if more were needed.

2. The battered Douglas shareholders must get a fair shake in the final proposal.

3. The successful bidder must be able to bring not only capital but management to Douglas. Moreover, the management must be available at all levels, not just at the top.

4. The winner must have a record establishing both an ability to exert tight controls on operations and a promising growth potential of its own.

The following companies made aggressive presentations and formal bids in the interest of acquiring the Douglas Aircraft Company: General Dynamics, North American Aviation, Fairchild Hiller, Garrett Corporation, a wholly owned subsidiary of Signal Oil and Gas Company, and McDonnell Aircraft Company. Each company made its presentation before the Douglas Committee and displayed its ability to meet the criteria in varying proposals. McDonnell Aircraft Company's concern about the considerable interest by its competitors, increased its original offering substantially, the result being that the McDonnell Aircraft Company proposal was accepted. This spirited competitive effort to acquire Douglas Aircraft Company would not indicate a rescue operation.

Apart from the advantage of diversification which the commercial sector of Douglas Aircraft Company provides, the motivation could well have been the approximately $56 million in tax carry forward benefits resulting from net operating losses and investment credits of Douglas Aircraft Company operations prior to the merger. Moreover, the contractor's request that the year of merger 1967, and the years 1968 and 1969 be renegotiated without separate evaluation of the costs and profits of the respective McDonnell and Douglas segments, resulted in a substantial advantage to McDonnell Douglas Corporation by offsetting the McDonnell Company's excessive profits against the low to marginal profits of the Douglas Aircraft Division.

Finally, for the overwhelming reason that full information was not disclosed, it is not possible to address this dissent to the statutory factors. To appropriately apply them to the two major segments (the McDonnell Company and the Douglas Aircraft Division) would involve factually disputable conjecture.

Goodwin Chase
Board Member

ROUTING AND TRANSMITTAL SLIP		ACTION
1 TO (Name, office symbol or location) Mr. Chick Director, Office of Review	INITIALS	CIRCULATE
	DATE	COORDINATION
2	INITIALS	FILE
	DATE	INFORMATION
3	INITIALS	NOTE AND RETURN
	DATE	PER CONVERSATION
4	INITIALS	SEE ME
	DATE	SIGNATURE

REMARKS

McDonnell Douglas Corporation Dissent.
Fiscal Years Ending December 31, 1967-68-69

Revised
7/27/74

Do NOT use this form as a RECORD of approvals, concurrences, disapprovals, clearances, and similar actions.

FROM (Name, office symbol or location)	DATE
Goodwin Chase, Board Member	4/15/74
	PHONE

OPTIONAL FORM 41
AUGUST 1967
GSA FPMR (41CFR) 100-11.206

GPO 643—16—51418-1 419-015 5041-101

MEMORANDUM TO: H. M. Chick, Director
Office of Review

June 7, 1974

SUBJECT: McDonnell Douglas Corporation (Consolidated)
St. Louis, Missouri 63166
Fiscal Years Ended December 31, 1967, 1968 and 1969
Assignment Nos. 10354-67, -68 and -69
Class "A" 1967 - $5,000,000 Impasse (from WRRB)
1968 - Proposed Clearance
1969 - Proposed Clearance
Western Regional Renegotiation Board

At your request, I have undertaken a review of the above subject cases in a further effort to attempt to break-out Divisional or product-line profit and loss information. This attempt was made fully realizing that the contractor's currently stated position is that it feels that it has already provided the Board with sufficient data on which an evaluation can be made for each of the three fiscal years -- 1967, 1968 and 1969 -- and does not, at this time, choose to provide any further data. The contractor stated that it is its position that it should be renegotiated in total and not on a contract-by-contract, product line, or Divisional basis. The contractor was advised that in the final analysis it will be renegotiated on an overall basis; however, the Board is entitled to look at and evaluate the various segments in whatever form they might exist. The contractor did offer, however, to assist the Board and the staff in any way it could in reviewing, interpreting and evaluating the large amount of data previously furnished in these cases.

With the above in mind, visits were arranged to the contractor's facility in St. Louis. These visits were made on May 8, May 23&24, and May 28-31, 1974 by the undersigned and Mr. John Perkowski, the Regional accountant who had initially worked on the cases. It was known ahead of time that one of the contractor's key employees familiar with its renegotiation filings, Mr. R. A. Mundloch, Manager of Accounting, was to be hospitalized and would not be available for our initial visit on May 8. Instead, we met with his immediate supervisor, Mr. A. W. Hyland, a Staff Vice President and Corporate Assistant Controller. During our

subsequent visits, Mr. Mundloch and his staff were available to and met with us. Our meetings were conducted in a cordial atmosphere and, at the time of the initial visit, a breakdown of sales, costs and profits by the McDonnell component and the Douglas component was furnished for the 1967 year. In addition, renegotiable sales, costs and profits by type of contract for the Douglas component was also furnished for the 1967 year. Mr. Hyland explained that they felt that since the Board had already identified renegotiable sales, costs and profits by type of contract for the corporation as a whole (see Schedule A, Part II, as revised 6/14/73), it was necessary only to break out one of the components (Douglas) and the other component (McDonnell) would represent the balance.

Mr. Hyland also stated that since the basis for the Divisional information developed for Douglas was from information the Board had already received, they were willing to help compile the figures in an effort to substantially reduce the amount of time necessary for us to compile the information from the mass of data previously furnished. During the course of the initial visit on May 8, Mr. Perkowski and I spent several hours going through some of the 1967 files in order that I could become better acquainted with the available data in as short a time as is reasonably possible. I also discussed at length with Mr. Perkowski the procedures he followed in reviewing the contractor's filing for each of the three years currently under review and he stated that he had spent considerable time reviewing, analyzing and evaluating the reasonableness of the back-up data and worksheets supporting the renegotiation filings. This data included Divisional input. Mr. Perkowski said that except for the adjustments contained in the Accounting Report, he was completely satisfied with the contractor's methodology and preparation of its consolidated RB Form 1 renegotiation filings for each of the three fiscal years under review.

The contractor claimed that it did not have comparable information for 1968 and 1969 as they had for 1967 because the contractor reorganized and consolidated its operations beginning in 1968 with the result that certain activities that had previously been separate McDonnell activities and separate Douglas activities were now combined into single Divisions; for example, the McDonnell Astronautics Company was combined with the Douglas Missile & Space Systems Division into a single management structure, the McDonnell Douglas Astronautics Company (MDAC) with headquarters in Huntington Beach, California. In addition, there are now three other main Divisions -- the McDonnell Aircraft Company, the Douglas Aircraft Company, and the McDonnell Automation Company. The contractor stressed that these Divisions are by location, only, and do not necessarily reflect separate product line operations. However, the company did accumulate its sales, costs and profits by Divisions for 1968 and 1969.

At the time of our initial visit on May 8, I asked Mr. Hyland if I could review the contractor's working paper files for the 1968 and 1969 renegotiation filings. (As previously stated, Mr. Perkowski had already done this at the time he conducted his field examinations for those years.) Mr. Hyland said he had no problem with my examining those files but begged off at that time because Mr. Mundloch was not available. He explained that (1) he was not sure where the files were and (2) he would prefer not to "turn me over" to anyone else in Mr. Mundloch's office and asked that I defer any review of the 1968 and 1969 working paper files until after Mr. Mundloch's return to work. In summarizing the initial visit, I feel we obtained or identified all of what we had sought for 1967. My visit with Mr. Perkowski was most beneficial and informative and allowed me to become better acquainted with the cases in a relatively short period of time. Because of the non-availability of Mr. Mundloch, it would have served no useful purpose to extend the initial trip beyond the one day.

After Mr. Mundloch's return to work, further visits were arranged to the contractor's offices for the purpose of reviewing and evaluating the available working paper files for the 1968 and 1969 fiscal years. Because of the contractor's refusal to allow us to make xerox copies of any of its working papers, it was necessary to first review and then extract all pertinent data necessary to the preparation of the attached schedules. This enormous and time-consuming task was accomplished with the contractor's knowledge, although on several occasions it stressed its objections to anything even remotely familiar to a Divisional or Component breakdown of sales, costs and profits. Except for not allowing us to copy its working papers, the contractor was most cooperative and helpful in answering any of our questions. For both 1968 and 1969, the contractor accumulated its basic financial data used in its renegotiation filings by Divisions, and for renegotiable work by type of contract within each Division. Because of the way the data was accumulated for these years, it was possible to identify each Division (or Divisional cost center) as being comparable to either a McDonnell component or a Douglas component. For example, in 1969 the McDonnell Douglas Astronautics Company (MDAC) had its sales, costs and profits accumulated by its Eastern location and its Western location. The Eastern location was the old McDonnell Astronautics Company, while the Western location was the old Douglas Missile & Space Systems Division.

Because of being able to associate each cost center as either a McDonnell component or a Douglas component, the 1968 and 1969 schedules have been prepared in a form similar to 1967. However, the contractor has gone to great lengths to stress to us that, in its opinion, each of the three years, when broken down into components, is not comparable with the other two because of its ever-changing situation and circumstances. Some of the things pointed out by the contractor were:

1. There was a significant movement of top and middle management between McDonnell and Douglas beginning in 1967 and continuing through 1968 and 1969.

2. The McDonnell Corporate Office was established in 1969 and assumed all of the Douglas corporate functions. Before that, McDonnell Aircraft Company performed what might be comparable to a corporate function. 1967 showed very little Corporate Office expense while 1968 and 1969 showed increasing amounts in each year.

3. Initially, when the Astronautics Company was formed into an Eastern and Western location, there was some duplicity of functions at each location.

4. By 1969, all West Coast locations had adopted the same overhead base consistent with the Eastern locations. This was not necessarily the case in 1967 and 1968.

5. In 1968, Douglas Aircraft Company changed its accounting method to a percentage-of-completion for all Government contracts, except for military versions of commercial products, in order to be consistent with the McDonnell Aircraft Company (see pages 19 and 20 of 1968 Accounting Report).

6. Intracompany (between Divisions of McDonnell Douglas Corporation) and intercompany (between McDonnell Douglas Corporation and its subsidiaries) sales increased in each year, particularly 1969. However, it should be noted that in both 1967 and 1968 these sales were less than 1% of total corporate sales and in 1969 were less than 4% of total corporate sales. The only significant effect intra and intercompany sales have on the presented figures is in the McDonnell components' nonrenegotiaale figures for 1969. For example, the 18.4% return on nonrenegotiable sales of the McDonnell component for 1969 would be reduced to 12.1% if inter-component nonrenegotiable sales of $76,463,272 were not eliminated.

7. Because of similar capabilities at each location, the contractor had considerable flexibility in placing some of its Government contracts as between McDonnell Aircraft Company or Douglas Aircraft Company. The decisions as to where to place these contracts were made completely without any thought being given to what the consequences, if any, of renegotiation might be. Had the contractor been aware of the possibility of the Board using Divisional data, it conceivably, could have placed some of its contracts in another Division. For example, potentially higher profit contracts could have been placed in the Douglas Aircraft Company and potentially lower profit contracts could have been placed in the McDonnell Aircraft Company in an effort to achieve more balanced profits between the two. This was not done.

In addition to the visits to the contractor's offices, I have also made a review of each of the 16 files involved in the three review years for the purpose of ascertaining that which is relevant to this project. Also, for all three years, I have satisfied myself as to the validity of the figures provided us during our visits. I have done this partially with Mr. Perkowski, but, also, independently upon my return to the office. I am satisfied as to the reasonableness of the figures for each of the three years as broken down between the McDonnell component and the Douglas component. The attached schedules reflect the sales, costs and profits for both the McDonnell component and the Douglas component for renegotiable, nonrenegotiable and total business. In addition, for renegotiable business only, this information is further broken down by type of contract. A schedule showing historical renegotiable financial data by type of contract for both McDonnell and Douglas is shown on page 14 of the 1967 Accounting Report.

Through 1967, Douglas has historically had large amounts of Other Deductions, most of which have been allocated to nonrenegotiable business. The largest single Other Deduction item has been an item called "Specific Development Expense". It pertains to development expense in the DC 8 and 9 commercial aircraft and has been charged in total to nonrenegotiable business. Beginning in 1968, "Specific Development Expense" was charged as a General and Administrative Expense but still completely nonrenegotiable. Other costs included as Other Deductions include general research and development expense and interest expense. In the three review years, these expenses were charged predominantly to nonrenegotiable business. However, in some prior years, 1965 for example, they were charged predominately to renegotiable business but the amounts were much smaller at that time. McDonnell has no such significant corresponding expenses.

One further point in connection with the attached schedules: The figures, as shown for each separate component (McDonnell and Douglas) are consistent with those figures included in the consolidated figures, i.e., inter-company sales have been eliminated. As previously stated, the only significant effect these sales have on the presented figures is for the 1969 McDonnell component nonrenegotiable figures. In all other instances, the effect of inter-company sales on the presented figures is minimal.

McDonnell Douglas Corporation and Subsidiaries
Statement of Income - By McDonnell and Douglas Components
Separated as to Renegotiable and Nonrenegotiable Business
Fiscal Year Ended December 31, 1967 *
(000's omitted)

	Total			Renegotiable			Nonrenegotiable		
	Total	McDonnell	Douglas	Total	McDonnell	Douglas	Total	McDonnell	Douglas
Total Net Sales	$2,548,133	$1,260,768	$1,287,365	$1,618,566	$1,123,609	$494,957	$929,567	$137,159	$792,408
% of Distribution	100%	100%	100%	63.5%	89.1%	38.4%	36.5%	10.9%	61.6%
Cost of Goods Sold	2,253,840	1,055,416	1,198,424	1,350,946	935,553	415,393	902,894	119,863	783,031
Selling and Advertising Expense) General and Administrative Expense)	193,639	103,558	90,081	132,281	91,050	41,231	61,358	12,508	48,850
Federal Tax Adjustments	(42,690)	(5,976)	(36,714)	(1,538)	(1,337)	(201)	(41,152)	(4,639)	(36,513)
Total Costs and Expenses	2,404,789	1,152,998	1,251,791	1,481,689	1,025,266	456,423	923,100	127,732	795,368
Operating Profit	143,344	107,770	35,574	136,877	98,343	38,534	6,467	9,427	(2,960)
% of Sales	5.6%	8.5%	2.8%	8.5%	8.8%	7.8%	0.7%	6.9%	Loss
Other Income (or Deductions), Net	(53,477)	(238)	(53,239)	(6,160)	(161)	(5,999)	(47,317)	(77)	(47,240)
Profit for Renegotiation Before State Income Taxes	$ 89,867	$ 107,532	$ (17,665)	$ 130,717	$ 98,182	$ 32,535	$ (40,850)	$ 9,350	$(50,200)
% of Sales	3.5%	8.5%	Loss	8.1%	8.7%	6.6%	Loss	6.8%	Loss

* Includes Douglas figures for the approximate eight month period subsequent to the merger on April 28, 1967.

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McDonnell Douglas Corporation and Subsidiaries
Statement of Income - By McDonnell and Douglas Components
Separated as to Renegotiable and Nonrenegotiable Business
Fiscal Year Ended December 31, 1969
(000's omitted)

	Total			Renegotiable			Nonrenegotiable		
	Total	McDonnell	Douglas	Total	McDonnell	Douglas	Total	McDonnell	Douglas
Total Net Sales	$2,991,896	$942,930	$2,048,966	$1,380,547	$797,315	$583,232	$1,611,349	$145,615	$1,465,734
% of Distribution									
Cost of Goods Sold	2,345,844	779,255	1,566,589	1,114,723	657,622	457,101	1,231,121	121,633	1,109,488
Selling and Advertising Expense) General and Administrative Expense)	392,827	106,029	286,798	171,305	92,051	79,254	221,522	13,979	207,543
Federal Tax Adjustments	166,194	(27,990)	194,184	3,808	(11,009)	14,817	162,386	(16,982)	179,368
Total Costs and Expenses	2,904,865	857,294	2,047,571	1,289,836	738,664	551,172	1,615,029	118,630	1,496,399
Operating Profit	87,031	85,636	1,395	90,711	58,651	32,060	(3,680)	26,985	(30,665)
% of Sales	2.9%	9.1%	0.1%	6.6%	7.4%	5.5%	Loss	18.5%	Loss
Other Income or (Deductions), Net	(4,009)	(929)	(3,080)	(3,130)	(724)	(2,406)	(879)	(205)	(674)
Profit for Renegotiation Before State Income Taxes	$ 83,022	$ 84,707	$ (1,685)	$ 87,581	$ 57,927	$ 29,654	$ (4,559)	$ 26,780	$ (31,339)
% of Sales	2.8%	9.0%	Loss	6.3%	7.3%	5.1%	Loss	18.4%	Loss

McDonnell Douglas Corporation and Subsidiaries
Statement of Income - By McDonnell and Douglas Components
Separated as to Renegotiable and Nonrenegotiable business
Fiscal Year Ended December 31, 1968
(000's omitted)

	Total			Renegotiable			Nonrenegotiable		
	Total	McDonnell	Douglas	Total	McDonnell	Douglas	Total	McDonnell	Douglas
Total Net Sales	$3,615,876	$1,200,401	$2,415,475	$1,644,075	$973,574	$670,501	$1,971,801	$226,827	$1,744,974
% of Distribution	100%	100%	100%	45.5%	81.1%	27.8%	54.5%	18.9%	72.2%
Cost of Goods Sold	3,049,832	998,740	2,051,092	1,354,906	796,684	558,222	1,694,926	202,056	1,492,870
Selling and Advertising Expense) General and Administrative Expense)	337,354	107,553	229,801	160,158	87,239	72,919	177,196	20,314	156,882
Federal Tax Adjustments	5,100	(21,273)	26,373	2,943	985	1,958	2,157	(22,258)	24,415
Total Costs and Expenses	3,392,286	1,085,020	2,307,266	1,518,007	884,908	633,099	1,874,279	200,112	1,674,167
Operating Profit	223,590	115,381	108,209	126,068	88,666	37,402	97,522	26,715	70,807
% of Sales	6.2%	9.6%	4.5%	7.7%	9.1%	5.6%	4.9%	11.8%	4.1%
Other Income (or Deductions), Net	(1,163)	(619)	(544)	(706)	(474)	(232)	(457)	(145)	(312)
Profit for Renegotiation Before State Income Taxes	$ 222,427	$ 114,762	$ 107,665	$ 125,362	$ 88,192	$ 37,170	$ 97,065	$ 26,570	$ 70,495
% of Sales	6.2%	9.6%	4.5%	7.6%	9.1%	5.5%	4.9%	11.7%	4.0%

McDonnell Douglas Corporation and Subsidiaries
Statement of Profit from Renegotiable Business
Fiscal Years Ended December 31, 1967, 1968 & 1969
(000's omitted)

Renegotiable Only	Corporate Total	McDonnell Component					
		Total	FFP	CPFF	FPI	CPIF	Facilities
1967							
Total Net Sales	$1,618,566	$1,123,609	$175,436	$ 7,643	$905,857	$34,008	$665
Total Costs and Expenses	1,481,689	1,025,266	159,403	7,601	825,495	32,102	665
Operating Profit	136,877	98,343	16,033	42	80,362	1,906	-
% of Sales	8.5%	8.8%	9.1%	0.6%	8.9%	5.6%	
Other Income or (Deductions), Net	(6,160)	(161)	(42)	(69)	(47)	(3)	-
Profit for Renegotiation	$ 130,717	$ 98,182	$ 15,991	$ (27)	$ 80,315	$ 1,903	$ -
% of Sales	8.1%	8.7%	9.1%	Loss	8.9%	5.6%	
1968							
Total Net Sales	$1,644,075	$ 973,574	$148,971	$21,272	$786,230	$17,034	$ 67
Total Costs and Expenses	1,518,007	884,908	137,034	21,140	710,521	16,146	67
Operating Profit	126,068	88,666	11,937	132	75,709	888	-
% of Sales	7.7%	9.1%	8.0%	0.6%	9.6%	5.2%	
Other Income or(Deductions), Net	(706)	(474)	(174)	(30)	(270)	-	-
Profit for Renegotiation	$ 125,362	$ 88,192	$ 11,763	$ 102	$ 75,439	$ 888	$ -
% of Sales	7.6%	9.1%	7.9%	0.5%	9.6%	5.2%	
1969							
Total Net Sales	$1,380,547	$ 797,315	$131,313	$39,911	$574,773	$51,184	$134
Total Costs and Expenses	1,289,836	738,664	121,225	37,904	520,366	50,035	134
Operating Profit	90,711	58,651	10,088	2,007	45,407	1,149	-
% of Sales	6.6%	7.4%	7.7%	5.0%	7.9%	2.2%	
Other Income or (Deductions), Net	(3,130)	(724)	(114)	(45)	(544)	(21)	-
Profit for Renegotiation	$ 87,581	$ 57,927	$ 9,974	$ 1,962	$ 44,863	$ 1,128	$ -
% of Sales	6.3%	7.3%	7.6%	4.9%	7.8%	2.2%	

McDonnell Douglas Corporation and Subsidiaries
Statement of Profit from Renegotiable Business
Fiscal Years Ended December 31, 1967, 1968 & 1969
(000's omitted)

Renegotiable Only	Total	Douglas Component				
		FFP	CPFF	FPI	CPIF	Facilities
1967						
Total Net Sales	$494,957	$137,754	$28,813	$182,493	$143,356	$2,541
Total Cost and Expenses	456,423	134,396	25,768	165,653	128,065	2,541
Operating Profit	38,534	3,358	3,045	16,840	15,291	-
% of Sales	7.8%	2.4%	10.6%	9.2%	10.7%	
Other Income or (Deductions), Net	(5,999)	(1,565)	(438)	(1,823)	(2,173)	-
Profit for Renegotiation	$ 32,535	$ 1,793	$ 2,607	$ 15,017	$ 13,118	$ -
% of Sales	6.6%	1.3%	9.0%	8.2%	9.2%	
1968						
Total Net Sales	$670,501	$200,573	$57,322	$196,225	$214,157	$2,224
Total Cost and Expenses	633,099	206,361	53,392	178,662	192,460	2,224
Operating Profit	37,402	(5,788)	3,930	17,563	21,697	-
% of Sales	5.6%	Loss	6.9%	9.0%	10.1%	
Other Income or (Deductions), Net	(232)	(45)	(28)	(67)	(92)	-
Profit for Renegotiation	$ 37,170	$ (5,833)	$ 3,902	$ 17,496	$ 21,605	$ -
% of Sales	5.5%	Loss	6.8%	8.9%	10.1%	
1969						
Total Net Sales	$583,232	$169,424	$75,441	$145,105	$192,905	$ 357
Total Cost and Expenses	551,172	166,305	70,779	134,445	179,286	357
Operating Profit	32,060	3,119	4,662	10,660	13,619	-
% of Sales	5.5%	1.8%	6.2%	7.3%	7.1%	
Other Income or (Deductions), Net	(2,406)	(132)	(434)	(735)	(1,105)	-
Profit for Renegotiation	$ 29,654	$ 2,987	$ 4,228	$ 9,925	$ 12,514	$ -
% of Sales	5.1%	1.8%	5.6%	6.8%	6.5%	

7. Final Opinion for the fiscal year 1967, dated June 18, 1974, mailed to the Contractor attached to the Agreement, on July 1, 1974.

JUN 18 1974

THE RENEGOTIATION BOARD
2000 M Street, N. W.
Washington, D. C. 20446

FINAL OPINION

MCDONNELL DOUGLAS CORPORATION (AGENT)
St. Louis, Missouri 63166
Consolidated with:

McDonnell Douglas Corporation, Successor-in-Interest to Conductron Corporation

Actron Industries, Inc., Successor-in-Interest to Tridea Electronics Company
(Wholly owned by Conductron Corporation)

Actron Industries, Inc., Successor-in-Interest to Advanced Communications, Inc.
(Wholly owned by Conductron Corporation)

McDonnell Douglas Corporation, Successor-in-Interest to McDonnell Automation Company of Texas, Inc.

McDonnell Douglas Corporation, Successor-in-Interest to McDonnell Automation Company of Colorado

Fiscal Year Ended December 31, 1967
Assignment No. 10354-67

The renegotiable sales and profits and the returns on capital and net worth considered by the Board in this proceeding were as follows (000's omitted):

Sales	$1,618,566
Profits	130,717
Percent	8.1%
Return on Capital	30 %
Return on Net Worth	61 %

On April 28, 1967, Douglas Aircraft Company was acquired by McDonnell Aircraft Corporation and the company name was changed to McDonnell Douglas Corporation. Thus, the renegotiable business reviewed by the Board, as reflected in the foregoing figures, was the result of the combined efforts of two large companies (8 months' operations of Douglas and a full year's operations of McDonnell), which formerly had played a significant separate and independent role in the aerospace industry. Although five subsidiaries were

included in the consolidation, the parent accounted for 99% of the renegotiable sales and all the renegotiable profits.

The Board evaluated the contractor's renegotiable business on the basis of a broad application of the statutory factors to the combined performance of the McDonnell and Douglas segments. In reaching this position, the Board recognized that prior to the merger each of these airframe companies had been engaged in the same industry and, with the resulting interchange of vital information , technical know-how and management personnel, the identity of the two individual contractors gradually became lost after the merger. In addition, the contractor had similar capabilities at the facilities of each segment and, thus, had considerable flexibility in the placement of Government contracts. The contractor's objective in the placement of these contracts was to achieve maximum efficiency with consideration for the resources available to it at the different locations and not the overall profitability of individual segments. However, the Board did give full consideration to the geographic changes in the contractor's business following the Douglas acquisition, the different types of products and contract-mix, and different labor, manufacturing, and other factors with which the contractor was confronted in this first year of combined operations.

Renegotiable business (64% of total business) consisted of the manufacture of highly specialized, advanced military aircraft, spacecraft, missiles, support systems and other products and certain related research, design and development work. The principal items produced in the review year were the Phantom F-4 supersonic fighter aircraft (56% of total renegotiable sales); S-IVB Saturn space vehicles (7%); manned orbiting laboratory spacecraft (7%); A-4 attack aircraft (5%); and the balance consisting of Spartan missiles; Thor and Delta launch vehicles; Gemini spacecraft; and, the F-111 crew-escape systems. There were seven different models of the F-4 manufactured in the review year, which models had varying characteristics. For example, there were five different types of engines involved, seven different radar systems, and various other differences in electronics and other components.

The advanced nature of the aircraft, spacecraft and other products required highly complex manufacturing techniques and a high degree of efficiently applied engineering skills and involved the utilization of substantial manufacturing and engineering facilities, specialized equipment and trained personnel. Combined material and subcontracting costs in the review year ran about 54% of total cost of sales. Many new machining, fabricating, assembly and manufacturing techniques were developed, and a large amount of research development and design operations was conducted.

The Board considered the contractor's operations to be highly complex.

The contractor maintained very good quality and delivery standards and achieved cost reductions in the review year. The contractor also presented documents demonstrating increasingly lower maintenance time for the F-4 aircraft due to continued improvements in the aircraft. On the basis of the favorable performance and other data in the Board's files, the Board considered the contractor to be a highly efficient producer.

Approximately 19% of total renegotiable sales in the review year were under firm fixed-price contracts. The comparable percentages for McDonnell Aircraft Corporation in its prior two years were 32% and 75%. For Douglas Aircraft Company the percentages for the prior two years were 32% and 30%. Fixed-price incentive contracts accounted for approximately 67% of renegotiable business with cost-reimbursement type contracts accounting for the remaining 14%. Almost all of the firm fixed-price business consisted of the production of F-4 and A-4 aircraft and bomb racks, all of which were procured by the Government on a negotiated sole source basis. Most of the fixed-price incentive sales involved the F-4 Phantom aircraft which had been produced in unusually large quantities in previous years, including 1,000 of the Phantom aircraft that had been delivered under firm fixed-price contracts in prior years. Although the contractor had gained experience on the F-4 and A-4 in earlier years and enjoyed a favorable cost-sharing curve in its incentive business, the Board considered that the contractor did assume significant pricing risk in the review year particularly because of the number of models manufactured.

The contractor contended that it assumed risk by increasing the production of F-4 aircraft to a peak rate of 71 per month in the review year compared with a monthly rate of only 40 in January 1966. During the production buildup, employment increased by 10,000. The Board recognized that the contractor assumed some risk in this regard.

During the review year the contractor had the use of Government-owned facilities with a cost value of $236.7 million and was also furnished substantial Government progress payments showing an unliquidated balance of $385.3 million at the end of its fiscal year. The Board recognized that not all of the $236.7 million of Government-owned facilities were utilized since some were not adaptable to the review year renegotiable business. The ratio of the cost of Government facilities to the total cost of Government and contractor facilities ($236.7 million divided by $589.3) is 40.2% of such total.

In evaluating the contractor's performance under the capital-employed factor, the Board, to the extent possible, relied on specific identification of assets in computing returns rather than to follow the customary practice of allocating capital employed to renegotiable business on the cost-of-sales ratio. Such returns are stated on the basis of contractor's books at the beginning of the year and are without regard to the amount of Government-furnished equipment described above. As so computed, the contractor's review year returns on capital and net worth allocated to renegotiable business were 30% and 61%, respectively, and for the reasons cited above, they were not comparable to the prior years' returns.

The Board considered the contractor's returns on capital and net worth in the review year to be high and indicative of excessive profits. Those returns, however, should be considered in light of the following statements made by the Tax Court in the LTV case:

> "First, ...where a contractor risks relatively little of its own capital it is primarily a manager of property, and thus not entitled to as great a return for risk-taking as a contractor which supplies its own assets. Secondly, whereas a contractor

which uses its own assets is entitled to an element of return equivalent to the rental value of the assets, a contractor using the assets of others is not. For these reasons, a contractor using largely public capital -- either rented property or Government-furnished property -- is not entitled to as large an absolute amount of profit as a contractor using its own property."

"It does not follow that the contractor using capital supplied by others is necessarily entitled to a smaller rate of return on its own net worth. Profit is in part a payment to an entrepreneur for the productive use of assets. A contractor is entitled to an appropriate profit for such use based on the total capital it employs in its renegotiable business, whether the capital is owned by it or by others. CF. sec. 1460.11(b)(3), R. B. Regs. Two companies making the same kind of use of the same amount of capital should be entitled to the same amount of entrepreneurial profit, whatever the source of such capital. However, this entrepreneurial profit will inevitably be a larger percentage of the net worth of a company using primarily public capital than one using primarily its own capital. Therefore, the total profit -- the return on invested capital plus the entrepreneurial profit -- will be a larger percentage of the net worth of the contractor using public capital."

(See LTV vs. the Renegotiation Board, - 51 TC 369, (405) (1968)).

Thus, because of the utilization of a larger amount of public capital, i.e., Government-furnished equipment, the returns on capital and net worth in the instant case, after refund, are higher than the Board would consider reasonable were the foregoing facts not present.

Procurement sources largely considered the contractor to be an average cost producer in the review year. The contractor's material and labor costs showed a decline and, in the Board's opinion, on an overall basis, the contractor's costs were reasonable and well controlled.

The following is a comparison of the contractor's review year renegotiable sales, profits, and profit margin, as a percentage of sales, with those of McDonnell and Douglas in prior years (000's omitted):

	Sales	Profits	Percent
Review Year	$1,618,566	$130,717	8.1
McDonnell (6 mos.ended 12/31/66)1/	561,069	48,729	8.7
FYE 6/30/662/	986,684	82,073	8.3
FYE 6/30/653/	990,915	75,420	7.6
Douglas (5 mos. ended 4/28/67)	246,563	12,700	5.2
FYE 11/30/66	563,998	32,284	5.7
FYE 11/30/65	515,030	17,629	3.4

1/ After refund of $7 million.
2/ After refund of $27 million.
3/ After refund of $8 million.

Based on the foregoing and an analysis and evaluation of all information developed in these proceedings, a majority of the Board concluded that the contractor realized excessive profits in the amount of $5,000,000 (subject to appropriate adjustment for State and Federal income taxes) in the year under review, and the entire amount of excessive profits was allocated to McDonnell Douglas Corporation. The contractor has indicated its willingness to enter into an agreement for the elimination of such excessive profits. The effect of the Board's finding is to leave the contractor with adjusted renegotiable sales and profits as follows (000's omitted):

Sales	$1,613,566
Profits	125,717
Percent	7.8%
Return on Capital	29 %
Return on Net Worth	59 %

Board Member, Mr. Goodwin Chase, dissented in this matter and will file a separate memorandum.

Signed: Richard E. Rapps

Richard E. Rapps
Secretary to the Board

8. Final Opinion for the fiscal years 1968 and 1969, dated June 18, 1974, mailed to the Contractor attached to the Clearances, on June 18, 1974.

JUN 18 1974

THE RENEGOTIATION BOARD
2000 M Street, N. W.
Washington, D. C. 20446

FINAL OPINION

MCDONNELL DOUGLAS CORPORATION (AGENT)
St. Louis, Missouri 63166

Consolidated with:

McDonnell Automation Company

McDonnell Douglas Corporation, Successor-in-Interest to Conductron Corporation

Actron Industries, Inc., Successor-in-Interest to Tridea Electronics Company
(Wholly owned by Conductron Corporation)

Actron Industries, Inc., Successor-in-Interest to Advanced Communications, Inc.
(Wholly owned by Conductron Corporation)

McDonnell Douglas Corporation, Successor-in-Interest to McDonnell Automation Company of Texas, Inc.*

McDonnell Douglas Corporation, Successor-in-Interest to McDonnell Automation Company of Colorado

Fiscal Years Ended December 31, 1968
and 1969
Assignment Nos. 10354-68 and 69

The renegotiable sales and profits and the returns on capital and net worth considered by the Board in this proceeding were as follows (000's omitted):

	Sales	Profits	Percent	Return on: Capital	Net Worth
1968	$1,644,075	$125,362	7.6%	26%	49%
1969	1,380,547	87,581	6.3%	21%	43%

*Not included in 1969 consolidation.

On April 28, 1967, Douglas Aircraft Company was acquired by McDonnell Aircraft Corporation and the company name was changed to McDonnell Douglas Corporation. Thus, the renegotiable business reviewed by the Board, as reflected in the foregoing figures, was the result of the combined efforts of two large companies which formerly had played a significant separate and independent role in the aerospace industry. Although subsidiaries were included in the consolidation, the parent accounted for 99% of the renegotiable sales and all the renegotiable profits.

In view of the fact that McDonnell and Douglas companies had been engaged in similar work in the same industry, the combination resulted in a valuable interchange of vital information and technical know-how. In addition, the organizational methods adopted by the contractor's management lent themselves, even in the first year of operation, towards a smooth and orderly transition and a resulting well-functioning corporate structure. During the review years, the contractor's efforts to achieve maximum management efficiency continued with the establishment of an astronautics company with an eastern and western location; the change in the method of accounting for a significant portion of the Government contracts of the acquired Douglas operations to one consistent with the method employed by McDonnell, and the assumption by the McDonnell corporate office of the Douglas corporate functions.

The contractor also had considerable flexibility in the placement of Government contracts because of similar capabilities in the separate McDonnell and Douglas facilities. The contractor's objective in the placement of these contracts was to achieve maximum efficiency with consideration for the resources available to it at the different locations and not the overall profitability of individual segments. Thus, the Board evaluated the contractor's business on the basis of a broad application of the statutory factors to the combined performance of the McDonnell and Douglas segments. However, the Board did give full consideration to the geographic changes in the contractor's business following the Douglas acquisition, the different types of products and contract-mix, and different labor, manufacturing, and other factors with which the contractor was confronted in combining the operations.

Renegotiable business (45% of total business in 1968 and 46% in 1969) consisted of the manufacture of highly specialized, advanced military aircraft, spacecraft missiles, support systems and other products and certain related research, design and development work. The principal items produced in the review years were the F-4 and F-15 supersonic fighter aircraft; S-IVB Saturn space vehicles; manned orbiting laboratory spacecraft; A-4 attack aircraft; and the balance consisting of Spartan missiles; Thor and Delta launch vehicles; Gemini spacecraft; and, the F-111 crew-escape systems. There were seven different models of the F-4 manufactured in the review years, which models had varying characteristics. For example, there were five different types of engines involved, seven different radar systems, and various other differences in electronics and other components.

The advanced nature of the aircraft, spacecraft and other products required highly complex manufacturing techniques and a

high degree of efficiently applied engineering skills and involved the utilization of substantial manufacturing and engineering facilities, specialized equipment and trained personnel. Combined material and subcontracting costs ran about 55% of total cost of sales in 1969 and 41% in 1969. Many new machining, fabricating, assembly and manufacturing techniques were developed and a large amount of research, development and design operations was conducted.

The Board considered the contractor's operations to be highly complex.

The contractor maintained very good quality and delivery standards and achieved cost reductions in the review years. The contractor also presented documents demonstrating increasingly lower maintenance time for the F-4 aircraft due to continued improvements in the aircraft. On the basis of the favorable performance and other data in the Board's files, the Board considered the contractor to be a highly efficient producer.

Approximately 21-22% of total renegotiable sales in the review years were under firm fixed price contracts compared to 19% in the prior year. Fixed price incentive contracts accounted for approximately 60% of renegotiable business in 1968 and 45% in 1969 with cost-reimbursement-type contracts accounting for the remaining 19% in 1968 and 13% in 1969. Almost all of the firm fixed price business consisted of the production of F-4 and A-4 aircraft and bomb racks, all of which was procured by the Government on a negotiated sole source basis. Most of the fixed price incentive sales in 1968 involved the F-4 Phantom aircraft which had been produced in unusually large quantities in previous years, including 1,000 of the Phantom aircraft that had been delivered under firm fixed price contracts in prior years. Although the contractor had gained experience on the F-4 and the A-4 in earlier years and enjoyed a favorable cost-sharing curve on its incentive business, the Board considered that the contractor did assume significant pricing risk in the review years particularly because of the number of models manufactured.

During the review years, the contractor had the use of Government-owned facilities with a cost value of $246.7 million in 1968 and $197.1 million in 1969, and was also furnished substantial Government progress payments showing an unliquidated balance of $293.4 million at the end of 1968 and $276.5 million at the end of 1969. The Board recognized that the Government-owned facilities were not all utilized since some were not adaptable to the review year renegotiable business. The ratio of the cost of Government facilities to the total cost of Government and contractor facilities was 37% in 1968 and 29% in 1969.

In evaluating the contractor's performance under the capital-employed factor, the Board, to the extent possible, relied on specific identification of assets in computing returns rather than to follow the customary practice of allocating capital employed to renegotiable business on the cost-of-sales ratio. Such returns are stated on the basis of the contractor's books at the beginning of the year and are without regard to the amount of Government-furnished equipment described above. As so computed, the contractor's review

year returns on capital and net worth allocated to renegotiable business were 26% and 49%, respectively, in 1968, and 21% and 43%, respectively, in 1969. For the reasons cited above, the returns were not comparable to the years prior to 1967 when capital and net worth were allocated on the cost-of-sales ratio. For 1967, the contractor's returns on capital and net worth, after refund, were 29% and 59%, respectively.

The Board considered the contractor's returns on capital and net worth in the review years to be high, but felt they should be considered in light of the following comments by the Tax Court in the LTV case:

> "First,.....where a contractor risks relatively little of its own capital it is primarily a manager of property, and thus not entitled to as great a return for risk-taking as a contractor which supplies its own assets. Secondly, whereas a contractor which uses its own assets is entitled to an element of return equivalent to the rental value of the assets, a contractor using the assets of others is not. For these reasons, a contractor using largely public capital -- either rented property or Government-furnished property -- is not entitled to as large an absolute amount of profit as a contractor using its own property."
>
> "It does not follow that the contractor using capital supplied by others is necessarily entitled to a smaller rate of return on its own net worth. Profit is in part a payment to an entrepreneur for the productive use of assets. A contractor is entitled to an appropriate profit for such use based on the total capital it employs in its renegotiable business, whether the capital is owned by it or by others. Cf. Sec. 1460.11(b)(3), R. B. Regs. Two companies making the same kind of use of the same amount of capital should be entitled to the same amount of entrepreneurial profit, whatever the source of such capital. However, this entrepreneurial profit will inevitably be a larger percentage of the net worth of a company using primarily public capital than one using primarily its own capital. Therefore, the total profit -- the return on invested capital plus the entrepreneurial profit -- will be a larger percentage of the net worth of the contractor using public capital."
>
> (See LTV vs. the Renegotiation Board - 51 TC 369(405)(1968)).

Thus, because of the utilization of a large amount of public capital, i.e., Government-furnished equipment, the returns on capital and net worth in the instant case are higher than the Board would consider reasonable were the foregoing facts not present.

Procurement sources largely considered the contractor to be an average-cost producer in the review years. The contractor's material and labor costs showed a decline and, in the Board's opinion, on an overall basis, the contractor's costs were reasonable and well-controlled.

The following is a comparison of the contractor's review years (renegotiable sales, profits, and profit margin, as a percentage of sales) with those of McDonnell and Douglas in prior years (000's omitted):

	Sales	Profits	Percent
Review Years:			
1969	$1,380,547	$ 87,581	6.3%
1968	1,644,075	125,362	7.6%
Prior Years:			
1967 1/	1,613,566	125,717	7.8%
McDonnell (6 mos.ended 12/31/66) 2/	561,069	48,729	8.7%
FYE 6/30/66 3/	986,684	82,073	8.3%
FYE 6/30/65 4/	990,915	75,420	7.6%
Douglas (5 mos. ended 4/28/67)	246,563	12,700	5.2%
FYE 11/30/66	563,998	32,284	5.7%
FYE 11/30/65	515,030	17,629	3.4%

1/ After refund of $5 million.
2/ After refund of $7 million.
3/ After refund of $27 million.
4/ After refund of $8 million.

Based on the foregoing and an analysis and evaluation of all information developed in these proceedings, a majority of the Board concluded that the contractor did not realize excessive profits during its fiscal years ended December 31, 1968 and 1969.

Board Member, Mr. Goodwin Chase, dissented in this matter and will file a separate memorandum.

Signed: Richard E. Rapps

Richard E. Rapps
Secretary to the Board

Letter to McDonnell Douglas Corporation, dated July 9, 1974, enclosing a copy of Mr. Chase's dissent for the fiscal year 1967, dated July 3, 1974.

JUL 9 1974

McDonnell Douglas Corporation
P. O. Box 516
St. Louis, Missouri 63166

Attention: Mr. John E. Forry
Corporate Vice President
Controller

Subject: Renegotiation Proceedings -
MCDONNELL DOUGLAS CORPORATION (AGENT)
(CONSOLIDATED)
Fiscal Year Ended December 31, 1967

Gentlemen:

Forwarded herewith is the Dissent of Mr. Goodwin Chase; Board Member, from the Final Opinion dated June 18, 1974, relative to the subject proceedings.

Very truly yours,

Signed: Richard E. Rapps

Richard E. Rapps
Secretary to the Board

Enclosure: As stated

cc: The Board
General Counsel
Review
Accounting
Central Files

July 3, 1974

MEMORANDUM TO: Richard E. Rapps
Secretary to the Board

FROM : Goodwin Chase
Board Member

SUBJECT: McDonnell Douglas Corporation, SII to
Conductron Corporation

Actron Industries, Inc., SII to
Tridea Electronics Company
(Wholly owned by Conductron Corporation)

Actron Industries, Inc., SII to
Advanced Communications, Inc.
(Wholly owned by Conductron Corporation)

McDonnell Douglas Corporation, SII to
McDonnell Automation Company of Texas, Inc.

McDonnell Douglas Corporation, SII to
McDonnell Automation Company of Colorado

Fiscal Year Ended December 31, 1967

Please distribute copies of the attached dissent to those people who appropriately should have them and advise me to whom they have been directed.

Dissent of Mr. Goodwin Chase
From
FINAL OPINION

McDonnell Douglas Corporation (Agent)
St. Louis, Missouri 63166
Consolidated with:

McDonnell Douglas Corporation, Successor-in-Interest to
Conductron Corporation

Actron Industries, Inc., Successor-in-Interest to
Tridea Electronics Company
(Wholly owned by Conductron Corporation)

Actron Industries, Inc., Successor-in-Interest to
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McDonnell Douglas Corporation, Successor-in-Interest to
McDonnell Automation Company of Texas, Inc.

McDonnell Douglas Corporation, Successor-in-Interest to
McDonnell Automation Company of Colorado

Fiscal Year Ended December 31, 1967
Assignment No. 10354-67

A majority of the Board in its Final Opinion of June 18, 1974 made the affirmative determination that the McDonnell Douglas Corporation for the Fiscal Year Ending December 31, 1967, had excessive profits in the amount of $5 million. As a result of the 1967 purchase of Douglas Aircraft Company by McDonnell Aircraft Company forming a new corporate entity, the two major segments of the newly formed McDonnell Douglas Corporation were known as the McDonnell Company and the Douglas Aircraft Division.

The genesis of this dissent concerns:

(1) In the initial development of data necessary to the renegotiation process, The Renegotiation Board requested the contractor to furnish full and complete financial information relating to the McDonnell Company and full and complete financial information relating to the Douglas Aircraft Division for the years under review. Thereafter, the Board acceded to the contractor's request that such information not be required. By not lifting the veil of the conglomerate, a majority of the Board failed to exercise its obligation to examine information essential to an accurate determination of excessive profits by contract type for each of the operating divisions and subsidiaries of the McDonnell Douglas Corporation.

(2) The Board renegotiated the contractor on a consolidated basis and combined McDonnell Company, its five subsidiaries and Douglas Aircraft Division in their evaluation of McDonnell Douglas Corporation. By this procedure the Board has afforded the contractor the substantial benefit of diluting the proven McDonnell Company history of high earnings with the low profit levels generated by the Douglas Aircraft Division; in the year under review and finally,

(3) the pronounced lack of in-depth probing of the accounting, analysis, and review function in these areas lessens the Board's ability to make a completely accurate analysis and determination of the presence of excessive profits.

* * * * *

By combining the segments, McDonnell Company, its subsidiaries and the Douglas Aircraft Division, the Board has not exercised its authority under the statute (see General Counsel's Opinion* dated February 22, 1974) and the regulations to examine the segments separately and then to aggregate the results in arriving at a final determination; thus as noted above the contractor was accorded the benefit of having high profits of the McDonnell Company diluted by the lower profits of the Douglas Aircraft Division.

Where the determinations of excessive profits and clearances, made by the Renegotiation Board with respect to the renegotiable sales and profits of the McDonnell Aircraft Corporation and the Douglas Aircraft Company for their respective fiscal years 1965 and 1966, are compared with their sales and profits as operating divisions of the newly merged McDonnell Douglas Corporation in 1967, the final opinion rendered by a majority of the Board, graphically illustrates that the Board has not identified or recovered sufficient excessive profits.

---

* (Concluding paragraph of General Counsel's Opinion dated 2/22/74): In summation, it is my opinion that the Act and regulations give the Board authority to examine segments of a contractor's renegotiable business, such as a product line, profit center or division or types of contracts and determine the excessive profits of one without the other provided the profit excesses and deficiencies resulting from such examinations are aggregated in arriving at a final determination. This approach is analogous to the treatment frequently accorded by the Board to individual members of a consolidated group.

The following schedule reflects the Board's 1965, 1966 and 1967 determinations:

		In Millions ($)				
Company	Fiscal Period	Sales	Profit	% of Sales	Board Action	% of Sales after Board Action
McDonnell	FYE 6/30/65	$ 999	$ 83	8.4%	$ 8	7.6%
McDonnell	FYE 6/30/66	1,011	107	10.5%	27	8.1%
McDonnell	(6 mo. ended 12/31/66)	567	54	9.6%	7	8.5%
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Douglas	FYE 12/31/66	560	32	5.7%	Cleared	-
Douglas	(5 mo. ended 4/28/67)	245	13	5.2%	Cleared	-
		Review Year				
McDonnell	FYE 12/31/67	$1,124	98	8.7%	-	-
Douglas	FYE 12/31/67	495	33	6.6%	-	-
Consolidated	(FYE 12/31/67)	1,619	131	8.1%	$ 5	7.8%

Analysis of the above schedule is evidence that, for the two and one half years prior to the merger, the McDonnell Company's renegotiable earnings were substantial and Douglas Aircraft's renegotiable earnings were significantly lower. Excessive profits were recovered from the McDonnell Aircraft Company in each of those years. The two components, therefore, should have been examined and evaluated independently by contract type or by product line. This then would reveal the true excessive profits assessable to the McDonnell Company earnings and with such additional considerations as they may be entitled to collectively, the aggregate of the two components then would reflect the fair level of profits to be retained on a consolidated basis.

An examination of the legislative history of the Renegotiation Act of 1951, and the amendments thereto, confirms the absence of any intent by United States Congress to exempt the multidivision corporations nor the more recently emerged conglomerates from having their renegotiable costs examined by product line, type of contract or by profit center as a means of determining the reasonableness of profits and where appropriate to recapture excessive profits, of the individual unrelated product lines, contract type or profit centers.

The fact that the contractor reported for renegotiation (RB Form 1) for the review year by averaging the sales, costs and profits of the product lines of its various divisions and subsidiaries in a consolidated report is not based on the language of the Renegotiation Act, expressed or implied.

The published Forms and Instructions for Filing Renegotiation Reports, Section 1, Paragraph 1, requires:

> If you are engaged in more than one type of renegotiable business or if you operate on a divisional basis, schedules showing operating

results by principal products, services or divisions should be submitted to supplement the information in this section, separated between renegotiable and nonrenegotiable business.

The contractor's financial information furnished to the Regional Board was not, in my opinion, complete and in sufficient detail to satisfy the provisions of the Renegotiation Act and the applicable Renegotiation Board Regulations.

The Board recognized this deficiency in the contractor's filing and on November 27, 1973 issued a Notice of Points for Presentation letter pursuant to Section 105(a) of the Act, wherein the contractor was advised to be prepared to deal specifically and in appropriate detail with:

> The reasonableness of overall renegotiable profits of the consolidated group for the fiscal years 1967, 1968 and 1969, in light of the profits realized individually by Douglas Aircraft Company and McDonnell Corporation in the years prior to the acquisition of Douglas by McDonnell.

The McDonnell Douglas Corporation, in reply to this request by letter of November 30, 1973, declined to comply and subsequently restated this refusal on December 13, 1973, at a meeting with the Members of the Board in St. Louis, Missouri. In effect, the contractor in both instances has said that it reserves the right to comply only with those sections of the Renegotiation Act and the Board's regulations that are the least adverse to its best interest.

Further, in the context of this financial data requirement and as a basis of my first reason for this dissent, it is important to note that the McDonnell sales volume in 1966 (when $27 million was found to be the excessive profits year) is relatively at the same level as the year of the merger 1967, the year under review.

On or about April 30, 1974 the contractor agreed to a limited re-examination of the Company's books and records insofar as the consolidated filing for the review year was concerned. This examination of costs and profit records was again hampered by the limited access to the Divisional Accounting information imposed by the officers of the McDonnell Douglas Corporation.

The contractor again stressed its right of exemption to the provisions of the Act, but even more pointedly refused to allow the examination of any details of the costs of goods sold or general and administrative expenses in any way related to divisional or contract breakdown.

The information developed by the review in May 1974, although lacking in cost breakdown detail, bears out the second of my "genesis" of dissent. That is, the McDonnell Company is revealed to have generated renegotiable sales and profits comparable to the years prior to the merger, but the Douglas Aircraft Division, while having sales slightly lower, actually improved its historical profit position.

It is important to note that from the first delivery in 1960 through June 30, 1966, the sales of F-4 phantoms had exceeded $3 billion and that in the fiscal year ending June 30, 1966 almost 86% of these sales had been under sole source negotiated firm fixed price contracts. By contrast in the review year ending June 30, 1967, more than 84% of the F-4 phantom aircraft sales were produced under sole source negotiated fixed price incentive fee type contracts.

The significance of this shift in contract type in the review year is that these F-4 phantom sales accounted for $906 million of the McDonnell Company's review sales on which a profit of $80.3 million, or 8.9% on sales, was realized.

The fixed price incentive fee contracts are subject to the provision of Section 105(a) and 103(e) of the Renegotiation Act and are further accountable under the Renegotiation Board Regulations:

1460.2(b) - Separate consideration of certain types of contracts -

> While renegotiation will be conducted with respect to the aggregate of the contractor's renegotiable business . . . whether fixed price or cost-plus-a-fixed-fee, which contain incentive provisions . . . will be separately considered.

1460.2(c) - Comparisons -

> In evaluating the contractor's performance, comparisons will be made with the prices, costs and profits of other contractors engaged in the production of the same or similar products . . . .

1460.9(a) - Statutory provision -

> . . . the efficiency of the contractor or subcontractor with particular regard to attainment of quantity and quality production, reduction of costs, and economy in the use of materials, facilities, and manpower; . . .

1460.9(a)(5) - Comment

> Nature and objectives of incentive . . . contracts . . ., with respect to such contracts . . . in which the contract prices are based upon estimated costs, the Board will take into consideration the extent to which any differences . . . . . the contractor may, and if requested . . ., shall furnish . . . (i) a breakdown of the estimated costs . . . together with the amounts thereof . . ., (ii) a corresponding breakdown of the costs actually incurred . . . .

In compliance with these and such other of the Board's applicable regulations, the Renegotiation Board should have required that the contractor furnish a breakdown of the cost of goods sold, as well as the general and administrative and other expenses, for both the estimates on which the contract prices are based. Then this information compared with the actual cost applicable to the review year would establish a true basis upon which to apply the statutory factors including reasonableness of costs and profits as well as efficiency. In the absence of these cost details by elements of material, subcontracting, labor, overhead, etc., no true measure of the value added to the products manufactured can be made.

The rationale of quantifying assets employed, as expressed in the LTV case cited, for the purpose of statistical comparison with other contractors in the same industry employing equal amounts of their own capital does not lead to the conclusion reached in the Board's majority opinion that returns on assets employed by McDonnell Douglas "although high are acceptable".

The Tax Court held in the LTV case that use of capital supplied by others should be given favorable consideration if the usage and value were known. However, in that case the information was not available in sufficient quantity for the Tax Court to make an evaluation and they said:

> "We cannot say with accuracy what amount or percentage of the total capital employed by Temco was supplied by others because of lack of evidence."

While the contractor, as the Final Opinion states, used some part of the Government-owned facilities having a cost value of $236.7 million in production of the review year renegotiable business, there was no evidence of value in the year under review presented which would meet the minimal requirements of the LTV case.

The Tax Court concluded:

> . . . "that Temco is entitled to unfavorable consideration under this criterion to the extent that it is entitled to less return on invested capital than if it had supplied all the capital it employed." (emphasis supplied)

The McDonnell Douglas Corporation did not furnish information as to the usage and net value of the Government-owned facilities used during the review year on its renegotiable business, nor was any attempt made to compare returns on net worth with a company or companies like McDonnell Douglas. In the absence of this essential information, as viewed by the Tax Court in its consideration of the criterion for application of capital furnished by others as basis for determining the return on capital and net worth, the McDonnell Douglas Corporation is not entitled to any consideration for the use of facilities furnished by the Government in the determination that the 30% return on capital and the 61% return on net worth is high and indicative of excessive profits.

To whatever extent the product mix as well as the contract types varied from the prior year, the F-4 fighter aircraft being produced at the McDonnell component continued to account for a major share of the renegotiable revenues in 1966 and 1967. The aircraft design changes were not more than those of succeeding generations of F-4's and the normal advancement in the state of the art of a product that had been in continuous production for 8 years, generating revenues in excess of $4 billion, in addition to sales to foreign nations. All of the fixed price and fixed price incentive contracts were negotiated sole source with normal contingencies for increased quantities and accelerated deliveries negotiated into the contract price.

The complexity consideration expressed in the majority opinion has already been accorded the contractor in prior year's factor consideration. No new significant complexity information was furnished by the contractor in the review year. The initial complexity of a product does not per se denote complexity of production. This is more especially true when the learning curve of the manufacturing process has reached its apex, as it has in the case of the phantom fighter aircraft.

For the overwhelming reason that full information was not disclosed by product line or contract type, it is not possible to address this dissent to the statutory factors. In the absence of this meaningful information, to appropriately apply the statutory factors to the two major product lines (the McDonnell Company and the Douglas Aircraft Division) would involve factually disputable conjecture.

However, from information available based on prior years' refunds of excessive profits the following conclusions must be drawn from the $1.1 billion of renegotiable sales generated by the McDonnell Company in the review year, $906 million, or 82%, of these sales were generated on fixed price incentive fee contracts that the record shows were based on favorable cost-sharing formulas. Information was not available to evaluate these formulas.

The profits earned by the McDonnell Company on its total sales amounted to $98 million, or 8.7%, of renegotiable sales. The profit earned by the McDonnell Company on its fixed price incentive sales accounted for $80.3 million of the total McDonnell Company profits, or a margin of 8.9% of its renegotiable sales.

In summary, based upon the limited information available and for the reasons heretofore expressed, I have concluded that the McDonnell Company has excessive profits at least in the amount of $15,000,000 for the fiscal year ended December 31, 1967. Thus, the aggregate of the adjusted sales and profits after removal of $15,000,000 excessive profits, would be as follows:

(In Millions $)

	McDonnell Company	Douglas Aircraft Division	McDonnell Douglas Corporation Consolidated
Sales	$ 1,109	$ 495	$ 1,604
Profits	83	33	116
Percent	7.5%	6.6%	7.2%
Return on Capital	-	-	27.2%
Return on Net Worth	-	-	54.8%

Letter to McDonnell Douglas Corporation, dated July 9, 1974, enclosing copy of Mr. Chase's dissent for the fiscal years 1968 and 1969, dated July 3, 1974.

JUL 9 1974

McDonnell Douglas Corporation
P. O. Box 516
St. Louis, Missouri 63166

Attention: Mr. John E. Forry
Corporate Vice President
Controller

Subject: Renegotiation Proceedings -
MCDONNELL DOUGLAS CORPORATION (AGENT)
(CONSOLIDATED)
Fiscal Years Ended December 31, 1968
and December 31, 1969

Gentlemen:

Forwarded herewith is the Dissent of Mr. Goodwin Chase, Board Member, from the Final Opinion dated June 18, 1974, relative to the subject proceedings.

Very truly yours,

Signed: Richard E. Rapps

Richard E. Rapps
Secretary to the Board

Enclosure: As stated

cc: The Board
General Counsel
Review
Accounting
Central Files

July 3, 1974

MEMORANDUM TO: Richard E. Rapps
Secretary to the Board

FROM : Goodwin Chase
Board Member

SUBJECT: McDonnell Automation Company

McDonnell Douglas Corporation, SII to
Conductron Corporation

Actron Industries, Inc., SII to
Tridea Electronics Company
(Wholly owned by Conductron Corporation)

Actron Industries, Inc., SII to
Advanced Communications, Inc.
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McDonnell Douglas Corporation, SII to
McDonnell Automation Company of Texas, Inc.*

McDonnell Douglas Corporation, SII to
McDonnell Automation Company of Colorado

Fiscal Years Ended December 31, 1968 and 1969

*Not included in 1969 consolidation.

Please distribute copies of the attached dissent to those people who appropriately should have them and advise me to whom they have been directed.

Dissent of Mr. Goodwin Chase
From
FINAL OPINION

McDonnell Douglas Corporation (Agent)
St. Louis, Missouri 63166

Consolidated with:

McDonnell Automation Company

McDonnell Douglas Corporation, Successor-in-Interest to
Conductron Corporation

Actron Industries, Inc., Successor-in-Interest to
Tridea Electronics Company
(Wholly owned by Conductron Corporation)

Actron Industries, Inc., Successor-in-Interest to
Advanced Communications, Inc.
(Wholly owned by Conductron Corporation)

McDonnell Douglas Corporation, Successor-in-Interest to
McDonnell Automation Company of Texas, Inc. *

McDonnell Douglas Corporation, Successor-in-Interest to
McDonnell Automation Company of Colorado

Fiscal Years Ended December 31, 1968
and 1969
Assignment Nos. 10354-68 and 69

* Not included in 1969 consolidation.

A majority of the Board in its Final Opinion of June 18, 1974 made the affirmative determination that the McDonnell Douglas Corporation for the fiscal year ending December 31, 1968 and 1969 did not have excessive profits. As a result of the 1967 purchase of Douglas Aircraft Company by McDonnell Aircraft Company forming a new corporate entity, the two major segments of the newly formed McDonnell Douglas Corporation were known as the McDonnell Company and the Douglas Aircraft Division.

The genesis of this dissent concerns:

(1) In the initial development of data necessary to the renegotiation process, The Renegotiation Board requested the contractor to furnish full and complete financial information relating to the McDonnell Company and full and complete financial information relating to the Douglas Aircraft Division for

the years under review. Thereafter, the Board acceded to the contractor's request that such information not be required. By not lifting the veil of the conglomerate, a majority of the Board failed to exercise its obligation to examine information essential to an accurate determination of excessive profits by contract type for each of the operating divisions and subsidiaries of the McDonnell Douglas Corporation.

(2) The Board renegotiated the contractor on a consolidated basis and combined McDonnell Company, its five subsidiaries and Douglas Aircraft Division in their evaluation of McDonnell Douglas Corporation. By this procedure the Board has afforded the contractor the substantial benefit of diluting the proven McDonnell Company history of high earnings with the low profit levels generated by the Douglas Aircraft Division; in the year under review and finally,

(3) the pronounced lack of in-depth probing of the accounting, analysis, and review function in these areas lessens the Board's ability to make a completely accurate analysis and determination of the presence of excessive profits.

* * * * *

By combining the segments, McDonnell Company, its subsidiaries and the Douglas Aircraft Division, the Board has not exercised its authority under the statute (see General Counsel's Opinion * dated February 22, 1974) and the regulations to examine the segments separately and then to aggregate the results in arriving at a final determination; thus as noted above the contractor was accorded the benefit of having high profits of the McDonnell Company diluted by the lower profits of the Douglas Aircraft Division.

Where the determinations of excessive profits and clearances, made by the Renegotiation Board with respect to the renegotiable sales and profits of the McDonnell Aircraft Corporation and the Douglas Aircraft Company for their respective fiscal years 1965 and 1966, are compared with their sales and profits as operating divisions of the newly merged McDonnell Douglas Corporation in 1967, the final opinion rendered by a majority of the Board, graphically illustrates that the Board has not identified or recovered sufficient excessive profits.

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* (Concluding paragraph of General Counsel's Opinion dated 2/22/74): In summation, it is my opinion that the Act and regulations give the Board authority to examine segments of a contractor's renegotiable business, such as a product line, profit center or division or types of contracts and determine the excessive profits of one without the other provided the profit excesses and deficiencies resulting from such examinations are aggregated in arriving at a final determination. This approach is analogous to the treatment frequently accorded by the Board to individual members of a consolidated group.

The following schedule reflects the Board's 1965, 1966, 1967, 1968 and 1969 determinations:

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Consolidated	(FYE 12/31/67)	1,619	131	8.1%	5	7.8%
		Review Years				
McDonnell	FYE 12/31/68	$ 974	$ 88	9.1%	Cleared	-
Douglas	FYE 12/31/68	671	37	5.5%	Cleared	-
Consolidated	FYE 12/31/68	1,644	125	7.6%	Cleared	-
McDonnell	FYE 12/31/69	797	57	7.3%	Cleared	-
Douglas	FYE 12/31/69	583	29	5.1%	Cleared	-
Consolidated	FYE 12/31/69	1,381	88	6.3%	Cleared	-

Analysis of the above schedule is evidence that, for the three and one half years prior to the review years, the McDonnell Company's renegotiable earnings were substantial and Douglas Aircraft's renegotiable earnings were significantly lower. Excessive profits were recovered from the McDonnell Aircraft Company in each of those years. The two components, therefore, should have been examined and evaluated independently for each of the fiscal years 1968 and 1969 by contract type or by product line. This then would reveal the true excessive profits assessable to the McDonnell Company earnings and with such additional considerations as they may be entitled to collectively, the aggregate of the two components then would reflect the fair level of profits to be retained on a consolidated basis.

An examination of the legislative history of the Renegotiation Act of 1951, and the amendments thereto, confirms the absence of any intent by the United States Congress to exempt the multidivision corporations nor the more recently emerged conglomerates from having their renegotiable costs examined by product line, type of contract or by profit center as a means of determining the reasonableness of profits and where appropriate to recapture excessive profits, of the individual unrelated product lines, contract type or profit centers.

The fact that the contractor reported for renegotiation (RB Form 1) for the review years by averaging the sales, costs and profits of the product lines of its various divisions and subsidiaries in a consolidated report is not based on the language of the Renegotiation Act, expressed or implied.

The published Forms and Instructions for Filing Renegotiation Reports, Section 1, Paragraph 1, requires:

> If you are engaged in more than one type of renegotiable business or if you operate on a divisional basis, schedules showing operating results by principal products, services or divisions should be submitted to supplement the information in this section, separated between renegotiable and nonrenegotiable business.

The contractor's financial information furnished to the Regional Board was not, in my opinion, complete and in sufficient detail to satisfy the provisions of the Renegotiation Act and the applicable Renegotiation Board Regulations.

The Board recognized this deficiency in the contractor's filing and on November 27, 1973, issued a Notice of Points for Presentation letter pursuant to Section 105(a) of the Act, wherein the contractor was advised to be prepared to deal specifically and in appropriate detail with:

> The reasonableness of overall renegotiable profits of the consolidated group for the fiscal years 1967, 1968 and 1969, in light of the profits realized

individually by Douglas Aircraft Company and McDonnell Corporation in the years prior to the acquisition of Douglas by McDonnell.

The McDonnell Douglas Corporation, in reply to this request by letter of November 30, 1973, declined to comply and subsequently restated this refusal on December 13, 1973, at a meeting with the Members of the Board in St. Louis, Missouri. In effect, the contractor in both instances has said that it reserves the right to comply only with those sections of the Renegotiation Act and the Board's regulations that are the least adverse to its best interest.

Further, in the context of this financial data requirement as a basis of my first reason for this dissent, it is important to note that the McDonnell sales volume in 1966 and 1967 is relatively at the same level as the year 1968, with the sales of 1969 being slightly lower.

On or about April 30, 1974 the contractor agreed to a limited re-examination of the Company's books and records insofar as the consolidated filing for the review years was concerned. This examination of costs and profit records was again hampered by the limited access to the Divisional Accounting information imposed by the officers of the McDonnell Douglas Corporation.

The contractor again stressed its right of exemption to the provisions of the Act, but even more pointedly refused to allow the examination of any details of the costs of goods sold or general and administrative expenses in any way related to divisional or contract breakdown.

The information developed by the review in May 1974, although lacking in cost breakdown detail, bears out the second of my "genesis" of dissent. That is, the McDonnell Company is revealed to have generated renegotiable sales and profits for the fiscal year ending December 31, 1968 comparable to its prior years, and sales and profits only slightly lower for the fiscal year ending December 31, 1969. The Douglas Aircraft Division continued to maintain a sales volume and profit level during these two fiscal years comparable to its prior year experience.

In the fiscal year ending December 31, 1968 the F-4 phantom aircraft accounted for more than 76% of the total sales generated by the McDonnell Company. Ninety eight percent of these F-4 phantom sales were produced on negotiated fixed price incentive contracts on which the margin of profit was 9.5%.

Although the information available from the contractor does not break out the McDonnell Company's fiscal 1969 negotiated fixed price incentive fee contracts, it is noted that 72% of its total renegotiable sales were generated on negotiated fixed price incentive contracts. It would be reasonable to assume that a major portion

of the $575 million was a continuation of the F-4 phantom aircraft on which a profit of $45 million, or 7.8% of sales was earned.

The fixed price incentive fee contracts are subject to the provision of Section 105(a) and 103(e) of the Renegotiation Act and are further accountable under the Renegotiation Board Regulations:

> 1460.2(b) - Separate consideration of certain types of contracts -
>
> While renegotiation will be conducted with respect to the aggregate of the contractor's renegotiable business . . . whether fixed price or cost-plus-a-fixed-fee, which contain incentive provisions . . . will be separately considered.
>
> 1460.2(c) - Comparisons -
>
> In evaluating the contractor's performance, comparisons will be made with the prices, costs and profits of other contractors engaged in the production of the same or similar products . . . .
>
> 1460.9(a) - Statutory provision -
>
> . . . the efficiency of the contractor or subcontractor with particular regard to attainment of quantity and quality production, reduction of costs, and economy in the use of materials, facilities, and manpower; . . . .
>
> 1460.9(a)(5) - Comment
>
> Nature and objectives of incentive . . . contracts . . ., with respect to such contracts . . . in which the contract prices are based upon estimated costs, the Board will take into consideration the extent to which any differences . . . . . the contractor may, and if requested . . ., shall furnish . . . (i) a breakdown of the estimated costs . . . together with the amounts thereof . . ., (ii) a corresponding breakdown of the costs actually incurred . . . .

In compliance with these and such other of the Board's applicable regulations, the Renegotiation Board should have required that the contractor furnish a breakdown of the cost of goods sold, as well as the general and administrative and other expenses, for both the estimates on which the contract prices are based. Then this information compared with the actual cost applicable to the review year would establish a true basis upon which to apply the statutory factors including reasonableness of costs and profits as well as efficiency. In the absence of these cost details by elements of material, subcontracting, labor, overhead, etc., no true measure of the value added to the products manufactured can be made.

The rationale of quantifying assets employed, as expressed in the LTV case cited, for the purpose of statistical comparison with other contractors in the same industry employing equal amounts of their own capital does not lead to the conclusion reached in the Board's majority opinion that returns on assets employed by McDonnell Douglas "although high are acceptable".

The Tax Court held in the LTV case that use of capital supplied by others should be given favorable consideration if the usage and value were known. However, in that case the information was not available in a sufficient quantity for the Tax Court to make an evaluation and they said:

> "We cannot say with accuracy what amount or percentage of the total capital employed by Temco was supplied by others because of lack of evidence."

While the contractor, as the Final Opinion states, used some part of the Government-owned facilities having a cost value of $246.7 million in 1968 and $197.1 million in 1969 in the production of renegotiable business for these respective years, there was no evidence of the residual value of the facilities used, which would meet the minimal requirements of the LTV case.

The Tax Court concluded:

> . . . "that Temco is entitled to unfavorable consideration under this criterion to the extent that it is entitled to less return on invested capital than if it had supplied all the capital it employed." (emphasis supplied)

The McDonnell Douglas Corporation did not furnish information as to the usage and net value of the Government-owned facilities used during the review year on its renegotiable business, nor was any attempt made to compare returns on net worth with a company or companies like McDonnell Douglas. In the absence of this essential information, as viewed by the Tax Court in its consideration of the criterion for application of capital furnished by others as basis for determining the return on capital and net worth, the McDonnell Douglas Corporation is not entitled to any consideration for the use of facilities furnished by the Government in the determination that the contractor's review year returns on capital and net worth allocated to renegotiable business were 16% and 49%, respectively, in 1968, and 21% and 43%, respectively, in 1969. These returns are considered high and indicative of excessive profits.

To whatever extent the product mix as well as the contract types varied from the prior year, the F-4 fighter aircraft being produced at the McDonnell component continued to account for a major share of the renegotiable revenues in fiscal 1968 and 1969. The aircraft design changes were not more than those of succeeding generations of F-4's

and the normal advancement in the state of the art of a product that had been in continuous production for more than 9 years, generating revenues in excess of $5 billion, in addition to sales to foreign nations. All of the fixed price and fixed price incentive contracts were negotiated sole source with normal contingencies for increased quantities and accelerated deliveries negotiated into the contract price.

For the fiscal year ending December 31, 1968, the renegotiable sales generated by the McDonnell Company totaled $973.6 million, of which profits of $88.2 million, or 9.1% of sales, were earned. $786 million, or 81% of these McDonnell Company sales, were generated on fixed price incentive contracts, of which profits of $75.4 million, or 9.6% of sales, were earned on these FPIF contracts.

For the fiscal year ending December 31, 1969, the renegotiable sales generated by the McDonnell Company totaled $797.3 million, of which profits of $57.9 million, or 7.3% of sales, were earned. $574.7 million, or 72% of these McDonnell Company sales, were generated on fixed price incentive contracts, of which profits of $44.8 million, or 7.8% of sales, were earned on these FPIF contracts.

The record shows that these negotiated fixed price incentive fee contracts were based on favorable cost sharing formulas. Information was not available to evaluate these formulas.

In summary, based on the limited information available and for the reasons heretofore expressed, the McDonnell Company has continued to generate substantial profits on its renegotiable business, as shown above. It is further noted that even these profits have been diluted by losses generated by the wholly-owned subsidiaries for whom the parent (McDonnell Douglas Corporation) is the agent.

I have concluded that the McDonnell Company has excessive profits at least in the amount of $16,000,000 for the fiscal year ended December 31, 1968.

The aggregate of the adjusted sales and profits, after removal of $16,000,000 of excessive profits for the fiscal year ended December 31, 1968, would be as follows:

(In Millions $)

	McDonnell Company	Douglas Aircraft Division	McDonnell Douglas Corporation Consolidated
Sales	$ 958	$ 671	$ 1,628
Profits	72	37	109
Percent	7.5%	5.5%	6.7%
Return on Capital	-	-	17.4%
Return on Net Worth	-	-	62.3%

The conclusion to be drawn from the profits generated on the McDonnell Company, negotiated fixed price incentive contracts, as shown above, indicate excessive profits were continuing to be realized on the F-4 phantom aircraft production, but in the absence of more detailed information, I am unable to specify the amount to which excessive profits were realized by the contractor for the fiscal year ended December 31, 1969.

Excerpt (Page 23) from Report of Renegotiation, Western Board, Division of Accounting Report

McDonnell Douglas Corporation (Agent)
Fiscal Year Ended December 31, 1967

c. Profit Margins

After accounting adjustments made under the Special Accounting Agreement, the difference between the profit margins on renegotiable and nonrenegotiable fixed price business of the McDonnell Component is not significant.

Because of the dissimilarities in the types of products manufactured in the renegotiable fixed price and nonrenegotiable business of the Douglas Component, a comparison of the profit margins would not be meaningful.

6. Cost of Goods Sold

a. Summary

The Contractor's accounting system did not readily provide for the determination of cost of goods sold by elements for the several types of renegotiable contracts performed by the Contractor. A comparative summary of input costs for total business is as follows:

	Total Business ($000s omitted) 1967	
	-$-	-%-
Material	718,161	31.3
Subcontracting	514,727	22.4
Subtotal	1,232,888	53.7
Direct labor	524,110	22.8
Overhead	519,468	22.6
Other costs and credits	18,471	0.9
Total cost input	2,294,937	100.0
Inventory variance	20,035	
Reclassification of state income taxes	(11)	
Intercompany eliminations	(44,614)	
Intracompany elimination adjustment	(16,507)	
Consolidated Total Cost of Goods Sold	2,253,840	

b. Material and Subcontracting

(1) Material and Customer-Furnished Materials

Material cost consisted primarily of sheet and bar stocks, and castings of various types of metals, airframe and missile parts and components, equipment and supplies. The value of Government-furnished aircraft (GFAE) equipment consisting of aircraft engines, armament, missile propulsion units, etc, was not included in the cost of sales of renegotiable business. The value of GFAE issued to the McDonnell Component, including an undetermined amount relating to nonrenegotiable Foreign Military Sales of F-4 aircraft was $553,677,100. The estimated value of GFAE issued to the Douglas Component was not available. Receiving, inspection, handling, and installation of GFAE involved costs and responsibility to the Contractor similar to those relating to purchased equipment.

Source document, Memorandum of Decision of the majority of the Board, dated April 19, 1974, referred to in Hearing of July 25.

MEMORANDUM OF DECISION

McDonnell Douglas Corporation (Agent)
(Consolidated)
St. Louis, Missouri 63166
Fiscal Year Ended December 31, 1967
Assignment No. 10354-67

The renegotiable sales and profits and the returns on capital and net worth considered by the Board in this proceeding were as follows (millions):

Sales	$1,619
Profits	131
Percent	8.1%
Return on Capital	30%
Return on Net Worth	61%

On April 28, 1967 Douglas Aircraft Company was acquired by McDonnell Aircraft Corporation and the company name was changed to McDonnell Douglas Corporation. Thus, the renegotiable business reviewed by the Board, as reflected in the foregoing figures, was the result of the combined efforts of two large companies (8 months' operations of Douglas and a full year's operations of McDonnell), which formerly had played a significant separate and independent role in the aerospace industry. Although five wholly-owned subsidiaries were included in the consolidation, the parent accounted for 99% of the renegotiable sales and all the renegotiable profits.

In view of the fact that the McDonnell and Douglas companies had been engaged in similar work in the same industry, the combination resulted in a valuable interchange of vital information and technical know-how. In addition, the organizational methods adopted by the contractor's management lent themselves, even in the first year of operations, to a smooth and orderly transition and a resulting well function-

ing corporate structure. To all extent and purpose, the identity of the two individual companies was lost on the date of the merger. Thus, the Board evaluated the contractor's business on the basis of a broad application of the statutory factors to the combined performance of the McDonnell and Douglas segments. However, the Board did give full consideration to the geographic changes in the contractor's business following the Douglas acquisition, the different types of products and contract-mix, and different labor, manufacturing, and other factors with which the contractor was confronted in this first year of combined operations.

Renegotiable business (64% of total business) consisted of the manufacture of highly specialized, advanced military aircraft, space craft, missiles, support systems and other products and certain related research, design and development work. The principal items produced in the review year were the Phantom F-4 supersonic fighter aircraft (56% of total renegotiable sales); S-IVB Saturn space vehicles (7%); manned orbiting laboratory spacecraft (7%); A-4 attack aircraft (5%); and the balance consisting of Spartan missiles; Thor and Delta launch vehicles; Gemini spacecraft; and, the F-111 crew-escape systems. There were seven different models of the F-4 manufactured in the review year, which models had varying characteristics. For example, there were five different types of engines involved, seven different radar systems, and various other differences in electronics and other components.

The advanced nature of the aircraft, spacecraft and other products required highly complex manufacturing techniques and a high degree of engineering skills and involved the utilization of substantial manufacturing and engineering facilities, specialized equipment and trained personnel. Combined material and subcontracting costs in the review year

ran about 54% of total cost of sales. Many new machining, fabricating, assembly and manufacturing techniques were developed and a large amount of research, development and design operations was conducted.

The Board considered the contractor's operations to be highly complex.

The contractor maintained very good quality and delivery standards and achieved cost reductions in the review year. The contractor also presented documents demonstrating increasingly lower maintenance time for the F-4 aircraft due to continued improvements in the aircraft. On the basis of the favorable performance and other data in the Board's files, the Board considered the contractor to be a highly efficient producer.

Approximately 19% of total renegotiable sales in the review year were under firm fixed price contracts. The comparable percentages for McDonnell Aircraft Corporation in its prior two years were 32% and 75%. For Douglas Aircraft Company the percentages for the prior two years were 32% and 30%. Fixed price incentive contracts accounted for approximately 67% of renegotiable business with cost-reimbursement type contracts accounting for the remaining 14%. Almost all of the firm fixed price business consisted of the production of F-4 and A-4 aircraft and bomb racks, all of which were procured by the Government on a negotiated sole source basis. Most of the fixed price incentive sales involved the F-4 Phantom aircraft which had been produced in unusually large quantities in previous years, including 1,000 of the Phantom aircraft that had been delivered under firm fixed price contracts in prior years. Although the contractor had gained experience

on the F-4 and A-4 in earlier years and enjoyed a favorable cost-sharing curve on its incentive business, the Board considered that the contractor did assume significant pricing risk in the review year particularly because of the number of models manufactured.

The contractor contended that it assumed risk by increasing the production of F-4 aircraft to a peak rate of 71 per month in the review year compared with a monthly rate of only 40 in January, 1966. During the production build-up, employment increased by 10,000. Since there were no other aircraft or similar manufacturers in the St. Louis area, the contractor faced a serious shortage of experienced workers. As a result, it had to lower its employment standards and hire employees some of whom did not even have a high school education. The Board recognized that the contractor assumed some / risk in this regard.

At the time of its acquisition by McDonnell Aircraft Corporation, the Douglas Aircraft Company was experiencing severe financial difficulties due to large losses on commercial business. Accordingly, McDonnell assumed a great financial risk in the merger with Douglas Aircraft Company and this redounded to the Government's benefit, in that the Douglas productive capabilities still continued in the performance of Government contracts. The Board favorably considered this risk.

During the review year the contractor had the use of Government-owned facilities with a cost value of $236.7 million and was also furnished substantial Government progress

payments showing an unliquidated balance of $385.3 million at the end of its fiscal year. The Board recognized that all the $236.7 million of Government-owned facilities were not utilized since some were not adaptable to the review year renegotiable business. The ratio of the cost of Government facilities to the total cost of Government and contractor facilities ($236.7 million divided by $589.3) is 40.2% of such total.

In evaluating the contractor's performance under the capital-employed factor, the Board, to the extent possible, relied on specific identification of assets in computing returns rather than to follow the customary practice of allocating capital employed to renegotiable business on the cost-of-sales ratio. Such returns are stated on the basis of contractor's books at the beginning of the year and are without regard to the amount of Government-furnished equipment described above. As so computed, the contractor's review year returns on capital and net worth allocated to renegotiable business were 30% and 61%, respectively, and for the reasons cited above, they were not comparable to the prior years' returns.

The Board considered the contractor's returns on capital and net worth in the review year to be high and indicative of excessive profits, but should be considered in light of the following comments by the Tax Court in the LTV case:

"First,.....where a contractor risks relatively little of its own capital it is primarily a manager of property, and thus not entitled to as great a return for risk-taking as a contractor which supplies its own assets. Secondly, whereas a contractor which uses its own assets is entitled to an element of return equivalent to the rental value of the assets, a contractor using the assets of others is not. For these reasons, a contractor using largely public capital -- either rented property or Government-furnished property -- is not entitled to as large an absolute amount of profit as a contractor using its own property."

"It does not follow that the contractor using capital supplied by others is necessarily entitled to a smaller rate of return on its own net worth. Profit is in part a payment to an entrepreneur for the productive use of assets. A contractor is entitled to an appropriate profit for such use based on the total capital it employs in its renegotiable business, whether the capital is owned by it or by others. Cf. sec. 1460.11(b)(3), R. B. Regs. Two companies making the same kind of use of the same amount of capital should be entitled to the same amount of entrepreneurial profit, whatever the source of such capital. However, this entrepreneurial profit will inevitably be a larger percentage of the net worth of a company using primarily public capital than one using primarily its own capital. Therefore, the total profit -- the return on invested capital plus the entrepreneurial profit -- will be a larger percentage of the net worth of the contractor using public capital."

(See LTV vs. the Renegotiation Board - 51 TC 405)

Thus, because of the utilization of a large amount of public capital, i.e. Government-furnished equipment, the returns on capital and net worth in the instant case, after refund, are higher than the Board would consider reasonable were the foregoing facts not present.

Procurement sources largely considered the contractor to be an average cost producer in the review year. The contractor's material and labor costs showed a decline and, in the Board's opinion, on an overall basis, the contractor's costs were reasonable and well-controlled.

The following is a comparison of the contractor's review year renegotiable sales, profits, and profit margin, as a percentage of sales, with those of McDonnell and Douglas in prior years (millions):

	Sales	Profits	Percent
Review Year	$1,619	$ 131	8.1
McDonnell (6 mos. ended 12/31/66)1/	560	47	8.5
FYE 6/30/66 2/	984	80	8.1
FYE 6/30/65 3/	991	75	7.6
Douglas (4 mos. ended 4/28/67)	245	13	5.2
FYE 12/31/66	560	32	5.7
FYE 12/31/65	510	18	3.4

1/ After refund of $7 million
2/ After refund of $27 million
3/ After refund of $8 million

The Board found that the contractor realized excessive profits in the amount of $5,000,000 in the year under review, and the entire amount of excessive profits was allocated to McDonnell Douglas Corporation and the contractor has indicated its willingness to enter into an agreement for the elimination of such excessive profits. The effect of the Board's finding is to leave the contractor with adjusted renegotiable sales and profits as follows (millions):

Sales	$1,614
Profits	126
Percent	7.8%
Return on Capital	29%
Return on Net Worth	59%

Richard E. Rapps
Secretary to the Board

THE RENEGOTIATION BOARD
COORDINATION SHEET

This form not for routing mail. Attach firmly to central file (green) copy. This form must accompany all documents for signature of board members, office and division directors, as listed.

TITLE AND DESCRIPTION OF ATTACHED DOCUMENT

MEMORANDUM OF DECISION: MCDONNELL DOUGLAS CORPORATION (AGENT) (Consolidated) FYS 12/31/67

DATE INITIATED: 4/9/74

Mr. Dugan

INDORSEMENT OF INITIATING OFFICE OR DIVISION

This proposed document is a complete and clear statement of all essential facts, all essential data are accurate, and in my judgment its release is appropriate to the circumstances.

Concurrences of all offices concerned with the subject matter are checked below.

DATE: April 9, 1974 SIGNATURE: R. H. Harrison, Deputy Director, Office of Review (Director, Initiating Office or Division)

CONCURRENCES OF OTHER OFFICES

(Initiating office must obtain all necessary concurrences and will indicate by check (✓) mark all offices concerned with the subject matter of proposed document.)

CONCURRENCE

✓	OFFICE OR DIVISION	CONCURRING SIGNATURE OF OFFICE OR DIVISION DIRECTOR, OR AUTHORIZED ALTERNATE	DATE RECEIVED	DATE FORWARDED
	BOARD CHAIRMAN			
	BOARD MEMBER (INDICATE NAME)	Mr. Chase		
	BOARD MEMBER (INDICATE NAME)			
	BOARD MEMBER (INDICATE NAME)			
	BOARD MEMBER (INDICATE NAME)			
	ADMINISTRATION			
	ECONOMIC ADVISOR			
	ASSIGNMENTS			
	SECRETARY TO THE BOARD			
	COUNSEL			
	REVIEW			
	SCREENING AND EXEMPTIONS			
	ACCOUNTING			
	PROCUREMENT AFFAIRS			
	RENEGOTIATING			

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Source documents, Items 18, 18A and 18B of information furnished at Hearing of July 25, 1974 concerning study of product line renegotiation in response to Brooks Committee Report.

1. Product Lines

2. Conglomerates

We have combined the two subjects for the purpose of this paper because of the similarity of the problems of the two, e.g. conglomerates typically produce a wide variety of products.

Recommendations of Others
Concerning Product Line Renegotiation
and Renegotiation of Conglomerates

Brooks' Subcommittee

The Brooks' Subcommittee has recommended that contractors' sales be classified according to individual commodity groupings and base renegotiation on product line sales rather than basing renegotiation on total company sales. To facilitate renegotiation on a product line basis, contractors should be required to report costs and profits on defense contracts over $100,000 on a contract-by-contract basis. These cost and profit reports should be audited by Defense Department auditors prior to submittal. [(d)(4)]

Reexamine and modify as necessary the renegotiation process to compensate for the impact that corporate mergers and acquisitions have had on the renegotiation process. Consideration should be given to eliminating the loopholes that allow conglomerates, through fiscal operations and overhead allocations, to frustrate or void the recoupment of what otherwise would constitute excessive profits under the act. [(d)(7)]

Commission on Government Procurement

The Commission made no recommendation concerning product line renegotiation nor the renegotiation of conglomerates.

General Accounting Office

The Comptroller General of the United States in his report dated May 9, 1973 (Report #B-163520) made no recommendation concerning product line renegotiation nor the renegotiation of conglomerates.

Development in Other Areas
Concerning Product Lines Financial Data

In the course of conducting renegotiation by product lines -- as recommended by the Brooks' Subcommittee -- it should be noted that the Federal Trade Commission and the Securities and Exchange Commission have projects, the objective of which is more refined financial data.

Federal Trade Commission

For many years, the Federal Trade Commission has been publishing on a quarter-annual basis financial data concerning return on sales and capital and net worth on 31 industrial classifications. These classifications, by reason of being limited to 31, naturally cover very broad industries. For approximately one year, we have been using the results of this report by the Federal Trade Commission in the screening operation.

For several years, the Federal Trade Commission has been working on a project whereby it would develop financial data covering smaller segments of industry. The Federal Trade Commission has developed its own four-digit classification for industries. These new groupings in contrast to the present larger groupings, which cover only manufacturing efforts, would include the non-manufacturing sector of industry. There has been a substantial amount of industry opposition to furnishing such data to the Commission. Nevertheless, the project now seems to be at the point where the F.T.C. believes that in the near future this project will generate financial data from companies' 1973 activities.

Securities and Exchange Commission

The SEC for several years has required the disclosure in registration statements of the approximate amount or percentage of total sales and operating revenues and of contribution to income before income taxes and extraordinary items attributable to each line of business which

contributed to certain portions of (1) total sales and revenues or (2) income before income taxes and extraordinary items. For companies with total sales and revenues over $50 million, the proportion is 10 percent; for smaller companies, 15 percent. Similar disclosure is also required with respect to any line of business which resulted in a loss of 10 percent or more (or 15 percent or more for smaller companies) of such income before deduction of losses. The term "line of business" is left largely to the discretion of management.

Thus, it is concluded that there is a strong probability that significantly more data will be available for use in making comparisons along product lines bases, at least to the degree of four-digit classification numbers.

Provisions of Statute and Regulations

The recommendation of the Brooks' Subcommittee concerning renegotiation being conducted on the basis of commodity groupings or product lines seems to imply that the Board should look at financial data by such groupings and thereby could find excessive profits in one or more while at the same time ignore other groupings with small profits or even losses.

The initial question is, does such a suggestion conflict with the statute or the Board's regulations?

Section 105(a) of the Act provides that "The Board shall exercise its powers with respect to the aggregate of the amounts received or accured during the fiscal year (or such other period as may be fixed by mutual agreement) by a contractor or subcontractor under contracts with the Departments and subcontracts, and not separately with respect to amounts received or accrued under separate contracts with the Departments or subcontracts except that the Board may exercise such powers separately with respect to amounts received or accrued by the contractor or subcontractor under any one or more separate contracts with the Departments or subcontracts at the request of the contractor or subcontractor."

The Board's regulations provide:

(a) "This provisions requires . . . . that renegotiation be conducted on an over-all basis unless the contractor and

the Board agree that renegotiation be conducted with respect to its contracts separately or as two or more groups." (RBR 1457.1(b))

(b) "General Policy.--Reasonable profits will be determined in every case by over-all evaluation of the particular factors present and not by the application of any fixed formula with respect to rate of profit, or otherwise." (RBR 1460.8(a))

The foregoing provisionsare, we believe, those responsible for the statement that renegotiation is conducted on an over-all basis. Some seem to have concluded and practiced the theory that by reason of over-all renegotiation, one must, in the case of some contracts or product lines with small renegotiable profits or losses, bring such contracts or product lines to a reasonable level of profit before considering excessive profits in other areas of the case. This is said to be without regard to the circumstances which caused the low profits or losses.

Upon reflection, we believe there is nothing in the statute or the regulations that require such a result if due regard is given to the circumstances which caused the low profits or losses in some product lines.

Thus, to accomplish that part of the recommendation of the Brooks' Subcommittee, is, in our view, only a matter of a policy declaration by the Board and no change would be required in the Act or the regulations. In fact, such principle has been used in a recent case by the Board.

Recommendation: It is recommended that the Board establish such a policy for the use of the Board's staff and for the information of contractors.

Renegotiation Board Procedures

The Board has long followed the practice in making determinations as to the reasonableness or excessiveness of renegotiable profits of comparing the contractor with other contractors who manufacture the same or substantially similar products or others who furnished substantially similar services or others who utilized substantially similar manufacturing techniques or technical abilities. The Board has been locating such com-

parisons by utilizing the four-digit Standard Industrial Classification number (SIC number).

In addition to utilizing the SIC number for the purpose of locating possible comparisons within the Board's own files, the SIC number is used to gain access to "industry" figures from the Statistics of Income published by the Internal Revenue Service. The word "industry" as used here may be misleading in that the Internal Revenue Service statistics include within a given four-digit classification the total figures of a multiple industry taxpayer. Such a taxpayer is assigned to that four-digit group which includes that taxpayer's major product line even though that line may be only a relatively small portion of the total business.

Thus, the Board has a long history of using as comparisons (1) financial data of other contractors producing the same or similar products or (2) financial data from IRS or other sources of an "industry". Of course, the former is subject to the deficiency that the Board may have only a few or no comparisons in its files and the latter is subject to the deficiency of the "industry" being so broad in character as to have limited usefulness.

Reporting Contract Costs and Profits on a Contract-by-Contract Basis

Another recommendation of the Brooks' Subcommittee is that to facilitate renegotiation on a product line basis, contractors should be required to report costs and profits on defense contracts over $100,000 on a contract-by-contract basis. These costs and profits should be audited by Defense Department auditors prior to submittal.

The concept of contract-by-contract renegotiation was the basis of the 1942 Renegotiation Act. History discloses that such a basis was quickly abandoned (five months after its initiation) by the 1943 Renegotiation Act for the current practice of renegotiation on a fiscal year basis. Under Secretary Patterson testified thereon as follows:

> ". . . . Excessive profits can be determined more quickly and accurately by an over-all study of a company's financial position and the profits, past and prospective, from its contracts taken as a whole than by analyzing each individual contract on a unit-

cost basis. In addition, this greatly simplifies the work of the board and of contractors by reducing the number of renegotiations by avoiding the necessity of allocating costs among the various contracts to determine the profit on particular contracts. It is believed that this method carries out the purpose of the statute, but it might well be expressly authorized -- and so an amendment so provides." (Hearings on Section 403 of Pub. Law No. 528 Before a Subcommittee of the Senate Comm. on Finance, 77th Cong., 2d Sess. - 1942)

Recommendation: In the light of the trial which has already been accorded contract-by-contract renegotiation, together with the prompt discontinuance thereof (5 months), it is recommended that the Board not recommend initiation thereof again.

As to the audit by Defense Contract Audit Agency, the Renegotiation Board regularly contacts DCAA for audits of total indirect expenses and amounts allocable to Government business. With respect to direct cost audits, experience indicates that exceptions by DCAA are minimal and as a rule such reports are not requested by the Board. The audits of total indirect expenses and amounts allocable to Government business are regularly requested and used in the course of processing an assigned case and in the case of screening every filing by a member of the 100 largest DOD suppliers.

It might also be noted that there are no DCAA audits available of competitively bid contracts. In the case of firm fixed price negotiated contracts, DCAA's involvement is limited to Truth in Negotiation (defective pricing). Generally, DCAA information is not requested with respect to firm fixed price subcontracts. In the future, it is anticipated that DCAA activities with respect to a contractor's disclosure statement under the Cost Accounting Standards Board requirements will be helpful.

Conglomerates

One might define a conglomerate as follows: An economic entity (consolidated) involved in different markets, different production processes and technologies, and, probably, having different planning strategies.

The definition evidences that a conglomerate includes an entity with multiple product lines.

Conclusion: Thus, it is evident that if the Board concurs in the above recommendation concerning product line renegotiation, that policy by its very terms would include conglomerates.

H. M. Chick

K. C. Behrens

Excerpt from Agenda Minutes, February 20, 1974:

THE RENEGOTIATION BOARD
Wednesday, February 20, 1974

3. McDonnell Douglas Corporation (Agent) (Consolidated) (1967, 1968 and 1969)
Class A Cases - Review

Reference was made to the action of the Board on July 31, 1973 (Minutes No. 1838-11), deferring renegotiation proceedings for MCDONNELL DOUGLAS CORPORATION (AGENT), consolidated with: ACTRON INDUSTRIES, INC., Successor-in-Interest to: ADVANCED COMMUNICATIONS, INC., TRIDEA ELECTRONICS COMPANY, MCDONNELL DOUGLAS CORPORATION, Successor-in-Interest to: CONDUCTRON CORPORATION, MCDONNELL AUTOMATION COMPANY OF COLORADO, MCDONNELL AUTOMATION COMPANY OF TEXAS (formerly known as MCDONNELL AUTOMATION CENTER OF TEXAS, INC.), "Members of an Affiliated Group", fiscal year ended December 31, 1967, until the Board could consider this contractor's 1968 and 1969 fiscal years at the same time.

There was submitted to the Board the memorandum dated February 14, 1974 (Exhibit B), of Mr. Park, Special Assistant to Mr. Rinehart. Mr. Rinehart served as the Division Chairman in this case, in connection with the reviews of the recommendations of the Western Regional Board that the subject contractor realized excessive profits in the gross amount of $5,000,000 for the fiscal year ended December 31, 1967 (the entire amount was allocated to McDonnell Douglas Corporation), and that the subject contractor realized no excessive profits for the fiscal years ended December 31, 1968 and 1969. The aforementioned memorandum read, in pertinent part, as follows: "On the basis of the foregoing and considering all available information pertaining to these cases, the Division recommends that the Board enter into an agreement with the contractor that it realized excessive profits in the FYE December 31, 1967 in the gross amount of $5 million subject to appropriate tax credits. The division also recommends that the Board find that the contractor did not realize excessive profits in the FYE December 31, 1968 and December 31, 1969. The Board should also direct that a Memorandum of Decision be prepared for the agreement and findings of no excessive profit."

Mr. Chase requested the Board to defer the final vote on the Division's recommendations until Mr. Rinehart, the Division Chairman, returned to Washington and was present. In support of his request, Mr. Chase advised he desired more time to study certain aspects of the case which he felt were of major significance. Discussion followed. Mr. Rinehart had informally advised by telephone that he wished the Board to act on the recommendations at today's Board meeting.

On motion, the Chairman, Messrs. Houston and Mattingly voted to approve the Division's recommendations. Mr. Chase dissented and will state his views in writing in the Memorandum of Decision.

A refund agreement will be entered into whereby the Board and this contractor determine and agree to the elimination of excessive profits in the amount of $5,000,000 (subject to appropriate adjustment on account of state and Federal income taxes) for the fiscal year ended December 31, 1967. The entire amount is allocated to McDonnell Douglas Corporation. A Clearance Notice will be issued to the contractor by the statutory Board for each of the fiscal years ended December 31, 1968 and 1969. The Board directed that a Memorandum of Decision be prepared with respect to these cases, a copy of which will be furnished the contractor.

4. Equipment, Inc. (1966, 1967 and 1968)

Reference was made to the action of the Board on September 13, 1973 (Minutes No. 1844-12), rejecting the offer of EQUIPMENT, INC., to enter into a renegotiation agreement for the elimination of excessive profits in the gross amount of $2,000,000 for the fiscal years ended December 31, 1966, December 30, 1967 and December 28, 1968, and finding that this contractor realized excessive profits in the amount of $6,000,000 (subject to appropriate adjustment on account of state and Federal income taxes) for the fiscal years indicated. On November 14, 1973, the Board furnished the contractor with a Memorandum of Decision explaining the basis for the Board's findings of refunds in the gross amounts of $3,000,000, $2,500,000 and $500,000, respectively, for the foregoing fiscal years. By letters dated December 13, and 14, 1973, the contractor's counsel requested other information from the Board with respect to the Memorandum of Decision the Board furnished the contractor. The Board replied by letter dated January 31, 1974. By letter dated February 14, 1974, the contractor's counsel advised the Board that the contractor did not wish to enter into an agreement to refund the aforementioned amounts of $3,000,000, $2,500,000 and $500,000, found by the Board to be excessive profits for the subject fiscal years, respectively.

There was submitted to the Board the memorandum of Mr. Park, Special Assistant for Mr. Rinehart, Monitor for this case, dated February 15, 1974, relative to the foregoing (Exhibit C).

STATUS OF OPINION

Mr. WHITEHEAD. Senator, may I say something?

You referred to the withdrawal of the opinion. There was never a filing of the opinion. It was in an informal statement, and it was available to Mr. Chase constantly. We didn't file a formal opinion until it was dispatched to the contractor without the dissenting opinion. Therefore the original was available to him and the revised which contained some figures that brought it up to date, and were not substantial at all in character.

STAFF PEOPLE RETURNING TO PLANT

Senator PROXMIRE. Will you supply us for the record with the names of the staff people who went back to the plant after the first opinion; that is, on or about May 22?

Mr. WHITEHEAD. Yes, sir. I have already done that. I will be happy to do it again, sir.

[The information follows:]

Mr. Robert Moreland
Mr. John Perkowski

STATUS OF DISSENTING OPINION

Senator PROXMIRE. Now Mr. Chase, let me ask you: Did Mr. Whitehead or did any other member of the Board do anything other than discuss your reasoning and your arguments for the purpose of getting you to not file a dissent or to change your dissent?

Mr. CHASE. Well, they were attempting to persuade me to change my dissent, certainly. That is why they sent the people out to St. Louis. Yes, indeed, they did.

Senator PROXMIRE. What did that have to do with changing your dissent?

Mr. CHASE. Not a thing. I never changed my dissent, but I did expand certain aspects of the original dissent.

Mr. WHITEHEAD. Mr. Houston would like to comment.

Senator PROXMIRE. What makes you think that they sent them out to change your dissent?

Mr. CHASE. I couldn't answer that.

Mr. WHITEHEAD. Mr. Houston, a Board member, would like to——

Senator PROXMIRE. Mr. Houston, go ahead.

REASONS FOR SECOND PLANT VISIT

Mr. HOUSTON. Senator Proxmire, I would like to indicate that Mr. Chase is not altogether correct in indicating that the Board did not issue that memorandum of opinion simply because it wanted to gather additional information to satisfy him or to cause him to change his opinion. There was at least one member of the Board, namely myself, that was interested in some of the points raised by Mr. Chase, and certainly that was one of the reasons why I was in favor of withdrawing that particular memorandum of decision.

I would like to indicate also that the sending of an additional staff person out to St. Louis later on, again was not simply to satisfy

Mr. Chase. It was also to provide the Board with additional information, and in my case I was concerned about whether or not the additional information gathered would satisfy my own mind regarding the validity of the majority decision, and it did.

Senator PROXMIRE. All right, sir.

Now, let me ask Mr. Chase how many staff persons of the Board are assigned to you personally as a member of the Board?

Mr. CHASE. Mr. Davis and Mrs. Lloyd.

Senator PROXMIRE. And what staff resources did you have to assist you in a case such as this when you find it necessary to dissent?

Mr. CHASE. I beg your pardon?

Senator PROXMIRE. I'm asking you how many staff people you have available to help you in developing your position and your opinion and in analyzing the situation and so forth?

Mr. CHASE. Only Mr. Davis and Mrs. Lloyd.

Senator PROXMIRE. Only Mr. Davis?

Mr. WHITEHEAD. Senator, each Board member has a special assistant, and in my case he is designated as the executive assistant. Mr. Chase has the same accessibility to any staff member, and he has made use of the staff itself outside his own immediate office.

Senator PROXMIRE. All right.

Let me ask you, Mr. Chase, in your judgment did you have adequate staff assistance in this case, and are there adequate staff resources generally on the Board?

Mr. CHASE. Must I answer that question?

Senator PROXMIRE. Yes, sir.

You see, one of the functions of this subcommittee is to provide funds for the Board so that it can do its job, and I think this goes right to our legislative function and responsibility.

Mr. CHASE. Mr. Chairman, I told you some time ago that I have limited experience in the specific area of renegotiation, and I did everything I could to learn as much about it as I could as soon as possible. When the McDonnell Douglas case came along, I called on Mr. Grenough and another gentleman in the office to give me a hand and advise with me on some of my conclusions. At a later date I was told that I was not to consult with any member of staff, general counsel, or any department head, and that left me entirely alone with my assistant to perform the analysis functions.

Senator PROXMIRE. Now, who told you that?

You said you were told.

Mr. CHASE. The Chairman.

Senator PROXMIRE. Mr. Whitehead told you that?

Mr. CHASE. Yes, sir.

Senator PROXMIRE. Do you remember the date he told you that?

Mr. CHASE. No, I do not.

Mr. WHITEHEAD. Mr. Chairman, Mr. Chairman.

Senator PROXMIRE. Just a minute, Mr. Whitehead. I want to get Mr. Chase's response.

Do you have any evidence that he told you that?

LOG

Mr. CHASE. Yes, sir, I have a log.

Senator PROXMIRE. You have a log?

Mr. CHASE. Yes, sir.

Senator PROXMIRE. Will you make that available for the record?

Mr. CHASE. I'll make that part of it available when the hearings resume.

Senator PROXMIRE. Fine, that will be acceptable.

USE OF HEADQUARTERS STAFF

Mr. Whitehead.

Mr. WHITEHEAD. Mr. Chairman, never did I tell Mr. Chase not to utilize the staff for any purpose whatsoever. I did say to him one day, you are tying up the staff to a great extent on a number of matters, and it is making it impossible for them to complete the day-to-day work that comes up. Never was McDonnell Douglas mentioned at any time.

Senator PROXMIRE. Now, Mr. Whitehead——

Mr. WHITEHEAD. From an administrative standpoint, I've got to keep the work moving, and the staff cannot be in his office a great part of their time and complete their own respective responsibilities, sir.

Senator PROXMIRE. Now, Mr. Whitehead, one of the very vital functions of the Congress is to see that agencies such as this, if they are going to remain in existence, do an effective job. You cannot do an effective job unless members of the staff have access to adequate staffing. If the staffing is not adequate, you can come to the Congress, come to this subcommittee—that is our responsibility—and tell us that you need more funds. And that has been one of the questions we have been persistently asking here, one of the fights I have been making for as long as the last 10 years, to provide the Renegotiation Board with the kind of personnel it needs, the kind of staffing it needs, so that the personnel can do the job it should do.

Now, it seems to me that Mr. Chase certainly should, in a case of this enormous dimension and complexity, have an opportunity to have more than one assistant. Mr. Davis appears to be an extraordinarily competent man, but one man cannot possibly cope with a situation of this complexity, it would seem to me, within this period of time.

If you tell a staff member, under these circumstances—and you just say you told him that he is tying up members of the staff—it seems to me that any intelligent staff member could consider the Chairman's responsibility and would be inclined to feel intimidated that he should not use the staff for the purposes——

Mr. WHITEHEAD. That is absolutely untrue, sir, in all due respect to you. Mr. Chase used an inordinate amount of the staff's time for every nitpicking subject that there was that came up. And you can poll the staff people here now, if you care to. I just feel that if a staff director is tied up in one Board member's office for an inordinate amount of time, and for matters which he can gain from his administrative assistant or the administrative assistant can gather, that would suffice.

Senator PROXMIRE. Let me get a specific answer to this.

Mr. CHASE. Mr. Chairman, I would like to respond to that.

Senator PROXMIRE. All right.

Mr. CHASE. I would appreciate it if you would poll every man here who is a staffman and ask him how many times I consulted with them. I was told that I couldn't do this. I must say however, that I agree

with you as regards the staff. And if the Chairman is going to take the position that inquiring of the staff about one of the largest defense contractors in the United States, with $1,623 million in contracts in 1 year, is nitpicking, then I have lost my faith in the renegotiation process.

Mr. WHITEHEAD. I said "on other business." I never talked to him about using the staff on McDonnell Douglas. There were other matters that came to the fore which his administrative assistant could obtain readily by going to the staff directors or their staffs to obtain such information. McDonnell Douglas was never mentioned to him, and I resent very much him implicating—making the record look as if I am trying to defend a defense contractor. My record is open and clean, and that is the way it is going to continue to be.

Senator PROXMIRE. Now, may I ask the people who are here today who are members of the staff of the Renegotiation Board to rise, any member of the staff to rise.

All right sir; now there are five of you. I am going to ask each of you—you can all sit down—I am going to ask each of you in turn whether or not Mr. Chase asked you about these matters in such detail and with such persistence that it, in your view, made it impossible for you or difficult for you to do the job that you feel you should do.

Let's start right here.

Yes. sir.

POLLING OF HEADQUARTERS PERSONNEL

Mr. LENCHES. My name is George Lenches. I am Director of the Office of Planning and Analysis. I am not in the line service in the renegotiation of cases. Mr. Chase has no opportunity to ask me and he has not asked me anything about it.

Senator PROXMIRE. All right.

Now I am going to ask Mr. Lambert, I hope you will wait for a little later, Mr. Lambert: I will come to you a little later. I have some specific questions for you.

Yes, sir.

Mr. GRENOUGH. My name is Donald Grenough. I am the Director of the Office of Accounting. I have had frequent contacts with Mr. Chase, as have members of my staff. Inordinate is a relative term, but I will say that I have spent time and my staff has spent more time for him in the last 6 months than with other Board members.

Senator PROXMIRE. Do you feel that his inquiries have been nitpicking and have been so excessive that they did interfere with your ability to do your job or that of your staff?

Mr. GRENOUGH. I would not use the term "nitpicking," sir; I would view it as part of a learning process, as I perceived it, from Mr. Chase's point of view. It was time consuming, and part of it was relatively mundane, but not all of it; in the sense that he did not have a background in certain things that other members of the Board had.

Senator PROXMIRE. Did you complain or did other members of your staff complain to the chairman that you were being bothered too much by Mr. Chase?

Mr. GRENOUGH. No, sir. But it is not—if I may put that in perspective, sir—it is not the type of point that I would go to the chairman and indicate that Mr. Chase is spending, in my opinion, too much of my time or my staff's time.

Senator PROXMIRE. Well, in your opinion, was he spending too much of your time? Taking too much of your time?

Mr. GRENOUGH. No, sir.

Senator PROXMIRE. He was not.

All right, the next gentleman—no, not Mr. Lambert.

You are Mr. Lambert; we want to save you for a little later.

Mr. HARRISON. All right, sir. My name is William Harrison. I am the Acting Director of the Office of Review.

During the period in question I was the Deputy Director of this office and was not, therefore, directly connected with and could not speak for the entire time that members of that staff took with Mr. Chase. My personal contact has been very minimal with Mr. Chase.

If the Director were here, I'm certain he could answer that question far better, sir.

Senator PROXMIRE. All right, sir.

Mr. STONE. My name is Harold Stone, Mr. Chairman. I am the Director of the Office of Administration. It is not a part of my responsibility to assist in the processing of cases; of the decisionmaking process; so Mr. Chase would not have any occasion to discuss cases with me. And in this particular case, he did not.

Senator PROXMIRE. All right.

Let me first ask Mr. Whitehead—did you instruct Mr. Lambert to not give or to stop giving legal advice to Mr. Chase in connection with his dissent in the *McDonnell Douglas* case or in any other case?

ROLE OF GENERAL COUNSEL

Mr. WHITEHEAD. I suggested to Mr. Lambert that he prepare a memorandum for the Board where a policy was involved, and that the memorandum be addressed to the Board as a whole, and not to Mr. Chase, so that we would be well informed as to what is going on. That is the extent of it, sir.

Senator PROXMIRE. Then I am not sure you answered my question.

Did you instruct Mr. Lambert at any time to not give or to stop giving legal advice to Mr. Chase in connection with his dissent in the *McDonnell Douglas* case or in any other case?

Mr. WHITEHEAD. The answer is no, except that I wanted the rest of the Board members to have the same information. That was the qualification.

Senator PROXMIRE. All right.

Mr. Lambert, I know it is distasteful for you to be placed in the middle. I would like for you to tell us whether Mr. Whitehead or anyone else on the Board advised, suggested or instructed you to stop giving or refrain from giving legal advice or other assistance to Mr. Chase in connection with the *McDonnell Douglas* case or any other case.

Mr. LAMBERT. Mr. Chairman, my job is to provide legal counsel to the Board as a whole, and the individual members of the Board as

they request it. And I have provided this counsel and made my services available whenever that was necessary or whenever it was requested.

Mr. Chase has requested my counsel, as have other members of the Board.

So, to answer your question, as to whether I was told that I was furnishing too much assistance to Mr. Chase, I am sorry to say that the answer is "Yes."

Senator PROXMIRE. All right, now, were you told that you stop giving or refrain from giving legal advice or other assistance to Mr. Chase?

Mr. LAMBERT. To refrain from it?

Senator PROXMIRE. Yes.

You have told us now that you were told that you were giving too much. Were you told to stop giving advice to Mr. Chase?

Mr. LAMBERT. I was told to stop giving legal assistance to Mr. Chase personally.

Senator PROXMIRE. Was it in connection with McDonnell-Douglas?

Mr. LAMBERT. In connection with anything, sir. And I followed those instructions.

Senator PROXMIRE. Can you provide us with details as to the dates, time, place and so forth, to the best of your knowledge?

Mr. LAMBERT. Mr. Chairman, I don't wish to be nonresponsive and I don't intend to be. I think these are questions which I have a great deal of difficulty finding the relevance to the subject at hand. However, it you wish me to continue, I will.

Senator PROXMIRE. Well, let me tell you what the relevance is.

We have a matter of the greatest importance to the taxpayers and to the country and to the defense of the country. This is a very important contractor, one of the very biggest, as you know. We have a dissent here, and I think a dissent which has a great deal of merit. It may or may not be right, but it has a great deal of merit. And I think that the capability of a man like Mr. Chase, his ability to be independent and make his own, arrive at his own opinions, depends upon the quality of legal advice and other advice and technical advice and assistance that he can get. In the event that you are not in a position to provide him with that, if you were told by the chairman not to do it or to give him less or less than he needs, it seems to me that the taxpayer is not being well served, the Government is not being well served; and, in my view, the law is not being properly executed.

Do you not think that is relevant?

Mr. LAMBERT. Mr. Chairman, I do not disagree with that. I feel that this is a subject which—it certainly is important to you, or you wouldn't ask the question—but it certainly puts me and the other members of the staff in a very awkward position. I think that the relevancy aspect of the problem is worth stating.

Now, you asked me whether I was told not to furnish additional assistance to Mr. Chase, and the answer was yes.

As an alternative to that, I offered other members of my staff, and he said he would wait until I was free to respond to his requirements.

Senator PROXMIRE. When were you told this? What was the date?

Mr. LAMBERT. Specifically, it was June 21.

Senator PROXMIRE. That was in connection with the McDonnell-Douglas case?

Mr. LAMBERT. No, sir.

Senator PROXMIRE. All cases?

Mr. LAMBERT. It was in connection with the fact that I was giving too much assistance to Mr. Chase, and I was advised that it was not in my best interest to continue to do so.

Mr. WHITEHEAD. Mr. Chairman, may I——

Senator PROXMIRE. Was this not when Mr. Chase was trying to write his dissenting opinion, his final dissenting opinion?

Mr. LAMBERT. I believe it would be in the same time.

Senator PROXMIRE. Yes; he said July 2 was the time his final opinion was filed.

All right, now, do you know of any other members of the staff that were similarly instructed?

Mr. LAMBERT. There were two other members of the Board, sir, that Mr. Whitehead advised with me who were of the same view, and I asked who they were.

Senator PROXMIRE. You say of the same view. You are referring to what?

Mr. LAMBERT. Of furnishing too much assistance to Mr. Chase.

Senator PROXMIRE. Oh, I see; I see.

Now, Mr. Whitehead told you that, or the other members of the Board?

Mr. LAMBERT. Mr. Whitehead told me that.

Senator PROXMIRE. I see.

Mr. MATTINGLY. Mr. Chairman, if I could speak——

Senator PROXMIRE. Did the chairman threaten to fire you if you did not stop?

Mr. LAMBERT He said that action would take place.

Senator PROXMIRE. He said he would fire you if you did not stop?

Mr. LAMBERT. Yes, sir.

Mr. WHITEHEAD. May I respond?

Senator PROXMIRE. Mr. Whitehead, I see you smiling. I think that is a very, very grave assertion. You men are all under oath. And I do feel deeply for you; I know this is most difficult. But I would certainly like an explanation of that, sir.

Mr. WHITEHEAD. Well, let me say again that my instructions to Mr. Lambert, first of all, were that if he was going to prepare a memoranda on points of law, that it should be addressed to all of the Board and not just to Mr. Chase, which he had done on a number of occasions.

Now, with respect to going down and spending a lot of time with Mr. Chase on all matters, I did tell him that he was going down there too much and that he ought to send his staff down there instead.

Now, with respect to his possible dismissal from the staff, there were three Board members that felt that his work had not measured up to what it should be, and that he was getting to a point——

Senator PROXMIRE. Who were the members of the Board?
Mr. WHITEHEAD. Mr. Mattingly and Mr. Rinehart.
And that he was involved in too many policy matters.
Senator PROXMIRE. I am sorry, sir; I did not get the names.
Mr. WHITEHEAD. Mr. Mattingly and Mr. Rinehart.
Senator PROXMIRE. Mattingly, Rinehart and Whitehead, right?
Mr. WHITEHEAD. Right.
Mr. Lambert has a habit of getting into policy matters which do not concern him. I told him that his job was to determine the legal sufficiency or insufficiency on matters and let it rest right there. I found that where I had established an ad hoc committee, he would do everything that he possibly could to take over and be the big shot on all committees. We have a very competent staff, and I wanted that responsibility spread around.

PERFORMANCE OF GENERAL COUNSEL

Senator PROXMIRE. Mr. Mattingly, it has been said that you also were critical of the work of Mr. Lambert, and you felt he should be fired if he did not desist in getting into policy matters and confine his recommendations to legal matters.
Mr. MATTINGLY. Mr. Chairman, I wanted to respond earlier and put this into perspective that it really was—for several months now, Mr. Rinehart and I have had the bulk of the cases, simply because of the carryover before the new members came aboard. We had a terrific amount of work to do.
My discussion with Mr. Lambert was to this extent: he came into my office to inquire about this matter.
Senator PROXMIRE. You are talking about the McDonnell-Douglas matter?
Mr. MATTINGLY. I'm not talking about any case in particular.
Senator PROXMIRE. You said about this matter.
Mr. MATTINGLY. About the matter of him spending an inordinate amount of time in Mr. Chase's office.
Senator PROXMIRE. I see; all right.
Mr. MATTINGLY. I didn't mention anything to him about being fired, because I don't feel that that is my prerogative to do so. My concern was that he himself should devote more time to managing his office, where specific attorneys are assigned to cases, and that those attorneys be dealt out to the Board members for any information that they might desire.
Senator PROXMIRE. Did you believe that Mr. Lambert should be——
Mr. MATTINGLY. There was no——
Senator PROXMIRE. Let me just ask, did you believe Mr. Lambert should be discharged for not doing a good job?
Mr. MATTINGLY. I never said that, Mr. Chairman.
Senator PROXMIRE. Did you believe it?
Mr. MATTINGLY. Did I believe it?
Senator PROXMIRE. Yes, sir.
Mr. MATTINGLY. At this time, I have no opinion on that, sir.
Senator PROXMIRE. All right; go ahead.

Mr. MATTINGLY. The only opinion that I do have is, as I was trying to state, that he was spending an inordinate amount of time in Mr. Chase's office. I also, in my conversation with him, stated that Mr. Grenough was spending an inordinate amount. I also said that I had several cases that I had been trying to get out of Mr. Grenough's office, and I think he will have to admit that that is the case, and they were some big ones, too. When you talk about McDonnell-Douglas, I have one on IBM, that I am the chairman of the case; and I think I would have to support the chairman's view, perhaps my verbiage would be different, but it is a matter of managing the personnel that is available there.

Now, in the Office of Review, for example, it is very seldom that any one of us would get Mr. Chick, as such, as the Director, or Mr. Harrison, who is now the Acting Director, in their offices. We would try to utilize the reviewer that had been assigned to the case.

So, in my opinion, it is a matter of management. Now, I never mentioned any word of firing Mr. Lambert or any such thing, and I think he would have to attest to that. As a matter of fact, I said, merely as a guidance to you, that I think that you should spend your time delegating this authority to others.

Senator PROXMIRE. Mr. Rinehart.

Mr. RINEHART. Mr. Lambert came to see me on this same matter, and I merely suggested this to Mr. Lambert——

Senator PROXMIRE. He came to see you again on what matter?

Mr. RINEHART. On the matter of——

Senator PROXMIRE. The Chairman having told him not to provide so much time to Mr. Chase?

Mr. RINEHART. Yes. And I merely suggested that we have Mr. Lambert—and he has, I believe, five or six lawyers in his staff—and in my opinion, his job was to assign a lawyer on a particular case and not try to answer all of the questions himself for every member of the Board. And the reason I made that statement—we have many cases, as you know, a big backlog, and legal has a big backlog that they have not caught up with; and I merely suggested to him that he should not get involved in policy procedure, in policy matters, but administer the legal staff.

LEGAL ADVICE TO BOARD MEMBERS

Senator PROXMIRE. Well, it seems to me—I construe your answer—I do not want to be unfair—that the General Counsel should give general counsel on legal matters to all members of the Board. Is that unfair?

Mr. RINEHART. No, you misunderstood me.

Senator PROXMIRE. All right, what were you saying?

Mr. RINEHART. I am saying that Mr. Lambert, if he has an attorney assigned to a case which I am handling, does not have to be in my office every time I need a lawyer. I expect the attorney that is assigned to a given case to give me whatever assistance I need.

Senator PROXMIRE. Now, let me ask you this, though: If Mr. Lambert—I presume one of the reasons he is the legal counsel is because he is a highly competent lawyer—at least somebody must have thought so. And I am impressed by his qualifications. If the

headman comes in to see a member of the Board, I cannot think of a more important responsibility that he has than to see members of the Board. That is his function; that is his responsibility; is that not correct?

Mr. RINEHART. I am not questioning his competence. If Mr. Lambert can take care of the whole workload, then we don't need six other lawyers; that is my point.

Senator PROXMIRE. Did you think that Mr. Lambert should be discharged?

Mr. RINEHART. I never said he should be discharged.

Senator PROXMIRE. All right, now, that is a direct——

Mr. Whitehead, I understood you to say that you were joined by two other members of the Board, so the three of you agreed that unless Mr. Lambert desisted from this kind of activity, that he should be discharged.

Mr. Mattingly and Mr. Rinehart have both denied that. And neither did they both have an opinion that he should be discharged.

Mr. WHITEHEAD. Well, we discussed the matter of replacement, and when you discuss a matter of replacement—I told Mr. Lambert that there were 2½ votes against him, and that he ought to go see Mr. Rinehart and Mr. Mattingly and discuss this thing. And that he was not devoting the full amount of time to the supervision of the general counsel's office, and that if this did not occur and he didn't delegate responsibility, that we would have to look elsewhere for a replacement. And that essentially was the understanding that was the gist of the discussion that I had with Mr. Mattingly and Mr. Rinehart.

Senator PROXMIRE. Mr. Mattingly and Mr. Rinehart—they can correct me if I am wrong—have just indicated that they had no opinion and that they had made no statement that Mr. Lambert should be fired or discharged or that they should look elsewhere or anything of the kind. They had an opinion on the time that he spent; they may have been critical about it, but——

Mr. WHITEHEAD. I have stated my answer, and I know that I am under oath; and that is the discussion that we all three had. I mentioned it several times.

Mr. LAMBERT. Mr. Chairman——

Mr. CHASE. Mr. Chairman——

Senator PROXMIRE. Let me—Mr. Lambert, and then I will come to you, Mr. Chase.

Mr. LAMBERT. I am very concerned that the line of testimony has taken this course, which I think has put me in a very embarrassing position. I want to say, though, that in this discussion I had with Mr. Whitehead, it was very clear that, as he said, there was 2½ votes, and that he was the swing vote on it. And I asked him if I could discuss this matter, because we were talking about performance, talking about what he termed as "decentralization of my operation." And I wanted to talk to Mr. Rinehart and Mr. Mattingly about it, to discuss it and to see what improvements could be made. And I might say here that every one of my attorneys is assigned to a case, and all cases that these gentlemen have, have an attorney assigned to them. And he reviews the legal status of the work with me, and I supervise it, along with my deputy. So, in terms of my being involved in every

situation, that is not so. But Mr. Whitehead, after I asked him if I could see these two gentlemen and discuss with the other Board members the general operation—because after all, I'm in a service position and attempting to meet their requirements. He told me at that time that he would have to talk to them before he could give me clearance to meet with them.

He called me up—I think our first discussion was on a Friday—Monday morning and said I could go and talk to Mr. Rinehart and Mr. Mattingly.

Senator PROXMIRE. Now, before I call on Mr. Chase, let me say this appears to me to be a very clearcut case of intimidation of a civil servant. Mr. Chase was writing a dissent which you and other members of the Board did not like. And it seems to me that there was a clearcut documented attempt to strip him of the kind of legal assistance and other assistance he needed in order to do the job.

Mr. Chase.

Mr. WHITEHEAD. I can't agree with that at all, Senator.

Senator PROXMIRE. I did not expect you to.

Mr. HOUSTON. Senator Proxmire.

Senator PROXMIRE. Yes.

PERFORMANCE BY GENERAL COUNSEL

Mr. HOUSTON. I would like an opportunity to say something about our general counsel.

Senator PROXMIRE. Mr. Houston, yes sir.

Mr. HOUSTON. As indicated, I was not one of the three that had anything to do with the discussion that we have just heard about this morning. As a matter of fact, this is the first time that I have heard about it. I knew that there was some concern about the amount of legal and staff time being spent in Mr. Chase's office, but this is the first time that I have heard anything of the type that was presented this morning.

I would like to say that in my opinion, our general counsel is extremely competent. And in addition, he does possess certain qualities of management which are necessary in order to operate an office of general counsel within a Federal Agency. I have had some experience in a very large and complex Federal Agency, the Department of Health, Education, and Welfare, as well as experience within a corporation in private business. It is my judgment that Mr. Lambert not only possesses the qualifications and background necessary, but is an able manager. And I want to emphasize it because I think that that point is extremely important as we evaluate the effectiveness of the Board as a whole.

I would like to point out—and this alludes to an earlier point that you made today——

Senator PROXMIRE. Before you go on to that point, let me just ask Mr. Mattingly and Mr. Rinehart do you disagree with what Mr. Houston has just said about the ability of Mr. Lambert as a manager? I think this is very critical here, if we are going to arrive at a conclusion.

Mr. MATTINGLY. Personally, I do not believe that I was put in that position to answer that particular question. The matter at hand was the utilization of the time that was going on, and that was the point I was concerned with.

In the matter of setting policy and some of these objectionable things that perhaps might be wrong, if that sort of thing continued out of his office, perhaps I would even support replacement. But that was not the point I was concerned with at all. The point I was concerned with was the better utilization of the time, not only in his office, Mr. Chairman, but in the office of accounting—particularly those two.

Senator PROXMIRE. Mr. Rinehart, did you want to comment on Mr. Houston's statement?

Mr. RINEHART. I do not want to say that Mr. Lambert isn't a competent lawyer and competent in running an office. My point is this: he cannot supervise six lawyers on his staff and spend as much time with the other four Board members as he does with Mr. Chase. He wouldn't have any time. My point was this: as our chief legal office to the Board, he should assign more of this work to his own staff. I have no questions about his ability.

Senator PROXMIRE. Mr. Houston, would you like to respond?

Mr. HOUSTON. Mr. Chairman, one very important point that I would like to make—and I think Mr. Rinehart makes a point that leads right into this—is that in my opinion the General Counsel's office is understaffed. It is far understaffed. In my opinion, the entire staff of the Board is too small. I was not a member of the Board at the time action was taken on the last budget. I feel that it is altogether too small. I would be glad to discuss that if the time presents itself, and it is my intention to discuss these matters appropriately when the matter of the 1976 budget comes before the Board for action.

Senator PROXMIRE. Thank you very much.

Mr. WHITEHEAD. Mr. Chairman?

Senator PROXMIRE. Yes, sir?

Mr. WHITEHEAD. No. 1, I would like to have you ask—or I will ask him—the Director of the Office of Administration, if Mr. Lambert is not an employee appointed by the Board without regard to civil service regulations and one whose salary is also established by the Board. That is the first point I would like to make.

Senator PROXMIRE. Let me ask you, why do you make that point, sir, as to whether or not you could——

Mr. WHITEHEAD. I'm not so sure. You refer to him as a civil service employee, and I do not know whether he is or not, because his salary——

Senator PROXMIRE. No, I said he was a civil servant. I consider myself a civil servant too.

Mr. WHITEHEAD. Well, so do I. I thought you were implying that he was under civil service.

Senator PROXMIRE. No, I did not mean that issue at all. I am glad you clarified that.

HEADQUARTERS STAFFING

Mr. WHITEHEAD. OK.

Now, the second thing is, with respect to the possibility of increasing the budget for 1976, I received from the Office of Management and Budget this morning or yesterday morning, a letter in which they stressed the austerity of our budget for 1976, and they want us to keep it at the 1975 level.

Now, we do what we can. We have just gone through 1974. And I am sorry, when you made your statement on the floor a couple of

weeks ago that you did not point out that in 1974 we collected more, we assessed more excessive profits than in any year in the past 15 years, and it is a doggone good record. We are all very proud of it.

Senator PROXMIRE. I think the McDonnell Douglas case is a case of why they want to keep it small. The defense budget isn't going to be kept at the same level in 1976, you can bet your last bottom dollar on that. At least, that's not going to be the recommendation. Congress may succeed in acting otherwise, but the recommendation will be—that will go up very sharply, as it did this year.

And if that goes up, I don't see any alternative. If you're going to have a Board—there's a strong case for not having a Board at all—but if you're going to have a Board, you ought to have the adequate staff and the adequate capabilities so they can do the job.

Mr. Chase?

Mr. CHASE. Mr. Chairman, may I have a moment?

Senator PROXMIRE. Yes, sir.

Mr. CHASE. I really am distressed at the indictment that has been given to Mr. Lambert here this morning by the chairman. In my opinion I have been associated with him, as I have with the Division Chairman, Division Directors, since October 10, 1973. He is a man of quality; he gets along with people. In all of that time, I have never once heard him discuss a policy matter per se. But when, indeed, a policy matter is brought to his attention at a Board meeting, he would speak out on that policy matter as it pertains to the legal consequences. And I defy any man to say that this man is not one of honor and great expertise in his field.

Now, I have to call to your attention that I only called on Mr. Lambert in the early stages of my need for legal information. It should be pointed out, sir, that Mr. Lambert was the attorney for the McDonnell Douglas case. He was assigned as the attorney, and I was deprived of his service, and I had to call upon members of his staff who were not well acquainted with McDonnell Douglas.

And I would like, moreover, sir, to point out one other thing. My office is at the other end of the building from the other members of the Board, and it would appear that they have great knowledge about how much time these people spent in my office. I wonder if they had someone there monitoring the ins and outs of Mr. Lambert, Mr. Grenough, and Mr. Harrison and Mr. Chick and others.

I assure you, Mr. Chairman, that Mr. Grenough, since October 10, has not been in my office a half a dozen times, and members of his staff have not been in my office more than five or six times for reasonable discussions on the various cases with which I have been associated.

And I am confident that a great harm has been done to Mr. Lambert here today, and I hope that, for the record, this, to some measure, will espouse at least my high regard for him, as Mr. Houston has said.

Senator PROXMIRE. That is a very, very useful statement.

ADEQUACY OF LEGAL STAFF SUPPORT

Mr. WHITEHEAD. May I clarify?

There was no monitoring of Mr. Chase's office whatsoever.

Senator PROXMIRE. If there's no monitoring, Mr. Whitehead, how can you clarify the facts he has given us?

He has told us the number of times Mr. Lambert has been in his office, the number of times others have been there, and it seems to me that is kind of an objective factor. You cannot dispute it. It seems to me it would stand up against any generalized argument that is being made.

Mr. WHITEHEAD. Over a period of time this has come to me from staff that he was utilizing the staff——

Senator PROXMIRE. All right.

What staff? Can you identify the staff?

Will they give us——

Mr. WHITEHEAD. The legal—Mr. Lambert's time, accounting time, accounting office time.

Senator PROXMIRE. Let me just say—I am going to call on Senator Mathias in just a minute. Let me just say I just asked the members of the staff who are here, and they have denied that.

Mr. WHITEHEAD. All right.

Senator PROXMIRE. The closest we came was——

Mr. WHITEHEAD. I wouldn't raise the question if it wasn't reasonable.

Senator PROXMIRE. Well, Mr. Grenough did say that he spent a substantial amount of time, but he did not indicate that it was excessive or nitpicking. He said that it was a learning process.

Mr. WHITEHEAD. I'm not talking about McDonnell Douglas. I'm talking about the utilization on all matters.

Senator PROXMIRE. I'm sorry.

Senator Mathias.

Senator MATHIAS. Mr. Chairman——

Mr. WHITEHEAD. It's an administrative responsibility, and I did what I thought was right. I thought that there should be less personal attention given to Mr. Chase, and in the case of where opinions were written, which the chairman did write, and the cases where Mr. Lambert did write opinions for Mr. Chase, I pointed out to him that I thought that they should be made to the attention of the entire Board and not to Mr. Chase alone.

Senator PROXMIRE. Senator Mathias.

Senator MATHIAS. Mr. Chairman, I would like to just inquire of Mr. Lambert the kind of methods that they use to divide up the available legal services.

Did you assign the attorneys to the different cases?

Mr. LAMBERT. Yes, sir.

Senator MATHIAS. And an attorney was assigned to a case and not to a member, is that correct?

Mr. LAMBERT. Pardon?

Senator MATHIAS. The attorney was assigned to the case and not to the member?

Mr. LAMBERT. Yes, they are assigned to the chairman of the Division hearing the case.

Senator PROXMIRE. The question of Senator Mathias was, the attorney would be assigned to a particular case but not to the member of the Renegotiation Board?

Mr. LAMBERT. No, sir. He would be assigned to the Division hearing the case. There would be an attorney, an accountant, and a renegotiator, and he is a part of that group. He is at the call of the

chairman of the Division and he provided him with legal assistance—if there are legal problems, the chairman or a member of the Division would call on him to discuss any legal issues. In some instances, they might call on me. I would send him. or I would go with him.

There are many legal questions affecting policy which arise in these matters, Senator—where there is not a uniform position.

Senator MATHIAS. Now, the point I want to get to is, how many people would have normal access to an attorney's time while he was working on a case, a typical case.

The chairman of the Division and other members of the Division, is that right?

ASSIGNMENT OF ATTORNEYS

Mr. LAMBERT. That's right. On call.

Senator MATHIAS. On call.

Mr. LAMBERT. Absolutely.

Senator MATHIAS. And if it happened that the full Board was sitting as a Division, then the full Board would have access to that attorney?

Mr. LAMBERT. That's right.

Senator MATHIAS. And they should each have a reasonable opportunity to have access to that attorney?

Mr. LAMBERT. They have the opportunity to have full access to the attorney assigned to the case. They have full access to any of the lawyers in the office.

Senator MATHIAS. So you had how many people consulting a given attorney about a given case?

Mr. LAMBERT. Consulting the attorney, sir?

Senator MATHIAS. Yes.

Mr. LAMBERT. Well, normally, you mean the number of cases that were assigned to one attorney?

Senator MATHIAS. No. We're talking about one typical case. You would have each member of the Board who would be calling him up about it or asking him to come see them about that case.

What about the acountant?

Would he have to consult with the attorney?

Mr. LAMBERT. If there was a legal question that involved accounting, then they would get together and discuss it. There is nothing unusual about the method of operation.

Senator MATHIAS. What I'm trying to find out is, how many people had access to that attorney's time during a typical case?

Mr. LAMBERT. It would depend on the complexity of the case and depend on what the legal issues were, if there were any. It is that attorney's job to monitor that entire case all the way through.

Senator MATHIAS. So if all the members of the Board were sitting as members of the Division, plus the accountants, plus the negotiators, you would have six, seven, eight people who would be consulting that attorney about that case?

Mr. LAMBERT. Normally, the cases are developed by the staff, so there would initially be possibly three staff people immediately involved plus the staff assistants of the Board members and then as the case developed through conferences with the Board members the number of people in contact with the attorney could increase. So I don't believe it is quite as extensive as you suggest but that there could be eight people contacting the attorney.

Senator MATHIAS. That's what I'm trying to get at.

Mr. LAMBERT. It doesn't operate to that extent, although it could.

Senator MATHIAS. Did it operate that way in the *McDonnell Douglas* case?

Mr. LAMBERT. No, sir. There was only one attorney. I was the attorney on the case, and I used some of my assistants occasionally, but basically I was the man.

Senator MATHIAS. How many people were calling you for advice and counsel and legal judgments on the case?

Mr. LAMBERT. On McDonnell Douglas?

Senator MATHIAS. Yes.

Mr. LAMBERT. I would say the request for legal assistance at the staff level was more than from the Board members.

Senator MATHIAS. Do you keep timesheets?

Mr. LAMBERT. No.

Senator MATHIAS. You do not?

Mr. LAMBERT. No. We really have to be too flexible by the very nature of our supporting activity, so that I don't think that would be practical.

Senator PROXMIRE. Gentlemen, there is a rollcall, and it is 12:15. I am going to suggest that we recess until 10 o'clock tomorrow morning, and we will reconvene.

We have gotten into such very vital material that I think we simply have to go right ahead with this, so we will recess now until 10 o'clock tomorrow morning.

Mr. WHITEHEAD. Senator, may I ask if we could carry it over until Monday morning? I have reservations to leave for the coast at 5 o'clock this afternoon. It is in connection with the relocation of our office in Los Angeles. This is the third postponement, and I would deeply appreciate the opportunity of fulfilling——

Senator PROXMIRE. Well, we can't possibly meet on Monday morning.

Mr. WHITEHEAD. Could we meet Tuesday morning, or someday at your convenience next week?

Senator PROXMIRE. We'll have to do it to the call of the Chair. We cannot meet Monday morning.

These days are tremendously crowded for all of us, and I have had to make a cancellation in order to make it Friday morning. If we can't meet then, we will meet subject to the call of the Chair. We'll try to work out a time that is convenient.

Mr. WHITEHEAD. Mr. Chase is leaving tomorrow for a month's leave.

Senator PROXMIRE. You're leaving tomorrow?

Mr. CHASE. Mr. Chairman, my wife is a Norwegian, and we have——

Senator PROXMIRE. You've made the strongest argument I've heard yet. Our State is a Norwegian State of the Union, you know, Wisconsin.

Mr. CHASE. No, I think Washington State is.

Senator PROXMIRE. No, no, no. They are second.

Senator MATHIAS. Mr. Chase, never argue with the court.

Mr. CHASE. Mr. Chairman, in February, my first wife's relatives said they would come here, and they are going to be here on Satur-

day. And we have a little summer place up in the San Juan Islands, and they're going to be here 5 days. And I have been planning it since February.

Could we not maybe adjourn until this afternoon?

Senator PROXMIRE. We have a markup, unfortunately, this afternoon.

I will tell you, we are going to meet. Maybe we'll meet on a Saturday or a Sunday or a Sunday afternoon, or something like that.

Mr. WHITEHEAD. That's all right.

Senator PROXMIRE. We will meet, and we will meet soon. But we'll have to meet at the call of the Chair.

Mr. CHASE. But I have to leave tomorrow.

Mr. WHITEHEAD. Do I understand that the meeting will not——

Senator PROXMIRE. Mr. Chase, you can go. We will not meet in the next 4 or 5 days.

You say you'll be gone for 5 days?

Mr. CHASE. I was going to be gone for a month, but I will come back.

Senator PROXMIRE. All right. That is fine.

We will accommodate your Norwegian wife by not meeting for the next 4 or 5 days.

Mr. WHITEHEAD. Do I understand, Senator, that we will not, then, meet this afternoon?

SUBCOMMITTEE RECESS

Senator PROXMIRE. We will not meet this afternoon. We'll meet at the call of the Chair.

Mr. WHITEHEAD. At the call of the Chair?

Senator PROXMIRE. That's right. We'll wait until you get back from the coast.

Mr. WHITEHEAD. Thank you very kindly.

[Whereupon, at 12:18 p.m., Thursday, July 25, the subcommittee was recessed, to reconvene at the call of the Chair.]

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, SPACE, SCIENCE, VETERANS, AND CERTAIN OTHER INDEPENDENT AGENCIES APPROPRIATIONS FOR FISCAL YEAR 1975

WEDNESDAY, OCTOBER 2, 1974

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, D.C.

The subcommittee met at 2:45 p.m., in room 1318, Everett McKinley Dirksen Office Building, Hon. William Proxmire (chairman) presiding.

Present: Senators Proxmire and Mathias.

RENEGOTIATION BOARD

TESTIMONY OF WILLIAM S. WHITEHEAD, CHAIRMAN

ACCOMPANIED BY:
D. ELDRED RINEHART, BOARD MEMBER
GOODWIN CHASE, BOARD MEMBER
NORMAN B. HOUSTON, BOARD MEMBER
DONALD S. GRENOUGH, DIRECTOR, OFFICE OF ACCOUNTING
H. M. CHICK, DIRECTOR, OFFICE OF REVIEW
HAROLD E. STONE, DIRECTOR, OFFICE OF ADMINISTRATION
DAVID M. F. LAMBERT, GENERAL COUNSEL
GEORGE LENCHES, DIRECTOR, OFFICE OF PLANNING AND ANALYSIS
WILLIAM H. HARRISON, DEPUTY DIRECTOR, OFFICE OF REVIEW
FRED G. REED, EXECUTIVE ASSISTANT TO THE CHAIRMAN
JOHN B. DAVIS, SPECIAL ASSISTANT TO MR. CHASE
WILLIAM F. PARK, SPECIAL ASSISTANT TO MR. RINEHART

HEARING PROCEDURE

Senator PROXMIRE. The subcommittee will come to order.

I apologize for being late. We have had a series of votes on the floor; we are going to have another vote in about 10 minutes or so and it is going to be that kind of a day, unfortunately.

This afternoon we are resuming hearings on the Renegotiation Board which were recessed on July 25, 1974. All members of the Board and several staff members have been invited and testimony will be given under oath as it was on July 25.

I am informed that one Board member, Mr. Rex M. Mattingly, has taken a month's vacation in Europe and is absent from the hearing for that reason.

RÉSUMÉ OF CASE HISTORY

These hearings were begun as an inquiry into the handling of two cases involving McDonnell Douglas and other recent decisions by the Board. In each of the two McDonnell Douglas cases one Board member dissented from the majority opinion. The dissents, filed by Mr. Goodwin Chase, allege that the majority vastly understated the amount of excessive profits retained by McDonnell Douglas for the fiscal years 1967, 1968, and 1969.

The majority found that the company had $5 million in excessive profits for 1967 and no excessive profits for 1968 and 1969. Mr. Chase asserts that the company should have been charged with at least $15 million in excessive profits for 1967, at least $16 million for 1968, and an additional indeterminate amount for 1969.

According to Mr. Chase, the Board failed to exercise its obligation to examine information essential to an accurate determination of excessive profits, permitted the company to offset the high profits of one of its divisions with the low profits of subsidiary divisions, and conducted only a superficial probe.

Some of these charges were discussed at the previous hearing. I hope we can complete that discussion without unnecessarily going over the same ground covered before, but I realize there will be some overlapping.

Several other matters have been brought to the subcommittee's attention since July 25, and I will go into at least some of them today.

Before we begin the questioning, I want to make a brief comment.

As a government, we seem to be stuck in the age of the captive regulatory agency. Scandal after scandal have shaken Washington in recent years. These scandals concern the lack of enforcement or the poor enforcement of government regulations. They concern conflicts of interest, favoritism, sophisticated and crude forms of corruption.

Corruption or lack of diligence in the regulatory agencies has become so commonplace that many people believe, rightly or wrongly, that the agencies are dominated by the private groups they are supposed to regulate. As a result, people are losing faith in the ability of the Government to regulate fairly. In my view, recent calls for the repeal of regulatory laws is not unrelated to this situation. In addition, the public is bound to be poorly impressed with the ability of congressional committees to properly perform its oversight responsibilities with regard to the executive agencies.

It is no secret that I am appalled at the recent work of the Renegotiation Board. What transpired at the July 25 session added to my concern. There is strong evidence in that testimony that at least one Government employee has been improperly intimidated by the head of this agency. I have decided, after studying the record, to turn this

matter over to the Civil Service Commission and the Justice Department for a full investigation. I may take other steps after the conclusion of today's proceeding.

OATH TAKEN BY WITNESSES

Now, will the members of the Board and staff members of the the Renegotiation Board please rise? I will ask you to raise your right hand.

Do you solemnly swear that the testimony you will give today will be the whole truth and nothing but the truth, so help you God?

Mr. WHITEHEAD. I do.
Mr. RINEHART. I do.
Mr. CHASE. I do.
Mr. HOUSTON. I do.
Mr. GRENOUGH. I do.
Mr. CHICK. I do.
Mr. STONE. I do.
Mr. LAMBERT. I do.
Mr. LENCHES. I do.
Mr. HARRISON. I do.
Mr. REED. I do.
Mr. DAVIS. I do.
Mr. PARK. I do.
Senator PROXMIRE. All right, gentlemen.
Mr. Whitehead.

RESIGNATION OF CHAIRMAN WHITEHEAD

Mr. WHITEHEAD. Good afternoon, sir.

Senator PROXMIRE. Good to have you here.

According to this morning's Washington Post, you have submitted your resignation to the President, and it is to be effective December 31, 1974.

Have you submitted your resignation, and has an effective date been set?

Mr. WHITEHEAD. Yes, sir. I have asked that I be given retirement as of December 31, 1974. I have 18 years of Government service, and that date was mutually agreed on, although I have had no response from the White House as of yet, or the President.

Senator PROXMIRE. So, it is your wish, although as you say you have had no response from the President, it is your proposal that you resign as of December 31, 1974; is that correct?

Mr. WHITEHEAD. It was mutually agreed to, yes sir, by the staff people with whom I have been talking at the White House.

Senator PROXMIRE. But you said that you had no response from the President.

Mr. WHITEHEAD. I wrote a letter requesting retirement, and I have not as yet received a written official reply.

Senator PROXMIRE. When you say it has been mutually accepted——

Mr. WHITEHEAD. Mutually agreed.

Senator PROXMIRE. With whom was the agreement made?

Mr. WHITEHEAD. A representative on Governor Scranton's staff who is handling personnel matters now, Secretary Beal, former Under Secretary of the Army.

Senator PROXMIRE. When was that agreement reached?

Mr. WHITEHEAD. Last week sometime, I do not know which day, Wednesday or Thursday.

Senator PROXMIRE. That is you say, General Beal or Mr. Beal?

Mr. WHITEHEAD. They call him——

Senator PROXMIRE. Former Under Secretary?

Mr. WHITEHEAD. Yes. Mr. Ted Beal.

Senator PROXMIRE. Mr. Ted Beal. I see.

Mr. WHITEHEAD. I knew him when he was Under Secretary, slightly, and that is the reason I alluded or referred to him as Secretary.

Senator PROXMIRE. But there has been nothing in writing to confirm this, is it an oral agreement?

Mr. WHITEHEAD. No, I wrote a letter, but have not as yet received a reply.

Senator PROXMIRE. But you said you have had no response in writing.

Mr. WHITEHEAD. I have had no reply.

Senator PROXMIRE. In writing?

Mr. WHITEHEAD. That is correct. Yes, sir.

Senator PROXMIRE. So the understanding you have with Mr. Beal is simply an oral understanding between you and Mr. Beal, is that right?

Mr. WHITEHEAD. No, I was told the other day that the request for retirement went forward to the President and it has not yet come down from his office.

Senator PROXMIRE. Who told you that?

Mr. WHITEHEAD. Mr. Beal and Mr. Mayer, this morning.

Senator PROXMIRE. That means that you would be serving throughout the rest of this month, throughout November and throughout December, with the understanding that you would be leaving office on December 31.

Mr. WHITEHEAD. That is my understanding, yes, sir.

Senator PROXMIRE. Do you think this is a wholesome and effective situation for the agency to have you acting, in effect, as a lameduck, during this period?

Mr. WHITEHEAD. I expect no serious repercussions regarding that arrangement.

Senator PROXMIRE. Mr. Chase, I mentioned the matter of alleged intimidation of the staff in my opening remarks. On July 25 you testified that Chairman Whitehead told you not to consult with any member of the staff, General Counsel, or department head, and that you noted the date of this conversation in your log.

STAFF SUPPORT

Mr. CHASE. Yes, I did.

Senator PROXMIRE. A letter was received from your office stating that the date in question was July 2, 1974. First, I want to know, is that the correct date?

Mr. CHASE. According to my log, it was, Mr. Chairman.

Senator PROXMIRE. And can you tell us the circumstances and details recorded in your log of your conversation with Mr. Whitehead?

Mr. CHASE. Yes, I have.

Senator PROXMIRE. What were the circumstances?

Mr. CHASE. Just an outright statement that I was not to make further use of the staff, the professional staff, and that if I had any questions to ask they should be directed through my assistant, Mr. John Davis. I said that was not acceptable to me.

Senator PROXMIRE. Now, you have those notes in your logs to confirm that?

Mr. CHASE. Yes, I do.

Senator PROXMIRE. Can copies of that be made available to the subcommittee?

Mr. CHASE. Yes, indeed.

Senator PROXMIRE. I hope that you will make those available.

[The information follows:]

Excerpt from Mr. Chase's log of July 2, 1974:

I told Lambert Whitehead had later ordered me not to seek staff help hereafter without his prior approval—that Davis should seek out info.

INTERPRETATION OF STATEMENT

Senator PROXMIRE. Did you interpret Mr. Whitehead's statement as an effort to interfere or impede your actions with regard to the McDonnell-Douglas case or any other case pending before the Board, or as an attempt to prevent you from performing your responsibilities as a member of the Board?

Mr. CHASE. Unquestionably in my judgment, that was the motive. I have been without the benefit of our professional staff with the exception of those times that Mr. Grenough referred to, that Mr. Lambert referred to, and that others referred to, at the July 25 hearing here.

Senator PROXMIRE. Well, was there any other way that you could interpret the statement of Mr. Whitehead?

Mr. CHASE. I think you can just say that I was by myself with the help of my assistant. With the exception of those times I referred to, Mr. Chairman, I do not know how else I could interpret it.

It made it extremely difficult for me, because I am not a technically experienced person in the field of renegotiation of excessive profits.

Senator PROXMIRE. Mr. Whitehead, have you any comment at all on this?

Mr. WHITEHEAD. I certainly do, sir. I appreciate your asking me to comment.

In the first place, I am under oath and I tell you without equivocation that I never told him not to use any of the staff officers. The thing that concerned Mr. Mattingly, Mr. Rinehart, and myself was, he was tying up and unduly utilizing time of the senior staff officers to such an extent that other Board business was suffering.

No one ever told him that he could not use the staff officers. He was using them for unduly long periods of time, and quite frequently.

Senator PROXMIRE. Now, Mr. Chase, as has been noted, was a new member of the Board. He had not had experience. He needed staff assistance, and in view of the fact that he has a log which he is offering

as evidence to confirm his position, do you have any contrary evidence to confirm what you told——

Mr. WHITEHEAD. I have two signed statements, one from Mr. Mattingly and one from Mr. Rinehart, in which they both complain about the overindulgence in the use of staff officers by Mr. Chase.

Senator PROXMIRE. Were either of these gentlemen present when you talked with Mr. Chase?

Mr. WHITEHEAD. No, sir.

Senator PROXMIRE. Would you submit those statements for the record?

Mr. WHITEHEAD. I would be happy to, sir.

[The statement follows:]

THE RENEGOTIATION BOARD

Date: September 23, 1974.
To: William S. Whitehead, Chairman
From: D. Eldred Rinehart, Board Member
Subject: Extension of Remarks at Hearing on Thursday, July 25th, 1974, before the Subcommittee on Housing and Urban Development, Space Science, Veterans and Certain Other Independent Agencies, Committee on Appropriations, United States Senate. (See transcript: page 1406, line 17 through page 1408, line 7.)

On several occasions during the Spring, I discussed with the Chairman my concern about what I felt was the misuse of our staff by Board members. At a later date, I brought this question to the attention of the Board at a regular Board meeting. I stated at that time that, in my opinion, the Board members were calling on staff—particularly Mr. Lambert, General Counsel; Mr. Chick, Director, Office of Review; and Mr. Grenough, Director, Office of Accounting—for information and assistance far in excess of that required for ordinary case work, thereby contributing to the delay in moving the backlog of cases.

Subsequent to the Board meeting, in regard to one of the cases on which I was serving as Chairman of the division, it was necessary for the division and the Office of Review to have a legal opinion in regard to salary disallowance before proceeding with the case. After what seemed to me an unusual delay, the matter was discussed with the Chairman, and I advised him that I was concerned about such delays in the Office of General Counsel. I suggested to the Chairman that he bring this matter to the attention of Mr. Lambert as I felt that I, as a Board member, individually, could not be issuing orders concerning the Office of General Counsel and the delegation of staff time. I told him I would support him in whatever steps were necessary in order to correct the situation.

D. ELDRED RINEHART, *Board Member.*

AUGUST 1. 1974,

In June 1974, it came up in a discussion with the Chairman that the staff was spending so much time advising Mr. Chase that other work was being neglected. This was the most serious in connection with the involvement of the Office of General Counsel because we believed Mr. Lambert was personally spending an inordinate amount of his time in that area. We agreed that this was only one indication of the failure of Mr. Lambert to make adequate use of his staff.

We also discussed the problem of Mr. Lambert involving himself in Board policy matters without the authority of the Chairman.

It was agreed that the Chairman would discuss the above problems with Mr. Lambert and if not corrected the Chairman would have my support if he thought it necessary to make a replacement.

REX M. MATTINGLY, *Board Member.*

USE OF GENERAL COUNSEL

Senator PROXMIRE. Mr. Lambert?

Mr. WHITEHEAD. Sir, that also includes Mr. Lambert and other members of the staff that he was calling upon for undue lengths of time.

Senator PROXMIRE. Mr. Lambert, you testified that Mr. Whitehead threatened to fire you unless you stopped giving legal advice to Mr.

Chase and two other Board members. Mr. Mattingly and Mr. Rinehart were both supporting Mr. Whitehead's intention to fire you if you did not stop giving legal advice to Mr. Chase.

You then obtained permission from Mr. Whitehead to see the other two Board members about this matter, is that correct?

Mr. LAMBERT. That is correct.

Senator PROXMIRE. Did you see Mr. Mattingly about this?

Mr. LAMBERT. [Nods affirmatively.]

Senator PROXMIRE. What did he tell you with regard to Mr. Whitehead's threat to fire you?

Mr. LAMBERT. In my discussion with Mr. Mattingly, I went over the areas that Mr. Whitehead had discussed with me in his conversation, decentralization of staff being one and too much assistance to Mr. Chase being another. There were several other things that I do not recall at the moment. I went through each one of these subjects and when we got to the question of utilization of staff and my serving Mr. Chase, as I was serving all of the Board members, he raised an objection to that. He also said he would support the chairman in whatever the chairman wanted to do about it.

Senator PROXMIRE. Mr. Lambert, was this entirely oral, was any of this in writing?

Mr. LAMBERT. Nothing was in writing, sir.

Senator PROXMIRE. Were any third persons present when you were told this?

Mr. LAMBERT. No, sir.

Mr. WHITEHEAD. Mr. Chairman?

Senator PROXMIRE. Yes, Mr. Whitehead?

Mr. WHITEHEAD. May I interrupt at this point? These two statements which I will introduce specifically spell out the Lambert situation with respect to the position of Mr. Mattingly and Mr. Rinehart, and Mr. Mattingly has given me permission to introduce this.

Now the short memorandum in both instances have to do with the inordinate amount of time that Mr. Lambert was spending with Mr. Chase. One is signed by Mr. Mattingly and he also agreed that Mr. Lambert was meddling in policy matters which he should not have been.

Senator PROXMIRE. When you say "he", you are referring to——

ROLE OF GENERAL COUNSEL

Mr. WHITEHEAD. Mr. Mattingly. It is right in this memorandum. It has to do with the undue amount of time that was being spent by Mr. Lambert at Mr. Chase's request in his office, plus the fact that he says that he will support me if it is necessary to make a replacement.

Senator PROXMIRE. I want to make sure the antecedent is clear. When you say, "interfering in policy matters?"

Mr. WHITEHEAD. Yes, sir. I am quoting. "We also discussed the problem of Mr. Lambert involving himself in policy, Board policy matters, without authority of the Chairman."

I am happy to submit both of these statements for the record.

Senator PROXMIRE. We do want those statements.

Mr. WHITEHEAD. Thank you.

Senator PROXMIRE. Now, Mr. Lambert, did you interpret the statements of Mr. Whitehead, Mr. Mattingly—I beg your pardon. Did you see Mr. Rinehart and if you did, what did he tell you?

Mr. LAMBERT. Well, he again, I discussed the several areas. There were about four or five areas, Senator, one of them being the time I was spending with Mr. Chase. But that was the last one we talked about.

I asked him about the question of decentralization of my staff because that seemed to be a very vague term to me. I do not know how you decentralize a six-man law office in an agency located on one floor. That did not seem to be a specific problem to either Mr. Mattingly or Mr. Rinehart particularly, and then we talked about the question of policy matters.

Well, of course I have to address myself to Board policy matters. Certainly the legal aspect of them, and that is part of the basic job. I asked him about that and I discussed it with both of them. It did not seem to be any particular problem to them because there were no specifics.

Senator PROXMIRE. Before I get to Mr. Rinehart on this, let me ask you one further question. Did you interpret the statement of Mr. Whitehead, Mr. Mattingly, and Mr. Rinehart as efforts to impede your actions with regard to the *McDonnell Douglas* case, or any other case pending before the Board, as an attempt to prevent you from performing your responsibilities as General Counsel or as the attorney assigned to the *McDonnell Douglas* case?

Mr. LAMBERT. Yes, sir.

Senator PROXMIRE. You did interpret it that way?

Mr. LAMBERT. Yes, sir.

Senator PROXMIRE. Explain precisely how it affected *McDonnell Douglas,* or did not affect it.

Mr. LAMBERT. Certainly. The *McDonnell Douglas* case—I gathered Mr. Chase was working on a dissent.

Senator PROXMIRE. On a dissent?

Mr. LAMBERT. On a dissent in the *McDonnell Douglas* case. I sent up two of my attorneys and they did not appear to be satisfactory to him, for several reasons, all of them I think justified. So I really think he prepared the dissent without full benefit of legal counsel.

Senator PROXMIRE. Mr. Rinehart, what was your understanding of the situation?

Mr. RINEHART. Mr. Chairman, I have had an opportunity to review the transcript of the last hearing in July. Due to the fact that there has been a lot of irreparable harm already done to members of our staff, I have prepared an extension of my remarks which covers this in full and I would like to submit it for the record.

Senator PROXMIRE. All right, sir. How long a statement is it?

Mr. RINEHART. One page.

Senator PROXMIRE. Would you read it to us?

STAFF SUPPORT FOR BOARD MEMBERS

Mr. RINEHART. This has nothing to do with a particular individual, but this is an accumulation of problems over a 6-month period in the office.

Senator PROXMIRE. All right, sir.

Mr. RINEHART. On several occasions during the spring, I discussed with the Chairman my concern about what I felt was the misuse of our staff by Board members. At a later date I brought this question to the attention of the Board at a regular Board meeting. I stated at that time in my opinion the Board members were calling on staff, particularly Mr. Lambert, Mr. Grenough, Director of Office of Accounting, Mr. Chick, Director of Office of Review, for information and assistance far in excess of that required for ordinary casework, thereby contributing to the delay in moving the backlog of cases. Subsequent to the Board meeting, in regard to one of the cases in which I was serving as Chairman of the Division, it was necessary for the Division and the Office of Review to have a legal opinion in regard to salary disallowances before proceeding with the case. After what seemed to be an unusual delay, the matter was discussed with the Chairman.

I advised him that I was concerned about such delays in the Office of General Counsel. I suggested to the Chairman that he bring this matter to the attention of Mr. Lambert, as I felt that I, as a Board member, individually could not issue orders concerning the Office of General Counsel and the delegation of staff time.

I told the Chairman that I would support him in whatever steps necessary in order to correct the situation.

Again, I repeat, this has nothing to do with the particular case or any individual.

Senator PROXMIRE. Are you telling us that you agreed that the General Counsel, Mr. Lambert, be instructed not to consult with another Board member?

Mr. RINEHART. [Nods negatively]. I refer to my statement. I did not say that in my statement, sir.

Senator PROXMIRE. What is your answer? Did you or did you not agree that Mr. Lambert should be so instructed?

Mr. RINEHART. I did not instruct anyone to tell Mr. Lambert this.

Senator PROXMIRE. Did you reinforce that instruction?

Mr. RINEHART. Did I reinforce it?

Senator PROXMIRE. Did you not reinforce it by what you are telling us here?

Mr. RINEHART. In what respect?

Senator PROXMIRE. Well, you seem to go along with the directions to Mr. Lambert. Mr. Lambert interpreted that as meaning that he should not consult with Mr. Chase and Mr. Chase has the same understanding.

Mr. RINEHART. I do not have the same understanding, sir.

Senator PROXMIRE. I am not sure what your understanding is, then, sir.

Mr. RINEHART. My statement does not say that I instructed Mr. Whitehead to instruct Mr. Lambert not to confer with Mr. Chase.

I am saying we were all abusing Mr. Lambert and it should be corrected.

Senator PROXMIRE. Do you agree with the position that Mr. Lambert should be fired if he did not stop what was regarded as excessive consultation with Mr. Chase?

Mr. RINEHART. It never got to that point, sir.

Senator PROXMIRE. All right. Mr. Whitehead, do you want to respond or add anything to what Mr. Rinehart said?

Mr. WHITEHEAD. The last sentence in Mr. Rinehart's statement is, and this refers to "I told him," meaning myself, "I would support him in whatever steps were necessary to correct the situation" and I interpret that to mean that we did discuss briefly a replacement at this particular time.

And if I might read with your permission, Mr. Chairman, the statement that Mr. Mattingly has authorized me to introduce, I would appreciate it.

Senator PROXMIRE. How long a statement is that, sir?

Mr. WHITEHEAD. Very short [indicating.]

Senator PROXMIRE. All right.

Mr. WHITEHEAD:

"In June, 1974, it came up in a discussion with the chairman that the staff was spending so much time advising Mr. Chase that other work was being neglected. This was the most serious in connection with the involvement of the Office of General Counsel because we believed Mr. Lambert was personally spending an inordinate amount of time in that area. We agreed that this was only one indication of the failure of Mr. Lambert to make adequate use of his staff.

We also discussed the problem of Mr. Lambert involving himself in Board policy matters without the authority of the Chairman. It was agreed that the Chairman would discuss the above problems with Mr. Lambert and if not corrected the Chairman would have my support if he thought it necessary to make a replacement. Signed Rex M. Mattingly, Board member."

Senator PROXMIRE. Is there anything else you would like to add at this point?

Mr. WHITEHEAD. I think there was a reference made to the fact that the use of the staff by Mr. Chase was pertinent to McDonnell Douglas and I want to assure you that McDonnell Douglas was never mentioned in my conversation with Mr. Chase and I wholeheartedly tell you that that was not the reason why we felt that Mr. Lambert was spending too much time with Mr. Chase.

McDonnell Douglas did not enter into it, sir.

Senator PROXMIRE. Now, Mr. Lambert, and then Mr. Chase, I would like to ask each of you to try to clarify the situation as much as you can to see precisely where you disagree with what you have heard from Mr. Whitehead, Mr. Rinehart, and Mr. Mattingly's statement.

Go ahead, Mr. Lambert.

Mr. LAMBERT. What my understanding was of my conversation with these gentlemen?

Senator PROXMIRE. Yes. And whether there is anything else they have said in their rebuttal with which you disagree.

Mr. LAMBERT. With the exception of knowing generally what Mr. Rinehart proposed to put into a statement, this is the first time I am aware of the final contents of these memorandums. I believe that if someone were to come and examine the workload which we had in the General Counsel's office and our handling of the cases, I think that they would conclude that the timing was reasonable.

We had many priority items and they are always competing and sometimes you cannot get all things done in 1 day. You have to work on them over a period of time.

Senator PROXMIRE. When you say the time was reasonable, can you give us some notion of how much time you spent with Mr. Chase compared to the time you spent with other Board members?

Mr. LAMBERT. It is a little difficult to say because I do not think there was that much time. I do not know whether it was—it certainly was not on a daily basis. I just do not think it was that much time and frankly I am amazed that so much has been made over the time that we did spend discussing things. It involved office business and office cases.

Senator PROXMIRE. How about the argument that you intruded into policy matters as a non-Board member, an employee of the Board?

Mr. LAMBERT. Well, Senator, that is a very confusing statement, or charge, if you will, because for one thing, my job description mentions policy in the first paragraph.

You cannot have a General Counsel that does any kind of work which is not involved in policy so I really do not understand the meaning of that particular statement.

Senator PROXMIRE. And now, Mr. Chase.

Mr. CHASE. Mr. Chairman, at the outset I think the word "policy" is poorly used here. I think the policy of the Renegotiation Board is to have no policy, but in those instances wherein Mr. Lambert discussed policy matters, those few instances that I can recall, he was called upon to meet his responsibility with reference to whatever that direction was as related to legal matters and the rules and regulations promulgated by the Renegotiation Board.

Senator PROXMIRE. Are you saying it was not a matter of making or changing policy but simply interpreting how it should apply?

Mr. CHASE. Yes or addressing himself to what was in the best interest of the Board insofar as his legal responsibility concerned. At the July 25 hearing, we heard this phrase over and over again by Mr. Whitehead and to a lesser degree by Mr. Mattingly, that I was using an inordinate amount of the staff's time. Now that is clearly, to be putting it charitably, a distortion. It is in fact a misrepresentation. You polled our staff members here on July 25 and each without exception denied that I had used an inordinate amount of their time.

On the point of the use of time that I called upon Mr. Lambert for, you must remember that Mr. Lambert had been asssigned by the chairman as the attorney for the *McDonnell Douglas* case. I spent nearly all of my time with the *McDonnell Douglas* case, not just 60 or 70 percent, I spent approximately 80 percent of my time on the case.

So I do not understand how Mr. Whitehead can sit here and say that these three men—Whitehead, Rinehart and Mattingly—know that I used an inordinate amount of the staff time when again I say the staff itself categorically denied that statement. That brings me to my comment of July 25 to you, sir, that I am located at the other end of the building. They would have had to have monitors watching these people they say came into and out of my office.

I did not use even a reasonable amount of staff time. I think I could have done far better in the preparation of my dissent if I could have had the same amount of staff assistance as had been given for the preparation of the majority opinion. It was a horrendous undertaking.

Senator PROXMIRE. So what you are saying is you spent about 80 percent of your time on this complicated *McDonnell Douglas* case that Mr. Lambert was the attorney assigned to that particular case, he was the only one you could consult, the only attorney on the Board you could consult who was on top of the case, so you spent some time with him. Is that right? But you feel it was not inordinate? Mr. Lambert testifies that his records indicate that he spent what he feels was a limited amount of time, but on the other hand the other members feel it was excessive.

TIME SPENT BY GENERAL COUNSEL

Mr. CHASE. I did not have anyone in front of Mr. Whitehead's office or Mr. Mattingly's office, or Mr. Rinehart's office, so I can't say that I know how much time he spent with them. But he did not spend very much time with me. I could have used more of his time. He was told if he were a good manager, which I think he is, he could better utilize his staff.

My question is, how could he do less than give attention to the case he had been assigned to?

Senator PROXMIRE. Let me ask you, Mr. Houston, you have not had an opportunity to give your view on this. You are a member of the Board. Can you give us your view on this matter?

Mr. HOUSTON. Well, yes, Mr. Chairman. First of all, as reflected in the transcript of the last hearing on July 25, the whole problem of the relationship between Mr. Lambert and the chairman was new to me. Although as I stated at that time I was aware that there were some problems and that there was this concern expressed.

However, I did not realize that the concern was as serious as it was until it was expressed here. I can say this, which is also repeating from the last time, that in my opinion and from my observation, which is from still another corner of the building, one of our problems is the way our offices are laid out as the Board members' offices are about 50 or 100 feet from each other at least. I was not aware of any situation where Mr. Lambert was spending an extraordinary amount of time consulting with Mr. Chase. Nor was I aware of the other charges involving the other staff members expending extraordinary amounts of time with Mr. Chase.

As to policy matters and Mr. Lambert's engaging in them, I would have to have some explanation from Mr. Whitehead, Mr. Rinehart, or Mr. Mattingly as to what they mean. I have heard this statement but I do not know what is meant by Mr. Lambert engaging in policy matters improperly.

As far as I——

Senator PROXMIRE. As far as you know, Mr. Lambert was available to you when you needed him?

Mr. HOUSTON. He was available to me when I needed him. I did use him. I was involved with several other cases and he was always available when I would call for him.

Senator PROXMIRE. And you felt that he did not abuse his position with respect to any policy matters?

Mr. HOUSTON. Not as far as I was concerned.

Senator PROXMIRE. Now, let me ask if there is any other member of the Board, or I should say any other staff member, I believe all mem-

bers of the Board have spoken, is there any member of the staff anyone-else present, who knows of any other direct or implied threats or intimidating actions against any staff members by Mr. Whitehead or other Board members?

Mr. WHITEHEAD. Mr. Chairman, may I add one point with regard to the statement that Mr. Lambert made? He said I assigned him to the McDonnell Douglas case. He assigned himself. One of the difficulties of operation——

Senator PROXMIRE. First let's make it clear. You said that he assigned himself. Then you would agree that Mr. Lambert was the attorney who was responsible for the legal aspects as far as the Board is concerned, in the *McDonnell Douglas* case?

Mr. WHITEHEAD. I could not deny that.

Senator PROXMIRE. All right you agree with that.

Mr. WHITEHEAD. I just would like to add that he assigns himself to a great many matters that should be dispersed to his staff on a good management basis.

Senator PROXMIRE. Does he have the responsibility of determining where the attorneys in the General Counsel's office are assigned to which particular case?

Mr. WHITEHEAD. Yes, sir.

Senaror PROXMIRE. In that case, he made that assignment.

Mr. WHITEHEAD. I do not want the record to show that I assigned him. I did not assign him at all.

Senator PROXMIRE. All right. Let me ask Mr. Rinehart to answer the next questions.

The essence of Mr. Chase's dissent is that the Board did not have detailed cost data in respect to the *McDonnell Douglas* case broken out by product line or contract type or individual contract when it made decisions in the *McDonnell Douglas* case.

In the absence of the cost detail showing materials, labor, overhead, the amount of subcontracting and so forth, how was the Board able to evaluate the reasonableness of the cost, the contractor's efficiency, or the amount of risk undertaken by the company?

Can you answer that, Mr. Whitehead?

INFORMATION FROM M'DONNELL DOUGLAS

Mr. WHITEHEAD. I thought you were addressing the question to Mr. Rinehart. I am sorry.

Senator PROXMIRE. Either one of you gentlemen. I understand that Mr. Rinehart was directly in charge of the *McDonnell Douglas* case. Is that right sir?

Mr. RINEHART. Yes, I was in charge of the day-to-day operation.

Senator PROXMIRE. Then would you like to answer that question?

Mr. RINEHART. I think that in evaluating the McDonnell Douglas case we had all of the necessary information which was required to properly evaluate the case.

Senator PROXMIRE. Well, would you agree that there was an absence of the cost details showing cost of materials, labor, overhead, the amount of subcontracting and so forth? Were those details available?

Mr. RINEHART. All was available that the contractor could supply us.

Senator PROXMIRE. Well, did he provide this information or not?

Mr. RINEHART. He provided all of the information that we requested.

Senator PROXMIRE. Did he provide this information? Did you request this information?

Mr. RINEHART. We did not request it by product line.

Senator PROXMIRE. You did not request it?

Mr. RINEHART. No.

Senator PROXMIRE. Why not?

Mr. RINEHART. We did not deem it necessary in this case.

Senator PROXMIRE. How can you evaluate the reasonableness of the cost of a contract and its efficiency without knowing what the materials, labor and overhead and so forth were? Is that not the crux, the heart of any determination of the reasonableness of the cost?

Mr. RINEHART. It is an accounting problem and we have our accountant here, Mr. Grenough, and I think he would be prepared to answer this question as to what the Office of Accounting required and what they received.

Senator PROXMIRE. Before we get to the accounting, how would you make this determination in the absence of having the details, having the facts?

Mr. RINEHART. We had all of the facts, sir, all of the facts that we thought were necessary to properly evaluate the case as far as we were concerned.

Senator PROXMIRE. But you did not have the details of the cost.

Mr. RINEHART. We had substantial detail insofar as cost was concerned.

Senator PROXMIRE. How do you know for example that 90 percent of the work was not subcontracted out?

Mr. RINEHART. We have it reported in the record how much was subcontracted.

Senator PROXMIRE. Do you show that for product line?

Mr. RINEHART. No, we do not.

Senator PROXMIRE. How do you know then, in a major given product line, what the costs actually are?

Mr. RINEHART. We are evaluating this contractor on an overall basis according to the statute.

Senator PROXMIRE. You are evaluating these product lines on what basis, sir?

Mr. RINEHART. This contractor, sir, we are evaluating this contractor on an overall basis according to the statute.

Senator PROXMIRE. On an overall basis?

Mr. RINEHART. Right.

Senator PROXMIRE. Without breaking it out into what the labor costs are, what the materials costs are and so forth?

Mr. RINEHART. I do not know whether we have gone into detail that deep or not. But in evaluating that contractor, we depend upon our staff to evaluate, the office of accounting to evaluate the accounting, the office of review to review the case and we are guided by our staff.

Senator MATHIAS. Mr. Chairman?

Senator PROXMIRE. In one moment I will yield to you, Senator Mathias.

Is it not correct that the law requires you to consider reasonableness of cost, efficiency in making a proper determination? Are you not required to do that by law?

Mr. RINEHART. Yes.

Senator PROXMIRE. Well then, do you not have to have the details of the cost when you consider them? How can you do it on an overall basis without knowing just how the costs are broken down?

COSTS DATA

Mr. RINEHART. We have the costs broken down to a certain extent.

Senator PROXMIRE. You say you have them broken down to a certain extent but you did not know the details of the labor, the subcontracting, and so forth? I am not asking for an infinite breakdown, I am not asking you to follow up every detail, every element of cost that goes into it. But these are the major subcomponents of cost, and it seems to me that you should know that if you are going to have any notion of reasonableness of the cost, and without knowing what the costs are how can you determine whether the profit is fair or not?

Mr. RINEHART. I am certain we know what the costs are, Senator.

Senator PROXMIRE. You do not know if they are reasonable?

Mr. RINEHART. We apply the costs in the aggregate as to whether they are reasonable or not.

Senator PROXMIRE. Senator Mathias?

Senator MATHIAS. Thank you, Mr. Chairman. I think it might be useful to know the depth to which this investigation is carried. For instance, Mr. Rinehart, did you reply on information forwarded to the Washington office of the Renegotiation Board or did you or any member of the staff or the Board actually go to the company's offices and examine the original records of the company?

Mr. RINEHART. Senator Mathias, we have to, in order to get the true picture of this case—renegotiations started on this case before I was even named to the Board. It has been in the regional office for 4 years. Renegotiation started on August 1, 1969, at the Western Board, and went through every step, every procedure, of the Western Board's review, accounting and evaluation.

Senator MATHIAS. Would this be review of the company's original records?

Mr. RINEHART. This would be a review of the company's original records and the files in the company's offices. And when the regional board was finished evaluating the case and deciding the case they found a $5 million refund and so recommended it. The contractor refused to enter into an agreement. The contractor and the Western Board could not arrive on an agreement. It was then passed to our Board.

That is when it was turned over, 4 years later, and I was appointed chairman of the Division to handle the case.

Senator MATHIAS. When the Western Board was making its original investigation, when it was investigating the original books of the company, would they look at cost figures, at that time?

Mr. RINEHART. They would look at cost figures in processing this case the same as they would any other case.

Senator MATHIAS. And that would include all elements of cost?

Mr. RINEHART. All elements of cost.

Senator MATHIAS. After the $5 million refund was recommended and that recommendation came to the Washington office, was there any on-site investigation made by the Washington office ordered by members of the Commission or members of the staff, rechecking the work of the Western Division?

Mr. RINEHART. Our staff rechecked the work of the Western Division in detail accountingwise and later, in the office of review insofar as the Board is concerned.

Senator MATHIAS. Was this done in the Washington office or was any of this done in dealing with original records of the company in the company's office?

NEED FOR ADDITIONAL INFORMATION

Mr. RINEHART. No. There were several points brought up during the discussion of this case. Another member of the Board wanted additional information. The office of accounting sent our own accountants, our own staff, out to the company's offices, to try to obtain that information, which they did obtain.

Senator MATHIAS. Did they go because the company had refused to give it otherwise? Or because it was more effective to go and actually look at the records?

Mr. RINEHART. No. This information was deemed not necessary by the Western Board and was also deemed not necessary by the majority of the Board.

One member of the Board thought that this information would be helpful to him and that is the reason we sent our staff back to get the original information.

Senator MATHIAS. Did the Western Division or to your knowledge, has the Washington staff ever found the information requested as to cost, material, labor or any other item was unavailable, or was denied to the Board?

Mr. RINEHART. No information was denied the Board by the company.

Senator PROXMIRE. Mr. Rinehart, I think there is a confusion here. I think we have made it clear. What I am talking about is breaking down these details by product lines. Did you or did you not have the labor, the material costs and so forth by product lines?

Mr. RINEHART. I would like to defer that question to Mr. Grenough. He was running the office of accounting.

Senator PROXMIRE. You were in charge I think you should know. You are the Board member in charge of the inquiry.

Mr. RINEHART. I don't think we requested it by product line.

Senator PROXMIRE. You did not request it and you did not have it; is that the answer?

Mr. RINEHART. That is my knowledge.

Senator PROXMIRE. Let me point out that one of the product lines for example, is the F–4 and it seems to me it is very, very hard to determine whether or not the profits were reasonable and the costs were reasonable if you do not know on the F–4 what you paid for materials, what you paid for labor, how much was subcontracted out.

You have this on a global basis and do not have the specific product lines. How can you make a determination as to whether the profits were actually reasonable?

Mr. RINEHART. We knew how much was subcontracted out and we knew who the subcontractors were.

Senator PROXMIRE. You say you do not know?

Mr. RINEHART. We do know. It is a matter of record.

Senator PROXMIRE. On the F–4?

Mr. RINEHART. On the F–4.

Senator PROXMIRE. Did you have labor, materials, overhead?

Mr. RINEHART. We know what any material—any work that is subcontracted out, we know who the subcontractor is and the percentage or amount.

Senator PROXMIRE. Well, did you have, did you or did you not? I thought I understood you to indicate to me that you did not have the information on the F–4 for example, or other product lines with respect to costs and I am talking about labor, overhead, materials.

Mr. RINEHART. We did not have the costs for labor or materials.

Senator PROXMIRE. Now let me ask Mr. Chase, would you care to comment on these questions?

Mr. CHASE. Yes indeed, Mr. Chairman. I think it is important here to point out in connection with Mr. Rinehart's statements that it is true that all of the information that we asked for was supplied and all of the facts that we thought necessary to quote him were supplied.

But what he is not saying is that this information was furnished to us on a consolidated basis so that the extremely excessive high profits of the F–4 phantom jet were offset by the low to moderate profits of other, dissimilar product lines such as the space module, missiles, and so on.

A missile is not the F–4. A space module is not an F–4. One was a contract with NASA, the other a contract with the Navy.

Senator MATHIAS. Mr. Chase, you mention product lines which are, I would judge, all matters of government procurement.

PRODUCT LINES

Mr. CHASE. I am talking about product lines, Senator Mathias, as they relate to dissimilar product lines of a profit center.

Senator MATHIAS. All right. Now, differentiating between an industrial operation in which you may have several products and a conglomerate in which you have very, very diverse activities, you make toothpaste over here and earphones over here and Sherman tanks over here.

Are you talking about that wide a spectrum or are you just talking about the spectrum which you have described?

Mr. CHASE. I am talking about the Renegotiation Board process by product line.

Senator MATHIAS. What is your own philosophy on what should be done?

Mr. CHASE. Senator, I do not think it is correct to ask, if I may say so, what my philosophy is. My responsibility is to meet the mandate of the Congress and in this regard the statute is clear. The regulations promulgated by our office are clear. It is not a case of my philosophy.

My philosophy is to do what the statute provides and respond to the mandate of Congress and we have not done that by any test that you want to apply.

Senator MATHIAS. What is your view of what the mandate of Congress is? Maybe that is a better way of starting.

Mr. CHASE. My view of the mandate of Congress is that the Board has discretionary authority to examine product lines of a similar product of Defense, Space, Maritime Commission, Atomic Energy Commission, and those other agencies we are involved with and not to permit a conglomerate or a multidivisional corporation to escape with excessive profits because it has in one division in Santa Monica a low profit yielding missile against in St. Louis enormous, excessive profits in the F–4 fighter plane that they have been building for 9 or 10 years particularly where the learning curve has flattened out and has the same basic configuration. To make a judgment on a philosophical basis would not be realistic.

The majority of the Board took the position that the total multiplicity of contracts should be considered on a consolidated basis for the purpose of recovering excessive profits in 1967 involving sales of more than a billion dollars and profits of more than a hundred million dollars. A majority of the Board determined that $5 million was sufficient refund.

I am saying that if we had addressed ourselves to recovery of excessive profits by product lines we would have had a substantially higher return to the Treasury Department.

Senator MATHIAS. What I am trying to get at, and we all want the highest return for the Treasury, and that is why we are all here meeting together.

What I am trying to get is your philosophy, where you draw the line.

What do you call a product line? If you have a factory, an aircraft factory which is making several models of aircraft for the Government, do you average the profit and loss on that whole operation? But suppose you have a conglomerate which is making toothpaste in another city, not only another factory but another city, and earphones in still a third city at a third factory, do you want to average in the toothpaste and the earphones along with the airplanes or do you just consider the airplanes?

Mr. CHASE. No; we do not.

Senator MATHIAS. No, you do not what?

Mr. CHASE. In answer to your question, considering that all of the sales are renegotiable as to the first part, we could average the profits but different contract types should be looked at separately. As to the conglomerate, each factory, in my opinion, is a separate profit center and each product is a separate product line, and as such, should be looked at individually for determination of excessive profit of one without the other, then put back in the aggregate in arriving at a final determination.

Today as you heard here and on the 25th of July Mr. Rinehart has said we examined all of the original records. Well of course we examined the original records, but McDonnell Douglas would not let us obtain the records and information that I wanted to break out by product line to disclose the elements of the cost of goods sold.

I think that to say we were given all of the information we asked for is making a proposal that is far short of what is needed and required. In this regard perhaps I could give you a bit of documentation, Mr. Chairman, Senator Mathias. May I proceed with this documentation?

Senator PROXMIRE. Yes. Go right ahead.

COSTS DATA REQUESTED

Mr. CHASE. On August 7, Mr. Grenough, who is the Director of Accounting for the Statutory Board, was the author of a paper that was involved with the discussion he and Mr. Davis, my assistant, and Mr. Stone had with Mr. Richard Kaufman who is on the staff of Senator Proxmire's subcommittee. I will not concern you with all of it because it is lengthy.

They are talking about the questions as they pertain to this subject of our discussion here and he says: Certain questions were asked relating to the absence of cost of goods sold, broken down by elements of cost and then goes on to say that the knowledge of material, labor and overhead in connection with those costs, was not obtained in the McDonnell Douglas case.

Those words from Mr. Grenough and concurred in by our Mr. Davis and Mr. Stone.

Senator PROXMIRE. Will you submit that document for the record?

Mr. CHASE. This confirms my statement of July 25.

Senator PROXMIRE. You may go ahead, but will you submit it for the record?

Mr. CHASE. Yes; I will send it to you. Mr. Davis, will you make a note of that?

[The document follows:]

MINUTES OF MEETING—WEDNESDAY, AUGUST 7, 1974

For the Board: Harold E. Stone, Director, Office of Administration, Donald S. Grenough, Director, Office of Accounting, John B. Davis, Special Assistant to Board Member

Staff of Senator Proxmire: Richard Kaufman, Maurice Pujol

Reference: McDonnell Douglas Corporation FY 1967, 1968 and 1969

Mr. Kaufman had called Mr. Stone asking for financial data related to the various divisions of McDonnell Corporation. After discussion with Mr. Rinehart's office and Mr. Grenough, Mr. Stone informed Mr. Kaufman that the attachment to Mr. Moreland's June 7, 1974 memorandum, which had previously been furnished as a result of the prior hearings, included schedules which segregated renegotiable sales, costs and profits for the McDonnell entity as opposed to the Douglas entity for the review years. In addition, the attachments subdivided the renegotiable sales, costs and profit for each of the McDonnell and Douglas components into type of contract, i.e., FFP, CPFF, FPI and CPIF.

In addition, Mr. Kaufman requested a display of products produced by the various divisions within the McDonnell Corporation. This information was prepared by Mr. Moreland and furnished to Mr. Kaufman, prior to the meeting on August 7, 1974.

After discussion of this matter with Chairman Whitehead, it was decided appropriate to visit with Mr. Kaufman and assist him in any questions he may have in regard to the information furnished.

In the meeting, Mr. Kaufman raised no question on the financial information previously described that had been furnished to him. Regarding the display of products produced by divisions, he said he would appreciate a more complete breakdown of the nature of the products produced within the divisions, so as to be more definitive as to the products actually produced. For example, he indicated

that the F–4 Phantom jet aircraft was not produced in its entirety by McDonnell, i.e., the engines for such aircraft were produced by someone else and furnished to McDonnell for inclusion in the aircraft. We pointed out that it is true that certain amounts of subcontracting work took place in any of the line items of products produced in the various divisions, and that such subcontracting could either be among the companies included in the consolidated filing, or could have been subcontracted to companies outside of the consolidated filing, i.e. companies not in any way connected with McDonnell Douglas Corporation.

Mr. Moreland prepared some additional information on this subject of types of products, and it was furnished to Mr. Kaufman on Friday August 9, 1974, who had no further questions on the matter.

Mr. Kaufman wanted to discuss the Chairman's "Notes" which described the method of renegotiating a contractor with renegotiable business in more than one division or subsidiary which was read into the record at the prior hearings on July 25. He was interested in knowing several things about this statement, i.e., who prepared it, whether it was circulated and coordinated with staff and/or Board Members. Mr. Grenough indicated that several days prior to the hearings the Chairman had expressed a desire to Mr. Harrison and Mr. Grenough to attempt to develop a brief statement that gave an overview of the process historically used by the Board in evaluating a multidivisional contractor. Mr. Grenough indicated that he had prepared a draft and had furnished it to the Chairman after discussion of certain concepts with other staff members.

Mr. Kaufman was informed that we did not know whether the Chairman had coordinated that statement with other Board Members or the extent to which he had discussed the matter with staff. The question was specifically asked whether or not the statement was coordinated with the Office of General Counsel, and Mr. Grenough said he didn't believe that it was.

In this connection, we believe the upcoming hearings may include questions of the relationship, and possibly inconsistencies, between General Counsel's February 22, 1974 memo to Mr. Chase and Chairman Whitehead's "Notes" described above.

Mr. Kaufman described his concern in understanding the portion of the statement at the bottom of page 1 "Instead the differences that concern the Board include such broad areas of technology, manufacturing, engineering techniques, types of contracts and history of products." Mr. Grenough suggested to Mr. Kaufman that this kind of question could best be directed to representatives of the Office of Review, since the accounting function within the Board relates primarily to the gathering of financial information, and verification thereof, it believes, in collaboration with the renegotiator, to be useful and necessary to the renegotiator and Board Members in the evaluation of the case. The actual evaluation of such financial data and the extent to which financial information is gathered, i.e., the decision to develop sales, cost and profit by various phases of the business, is an analytical question which relates to the nature of the case, and how the statutory factors will be applied to such case. Nevertheless, Mr. Kaufman wanted to pursue the issue, so several examples were furnished wherein sales, cost and profit data would be developed for substantially different phases of the business, such as where the contractor operated a GOCO plant and in addition manufactures a product with its own facilities. In these circumstances the implementation of the Chairman's statement would indicate that separate financial data would be developed for each of these two broad phases of the contractor's business.

Mr. Kaufman asked for a summary of those DOD top 100 contractors during fiscal years 1967–1970 wherein certain segments of the contractor's business were broken out from other segments so as to disclose sales, cost and profit for the separate segments. Mr. Kaufman wanted this information for only cases assigned to the region and completed by the Board. Mr. Kaufman asked for an estimate of how many of the top 10 companies would this procedure be followed, and Mr. Grenough speculated perhaps five to fifteen of the top 100 would be approached in this manner.

In collaboration with Mr. Stone, Mr. Grenough's office developed a list of such contractors which was furnished to Mr. Kaufman on Friday, August 9. The covering sheet attached to this data pointed out that in a consolidated filing any differences in product and financial data among the separate corporations are visible to the Board since each corporation entity in the consolidation files a separate RB–1. The data furnished to Mr. Kaufman is therefore confined to those separate corporate entities engaged in renegotiation activities that were suf-

ficiently diverse to warrant disclosing sales, costs and profits of various segments within the corporation.[1]

Mr. Kaufman asked certain questions relative to the absence of cost of good sold breakdown by elements of cost, which related to the prior testimony of Mr. Davis and Mr. Chase. The nature of this question was discussed to some extent as to the type of purposes to which such information could be used, i.e., the knowledge of material, labor and overhead and the type of use to which this information could be put in an evaluation sense. It was explained that this information was not obtained on the basis that it was not readily available when the case was being worked, but more importantly the information was not deemed necessary in order to properly evaluate the case by either the accountant or renegotiator or Board Members in the Western region, nor the statutory Board Members at this level.

Based on this meeting it would appear that Senator Proxmire may choose to ask questions in the following general areas:

(a) The absence of developing sales, cost and profit data for McDonnell as distinct from Douglas when the case was processed would seem to indicate that the statutory factors were applied to the contractor as a whole rather than to any select phases of its operations. Considering the breadth of the products produced, as evidenced by the display of products within the various corporate segments, how is it practical or possible to apply the factors to such a broad area of products? (Mr. Chick is developing some information on this subject).

(b) A further definition and better understanding of the circumstances that caused the Board to seek out sales, cost and profit data for segments of some contractor's operations rather than to apply the factors to the financial results of the corporation as a whole, as was done in the McDonnell Douglas case. (Mr. Chick is developing some information on this subject).

(c) The absence of the cost of goods sold elements, i.e., material, labor, overhead, subcontracting, etc. is dealt with in Mr. Chase's dissent as a deficiency in staff development of the case. In the absence of such information what analytical approach was used, if any, in lieu of this type of cost of goods sold breakdown? (Mr. Grenough and Mr. Moreland prepared a draft on this subject and furnished it to Mr. Chick for his consideration).

(d) Possible inconsistencies between the General Counsel's February 22, 1974 memo to Mr. Chase and Chairman Whitehead's "Notes" provided at the last hearing.

INADEQUATE INFORMATION

Mr. CHASE. Mr. Chairman and Senator Mathias, this confirms my statement of July 25 at this committee hearing. The Board did not obtain complete or adequate information from McDonnell Douglas to determine the true excessive profits for the years 1967–1968 and 1969. I would like to point out that when Mr. Rinehart is talking about sending out to St. Louis for additional information, it must be remembered that that was months after the Board majority made its determination of $5 million, months after it had made that decision. The man from staff who took that assignment is Mr. Robert Moreland. He returned on June 7 or the report at least is dated June 7. I would like to review from what Mr. Moreland reported. I asked a number of questions during our meeting following Mr. Moreland's return from St. Louis. In answer to one of my questions Mr. Moreland said the contractor, "does not at this time choose to provide any further data."

[1] For information purposes, the following describes the number of DOD top 100 filings assigned to the regions, and CWA during the period 1967–70. The number of such filings is in excess of 100 for each year, since it includes subsidiaries of companies listed in the DOD top 100 contractors:

	1967	1968	1969	1970
CWA	148	168	174	156
Assigned	38	37	36	67

Senator PROXMIRE. We would like that document for the record also.

Mr. CHASE. You already have it, I think.

Senator PROXMIRE. We have it? All right.

INFORMATION AVAILABLE

Mr. CHASE. Mr. Moreland further reported it is McDonnell Douglas' position, that it should be renegotiated in total, consolidated in other words, without the examination of product lines, or profit center or divisional basis. He goes on to say, that because of the contractor's refusal to allow us to make Xeroxed copies of any of its working papers, it was necessary to first review and then extract, by hand, all pertinent data necessary for the preparation of the schedules, and again on several occasions the contractor expressed its objection to anything even remotely similar to a divisional or component breakdown of the elements of sales, costs, and profits.

Mr. Chairman, I would like to give you Mr. Moreland's responses to my questions after he wrote his report. He is a very capable man but he went to St. Louis with instructions for limited information. He was told by the contractor that he could not get what we wanted in order to rewrite our dissent. So the trip was an exercise in futility. I asked Mr. Moreland and I refer to my memorandum, "Following the review of 1967, 1968, and 1969, did McDonnell submit photographic copies of the worksheets?" Mr. Moreland's response was, no.

I asked him if there was sufficient information obtained to break out the elements of the costs of goods sold, such as cost of materials, subcontracting and labor. Mr. Moreland said there were no elements for cost of goods sold by labor, material, or overhead.

I asked him if he thought he could determine the value added.

He stated that he could not.

Mr. Moreland was not able to determine the amount of labor employed in the production of the F–4 or the other profit centers or components of McDonnell Douglas. I asked him if we could make a comparison between the contractor's proposal or the cost estimates and actual costs of fixed price incentive contracts. Again, Mr. Chairman, Mr. Moreland's answer was "no."

Now, at the conclusion of the meeting, at which time Mr. Rinehart and members of staff were present, I attempted to relate percentage of profits to sales in the *Grumman* case, wherein the Board, on a product line basis, it produced the Hawk, made a determination of 6.3 percent after compromising from 6.7 percent with sales aggegating approximately $1 billion.

I inquired why, in the *McDonnell Douglas* case we determined a profit figure substantially higher, Mr. Rinehart said he could not answer that and he had no recollection of why the Board previously had ended up with 6 percent plus of sales in the *Grumman* case.

In relationship to one of the factors, we considered the matter of percentage of profits to net worth, among other statutory factors.

At the time I wrote my dissent, and considering the year 1967 alone, our regional office in Los Angeles reported that the McDonnell component made $98,182 million in profits.

That, sir, is a return of 98 percent on McDonnell's net worth, not 61 percent, that I accepted at that time as being an accurate return on net worth for McDonnell Douglas Corp. and is reflected as being valid in the memorandum of the majority opinion.

Senator PROXMIRE. Did you say there was a 98-percent return, even after they gave back the money?

Mr. CHASE. Before the refund.

Senator PROXMIRE. How much after the refund?

Mr. CHASE. We did not calculate that, Mr. Chairman.

Senator PROXMIRE. Would it be over 90 percent?

Mr. CHASE. It was subsequently reported to be 98-percent return on net worth. In other words, McDonnell made nearly as much before taxes in 1967 as their total net worth.

Senator PROXMIRE. After renegotiations, it was over 90 percent according to my calculations. Am I right or wrong?

Mr. CHASE. Yes, I presume approximately right.

Senator PROXMIRE. All right. Go ahead.

RETURN ON NET WORTH

Mr. CHASE. It is important to understand here, in fairness to my colleagues, that the 61-percent return on net worth was our Western Regional Board determination.

The region had a hearing with the McDonnell Douglas Co. and the company convinced the Regional Board that it should massage $68 million of the contractor's nonrenegotiable capital with renegotiable capital. That had to do with commercial sales, to reduce the percentage of profits to net worth, thus justifying the lesser refund of excessive profits. Our regional board bought it and so did the Statutory Board here.

Now, even with the massaging of that $68 million into this, if they had examined the product line of McDonnell alone, the F–4, it would have been 86.7 percent return on net worth for the McDonnell component which is a staggering return on net worth, but doing it on a consolidated basis it was 61 percent and that is what I erroneously accepted and is reflected in my dissent.

Senator PROXMIRE. But it is still a staggering excessive profit in my view if you make 61 percent of your net worth in 1 year under any circumstances.

Mr. CHASE. It was not 61 percent, it was 98 percent, for McDonnell by the Accounting Division in the region and it was 86.7 percent in the McDonnell segment even after massaging the figures.

Senator PROXMIRE. May I just ask you Mr. Chase, are you about through? How much more documentation do we have? We have some questions.

Mr. Chase. May I finish this?

Senator PROXMIRE. How long will it take?

Mr. CHASE. One minute.

Senator PROXMIRE. All right. Go ahead.

Mr. CHASE. The Director of the Division of Accounting, Mr. William Rice, was apparently so upset with his colleagues having been reversed that he wrote a memorandum to the file. We discovered it recently. I would like to read just one portion of it to point out his concern.

He says:

> The essence of the annualization of the Douglas component in the computation is to reflect the return as if the contractor had the net worth capital employed and profits for a full 12 months. Therefore, the allowance and he means by the region overriding him "of any portion of the $68.7 million would constitute a double allowance."

Mr. CHASE. It is the consensus here that McDonnell Douglas wanted to bring profits as a percentage of net worth to about 60 percent to conform to the so-called norm the *Grumman* case had been citied for. My assistant said, and I concur with him that if we had known at the time that 98 percent return on McDonnell Douglas net worth was the true return on net worth, the $31 million refund to which my dissent refers to would be a token refund.

Further, I would like to say, Mr. Chairman, in view of all the information my colleagues contend they have called upon as being adequate I took a further step. I had a highly responsible member of staff make an examination of this and he reported back to me that it was clearly wrong but more importantly that he could not determine from the files why it was done.

Senator MATHIAS. Mr. Chase, you said a minute ago and I would agree with it, and certainly respect the statement, that it was not your personal philosophy but the law under which the Board operated that had to cover your activities and judgments. I am not saying that the law is always right, times change and the law sometimes is too slow in changing with them.

But I am reading now from the act, in section 105, in which it says:

> The Board shall exercise its power with respect to the aggregate amounts received or accrued in the fiscal year or such period as may be fixed by mutual agreement by contractor or subcontractor in contracts with the Departments and subcontracts

And this is the important part:

> And not separately with respect to amounts received or accrued under separate contracts with the Department or subcontracts, except as the Board shall exercise such power separately with respect to amounts received or accrued with a contractor or subcontractor or under one or more separate contracts at the request of the contractor or subcontractor.

Does that not really mandate the Board to consider the total operation?

APPLICATION OF FACTORS

Mr. CHASE. Not at all, Senator Mathias. We have a legal opinion from our distinguished general counsel and I would suggest that you ask him to answer that question and when he does I will be glad to put my stamp of approval on it because I know that subject very well.

Senator MATHIAS. As I understand it, when Congress originally addressed this whole question, it did provide for contract by contract review, and that was subsequently changed to take in the aggregate question.

However, Mr. Chairman——

Senator PROXMIRE. Yes, we would like to hear from Mr. Lambert. Mr. Lambert, I might refer to the memorandum dated February 22, 1974, with which you responded to Mr. Chase and I will read two sentences in the beginning and you can comment.

> The answer is affirmative to your question of whether the Board under the present act and regulation may examine cost of profits generated by division, single profit center or product line of a contractor's filings, including more than one such division, single profit center or product line, whether the Board can apply the statutory factor to those individual entities.

This seems to be the issue and Senator Mathias did read a part of the statute that may seem to contradict that. Can you straighten us out on that?

Mr. LAMBERT. Yes, sir. I think the first point that might be made here is the fact that the Board has on many occasions looked at separate product lines and left profits at certain levels and then determined excessive profits from the other segments, but in conclusion the Board exercised its powers in the aggregate which included the complete entity.

Senator MATHIAS. Was that by agreement with the contractor?

Mr. LAMBERT. No, sir.

Senator MATHIAS. Over the protest of the contractor?

Mr. LAMBERT. No, sir.

Senator MATHIAS. Well, it is either with the agreement or over the protest of. Which one? It can't be both.

Mr. LAMBERT. The contractor did not object to it.

Senator MATHIAS. Did not object to it?

Mr. LAMBERT. That is right.

Senator MATHIAS. Well the statute very clearly provides where the contractor does not object that you can do it.

Mr. LAMBERT. Senator, the example I am referring to did not involve specific contracts as such. It involved separate operations or segments. One segment was a GOCO and one was a chemical operation. So specifically that language you referred to involves individual contracts as opposed to product lines, you are correct, you cannot renegotiate by contract, individual contract, without the expressed agreement in the contract. However, individual contracts may be examined.

Senator PROXMIRE. In the specific case with respect to McDonnell Douglas' F–4, did they object?

Mr. LAMBERT. They objected to discussing or making a presentation on their various product lines.

Senator PROXMIRE. Then what legal justification did you have for going ahead and doing this as Mr. Chase wanted to do it?

Mr. LAMBERT. Well, under the Renegotiation Act it is a judgmental matter for a board to decide in what depth they wish to go in looking at these contracts, and the Board, the majority of the Board, chose to look at McDonnell Douglas as one group.

Senator PROXMIRE. Well, the Board having done that as a whole, the Chairman has testified to that effect and apparently Mr. Rinehart was in charge. It was his determination. How can one member of the Board, then, or can one member of the Board, is he free somehow under the statute, to ask for a breakdown?

Mr. LAMBERT. I think it is implicit in any operation of a Board of this sort that the individual Board member has the right to be satisfied with reasonably relevant information, and I do not believe that a Board like this can operate by withholding or preventing a Board member from getting the information upon which he feels he wants to make his determination.

Senator PROXMIRE. Let me ask it this way. Did the Board have the authority to do what Mr. Chase wanted to do with respect to McDonnell Douglas under this statute?

Mr. LAMBERT. Yes. Without any question it had the authority.

Mr. CHASE. Mr. Chairman?

Mr. WHITEHEAD. Mr. Chairman.

Senator PROXMIRE. Let Mr. Chase answer that and then I will come back to you.

Mr. WHITEHEAD. He has been talking for a long time.

LEGAL OPINION

Mr. CHASE. I was asked to explain my position on this, Mr. Whitehead.

What Mr. Lambert had said is the essence of the problem. In its wisdom, the Congress, gave the Renegotiation Board a mandate and while clearly the Board has great discretionary powers, it also in my judgment has a high degree of fiduciary responsibility. On the one hand, there is a range of impreciseness in the renegotiation process, on the other, there is a point beyond which you cannot exceed that range. The Board exceeded the range considerably, and in my opinion violated its fiduciary responsibility.

If in a collateral way I may be permitted to support this position, I would like Mr. Davis, my assistant, to read a paragraph in the regulations which clearly identifies the question that Senator Mathias referred to.

Senator PROXMIRE. All right. Go ahead. And then we will go to Mr. Whitehead.

Mr. DAVIS. Mr. Chairman, to put this question in perspective with respect to the regulations, we have to keep in mind that we are dealing here with the contractor generating $1,600 million in renegotiable sales of which $906 million of those sales were generated by the McDonnell Co. on fixed price incentive contracts for the 1967 fiscal year.

With respect to fixed price incentive contracts, the regulations that are promulgated by the Board as an outgrowth of the statute provides, that while renegotiation will be conducted with respect to the aggregate of the contractor's renegotiable business whether fixed price or cost plus a fixed fee which contain incentive provisions, it will be separately considered. There will be a separate consideration of the incentive contracts and the details of the cost related thereto.

This is what we are talking about, the types of contracts. We were looking for the details of the cost of sales that was related to $906 million in sales on fixed price incentive contracts.

I might say further that we have precedent on the application of these regulations, wherein the Supreme Court has held that the regulations prescribed by a Government agency are binding upon them and those regulations have the force of law.

Senator PROXMIRE. You are reading from the regulations of the Board?

Mr. DAVIS. Yes, sir.

Senator PROXMIRE. I am sorry, Mr. Whitehead, but I would like Mr. Lambert once again to state his opinion on this matter.

It is in response to Senator Mathias. He was called away on the phone when you were replying.

Mr. LAMBERT. I forgot just where we were because I was talking while you were on the phone, Senator.

Senator PROXMIRE. Does the Board have the legal authority to do what Mr. Chase wished to do with respect to the breakdown?

Mr. MATHIAS. In the absence of a request or acquiescence from the contractor, in which case it would clearly be within the statute.

EXAMINATION OF CONTRACT DATA

Mr. LAMBERT. They have the legal authority to examine the contracts of the McDonnell segment as they have done in prior years, looking at them individually and collectively and then applying the statutory factors to them collectively as they did in the prior year and then treat them, exercise their powers, in the aggregate.

Senator MATHIAS. Right. To look at them separately. But in order to comply with the statute they would have to apply it in the aggregate.

Mr. LAMBERT. That is correct.

Mr. MATHIAS. I can understand that. Do you know, Mr. Chairman, it might be useful—and I do not want to interrupt Mr. Lambert. Are you finished?

Mr. LAMBERT. My point is the act says "exercise its powers with respect to the aggregate." The powers involve a whole series of things, the right to issue unilateral orders, the right of determining excessive profits, etc.

Senator PROXMIRE. Now, Mr. Whitehead, I wanted to conclude as soon as we can. There is a vote on now.

Senator MATHIAS. Mr. Chairman, it might be useful at this point to make one intervention here.

Although Mr. Chase very properly says he will not make any philosophical statements, perhaps I can.

It is interesting to look at the Brooks Committee's report on this point. They recommend this:

> To facilitate the accumulation of sales by a commodity grouping or product line, contractors should be required to report costs of products on a contract-by-contract basis.
>
> These reports should be audited by Defense auditors with modern day processing techniques and adequate staff resources. The accumulation, classification and evaluation of such information on a contract-by-contract basis would be both practical and reasonable.

Obviously, such information would be invaluable in auditing contracts and filings with negotiations.

Senator PROXMIRE. What Mr. Lambert and Mr. Chase are saying is that the Board already has the authority to do that. Is that right, Mr. Lambert?

Mr. LAMBERT. No, sir.

Senator PROXMIRE. Do you say you do not have the authority to do it?

Mr. LAMBERT. You do not have the authority to do what Senator Mathias was just talking about.

Senator MATHIAS. Those were the recommendations of the Brooks committee.

Let me say they appeal to me, but I think that the very fact that they recommend the changes in the law moving in that direction would indicate that at least the Brooks committee did not think that is what the law provided.

Mr. LAMBERT. Senator, the basic distinction between the act today and what you are suggesting is that the Brooks committee recom-

mended that they report the profits on a contract by contract basis. That would require a statutory change. That would mean we could no longer get the consolidated filing that we have today. That is the distinction.

Senator PROXMIRE. We have to go, I am sorry, we will be right back.

[Recess.]

Senator PROXMIRE. The subcommittee will come to order.

Mr. Rinehart, according to press reports, Mr. Rinehart conducted negotiations in a case involving the Miller Box Co. aboard Mr. Rinehart's 45-ft yacht in Florida. Is that true?

NEGOTIATIONS WITH MILLER BOX ATTORNEY

Mr. RINEHART. We did not negotiate the case. We discussed the settlement of the case, and I would like to correct you—it is a 43-ft cabin cruiser, sir.

Senator PROXMIRE. I was 2 feet off. Well, all right, it is good to be precise. Who initiated the meeting aboard this 43-ft cabin cruiser, and why were not negotiations conducted in more regular surroundings?

Mr. RINEHART. We were not conducting negotiations. This case was concluded by the Board, and we had arrived at an area of settlement, a figure which we had hoped we could arrive at an agreement. This case was heard and decided on the last week in January, I believe, if my memory serves me right. I was on my way to what I thought was a well-earned vacation, but it turned out to be a working vacation. Mr. Hinton, who was the owner of Miller Box, had called the staff and arranged to meet me in Florida instead of both of us flying back to Washington. It was not renegotiation. It was a matter of trying to work out an agreement.

This case had many legal problems in as far as salary disallowances were concerned, and this was not the only meeting we had with Mr. Hinton. We had had several meetings.

Senator PROXMIRE. If it was already decided, what remained to be done?

Mr. RINEHART. To try to work out an agreement. Mr. Hinton agreed on $5 million, and the Board thought the excessive profits should be $6 million.

Senator PROXMIRE. Well, a final decision had not been reached yet. I understand the Regional Board recommended Miller Box be charged with $8.3 million in excessive profits, but the amount agreed upon during the yacht negotiations was $5.75 million. Can you verify or correct my figures, and tell us what information was given you aboard the yacht to cause you to decrease the recommendations?

Mr. RINEHART. None whatsoever. It was an accounting adjustment, principally an accounting judgment.

Senator PROXMIRE. What adjustment?

Mr. RINEHART. An accounting adjustment, which was done prior to my meeting with Mr. Hinton.

Senator PROXMIRE. You say it was done prior to this discussion on the yacht?

Mr. RINEHART. Oh, yes. When Mr. Hinton visited me in Florida, and I believe prior to that in Washington, the feeling on the recommendation was $6 million, not $8 million.

Senator PROXMIRE. You have just testified, however, when I asked what was being done if everything had been decided before, you said you decided on the amount. Is that not what you said with respect to the proceedings on the yacht?

Mr. RINEHART. We decided on the amount on the yacht?

Senator PROXMIRE. Yes; is that correct?

Mr. RINEHART. That is not correct, sir.

Senator PROXMIRE. What did you decide?

Mr. RINEHART. We did not decide anything. We discussed the case. Mr. Hinton refused to agree to the $6 million refund. We shook hands. I bought him his dinner, paid for it myself, and he returned to Alabama.

Senator PROXMIRE. How many other matters have been decided on this 43-foot cabin cruiser?

Mr. RINEHART. Mr. Chairman, this is the only case to my knowledge that was ever discussed there, and the first time that I went on a working vacation, and I was concerned about this, sir.

Here we have a contractor who owes the government $6 million, has owed this money for 6 or 7 years, interest-free, not even 4 percent, and as a taxpayer and citizen of this country, I thought that the $25,000 per month that the Government was losing, the sooner we could bring this case to a conclusion, the better off we would be.

Senator PROXMIRE. You see what concerns us, Mr. Rinehart, is that you are representing the U.S. Government. You are on a Board of the Government regulating an industry, and it seems to be unusual to entertain the people whom you are regulating under these circumstances as a congenial host on your 43-foot cabin cruiser. It does not seem to fit into the usual notion of how a regulatory board ought to operate. We have criticized regulatory boards in the past, but this is a most unusual atmosphere at which to determine anything, or even to discuss the matter.

Mr. RINEHART. Well, are you inferring that we should have went out and leased a room somewhere to talk the matter over. I was there on vacation. Mr. Hinton wanted to discuss the case. He called my office about an appointment; an appointment was arranged. The fact of the matter is, I took some papers along on my vacation.

Senator PROXMIRE. You could have gone to the Federal courthouse and had an office there to discuss the matter with him.

Mr. RINEHART. It would make no difference to me where I discussed the case, whether I discussed it in the Federal courthouse, on my boat, or in a hotel room.

Senator PROXMIRE. All right, Mr. Whitehead, in a more recent case, the Board voted to clear without investigation a filing by Mobil Oil showing losses of its 1972 Defense contracts. Will you tell us why you decided there were no excess profits without requiring any investigation of the facts?

EVALUATION OF MOBIL FILING

Mr. WHITEHEAD. Mr. Chairman and Senator Mathias, in the cases where we have a filing like Mobil's, which is reviewed by the Office of Review to determine whether it should go to the field for intense review and hearing, et cetera, we have a report from that office.

On each one of these type of cases, and in this particular instance, on May 3, 1974, we, the Board, were provided a 10-page report from

the Office of Review and two reports totaling six pages from the Office of Accounting, as to the details and as to the effort and extent to which they went in evaluating this case to recommend whether the Board should go further into the case at the regional level.

[The information follows:]

August 3, 1973

MEMORANDUM TO: The Renegotiation Board

FROM: William H. Harrison
Acting Deputy Director

SUBJECT: DOD List of 100 Largest Companies and Affiliates
DS&E List #1583 - Mobil Oil Corporation

The Division of Screening and Exemptions recommends that Mobil Oil Corporation be referred to the Eastern Regional Renegotiation Board for verification to:

1. Determine methods of allocation of expenses.

2. Determine adjustment necessary to place the contractor on a consolidated basis.

Approved as CWA's
by Board 8/7/73

MEMORANDUM May 3, 1974

TO: The Renegotiation Board

FROM: William H. Harrison, Director
Division of Screening and Exemptions
Office of Review

SUBJECT: DS&E List No. 1665 - "DOD 100 Cases"
Recommended Clearances Without Assignment.

Renegotiation must be commenced
by September 17, 1974

Mobil Oil Corporation (New York)
#11482
FYE: 12/31/72
Parent of the following 23 wholly-owned subsidiaries:
#88008 Mobil Petroleum Co., Inc. (Guam Branch)
#88844 Mobil Oil Australia Limited
#88847 Mobil Oil Zaire
#88850 Mobil Oil de L'Afrique Occidentale
#88851 Mobil Oil East Africa Limited
#88854 Mobil Oil Hellas A.E. Petroleum Company
#88856 Mobil Oil Lebanon, Inc.
#88857 Mobil Oil Liberia, Inc.
#88858 Mobil Oil New Zealand Limited
#88860 Mobil Oil Philippines, Inc.
#88861 Mobil Oil Portuguesa,S.A.R.L.
#88863 Mobil Oil Southern Africa (Proprietary) Ltd.
#88865 Mobil Oil Turk Anonim Sirket
#89554 Mobil Oil Hong Kong Limited
#89555 Mobil Sales & Supply Corporation
#89557 Mobil Oil Maroc
#90039 Pinnacle Trading Company, Inc.
#92457 Handy Oil Corporation
#96128 Mobil Oil Aktiengesellschaft in Deutschland
#88846 Mobil Oil Company Limited
#93846 Mobil Research and Development Corporation
#96539 Mobil Oil Singapore-Pte. Ltd.
#88843 Mobil Oil Barbados Limited

The contractor has requested concurrent renegotiation for the parent company and all the listed subsidiaries and has waived the loss carry-forward on each company that sustained a renegotiable loss

The following sets forth a pro-forma consolidation of the parent and the twenty-three wholly-owned subsidiaries.

Renegotiable Business:	
Sales	$ 114,280
Profit	(503)
Percent	Loss
Non-renegotiable Business:	
Sales	6,101,116
Profit	(118,295)
Percent	Loss
Total Business:	
Sales	6,215,396
Profit	(118,798)
Percent	Loss

Mobil Oil Corporati

The following tabulation sets forth the renegotiable, non-renegotiable and total operations for the parent and each of the subsidiaries. All of the renegotiable business was under fixed price contracts.

No.		Renegotiable Business			Non-Renegotiable Business			Total Business		
		Sales	Profit	%	Sales	Profit	%	Sales	Profit	%
11482	- Mobil Oil Corporation	$ 95,218	$ 2,030	2.1	$2,225,823	$(48,324)	Loss	$2,321,041	$(46,294)	Loss
[illegible]	- Mobil Petroleum Co., Inc. (Guam Branch)	302	(4)	Loss*	13,622	1,976	14.5	13,924	1,972	14.2
[illegible]	- Mobil Oil Australia Limited	307	8	2.6	326,336	25,208	7.7	326,643	25,216	7.7
[illegible]	- Mobil Oil Zaire	74	5	6.8	25,311	1,664	6.6	25,385	1,669	6.6
[illegible]	- Mobil Oil De L'Afrique Occidentale	31	1	3.2	45,967	2,823	6.1	45,998	2,824	6.1
[illegible]	- Mobil Oil East Africa Limited	1,217	50	4.1	19,370	945	4.9	20,587	995	4.8
88854	- Mobil Oil Hellas A.E. Petroleum Company	15	1	6.7	98,792	2,690	2.7	98,807	2,691	2.7
88856	- Mobil Oil Lebanon, Inc.	3	-	-	32,459	671	2.1	32,462	671	2.1
88857	- Mobil Oil Liberia, Inc.	289	9	3.1	2,964	93	3.1	3,253	102	3.1
88858	- Mobil Oil New Zealand Limited	734	(12)	Loss*	54,408	6,426	11.8	55,142	6,414	11.6
88860	- Mobil Oil Philippines, Inc.	504	(31)	Loss*	55,505	(3,240)	Loss	56,009	(3,271)	Loss
88861	- Mobil Oil Portuguesa, S.A.R.L.	581	92	15.8	102,409	7,509	7.3	102,990	7,601	7.4
88863	- Mobil Oil Southern Africa (Proprietary) Ltd.	68	3	4.4	240,623	13,332	5.5	240,691	13,335	5.5
88865	- Mobil Oil Turk Anonim Sirketi	657	(194)	Loss*	198,121	49	-	198,778	(145)	Loss
89554	- Mobil Oil Hong Kong Limited	99	8	8.1	28,438	2,836	10.0	28,537	2,844	10.0
89555	- Mobil Sales & Supply Corporation	13,055	(2,471)	Loss*	1,365,971	(164,647)	Loss	1,379,026	(167,118)	Loss
89557	- Mobil Oil Maroc	198	13	6.6	31,322	1,050	3.4	31,520	1,063	3.4
90039	- Pinacle Trading Company, Inc.	1	-	-	25,729	(1,428)	Loss	25,730	(1,428)	Loss
92457	- Handy Oil Corporation	11	1	9.1	753	42	5.6	764	43	5.6
96128	- Mobil Oil Aktiengesellschaft in Deutschland	93	2	2.2	635,992	15,735	2.5	636,085	15,737	2.5
88846	- Mobil Oil Company Limited	616	8	1.3	462,537	15,382	3.3	463,153	15,390	3.3
93846	- Mobil Research and Development Corporation	27	(14)	Loss*	53,251	(198)	Loss	53,278	(212)	Loss
96559	- Mobil Oil Singapore - Pte. Ltd.	179	(8)	Loss*	50,949	1,043	2.1	51,128	1,035	2.0
88843	- Mobil Oil Barbados Limited	1	-	-	4,464	68	1.5	4,465	68	1.5
	Total	$114,280	$(503)	Loss	$6,101,116	$(118,295)		$6,215,396	(118,798)	Loss

* Waiver of loss carry forward submitted.

The parent companies' operations represent 83.3% of the total. Its statistics are set forth below:

1972: The renegotiable business was the production, refining, marketing and transportation of gasoline, jet fuels, residual fuels, lubricating products and transportation services.

Materials represent 80.6% of renegotiable cost of goods sold.

The return on allocated net worth was 3.9% and on capital employed was 2.5%.

The contractor has advised that there are no pending claims or litigation which would affect renegotiable sales and profits.

The IRS has not examined the year under review. The year 1965 and prior are settled. The last year examined is 1969 and there are a few items of this year still under review. None of the disputed items from 1966 through 1969 would have changed renegotiable sales or profits.

The FTC statistics on this contractor in this category are:

Group No. 72A-29 (Petroleum refining)

Return on Sales	8.4%
Return on Capital	6.6%
Return on Net Worth	10.9%

Because the parent contractor's statistics are less than those of the FTC, a C. W. A. is recommended.

This is one of the "DOD'100" contractors.

The parent company and its subsidizries were C. W. A.'d in the prior year on a more detailed format. A copy of this submission is attached hereto.

Attachment

MEMORANDUM August 3, 1973

TO: The Renegotiation Board

SUBJECT: Recommended Clearance Without Assignment - DS&E List No. 1583

Renegotiation must be commenced by
October 1, 1973

The Division of Screening and Exemptions, Office of Review, recommends that Mobil Oil Corporation and its twenty-two (22) wholly-owned subsidiaries for the fiscal year ended December 31, 1971 be cleared without assignment. (All figures are stated in thousands of dollars.)

The parent and subsidiaries on the DOD lists appear in the following amounts.

Fiscal Year ended December 31	No. on List	Contractor's Name	Amount
1970		Mobil Oil Corporation	$164,429
		Mobil Chemical Co.	496
		Mobil Oil Philippines, Inc.	671
	36	Total	$165,596
1971		Mobil Oil Corporation	$ 79,293
		Mobil Chemical Co.	187
		Mobil Oil Philippines	11
	55	Total	$ 79,491
1972		Mobil Oil Corporation	$110,149
		Mobil Chemical Co.	99
		Mobil Oil Philippines	48
	51	Total	$110,296

Review Year

Mobil Oil Corporation
#11482
FYE: 12/31/71
Parent of the following wholly-owned subsidiaries:
#88008 - Mobil Petroleum Co., Inc. (Guam Branch)
#88844 - Mobil Oil Australia Limited
#88847 - Mobil Oil Zaire (formerly Mobil Oil Congo S.C.R.L.)
#88849 - Mobil Oil de L'Afrique Equatoriale
#88850 - Mobil Oil de L'Afrique Occidentale
#88851 - Mobil Oil East Africa Limited
#88854 - Mobil Oil Hellas A. E. Petroleum Company
#88856 - Mobil Oil Lebanon Inc.
#88857 - Mobil Oil Liberia Inc.
#88858 - Mobil Oil New Zealand Limited
#88860 - Mobil Oil Philippines Inc.
#88861 - Mobil Oil Portuguesa S.A.R.L.
#88863 - Mobil Oil Southern Africa (Proprietary) Ltd.
#88865 - Mobil Oil Turk Anonim Sirket
#89554 - Mobil Oil Hong Kong Limited
#89555 - Mobil Sales & Supply Corporation
#89557 - Mobil Oil Maroc
#90039 - Pinnacle Trading Company, Inc.
#92457 - Handy Oil Corporation
#96128 - Mobil Oil Aktiengesellschaft in Deutschland
#88846 - Mobil Oil Company Limited
#93846 - Mobil Research and Development Corporation

The following sets forth a pro-forma consolidation of the parent and the twenty-two subsidiaries:

All renegotiable business was under fixed price contracts.

Renegotiable Business	
Sales	$ 125,199
Profit	3,623
Percent	2.9
Non-Renegotiable Business	
Sales	$5,538,131
Profit	(18,968)
Percent	Loss
Total Business:	
Sales	$5,663,330
Profit	(15,345)
Percent	Loss

The following tabulation sets forth the renegotiable, non-renegotiable and total operations for the parent and each of the subsidiaries. All of the renegotiable business was under fixed price contracts.

No.	Renegotiable Business			Non-renegotiable Business			Total Business		
	Sales	Profit	%	Sales	Profit	%	Sales	Profit	%
#11482 - Mobil Oil Corporation	$113,531	$3,440	3.0	$ 2,078,643	$ 5,549	0.3	$2,192,174	$ 8,989	0.4
#88008 - Mobil Petroleum Co., Inc. (Guam Branch)	581	(103)*	Loss	10,557	1,160	11.0	11,138	1,057	9.5
#88844 - Mobil Oil Australia Limited	456	12	2.6	303,437	25,301	8.3	303,893	25,313	8.3
#88847 - Mobil Oil Zaire	122	9	7.4	22,110	1,678	7.6	22,232	1,687	7.6
#88849 - Mobil Oil de L'Afrique Equatoriale	4	-	-	11,003	679	6.2	11,007	679	6.2
#88850 - Mobil Oil de L'Afrique Occidentale	45	2	4.4	37,781	2,313	6.1	37,826	2,315	6.1
#88851 - Mobil Oil East Africa Limited	793	24	3.0	15,797	655	4.1	16,590	679	4.1
#88854 - Mobil Oil Hellas A.E. Petroleum Company	26	1	3.8	85,664	2,423	2.8	85,690	2,424	2.8
#88856 - Mobil Oil Lebanon, Inc.	7	-	-	28,660	517	1.8	28,667	517	1.8
#88857 - Mobil Oil Liberia, Inc.	1,016	40	3.9	3,086	122	4.0	4,102	162	3.9
#88858 - Mobil Oil New Zealand Limited	862	(48)*	Loss	47,773	4,711	9.9	48,635	4,663	9.6
#88859 - Mobil Oil Philippines, Inc.	190	(A) *	-	55,170	150	0.3	55,360	150	0.3
#88861 - Mobil Oil Portuguesa,S.A.R.L.	568	105	18.5	87,738	5,729	6.5	88,306	5,834	6.6
#88863 - Mobil Oil Southern Africa(Proprietary) Ltd.	55	3	5.5	233,392	15,369	6.6	233,447	15,372	6.6
#88865 - Mobil Oil Turk Anonim Sirket	554	(49)*	Loss	180,355	(1,534)	Loss	180,909	(1,583)	Loss
#89554 - Mobil Oil Hong Kong Limited	116	9	7.8	23,162	2,199	9.5	23,278	2,208	9.5
#89555 - Mobil Sales & Supply Corporation	5,638	218	3.9	1,265,032	(120,878)	Loss	1,270,670	(120,660)	Loss
#89557 - Mobil Oil Maroc	191	11	5.8	26,189	909	3.5	26,380	920	3.5
#90039 - Pinnacle Trading Company, Inc.	6	1	16.7	26,010	(1,415)	Loss	26,016	(1,414)	Loss
#92457 - Handy Oil Corporation	10	-	-	724	30	4.1	734	30	4.1
#96128 - Mobil Oil Aktiengesellschaft in Deutschland	160	11	6.9	513,624	18,569	3.6	513,784	18,580	3.6
#88846 - Mobil Oil Company Limited	170	2	1.2	433,765	16,998	3.9	433,935	17,000	3.9
#93846 - Mobil Research and Development Corporation	98	(65)*	Loss	48,459	(202)	Loss	48,557	(267)	Loss
	$125,199	$3,623	2.9	$ 5,538,131	$(18,968)	Loss	$5,663,330	$(15,345)	Loss

* Waiver of loss carryforward submitted.

(A) Less than one thousand dollars

The contractor has requested concurrent renegotiation for the parent company and all the listed subsidiaries, and has waived the loss carryforward on each company that sustained a renegotiable loss.

Segregation of Sales and Allocation of Costs and Expenses

A review of the methods used in segregating sales and allocating cost and expenses has been made. Attachment "A" is Supplemental Data prepared by the Office of Accounting, dated November 29, 1972.

Attachment "B" is a memorandum to The Board from the Director, Office of Accounting, also dated November 29, 1972. This memorandum sets forth an outline of the program that would be required if The Board deems that additional verification is necessary.

Pending Claims

The contractor has advised that there are no claims or litigation of a substantial nature for or against Mobil Oil Corporation or its subsidiaries that would affect renegotiable profits for the year under review.

Contractor's Business

The renegotiable business of the two contractors in this group that represented 95.2% of the total renegotiable volume is:

#11482 - Mobil Oil Corporation

Gasoline, jet fuels and residual fuels.

#89555 - Mobil Sales & Supply Corporation

Fuel oil and services.

Cost of Goods Sold

The analysis of the cost of goods sold of the parent company is:

	Amount	Percent
Purchases - Net of inventory variations	$1,425,468	82.0
Operating expenses	282,600	16.3
General and admin. expenses	30,303	1.7
Total	$1,738,371	100.0

Result of Prior Years' Renegotiation

The following sets forth the operations of the parent company only:

	Renegotiable (All FP)	Non-Renegotiable	Total
1970			
Sales	$105,490	$2,023,430	$2,128,929
Profit	4,600	54,719	59,319
Percent	4.4	2.7	2.8
1969			
Sales	121,104	1,914,090	2,035,194
Profit	8,083	100,108	108,191
Percent	6.7	5.2	5.3
1968			
Sales	125,829	4,726,613	4,852,442
Profit	11,132	181,768	192,900
Percent	8.8	3.8	4.0

(Action for all years above - C. W. A.

The parent company's renegotiable business represented 88.2%, 88.3%, and 89.8% of the pro-forma consolidated sales for the years 1970, 1969, and 1968, respectively.

Return on Net Worth and Capital Employed

The contractor's return on allocated net worth was 5.5% and on capital employed was 2.7%.

Federal Trade Commission Statistics.

The FTC 1971 statistics for the industry group "Petroleum Refining and Related Industries" indicated the following:

Group No. 71-28	
Return on Sales	9.6%
Return on Capital	7.4%
Return on Net Worth	12.0%

The contractor's statistics in the three critical areas are well below the FTC statistics.

Competition Compared

Because the contractor's statistics in the three critical areas, namely, return on sales, net worth, and capital, are below the FTC statistics, comparison with contractor's competitors would not be meaningful.

Internal Revenue Service

Examination of the 1969 through 1971 years has not been initiated, but is contemplated.

There are no intelligence investigations in progress nor contemplated on any of the above companies or their subsidiaries. There have been no fraud penalties assessed against the companies or their subsidiaries.

Conclusion and Recommendation

It is concluded, based on information submitted, there is no possibility of excessive profits in the review year and clearance without assignment is recommended.

William H. Harrison, Acting Deputy Director
Office of Review

November 29, 1972

Supplemental Data for Screening Purposes

MOBIL OIL CORPORATION
and 22 Subsidiaries
Fiscal Year Ended December 31, 1971
Comments by Office of Accounting

MOBIL OIL CORPORATION

Sales Segregation

The contractor classified as renegotiable all prime contract sales to named departments based on a compilation of sales records. During the review year, over 96% of prime sales were to the Defense Fuel Supply Center of the Defense Supply Agency. The balance of prime contract sales were made directly to other agencies of the Department of Defense. Amounts reported on DOD printouts refer to master contracts let against anticipated purchases. As a part of the master contracts, the Government only guarantees to purchase $100 from the successful bidder.

In checking the Summary of Prime Contracts let for the period ended June 30, 1971 (twelve months) and the period ended December 31, 1971 (six months), it is noted that using $40 million or ½ of the twelve month period and the total of $93 million for the six month period, the estimated total of contracts let is $133 million. Contractor delivered $92 million and its subsidiaries delivered $11 million for a total of $103 million under let contracts.

Subcontract sales were products to numerous industrial customers, which products in some industries are used in processing a renegotiable product. As provided in Section 1456.2(b) of the Regulations, it was necessary for contractor to request information from customers to find out the amount of indirect Government business. In determining the customers to whom inquiries would be sent, contractor eliminated (1) customers whose business was such that it was unreasonable to expect them to be engaged in renegotiable business (service stations, etc.); and (2) customers whose business aggregated less than $2,500 representing sales too small to be renegotiable to any significant degree. Inquiries were sent out on a sample basis to the remaining customers whose aggregate business represented 19% of total commercial sales. Replies were received from 27% of the customers sampled. Based on ratios developed from these replies, contractor estimated renegotiable subcontract sales to be $21,929,158. This method is in substantial conformity with the regulations and considered acceptable.

Cost and Expense Allocations

In allocating Cost of Goods Sold applicable to performance outside of the United States, the realization basis for the unit involved was used; this is, in effect, similar to a modified sales ratio which is an acceptable method of costing used by the petroleum industry.

The domestic sales were also costed on a realization basis for Cost of Goods Sold but with further modifications to account for outside material and expenses, as well as so-called additives. Under this method costs were applied on an overall basis using a centralized costing procedure, the sales realization was determined by the use of annual average prices. The costs applicable to non-petroleum products was determined on an actual basis.

The sales realization method as applied to over 95% of contractor's sales follows the concept that all expenses, except additives, incurred in the production of all products produced jointly from petroleum raw materials are allocable to such products on the basis of their relative market values. Additive costs which are materials required for a specific product (gasoline by grade and/or jet fuel, etc.) are removed prior to the calculation of the market value ratio and re-added to product cost on an actual basis.

Other expenses are allocated as follows:

Storage and Handling and Commission-operated Plant Expenses are charged on a sales realization basis only to products actually stored or handled at marketing terminals or bulk storage facilities. Delivery Expense was charged on a sales realization basis as to sales of products actually delivered in owned or hired equipment. Selling and Servicing Expense was charged on a sales realization basis to all sales.

The above procedure of allocation is considered an appropriate basis and the results, in our opinion, show an equitable amount of expense charged. Of the total of such expenses incurred of $380 million, the allocation to renegotiable business was $12 million. If a sales ratio were used, the charge would be approximately $19 million.

The General and Administrative Expenses are allocated to marketing and distributing on a sales realization basis.

No problems are encountered by the acceptance of the above application to the allocation of cost by the Board. The method used is followed by most major peterleum refining companies.

MOBIL SALES AND SUPPLY CO.

Sales Segregation

Prime Contract Sales were determined by an examination of all Government Contracts and those with the named departments were reported as renegotiable.

Subcontract sales were based upon the results of circularizing 58 of 500 commercial customers. The total renegotiable business ($1.8 million) reported by the customers replying to the circularization was related to total sales ($39.8 million) to these customers. The resulting percentage was applied to the total to determine the renegotiable business to be reported.

Cost and Expense Allocations

Cost of Goods Sold applicable to Prime Contracts were determined by application of specific rates by port and product to renegotiable business.

Cost of Goods Sold applicable to indirect sales were determined by excluding cost applicable to Prime Contracts and allocating the balance on the ratio of non-renegotiable sales to subcontract sales.

All other expenses are allocated on the basis of barrels sold except for certain items which relate specifically to renegotiable and non-renegotiable business which are charged directly.

The segregation of sales and allocation of costs and expenses are considered acceptable for renegotiation purposes.

OTHER SUBSIDIARIES

The remainder of the companies listed segregate sales and costs as follows:

Sales are determined by analysis of all sales, those classified as renegotiable represent direct sales to the named departments.

Cost and Expenses are allocated directly except for Indirect Expenses which are allocated on a sales ratio basis.

The methods used by all the companies in segregating cost and expenses are considered acceptable for renegotiation purposes.

PRIOR REVIEW

Procedures used by the contractor were examined by the Eastern Regional Board during the processing of contractor's fiscal year ended December 31, 1967. Major cost areas for both the North American Division (refining)

and the marine operations (ocean transportation) were examined by the Region for the purposes of determining allocation methods used and the equitableness of the charges to Government business.

Refining

Contractor's method of charging crude oil at the refinery was reviewed with empahsis placed on pricing and handling of crude oil imports. Crude oil charged at the refinery represented 81.6% of the total cost of goods sold. In addition, the methods used for the distribution to regional areas of the selling and servicing pool and the general and administrative expense pool were examined as well as the subsequent allocation to renegotiable business within regional areas.

Marine Operations

As a result of the extremely high profit margin reported for the marine operations during the 1967 year, an indepth study was made of revenues (charters) and expenses. Details relating to each vessel used in renegotiable business were secured which included vessel revenue and operating expenses. Charter agreements were also secured. The principal element of overhead charged to renegotiation for marine operations (not vessel operating expense) was depreciation.

Conclusion

We have no reason to believe that the same procedures were not used for the year under review.

Prepared by:

Michael A. Miller

Concur:

for Ross M. Girard
Director
Office of Accounting

ATTACHMENT "B"
NE: 1/31/72

THE RENEGOTIATION BOARD

DATE : November 29, 1972

TO : The Renegotiation Board

FROM : Ross M. Girard, Director
Office of Accounting

SUBJECT: Mobil Oil Corporation and 22 Subsidiaries
Fiscal Year Ended December 31, 1971

There has been previously submitted to the Board an analysis of sales segregation and cost allocation which in the opinion of this Office may be accepted for renegotiation purposes.

However, if the Board deems that additional verification is required on the segregation and allocation methods employed by contractor, the following outlined program would be required.

Mobil Oil Corporation

For a review of segregation methods used by this contractor, a trip to the corporate offices would be required in order to examine billing invoices on prime contract sales and to investigate sampling techniques used to arrive at subcontract sales. Customers selected by contractor for sampling should be screened to establish the validity of the replies. In addition, an analysis would be required into the two classes of customers eliminated from the survey. Some testing should be performed into each of the eliminated classes. In addition, an examination of replies should be made to verify the validity of the renegotiable ratio established.

Contractor's allocation of costs and expenses can be verified during the office visit. The principal cost, crude oil, can be established by the examination of input charges at the refinery thru usage of petroleum industry posted price lists by locations maintained by all petroleum companies. Particular emphasis would have to be placed on the treatment by contractor of foreign crude and trade/crude (between non-related companies) to ascertain that posted prices only are charged at the refinery. Additive costs could be reconciled by an examination of invoices as costs are charged at actual. Other cost areas (storage and handling, selling and servicing, and general and administrative expenses) should be examined to determine the elements within each cost pool are allocable under the Act.

Mobil Sales and Supply Co.

A similar review of sales segregation would be required on the entity as described for Mobil Oil Corporation at its corporate office. As a distributor, verification of cost and expense allocation as applied to material costs would require the tracing of purchases for prime contracts to subsequent sales and a determination as to the reasonableness of the use of a sales ratio basis for the determination of subcontract material costs. Other costs are allocated based upon ratio of barrels sold. Other methods of allocating costs and expenses could be investigated.

Other Subsidiaries

Due to the number of subsidiaries involved (22) and the necessity of travel to individual offices, test verification of sales and costs would have to be made on a select basis. At the individual offices, records examined would include sales invoices and cost and expense allocation methods. Since both the direct charge method and the sales ratio method of allocation is employed with variances between companies, each office visited would involve a slightly different review approach.

Comment

The indicated review procedure outlined above for the 22 entities covered by this report would require extensive travel and man hours to obtain a meaningful result within an acceptable time span. The man power required for the review of Mobil Oil Corporation and Mobil Sales and Supply Co. would be considerable for each. The review on each subsidiary company would depend on the depth of the analysis. In addition, division and corporate level assistance would be required from contractor.

CASE CLEARED WITHOUT ASSIGNMENT

Mr. WHITEHEAD. Their recommendation was that this case should be cleared without assignment, and we have that authority under the law. We are permitted to do so. In this particular instance, I cannot recall the details, but what happened was the Board, by a 4-to-1 vote or by a majority vote as far as I recall, approved the clearance without assignment.

Now, Mr. Chase said that he would dissent, and he filed a dissent, and what he wanted us to do was to practically make a review of Aramco's financial condition as well as, and I quote:

> I suggest the staff consider the reasonableness of Mobil's cost of Aramco crude in relation to any gain that may have inured to Mobil. If the facts so warrant, the Board may wish to consider them as high costs on the basis of nonarm's length transaction that yielded significant profits to Aramco which may have been passed on to Mobil, thus, in effect, reducing Mobil's crude cost basis.

For the life of me, we do not have the know-how to conduct an investigation like that. Aramco files with the Board and, we examined them as for 1972. The profits that were made in a rather substantial manner were for fiscal years 1973 and 1974, and we have laid careful plans to go into those reports or those filings, when they are received.

Now it was just impractical to do what Mr. Chase asked us to do here, to go in and examine the costs of crude from Aramco to Mobil. We do not have technicians like that. We are not equipped to do things like that, and the fiscal year return for Mobil in this particular instance, was a loss. The company showed a loss on its filing, and to the best of our recollection, that is the reason that the Board, by a 4-to-1 vote, declared it cleared without assignment.

Senator PROXMIRE. Let me ask Mr. Chase to respond to that because he was involved in that.

REQUEST FOR ADDITIONAL INFORMATION

Mr. CHASE. Mr. Chairman, this again is to me a discouraging distortion of the facts. I am sure that if you polled the members of the Board and polled the members of the staff who are present, they would tell you that what I said was as follows—and I have notes here from which I will read.

The case came before the Board as a recommended clearance. There were $9 billion in sales, $114 million of which were renegotiable defense sales for a sophisticated jet fuel.

Mobil reported to us that they lost over $500,000 from the sale of the jet fuel to the United States Government, and reported that they had a substantial loss in sales involving the public, for your gas tank and mine, not renegotiable sales.

I told the Board and the staff that I was not quarreling with their position that if Mobil truly took a loss, that such a position is invalid. But it seemed strange to me that Mobil would report to the Board that it lost money in its renegotiable business and lost money in its nonrenegotiable business, when I recalled, in 1972, the company made substantial profits. I did not recall how much, but I said I thought '72 was a highly profitable year. All I asked was that we take it off the clearance calendar and assign it to the field for review and explanation from the Mobil Oil Co.

I do not recall that we talked about Mobil's Aramco affiliation. If we did, that would have no effect on the genesis of my request. I returned to my office and my secretary obtained a Moody's for 1972 on Mobil, and let me tell you what it reported. Mobil reported to its shareholders that the $9 billion in sales, in 1972, the company made 15.1 percent profit as a percentage of sale and 26.4 percent profits as a percentage of net worth. Mr. Chairman, I do not know how the Board could possibly clear Mobil when on the one hand it reports substantial profits to its stockholders and on the other reports losses to us.

So I began to examine Mobil as it related to Aramco, and I found Mobil owned 10 percent of Aramco. I think it significant to point out that of 1.911 billion barrels of petroleum production per day, Mobil used 506,000 barrels that came from its Aramco affiliate, or more than 25 percent of its total production requirements.

Mr. Whitehead addressed the problem of our involvement and lack of knowledge of the complex wellhead crude oil pricing formula. I do not think that is an excuse for clearing Mobil without assignment. I think it is our responsibility to have questions and conflicting information answered and that, sir, is all I asked for.

Mr. WHITEHEAD. Mr. Chairman?

Senator PROXMIRE. As I calculate it, the profits would be something like $1.35 billion, 15 percent of $9 billion. Is that right?

Mr. CHASE. The total company profits, $1.376 billion.

Senator PROXMIRE. So what you are arguing is that this very large profit on sales and on net worth a much bigger percent on net worth, 24 percent as you say, suggested that the sale to the Government, which they maintained was a loss, their transactions with the Government should at least warrant an explanation from the Mobil Oil Co. to be given to the regional office as to how they justified the fact that they made a huge profit on the overall matter and then claimed a loss. And you say, as I take it, Mr. Whitehead your position was that this was not worth getting an explanation from Mobil on. Is that right?

Mr. WHITEHEAD. No. I want to get things straight, for the record, Mr. Chairman. When this matter came before the Board, there was a discussion. Mr. Chase asked that it be further studied, and the official minutes are what I am reading from, extracts from the official minutes, and we did give this responsibility to the Office of Accounting, Office of Review, and the General Counsel to study the question raised by Mr. Chase and report on the results as soon as possible.

Now when the preliminary reports came in, we evaluated their contents and the Board, by a 4-to-1 vote, believed that a clearance without assignment was in order.

Now he certainly did raise the Aramco situation because I am reading quotes from his dissent.

Senator PROXMIRE. How did they reconcile this, the fact that the overall profits were so very big and Mobil claimed a loss on the Government transaction.

EFFECT OF EXEMPTIONS

Mr. WHITEHEAD. I cannot answer that offhand, but let me say this: one of the loopholes in the act—and I thought I had brought this

out at a previous hearing, either at an Appropriations hearing or the July 25 hearing—the Congress has seen fit to give stock item and commercial item exemptions to industry, and in the last decade the total amount of renegotiable business which has escaped our review, because of what the Congress did, amounts to about $10 billion.

Now in this particular instance, the oil companies asked, and are entitled to by law, for exemption of those oil products which are sold also in a commercial market. What I think may have happened here is that the commercial exemptions have been so large so that the overall result is a loss when you get a net figure. Also, it appears oil companies report to the public on a book basis rather than a tax basis, and I am informed by Dr. Lenches, that this accounts for a big part of the difference in profit figures cited. I believe that every reasonable action was taken by the Board in this particular filing by Mobil.

I want to say this: we have set up and are geared for a very intensive look-see at the 1973 and 1974 returns or filings which are going to be made by the oil companies.

Senator PROXMIRE. Let me just say that there is nothing in the law, as I understand it—maybe there is and maybe you can enlighten me on it—nothing in the law that would prevent you from having a regional board request from Mobil Oil an explanation of what appears to be a possible contradiction. You could have done that, could you not, and it was not done.

Mr. WHITEHEAD. We could have assigned it to the region, but on the basis of the loss they show and on the basis of the reports we got from our staff people, the four of us determined that we would clear it without assignment.

Senator PROXMIRE. Now, let me ask Mr. Lambert: You said you referred it to General Counsel. Let me ask Mr. Lambert to comment on this case.

Mr. WHITEHEAD. Senator, this is what the minutes say——

Senator PROXMIRE. All right. Mr. Lambert?

STAFF STUDY OF OIL PROFITS

Mr. LAMBERT. Mr. Chairman, my understanding of that situation, my recollection of it—and I do not have the minutes in front of me—was that the Mobil Oil case came up as one of the Defense 100's, and the information was presented to the Board on a recommended clearance. I think Mr. Chase wanted to look into this question of these very heavy losses and the cost base of the accounting report.

At that point in time, my recollection is that the majority of the Board voted to clear it without assignment, which they did, and they subsequently, at the same meeting, said, we would like to look into this whole question of the price of oil, crude in the oil industry as it may affect the oil companies filing with us. So that was a subsequent action that was started and has never been completed.

Senator PROXMIRE. So what you are saying is they decided to clear it?

Mr. LAMBERT. Yes, sir.

Senator PROXMIRE. First, and then subsequently look into the 1973–74 situation?

Mr. LAMBERT. Yes, that is my recollection.

Senator PROXMIRE. So you really did not have an opportunity to analyze it and determine whether there was, in effect, support for Mr. Chase's position. Is that right?

Mr. LAMBERT. That is my recollection, and these gentlemen were with me, and I think that is their recollection too.

Senator PROXMIRE. Is that right, gentlemen?

Please identify yourselves as you speak.

Mr. CHICK. My name is Henry M. Chick, and I am Director of the Office of Review, and that is my recollection, but I really do not have the minutes in front of me. Mr. Harrison, the deputy, was also there.

Senator PROXMIRE. All right, Mr. Harrison.

Mr. HARRISON. That is the best of my recollection, too. I, like Mr. Chick, do not have the minutes with me, so I really cannot refresh myself, but that is my recollection, sir.

Senator PROXMIRE. So there was no study, is that it? Mr. Chase?

Mr. CHASE. Mr. Chairman, we passed the Mobil Oil Co. on the 7th day of May of this year, and the reason that I was denied having it assigned for explanation was that we had higher priorities because our staff level is so low. Today is 7 months later, and we have not received the study or any information supportive of Mr. Whitehead's statement of a moment ago that we are getting information. In the meantime, we cleared without assignment a $114 million sales volume on this contractor——

Senator PROXMIRE. $114 million?

Mr. CHASE. That made huge profits as reported to its stockholders.

Senator PROXMIRE. So this study was done and not submitted to the Board.

Mr. CHASE. If it was done, I have never seen a copy of it. It was supposed to be prepared to further my knowledge of pricing crude at the wellhead. So I went out on my own and had a study made that gave me a fairly knowledgeable insight.

Senator PROXMIRE. Mr. Houston, have you ever seen a study by the staff?

Mr. HOUSTON. No, sir, I have not. I think this question brings up an important point that I made on July 25. In my opinion, the Board is terribly understaffed. One of the problems associated with Mr. Lambert's office being unable to give precisely the quality and quantity of service that might be desirable in the view of many of the Board members is the fact that his office is understaffed.

We have a problem in the Board. Mr. Chase put it a little facetiously, but it bears on the truth. He said the policy of the Board is to have no policy.

I cannot agree with that literally, but I would say that the Board is in need of pulling together and documenting its policy. The Board's policy is in many forms. It is in the statute; it is in the reports that have been given to various committees of the Congress. And it is in statements made here by Mr. Whitehead as to what our policy is, for example, on conglomerates or product line evaluation. We simply need to do a lot of things that a well-managed organization would ordinarily do; namely, pull together, evaluate, analyze, and document its policy and procedures in connection with the process, and on administrative matters. We just have not done it.

Senator PROXMIRE. All right, sir. Let me get back to this particular instance.

Mr. Whitehead, you indicated that a study was made. We have testimony now from the General Counsel and from the two men associated with him that they did not make the study. You have two members of the Board who said they saw no such study. This seems to be a mysterious situation.

STATUS OF OIL STUDY

Mr. WHITEHEAD. All right, may I explain?

[Senator Proxmire nods in the affirmative.]

Mr. WHITEHEAD. The reports that I refer to here were reports made by the Office of Review and the Office of Accounting, both of whom had no objection to clearance without assignment. When this came up at the May 7 meeting——

Senator PROXMIRE. As I understand it, the Director of the Office of Review said he made no report. Is that right?

Mr. WHITEHEAD. Here it is, signed by Mr. Harrison, dated May 3 of 1974.

Mr. CHASE. That is not the study, Mr. Chairman.

Mr. WHITEHEAD. That is not the study. I am coming to that.

Senator PROXMIRE. I am talking about a study.

Mr. WHITEHEAD. The study has not been made yet. If I was incorrect on that point, I wish to correct it. The Board directed that the Offices of Accounting, Review, and General Counsel study the question raised by Mr. Chase and report on its results as soon as possible.

Senator PROXMIRE. This is like Alice in Wonderland. The verdict first and the trial later, and then no trial.

Mr. WHITEHEAD. Well, I am trying to be constructive, Senator.

Senator PROXMIRE. I am not trying to be facetious, but that does seem to describe the situation, does it not?

Mr. WHITEHEAD. Well, you might poll the heads of Accounting and Review and General Counsel and see how far they have progressed in such a study.

Senator PROXMIRE. I thought I did it. Shall I do it again?

Mr. WHITEHEAD. Well, the Board directed them to do it.

Senator PROXMIRE. Well, gentlemen, how far have you progressed? Yes, sir.

Mr. CHICK. I do not recall that it was pursuant to this directive of the Board. I think it was pursuant to some leads Mr. Chase gave Mr. Grenough, Mr. Lambert, and I concerning talking to the IRS, and we did talk to the IRS at great length concerning the techniques the IRS had used in determining whether or not posted prices in the Middle East were in fact fair market, and I reported on this meeting to the Board by a set of minutes, and I think my colleagues agreed with the report.

What we found was that posted prices were not fair market prices in the Middle East during this period of time.

Senator PROXMIRE. I think that may be very useful, but that was not a report on the specific Mobil situation, or was it?

Mr. HARRISON. No, sir, it was not. It was on the situation generally, sir.

Senator PROXMIRE. I am talking about what appears to be the possibility of an excessive profit on the part of Mobil, although they did report a loss, in view of their overall very large profit.

Mr. WHITEHEAD. Mr. Chairman, what I have read from, was from our minutes, may I put this extract, as well as the two reports made by the Review and Accounting people, in the record, sir?

Senator PROXMIRE. All right, sir; yes.

[The information follows:]

MOBIL OIL CORPORATION AND SUBSIDIARIES (1972) CWAs APPROVED—DS&E LIST #1665

There was submitted to the Board the memorandum, together with attachments (Exhibit K), of the Director, Division of Screening and Exemptions, Office of Review, dated May 3, 1974, subject: DOD List of 100 Largest Companies and Affiliates, Recommended Clearances Without Assignment—DS&E List #1665—Mobil Oil Corporation, #11482, fiscal year ended December 31, 1972, parent and 23 wholly-owned subsidiaries.

Following the discussion of this case, the Board majority approved the issuance of Clearnaces Without Assignment to the contractors listed in DS&E List #1665, recommended by the Division of Screening and Exemptions, Office of Review.

Mr. Chase dissented for the reasons discussed during the meeting and his report of dissent is herewith attached as being a part of these minutes.

The Board directed that the Offices of Accounting, Review and General Counsel study the question raised by Mr. Chase and report on its results as soon as possible.

MOBIL OIL CORPORATION AND SUBSIDIARIES (1972)—DS&E LIST #1665
ATTACHMENT AS STATED IN ITEM 8 OF THESE MINUTES

The premise of Mr. Chase's dissent is as follows:

"Renegotiable sales ($114,280,000) for the Mobil Oil Corporation and its affiliates, fiscal year ended December 31, 1972, on the basis of a pro forma consolidation of the parent and 23 wholly-owned subsidiaries, resulted in losses ($503,000) in the year under review.

"During the year 1972 significant profits were generated by Arabian American Oil Company (ARAMCO) owned by four of the major oil companies of which Mobil's participation is 10%. Viewing the possibility Mobil may have purchased crude oil from ARAMCO at more than reasonable prices, I raised the question as to the need for the Board to consider the high profits of ARAMCO on the sale of crude to Mobil and Mobil's profits from ARAMCO as being an offset against Mobil losses.

"I suggested that the staff consider the reasonableness of Mobil's cost of ARAMCO crude in relationship to any gain that may have enured to Mobil.

"If the facts so warrant the Board may wish to consider them as high costs on the basis of a non-arms length transaction that yielded significant profits to ARAMCO which may have been passed on to Mobil, thus in effect reduced Mobil's crude cost base.

"Moreover, I recalled that Mobil reported substantial profits to its stockholders in 1972, thus raising the question of inconsistency when comparing that information with Mobil's sales and loss report to the Board.

"I dissented on the grounds that sufficient information was not presented for me to determine that the case should be cleared without assignment."

NORTHROP CORP. CASE

Senator PROXMIRE. With respect to the Northrop Corp. case, I understand that both Mr. Chase and Mr. Houston dissented from the majority position in this recent case, and I wonder if Mr. Chase and Mr. Houston could explain the reasons for their dissent? Mr. Chase?

Mr. CHASE. Mr. Chairman, Mr. Houston voted with the majority, and upon reflection a day or so later, came to the Board and said that

he had had some second thoughts about it, and he would like to have Northrop clearance withdrawn and assigned to the field. He seemed to be persuaded by my arguments, and the Board denied him.

Senator PROXMIRE. The Board did what?

Mr. CHASE. The Board denied him. He wanted it assigned to the field as I did.

Senator PROXMIRE. The Board denied him permission to withdraw and change his position. Is that correct?

Mr. CHASE. Why do we not have Mr. Houston answer for himself?

Senator PROXMIRE. All right, fine. And then you continue.

Mr. HOUSTON. All right. I would like to state this the way it actually was.

When the Northrop case was last presented to the Board on July 16——

Senator PROXMIRE. Of this year?

Mr. HOUSTON. Yes.

Senator PROXMIRE. All right.

Mr. HOUSTON. I voted with the majority of the Board to clear Northrop. About that time, my staff and I began reviewing the Board's policy in regard to conglomerates and product line renegotiation.

We are still preoccupied with that problem. As a result, however, and upon further reflection, I prepared two memorandums for the Board, one dated July 31, 1974, and another dated August 5, 1974. Copies of both were provided the subcommittee earlier. In these memorandums, I requested further review of the Northrop case and stated, in essence, that in my opinion the Board's policy is not altogether clear, and certainly not clearly stated, as it relates to multiproduct lines and complex corporate structures.

I gave some examples of different documents where policy was reflected. A great deal of policy is just in people's heads.

In any event, I subsequently sent a memorandum to the Secretary of the Board, Mr. Rapps, requesting that both memorandums be placed on the Board's agenda of August 6, 1974. The Chairman agreed. In my memorandum of July 31, I indicated that it is now my opinion that the Northrop case be subject to further review and recommended that the issuance of a clearance notice and the opinions be delayed until such time as the Board has had an opportunity to more clearly resolve its policy regarding the treatment of excessive and deficient profits in large multidivisional and multicorporate consolidated organizations.

It was my opinion that the issue needs considerably more analysis, policy resolution, and documentation.

Present at the Board's meeting of August 6 were Board members Whitehead, Mattingly, Rinehart, and myself. Mr. Chase was out of town on vacation. After some discussion, I moved that the Board reconsider its action in approving a clearance in the Northrop case, but the motion was not seconded. I can say that my motion was denied because it died for want of a second. I cannot say that it was not given consideration.

Senator PROXMIRE. You did dissent, is that right? Or you would have dissented? Or you simply wanted to review it?

Mr. HOUSTON. Let me read the motion. The motion was that the Board reconsider its action in approving a clearance in the subject case. The motion died for want of a second. Another Board member then moved that the clearance be issued. It was accepted.

Now, is it your question as to what would I have done if the Board had reconsidered?

Senator PROXMIRE. Perhaps you cannot answer the question under the present circumstances because, perhaps, you would have wanted to review it and determine then. But perhaps you had your mind made up?

EVALUATION OF NORTHROP DATA

Mr. HOUSTON. No; my mind was not made up. At this point it was very clear to me that we needed to resolve our policy in regard to how to handle companies with multiproduct lines.

In Northrop, we had a case which in some respects was clearer than McDonnell Douglas. Northrop had product-line accounting and McDonnell Douglas did not. In Northrop, a large profit was shown in their aircraft division with smaller profits or losses perhaps in other segments of their renegotiable business.

All I was trying to do was get the Board to resolve and document its policy in regard to these kinds of cases. We had just come through the previous hearing on McDonnell Douglas with your subcommittee, and reflecting upon it, I felt a need to resolve the Board's policy before taking further action on Northrop or any similar case.

Senator PROXMIRE. Did you think it should be referred to the region for further study, or did you simply want to resolve that policy matter?

Mr. HOUSTON. Well, I was concerned about resolving the policy matter first. Based upon that policy resolution, perhaps it would have been reversed, but I really cannot answer beyond what I was interested in initially.

Senator PROXMIRE. Let me call on Mr. Chase, and then Mr. Whitehead. Mr. Chase, go ahead; we would like the reasons for your dissent in the Northrop case.

Mr. CHASE. Yes. In the Northrop case, I refer you, Mr. Chairman, to Mr. Whitehead's opening statement at the July 25 hearing here, when he said, "We want you to understand how we arrived at a consolidation that McDonnell Douglas was airspace and similarity of product line." I completely disagree with that on the ground that a space module is not like a missile, is not like escape-hatch systems, is not like an F–4 jetfighter. In the case of Northrop, I called to attention that of the $343,600,000 in total Northrop sales there was 14.9—approximately 15 percent profit in the T–38 and F–5A fighter planes which they built.

Senator PROXMIRE. Was that on sales? You said 14.9 percent profit. On what basis?

Mr. CHASE. Sales.

I took the position that this was a classical case of exactly what Mr. Whitehead referred to in his opening statement of July 25. There is absolutely no similarity between one product line and another in the Northrop case. It is also a model case because we were given a breakout of the elements of the cost of goods sold by product lines.

They make transistors, electronic equipment, telecommunication equipment, chemicals—these have no relationship to the airplane division at all. And yet the airplane division disclosed 14.9 percent profit, which is clearly excessive, to my belief, if you consider the Grumman guideline of 6 percent a fair return of profits to sales. We are talking about a lot of money here and yet the Board issued over my dissent a clearance without assignment to the field and over the subsequent objection of Mr. Houston.

Senator PROXMIRE. Mr. Whitehead?

Mr. WHITEHEAD. Again, I would like to put a portion from the minutes of August 6 of the Board in the record, sir, if I may.

Senator PROXMIRE. All right.

Mr. WHITEHEAD. As well as the copy of the final opinion on Northrop.

Senator PROXMIRE. Both will be printed in the record.

[The information follows:]

24. Northrop Corporation (Consolidated) (1969)

Reference was made to the action of the Board on July 16, 1974 (Minutes No. 1890-2) approving a clearance with respect to NORTHROP CORPORATION, consolidated with: PAGE COMMUNICATIONS ENGINEERS, INC., NORTHROP CAROLINA, INC., THE HALLICRAFTERS COMPANY, and WARNECKE ELECTRON TUBES, INC., fiscal year ended July 31, 1969. The minutes of the meeting held July 16, 1974, stated in pertinent part:

"As recommended by the Western Regional Board and concurred in by Mr. Burrell, Reviewer, in the aforementioned Second Addendum to Reviewer's Comments dated June 28, 1974, and previously concurred in by the Director, Office of Review, in the aforementioned Review of Determination dated February 15, 1974, and the aforementioned Revised Review of Determination, dated March 15, 1974, the Board approved a clearance in the subject case for the fiscal year ended July 31, 1969. The Board approved the aforementioned Final Opinion. Mr. Chase dissented in this case."

There were presented to the Board Mr. Houston's memoranda dated July 31, 1974 (Exhibit Y) and August 5, 1974 (Exhibit Z) and Mr. Chase's dissent dated July 24, 1974, together with Green Sheet (Exhibit AA), relative to the foregoing.

Mr. Houston made a motion that the Board reconsider its action in approving a clearance in the subject case. The motion was not seconded.

The Board approved Mr. Mattingly's motion that the Clearance Notice and Final Opinion, together with Mr. Chase's dissent, be forwarded to the contractor. The Final Opinion, together with Mr. Chase's dissent, will be retyped by the Office of Review, and thereafter forwarded with the Clearance Notice to the contractor by the Office of the Secretary.

The Chairman designated Mr. Houston to study and report upon the subject of: "Policy on Product Lines and Conglomerates." The Chairman indicated that necessary staff would be available for Mr. Houston's assistance.

THE RENEGOTIATION BOARD
2000 M Street, N. W.
Washington, D. C. 20446

FINAL OPINION

NORTHROP CORPORATION (AGENT)
Century City, Los Angeles, California
Fiscal Year Ended July 31, 1969
Assignment No. 10449-69
Consolidated with:
PAGE COMMUNICATIONS ENGINEERS, INC.
Assignment No. 75038-69
NORTHROP CAROLINA, INC.
Assignment No. 90056-69
THE HALLICRAFTERS COMPANY
Assignment No. 91812-69
WARNECKE ELECTRON TUBES, INC.
Assignment No. 91484-69

The renegotiable sales and profits considered by the Board in these proceedings are as follows:

Sales	$344,597,773*
Profits	26,093,974
%	7.6%
Returns on:	
Capital	15.8%
Net Worth	32.6%

*Reflects an agreement with IRS per the contractor.

The above Schedule A figures include $936,000 of renegotiable sales and profits applicable to prior years. According to RBR 1457.5, review year sales and profits considered by the Board have been adjusted as follows:

Sales	$343,661,773
Profits	25,157,974
%	7.3%
Returns on:	
Capital	15.2%
Net Worth	31.4%

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The Board determined that the RBR 1457.5 adjustments did not disturb its clearance determinations made in prior years.

Divisions of Northrop Corporation and its wholly-owned subsidiaries included in the consolidation were individually evaluated by the Board.

The contractor's renegotiable business was relatively the same as in the prior year and consists of the design, development and manufacture of aircraft, electronic devices, communications and navigation systems, spacecraft recovery systems, and unmanned surveillance and target aircraft, etc. The Board considered renegotiable products and services to be highly complex.

Also, the Board considered that the contractor had greater pricing risks in the review year because of the 5% increase in fixed-price type contracts and the 36% reduction in cost type contracts. This pricing risk, however, was mitigated by the high profits earned on the T-38 Supersonic Trainer and the F-5 A and B Freedom Fighter. On an overall basis, the Board regarded risks assumed to be normal for the aircraft industry and other industries that are largely dependent upon defense business.

The contractor successfully participated in a variety of highly technical and complex DOD programs, and the Board gave some favorable consideration for contribution to the defense effort.

The Board considered the contractor to be an efficient manufacturer of renegotiable products. In the review year renegotiable sales declined $41.8 million, or 11%, while nonrenegotiable sales increased $115.1 million, or 133%. The Board recognized the effect of this product mix change on renegotiable costs and concluded that renegotiable costs overall were reasonable.

Renegotiable profits earned on fixed-price type contracts were lower than the prior year on an increased volume of business. Some contracts had deficient profits, and the Board in considering the high profits on the T-38 and F-5 aircraft and the relatively low profits on the other fixed-price type contracts considered that renegotiable profits on a consolidated basis were not excessive.

Compared to prior years, consolidated returns on allocated renegotiable capital and net worth were considered by the Board to be reasonable and not indicative of the presence of excessive profits.

On the basis of the foregoing, the Board finds that the contractor did not realize excessive profits for the review year.

GOODWIN CHASE, MEMBER, DISSENTS AS FOLLOWS:

A majority of the Board has determined that the consolidated renegotiable profits realized by the Northrop Corporation and its affiliated and related companies were not excessive.

I do not consider that Section 105 of the Renegotiation Act and the Renegotiation Board Regulations, applicable thereto, are intended to be administered independently of and to the exclusion of other pertinent and relevant sections of the Act and the Board's regulations having to do with the application of the statutory factors.

It would also be a gross inequity to impute that this Section 105 of the Act and the Renegotiation Board Regulation 1464 were intended to afford a method whereby a grouping of several operating divisions or subsidiaries into a consolidation will shield the high profits of one or more of the organization's segments.

In this context, the exceptionally high profits of the Aircraft Division of the Northrop Corporation, producing supersonic jet trainer tactical fighter aircraft, should not be accorded the benefit of lower profits of the other members of the group, producing entirely different product lines under unrelated Department of Defense programs. Each of the members of the related group that reflect low profits if renegotiated as independent entities would not be considered to have excessive profits, hence could be cleared without assignment by the Board. It does not follow that simply because some of the divisions or subsidiaries have low profits, those low profits should be enhanced, indirectly by the higher profits of other members of the group.

The Board has established only the provisions of RBR 1460.10(b)(5) and 1499.1-44(c), Ruling No. 44, as the basis for consideration of the extent to which deficient profits are applicable to determination of a contractor's renegotiable profits. Any other interpretation or rationale employed to equate a profit as being deficient is without the force or effect of the existing Renegotiation Act or the Board's Rulings or Regulations.

There having not been presented for the Board's consideration any supportive information that low profits generated by the members of the group was other than the results of management decisions of the respective contractors or the failure on the part of each such member to reasonably pursue available remedies for obtaining relief from such low profits that were available under their respective contracts, I cannot accept the offsetting of the high profits of the Aircraft Division with the low profits of the other members of the group in determining the reasonableness of profits for the consolidated report.

The risk assumed by the contractor attributable to contracting on a fixed price basis is minimized by the high profits earned on the T-38 Supersonic Trainer and the F-5A and B Freedom Fighter aircraft.

The sales of the T-38 and F-5 aircraft continued at a high volume in the Aircraft Division and although a high percentage of these sales had been produced on firm fixed price contracts, these contracts were negotiated on a sole source basis. The profit objective was reported to be 12% of cost for these aircraft purchased by the Air Force.

The substantial increase in the profit margin (14.9%) on sales experienced by the Aircraft Division for this review year is an indication of the high degree of repetitive production and resulting learning curve efficiencies that has been achieved by this Aircraft Division.

In view of the above, I must dissent from the action of a majority of the Board not to assign this case to itself for a further review of the costs and profits of the respective segments of the contractor's consolidated filing and by such action accorded a Clearance for the review year.

Signed: Richard E. Rapps

Richard E. Rapps
Secretary to the Board

Mr. WHITEHEAD. The Board referred this case to the Western Regional Office: they made a thorough study of it and they came back with a clearance recommendation. One of the best reviewers we have in the Office of Review went into this situation with a fine tooth comb, and he came up with a recommendation of clearance, which was concurred in either by the Deputy Director of the Office of Review or by the Director.

Now, there is one thing in these minutes of the meeting of August 6 that Mr. Houston failed or inadvertently omitted to tell the committee, and that is that I designated him as Chairman of an Ad Hoc Committee to look into the policy on product lines and conglomerates. And I have had no response since then on that matter.

Senator PROXMIRE. Could I ask you, Mr. Chase, what you were dissenting from if this was reviewed thoroughly by the region?

Mr. CHASE. Senator, I was looking at some notes here. Would you mind repeating the question?

Senator PROXMIRE. Did you hear what Mr. Whitehead said, that it was referred to the region and was carefully examined and analyzed, and then they said he had one of the most competent reviewers go over it; and it was on that basis that they came to the conclusion that the profits were not excessive? What is your response to that?

Mr. CHASE. Mr. Whitehead's statement is not valid. I have documents in the file here where our Regional Board does not know what our policy is, and in many instances they presume what it is, and would like to make analysis by product line.

Senator PROXMIRE. Be specific in this particular case. What was the region's study here, and what review was conducted, and why was it inadequate?

Mr. CHASE. The Board allowed the lower profits of dissimilar product lines to be offset as a deficiency against the substantially high and excessive profits of the aircraft division. Mr. Chairman, Mr. Whitehead by his own admission, acknowledged that you separate the segments when the product line is dissimilar, and in this case the Board did not do that; clearly an example of the so-called philosophical reason for doing it, as expressed in his opening statement here on July 25.

Senator PROXMIRE. So what you are saying is, clearly in this case, on the basis of the Board's own policy and practices in the past, they should not have been allowed to offset completely dissimilar matters, dissimilar products, the losses there or low profits there and the very high profits in the area under consideration.

Mr. CHASE. Exactly, and the Northrup people escaped with substantial excessive profits as a result of the Board's vacillating policy. In the year 1966, with McDonnell Aircraft Corp., we examined that on a product line basis. In the year 1967, the same company, the same airplane, we did not do it, and huge excessive profits escape. I do not understand what is going on, and I think many of our staff embrace that viewpoint.

Senator PROXMIRE. Mr. Houston?

Mr. HOUSTON. I think it is very clear from the discussion that we need to do something. Mr. Whitehead has pointed out that I have

been given the responsibility to study and make a report on this subject. There are a number of areas of policy that simply need resolving. The policy is not clear. I do not believe that you can find any place in the Board where the policy on this matter is clearly stated. The policy has been established by precedent, and precedent changes, quite often, from year to year and from case to case.

Senator PROXMIRE. Mr. Whitehead?

Mr. WHITEHEAD. I had a number of points in rebuttal to what Mr. Chase has just spoken about. I do not want to belabor the committee, but I think that I can be further helpful to it in going into some of these things on an interpretive basis; that is, as to practice which resolves itself to the fact that either we do business on an aggregate basis, or we do business on a product line basis. And if I could go into this a little bit——

Senator PROXMIRE. Are you taking the position that on all cases, you do it in an aggregate basis, even where you have dissimilar products?

RENEGOTIATING ON AGGREGATE BASIS

Mr. WHITEHEAD. I would like to make the presentation.

Senator PROXMIRE. All right, go ahead.

Mr. WHITEHEAD. We always look at what the profits and losses for the respective operating divisions are, and then make an overall evaluation of what the conglomerate or——

Senator PROXMIRE. You did not do that with the F–4, in the case of McDonnell Douglas, though.

[Pause.]

Mr. WHITEHEAD. The F–4 was the bulk of the business of the McDonnell people.

Senator PROXMIRE. Which is why you should have done it. Go ahead.

Mr. WHITEHEAD. May I proceed? In the first place, the law involves a matter of judgment. The lines of direction are imprecise, and we operate under what is known as the six statutory factors, with the efficiency factor being the dominant factor. In 1942 the Congress authorized the executive branch to make price redetermination adjustments of defense contracts on a contract-by-contract basis. When the 1943 Price Adjustment Act was passed, the Congress—and, I think, in their wisdom—determined that it would be on a fiscal year basis rather than upon a contract-by-contract basis; the reason being it was an horrendous task to review every contract.

Senator PROXMIRE. All right, sir.

Mr. WHITEHEAD. The Board in 1956 laid down a well-written policy, which has been applied since then; and it is a statement on the net worth factor, and it says, "In discharging its responsibility under this section,"—that is, under section 103(e)(2)—"the Board does not regard any particular rate of return on net worth or capital employed as excessive per se." In other words, what they are saying is that the net worth factor cannot be looked at alone. It must be looked at in the light of the other factors, statutory factors.

I would like to put this in the record if I may, sir.

Senator PROXMIRE. All right, sir.

[The information follows:]

THE RENEGOTIATION BOARD, WASHINGTON, D.C.

STATEMENT OF NET WORTH FACTOR

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

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

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

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

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

COMPREHENSIVE COMPILATION INTRODUCED EARLIER

Mr. WHITEHEAD. During one of the hearings we had with you in the past, I inserted into the record a very comprehensive compilation of where high returns on sales, capital and net worth are justified, and how they come about. I think this is a very fine document, which was prepared by the staff, and it was introduced in the record on March 26, 1974, and I see no reason to reintroduce it at this time. But, it reaffirms the position taken by the Board in 1956 on this particular question and has been applied since then.

Now, with respect to the conglomerates——

Senator PROXMIRE. I must leave temporarily. I will be back after the vote, but the committee will continue with Senator Mathias, and I will come back as soon as possible.

Senator MATHIAS (presiding). Mr. Whitehead, if a can interrupt you for a minute, I would like to make this observation—and I am sorry the chairman has had to leave. I think what is obvious here is that this dispute within the Board as to what the intent of the law is, reflects some absence of direct and clear communication on the part of the Congress; and while it is not the job of this committee, it is the job of the Authorizing Committee to clarify the law. I would suggest to the Chair that he and I might join in the letter to the Authorizing Committee suggesting some clarification of the law, because the economic facts have changed enormously since the original Authorizing Act was adopted. And we now have the growth of conglomerates and multinational corporations, which are totally new creatures.

While I have interrupted you, just let me refer a minute to the Miller case, because I want to make it clear, as I think the chairman did in his remarks, that any member of this Board, or in fact any official of any agency of any department of Government that dealt in any way with procurement, would raise a presumption against himself very hard to rebut by accepting hospitality from a contractor. But, I think we ought to have it clear just what happened in the Miller case, and I want to ask Mr. Rinehart, where did this conversation take place?

NEGOTIATING OF MILLER BOX SETTLEMENT

Mr. RINEHART. Accepting hospitality was in the reverse in this case.

Senator MATHIAS. Where did it take place?

Mr. RINEHART. It took place on my boat, which is my home while I am in Florida, tied up at Fort Lauderdale.

Senator MATHIAS. In Fort Lauderdale? All right.

Now, the suggestion was made that, instead of being on your boat—what was the man's name, Hinton?

Mr. RINEHART. Yes.

Senator MATHIAS. The suggestion was made that it might be held in the Federal courthouse, and you say this was in Fort Lauderdale?

Mr. RINEHART. To my knowledge, the nearest Federal building would probably be in Miami, 30 or 40 miles away.

Senator MATHIAS. I happen to be a member of the Judiciary Committee, and I know that the absence of Federal facilities in Fort Lauderdale has been the subject of some soreness in Florida for many years, that there may, in the future be a Federal courthouse in Fort Lauderdale. I think there is not one now. So I want to get back to this in a minute.

You were dealing with a $5 million refund due the Government. Is that right?

Mr. RINEHART. In the area of $6 million.

Senator MATHIAS. The only way the Government could get that money, if the contractor did not agree to pay, was to reduce it to judgment and collect on a judgment. Is that right?

Mr. RINEHART. That is correct.

Senator MATHIAS. And that could have involved another year of delay, is that right?

Mr. RINEHART. At least another year.

Senator MATHIAS. And the current Treasury rate on money is somewhere between 7 and 8 percent. Take the low figure, 7 percent.

That is $420,000 that it would cost the Government to delay 1 year. Is that right?

Mr. RINEHART. That is right, and we had already delayed approximately 5 years on this case.

Senator MATHIAS. All right.

So that the negotiation at the figure of $250,000 below the Board rate could have actually saved the Government the difference between the $250,000 adjustment and, say, the $420,000 at the current Treasury rate on $6 million?

Mr. RINEHART. Depending upon when the final order would be issued.

Senator MATHIAS. There is a vote on the floor now. I do not jog as fast as Senator Proxmire, so I have got to start jogging.

Mr. RINEHART. I just wanted to make this comment while I am here.

Senator MATHIAS. You continue to make the comment, and I will authorize staff to hear it, and the record will reflect it.

Mr. RINEHART. I have had the pleasure of serving as chairman of the Maryland Racing Commission under four Governors until I resigned. There is some suggestion here about wrongdoing which I feel very sensitive about, and this discussion which we are referring to was carried on with my administrative assistant with me. The minutes of the meeting were kept. Each Board member received a copy of the minutes. Now, how more thoroughly I could have carried on this meeting to protect everyone's interests, I am at a loss to know.

STAFF. I think we should go off of the record until the Senator's return.

[A brief recess was taken.]

Senator PROXMIRE. Go right ahead.

OPINION OF GENERAL COUNSEL

Mr. WHITEHEAD. I would like to introduce for the record a memorandum which the General Counsel prepared for me on the McDonnell-Douglas case, and it is dated August 23, 1974. It is ancillary to his opinion given Mr. Chase under date of February 22, 1974. And in it, he alludes to the fact that the Board operates by majority vote, and "in this instance the Board, on the basis of the broad application of statutory factors to the combined performance of McDonnell-Douglas segments having so concluded, it would appear perfectly proper for the Board to proceed to request only that information necessary for the contemplated method of evaluation."

So, the opinion goes—it has a further explanation——

Senator PROXMIRE. I do not want to cut you off. If you are going to read from the memorandum, I hope, you will submit it for the record. You are reading from old hearings, and we would be happy to have that in the record. I do not see how this is vital to have before us at the moment, but go ahead.

Mr. WHITEHEAD. It merely substantiates the position the Board has taken in connection with conglomerates and companies that produce a variety of products and services. It is enunciated by former Chairman Lawrence Hartwig before you in 1971 as chairman of the subcommittee, of the Joint Economic Committee.

What he is doing, is laying down the method by which he believes we should follow the Internal Revenue Code, and I would like to put this excerpt in the record also, rather than read it.

Senator PROXMIRE. Yes.

I was chairman at that time, and when he appeared I was shocked then as I am now.

[The information follows:]

THE RENEGOTIATION BOARD

DATE : AUG 23 1974

TO : The Chairman

FROM : General Counsel

SUBJECT: McDonnell Douglas Corporation
Fiscal years 1967, 1968 and 1969

Re: General Counsel's February 22, 1974 advisory opinion to Mr. Goodwin Chase re: The authority of the Board to examine contractors on the incremental parts of their business in arriving at the overall evaluation

With respect to the decision in the above referenced cases the Chairman of the Board requested, without Board members' objection, a General Counsel's opinion as to the propriety of the majority decisions. Specifically the Chairman inquired as to whether or not the Board's action was proper and within the scope of the advisory opinion referred to above.

The Board is constituted to operate by majority vote. In this case, it appears that the majority of the Board, after review of this contractor's operations and knowledge of its operations from previous years, concluded that McDonnell Douglas should be evaluated "on the basis of a broad application of the statutory factors to the combined performance of the McDonnell and Douglas segments." Having so concluded, it would appear perfectly proper for the Board to proceed to request only that information necessary for the contemplated method of evaluation.

On the other hand, had the Board concluded that a segmented analysis of this company was required under the

cricumstances, then, as indicated in the advisory opinion, the Board had authority to examine any data deemed necessary to that method of evaluation.

As I stated on page 3 of my opinion dated February 22, 1974 "a review of the legislative history would strongly suggest that the Board may, for the purposes of analysis, determine reasonable profit levels for divisions, single profit centers or individual product lines and aggregate the excesses and deficiencies from such analysis in reaching its final determination." Implicit in the foregoing interpretation of the Board's statutory authority is the Board's discretion as matter of policy, either to evaluate such individual profit centers separately or evaluate the company as a whole as the facts of any particular case may dictate.

The question of which method of analysis and procedure was appropriate under the facts and circumstances of this case is strictly a matter of Board judgment and policy, not a legal issue.

David M.F. Lambert
General Counsel

Conglomerates

Many large corporations market a variety of products or services through separate, subsidiary corporations bound together in a so-called conglomerate. Under the Renegotiation Act, as under the Internal Revenue Code, such corporations are entitled to be treated on a consolidated basis; and it is upon the totality of the profit that the Board's determination must be based.

This does not mean, however, that the evaluation—the analytical process—preceding a Board determination is also conducted on aggregate lines. Quite the contrary. A conglomerate is required to provide the Board with a separate statement of the renegotiable sales, costs, and profits of each corporate entity in the group, together with information sufficient to enable the Board to evaluate the activities of each such entity separately under the statutory factors. If the profits of a member of the group are found to be excessive, they are considered as such in the overall determination and can be offset only by a showing of losses or deficient profits of other members of the group.

Thus, excessive profits realized by a member of a conglomerate are not hidden or unknown, but are uncovered, and they have their full impact upon the final determination. This method of analyzing related corporations operating as a conglomerate is equally applicable, of course to a single large corporation operating in diverse fields through division.

The attention of this subcommittee has been called in particular to the problem of conglomerates in the shipbuilding industry. It was stated that the Renegotiation Board "no longer sees shipbuilding profits because they are averaged with profits or missiles or electronics or with any other defense activities of the parent corporation." That is not so. The renegotiable sales, costs, and profits of every major shipbuilder are reported regularly to the Board, not only as a part of the consolidated aggregate figures of the conglomerate to which he belongs, but also separately. Thus, the Board does know what profits are being made in shipbuilding contracts with the Government.

Conclusion

I Submit that the role of renegotiation is essential; that it supplements, but by no means duplicates, the techniques of the procurement process itself; and that it has been effective in eliminating excessive profits.

Thank you.

Conglomerates

Chairman PROXMIRE. Thank you very much, Mr. Hartwig.

Mr. Hartwig, apropos of your last section on conglomerates, on April 20 Admiral Rickover told this committee that most of the Navy's shipbuilders have been taken over by large conglomerates, and as a result, the Renegotiation Board doesn't see shipbuilding profits separately anymore. That is what he said. Your statement says that the Renegotiation Board does see shipbuilders' profits, so that you can recoup excess profits earned on Navy shipbuilding contracts. But from the discussion in your statement it seems that when a shipyard is taken over by a conglomerate, the shipbuilding profits will be averaged with the earnings of the parent corporation in renegotiation. Thus, the Renegotiation Board may see shipbuilders' profits, without being able to do anything in cases of excessive shipbuilders' profits.

Admiral Rickover told this committee about one shipyard, a division of the large conglomerate, that earned profits of about 50 percent on investment last year. That much profit seems excessive to me. But isn't it possible you might not recoup anything from this shipbuilder because of offsets to the parent company?

Mr. HARTWIG. In the first place, we have been unable to identify that company, Senator Proxmire.

Chairman PROXMIRE. You can't find a company that meets that criteria?

Mr. HARTWIG. No.

Chairman PROXMIRE. All right, we will be delighted to supply you that information.

Mr. HARTWIG. All right.

In the second place, if a member of a conglomerate had excessive profits, in our analysis of the case that would be carried into the total determination, and the group would not receive an overall clearance unless there were deficient profits or losses in other members of the conglomerate.

Chairman PROXMIRE. There are several questions that this poses. I know that you are abiding by the law. After all, you don't make the law, you execute it. I take it that your interpretation of the law is that this is your only alternative, to do it this way.

Mr. HARTWIG. Yes, sir.

Chairman PROXMIRE. It seems, however, that there is an incentive when you have this kind of a situation, No. 1, for the conglomerate to be in a position where it can buy into a contract even though it might not be able to qualify otherwise, to buy in because it knows that it is in a position to have excessive profits in some areas and write those off against any losses it might sustain?

Mr. HARTWIG. Whatever motivates conglomerates or other companies to buy in, I don't think that the chief motivation is renegotiation. There are other reasons for buying in—tax reasons, and others.

JOINT STUDY RECOMMENDATIONS

Mr. WHITEHEAD. The Brooks committee recommended the same general thing and I will not go into detail, but the last point I want to make is this: In the joint study conducted with the Joint Committee on Internal Revenue Taxation last year, the Board came up with a number of recommendations for changes in the law and other policy and procedural improvements. One was on the interpretation of the net worth factor, and we also recommended that the product line approach be authorized by the Congress at major industry level. We reported that, we recommended that, in the report to OMB and the Joint Committee on Internal Revenue Taxation. That is as far as it got.

We are trying to broaden our base by getting legislation that will permit us to do what Mr. Chase thinks he can do, but I do not think we can since we have to follow the Internal Revenue Code.

Senator PROXMIRE. Well, Mr. Chase's judgment is the judgment of one member, a new member. I am very much impressed by his judgment. But, however, he is one member of your Board, as you say. But your general counsel, it seems to me, with all respect, Mr. Whitehead, is your legal expert. And your general counsel has testified you have the authority to do this by product line. That is just his opinion. I have the document here dated February 22, 1974, in which he says:

> The answer is affirmative to your question as to whether the Board under the present acts and regulations may examine costs and profits generated by a division, single profit center or product line of a contractor who is filing, including more than one such division, single profit center or product line and whether the Board can apply the statutory factors to those individual entities.

So, he was very emphatic and clear on it.

Mr. WHITEHEAD. He also says that what we have done in the case of McDonnell Douglas is proper.

Senator, I have some goodies for you. I know you have been looking for them for a long time, and I would like to submit to you the three analyses which you requested from Mr. Burress in May 1973, that were included in the appendixes of our annual report in later years. I will submit these at this time.

I also want to tell you that the Board yesterday approved proposed regulations for implementing the Cost Accounting Standards, which had been hanging fire for several years.

STATEMENTS OF CLARIFICATION

And I have a couple statements I would like to put in the record clarifying further some of my former testimony.

Senator PROXMIRE. All right; that is good. We are glad to get that. We did want it a year ago. It was due in September of 1973, as you know.

Mr. WHITEHEAD. I did not assume the chairmanship until July, and I did not see the letter from you until a long time after that, but I have completed your request.

Senator PROXMIRE. Very good.

[The information follows:]

NET WORTH COMPUTATION

The 98.4% return on net worth referred to by Mr. Chase pertains to the McDonnell component only and is derived by dividing that component's profit for renegotiation of $98,182,000 as reflected in the 1967 Schedule attached to the memorandum of June 7, 1974 from Mr. Moreland to Mr. Chick by the original McDonnell component beginning renegotiable net worth balance of $97,735,000 as reflected on page 35 of the Accounting Report. In the final opinion, a majority of the Board considered the computation of returns on net worth for the consolidated corporation as a whole and also after reflecting those adjustments set out in addendum No. 3 to the Accounting Report.

October 2, 1974

Honorable William Proxmire, U.S.S.
Chairman, Subcommittee on HUD,
Space, Science, Veterans
Committee on Appropriations
United States Senate
Washington, D. C. 20510

Dear Senator Proxmire:

In a letter dated May 25, 1973, addressed to Richard T. Burress, then chairman of the Renegotiation Board, you requested that the Board prepare tables similar to those appearing in the appendix of the Board's annual report relative to Board determinations of excessive profits in fiscal years 1969, 1970, and 1971.

In his reply of June 8, 1973, Mr. Burress agreed to furnish the information requested but pointed out that, in view of the extensive nature of your request, a great deal of time and effort would be needed to compile the data. In the course of our appropriations hearings before your subcommittee, on March 26, 1974, I reconfirmed the Board's willingness to furnish the information but again pointed out the tremendous task the compilations of the data would impose on us.

We have now assembled the data and prepared the tables which, in structure, are identical to the tables in the appendix of the Board's fiscal 1973 annual report. I would like to request that these tables be accepted as part of the record of these hearings.

I also would like to request that the following material also be made part of the record of these hearings:

1. Copy of Notice of Proposed Rulemaking, expected to be published in the Federal Register in the near future, relative to contractor compliance with standards promulgated by the Cost Accounting Standards Board in renegotiation filings;

2. Copy of press release by the Renegotiation Board, dated May 31, 1974, and entitled A 15-Year Record;

3. Additional notes in connection with the testimony of the writer on July 25, 1974, pertaining to conglomerates and contractors producing a variety of products;

4. Clarification of testimony by the writer at the July 25, 1974 hearing, pertaining to the elapsed time between the verbal notice and the actual filing of dissent in the McDonnell Douglas case; and

5. Copies of signed statements by two Board Members regarding the writer's testimony at the July 25, 1974 hearing.

Sincerely,

(Signed) W. S. Whitehead

W. S. Whitehead
Chairman

THE RENEGOTIATION BOARD

PARTS 1459 and 1470

Renegotiation Regulations

NOTICE OF PROPOSED RULE MAKING

The Renegotiation Board proposes to amend its regulations to require that all financial statements filed with the Board shall be in conformance with Cost Accounting Standards promulgated by the Cost Accounting Standards Board. The Board was designated a "relevant Federal agency" under Public Law 91-379 (84 Stat. 796, approved August 15, 1970), 50 U.S.C. App. § 2168, and Cost Accounting Standards Board Regulation, Section 331.2, 4 C.F.R. § 331.2. The proposed compliance with the Cost Accounting Standards is being undertaken over a two-year period, with the first stage to become effective with respect to contractors' fiscal years beginning after December 31, 1974 but before January 1, 1976, and the second stage to be effective for fiscal years beginning on or after January 1, 1976.

The areas affected by the proposed amendments are contained in Parts 1459 and 1470 of the Board's regulations. The amendments are designed to provide better uniformity and consistency in the methods of accounting to be employed for renegotiation purposes.

The principal changes proposed are the following:

1. For fiscal years beginning after December 31, 1974 but before January 1, 1976, contractors with any renegotia-

ble contracts or subcontracts subject to one or more of the Cost Accounting Standards will be required to file financial statements with the Board with respect to all their renegotiable business for such fiscal years in conformance with all Cost Accounting Standards in effect with respect to any such renegotiable contract or subcontract. It is intended that, for such fiscal years, any Cost Accounting Standard which is applicable to any renegotiable contract or subcontract under 50 U.S.C. App. § 2168 for any portion of the contractor's fiscal year must be applied to all renegotiable business of such contractor for his entire fiscal year although none of the Cost Accounting Standards may be applicable to certain of his renegotiable contracts or subcontracts under 50 U.S.C. App. § 2168.

2. For fiscal years beginning on or after January 1, 1976, all contractors subject to renegotiation will be required to file financial statements with the Board with respect to all their renegotiable business in conformance with all Cost Accounting Standards in effect even though none of the contractor's renegotiable business is otherwise subject to such standards.

3. For good cause shown, the Board may except a contractor from compliance with one or more of the Cost Accounting Standards if such compliance is not required by 50 U.S.C. App. § 2168.

The Board proposes to issue the proposed amendments not earlier than December 2, 1974. Interested persons are hereby notified that any changes to be considered must be presented, in writing, to the Renegotiation Board, 2000 M Street, N.W., Washington, D.C. 20446, not later than November 25, 1974.

Written material or suggestions submitted will be available for public inspection during regular business hours in the library at the principal office of the Board, 2000 M Street, N.W., Washington, D.C.

Dated Oct. 4, 1974

(Signed)
W.S. Whitehead
Chairman

Published in the Federal Register October 9, 1974

DISTRIBUTION: Category IV

TITLE 32--NATIONAL DEFENSE

CHAPTER XIV--RENEGOTIATION BOARD

Subchapter B--Renegotiation Board Regulations

Under the 1951 Act

Miscellaneous Amendments to Chapter

PART 1459 COSTS ALLOCABLE TO AND ALLOWABLE AGAINST RENEGOTIABLE BUSINESS

Section 1459.1(b) Profits, cost allocation and allowance; general is amended as follows:

1. Subparagraphs (1) through (7) inclusive of paragraph (b) are deleted in their entirety and the following inserted in lieu thereof:

(b) Profits, cost allocation and allowance; general.--(1) Accounting methods.--In connection with renegotiation on an over-all fiscal year basis, except as otherwise provided in these

regulations, income received or accrued and costs paid or incurred will be considered as having been received or accrued or paid or incurred in the fiscal year to which such items are to be attributed in accordance with the method of accounting employed by the contractor in determining net income for Federal income tax purposes or in accordance with such other method of accounting as the contractor and the Board may agree upon pursuant to the provisions of subparagraph (3) of this paragraph (b): Provided that, the method of accounting to be employed is not in conflict with the contractor's obligations under subparagraph (2) of this paragraph (b). Except with respect to allocations made pursuant to such

subparagraph (2), nothing in the preceding sentence shall affect the authority of the Board under section 103(f) and (i) of the Act to determine the income received or accrued or the costs paid or incurred by the contractor with respect to renegotiable business in a fiscal year in accordance with such method of accounting as, in the opinion of the Board, properly reflects such income or costs, if the method of accounting employed by the contractor in determining net income for Federal income tax purposes does not, in the opinion of the Board, properly reflect such income or costs, and the contractor and the Board are unable to agree upon a method which does properly reflect such

income or costs.

(2) Cost accounting standards.--As a designated "relevant Federal agency" under Public Law 91-379 (84 Stat. 796, approved August 15, 1970), 50 U.S.C. App. § 2168, and Cost Accounting Standards Board regulation, section 331.2, 4 C.F.R. § 331.2, the Board extends recognition to uniform Cost Accounting Standards promulgated by the Cost Accounting Standards Board and contractors, in filing financial statements with the Renegotiation Board, are required to comply with such standards as provided herein.

(i) Fiscal years beginning after December 31, 1974 but before January 1, 1976.--For fiscal years beginning after

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December 31, 1974 but before January 1, 1976, contractors with any renegotiable contracts or subcontracts subject to one or more Cost Accounting Standards are required to file financial statements with the Renegotiation Board with respect to all of their renegotiable business for such fiscal years in conformance with all Cost Accounting Standards in effect with respect to any such renegotiable contract or subcontract.

(ii) Fiscal years beginning on or after January 1, 1976.--For fiscal years beginning on or after January 1, 1976, contractors are required to file financial statements with the Renegotiation Board as follows:

(a) Contractors with any renegotiable contracts or subcontracts subject to one or more Cost Accounting Standards are required to file financial statements with respect to all their renegotiable business in conformance with all Cost Accounting Standards in effect with respect to any such renegotiable contract or subcontract.

(b) Contractors with no renegotiable contracts or subcontracts subject to any Cost Accounting Standards are required to file financial statements with respect to all their renegotiable business in conformance with those Cost Accounting Standards in effect at the beginning of the contractor's fiscal year.

(iii) Exception.--Upon good cause

shown, the Board may except a contractor from compliance with one or more of the Cost Accounting Standards for a fiscal year to the extent that compliance is not otherwise required by 50 U.S.C. App. § 2168. A request for this exception shall be submitted to the Board in writing as soon as practicable after the close of the applicable fiscal year, but in no event later than the first day of the third month following the close of such fiscal year.

(iv) Accounting period.--The Renegotiation Board has been excepted from certain provisions of Cost Accounting Standard No. 406, "Cost Accounting Period." Thus, where the contractor's cost accounting period is different

from its fiscal year under the Act, the latter shall be used.

(3) Differing accounting methods.--(i) The Board will permit a contractor to adopt for renegotiation purposes a method of accounting other than that used by the contractor for Federal income tax purposes, provided that:

(a) The method of accounting to be adopted is not in conflict with the contractor's obligation under 50 U.S.C. App. § 2168 or subparagraph (2) of this paragraph (b) to comply with the Cost Accounting Standards.

(b) The Board finds that the method of accounting employed by the contractor for Federal income tax purposes is manifestly unsuitable for the purpose of

renegotiation because it does not clearly reflect the profits attributable to the contractor's performance of renegotiable contracts for the fiscal year under review, and the method of accounting to be adopted does clearly reflect such profits; and

(c) The contractor enters into a written agreement with the Board before the conclusion of the renegotiation proceedings for the year under review, providing among other things substantially as follows:

(1) That the contractor will employ such different method of accounting for the purposes of the renegotiation proceedings for the year under review and all subsequent years, whether such

proceedings are concluded by agreement or order;

(2) That no cost or expense recognized in the renegotiation proceedings for the first year covered by the agreement will be recognized in any subsequent renegotiation proceeding; and

(3) That the computation of losses, if any, in preceding fiscal years (see section 1457.8 of this subchapter) will be made on the basis of such different method of accounting.

(ii) Under this section, a contractor may adopt a different method of accounting for the purpose of determining all amounts received or accrued and costs paid or incurred in a fiscal year, as in the case of a change from a cash receipts and disbursements method of accounting to an accrual

method of accounting; or it may adopt a different method of accounting for a particular item of cost or for a particular class of items of cost which would result in recognizing such item or items in one fiscal year rather than another.

(iii) Subject to the foregoing conditions, the Board will also permit a contractor to adopt for renegotiation purposes the completed contract method of accounting for contracts to be performed over a period of more than one fiscal year, which, because of circumstances of performance, would require estimates of performance and allocation of income and cost that could result in material distortion in accounting on an interim basis

prior to completion. Such contracts may include contracts for construction of major facilities or major units (such as a vessel or group of vessels) when the profits can best be determined upon completion.

(iv) If a contractor employs, for the purposes of a renegotiation proceeding relating to the year under review, a method of accounting different from that which it employed for the purposes of a renegotiation proceeding relating to the preceding fiscal year, whether pursuant to this section or otherwise, it will be required to employ such different method of accounting for the purposes of all subsequent renegotiation proceedings, and the amounts

received or accrued and costs paid or incurred which have been recognized in prior renegotiation proceedings will not be recognized in the proceedings relating to the year under review.

(4) Allocation of costs.--In general, except as provided in subparagraph (2) of this paragraph (b), the costs paid or incurred with respect to renegotiable business in the fiscal year under review will be the costs allocated to such business and such year by the contractor's established cost accounting method if that method reflects recognized accounting principles and practices. If in the opinion of the Board there is no adequate or effective cost accounting method in

use, or if the method employed does not properly reflect such costs because there are unjustified or improper allocations of items of cost in the accounting records or in the reports or statements filed for the purpose of renegotiation, costs will be allocated in accordance with such method as in the opinion of the Board does properly reflect such costs. The fact that all receipts and accruals during a fiscal year are classifiable as renegotiable does not necessarily mean that all items of cost estimated to be deductible in that year are allocable to renegotiable business.

(5) Tax deductions.--When an item of cost is allocable in whole or in part to

renegotiable business, the Board will estimate the amount allowable as a deduction or exclusion under chapter 1 of the Internal Revenue Code, and such estimated amount will be allowed as a cost of renegotiable business in the fiscal year under review to the extent that it is allocable to such business and such year in accordance with the principles set forth in this paragraph (b). No such item of cost will be allowed in an amount less than or in excess of that estimated to be deductible or excludable from income under the Internal Revenue Code, and all items of cost will be allocated to the fiscal year in which they are allowable in the determination of taxable income under

said Code, except as otherwise provided in this paragraph (b). When it is clear that a contractor's deductions and exclusions under the Internal Revenue Code result in allowable costs of renegotiable business which are in the aggregate either high or low on a comparative basis, this circumstance will be considered in connection with the factor of the "reasonableness of costs" of the contractor and the determination of the amount of any profit adjustment to be required of the contractor. In estimating amounts allowable as deductions or exclusions under chapter 1 of the Internal Revenue Code, due consideration will be given to any pertinent action by the Internal Revenue Service. Published rulings of the Internal Revenue Service

on matters of general application will be adhered to in making such estimates. However, the allowance of items as costs is not required merely because they have been or are expected to be allowed for tax purposes by particular revenue agents or other field representatives of the Internal Revenue Service. Occasionally cases may be encountered in which revenue agents will have allowed salaries or other items as deductions for tax purposes which the Board concludes are not properly allowable under the Internal Revenue Code or are properly allowable in a different amount or for a different year. In such cases the action of the revenue agents is not regarded as conclusive. Similarly,

disallowances by such officials are not conclusive. The Board will exercise independent judgment on whether and to what extent and for what year items are allowable as deductions or exclusions under the Internal Revenue Code. Such judgment will be based upon an estimate of what the courts would do if the deductibility or excludability of the items were the subject of litigation.

(6) Effect of cost principles promulgated by other agencies.--Agreements for the allowance or disallowance of costs entered into by a contractor with another agency of the Government, either by specific contractual provision or by acceptance (expressed or implied) of Government regulations or policies, are not controlling with

respect to recognition of such costs for renegotiation purposes. Thus, a cost properly disallowed in accordance with the Armed Services Procurement Regulation, in connection with a contract to which such regulation is applicable, will nevertheless be recognized for renegotiation purposes if such cost is a proper Federal income tax deduction. Similarly, an item allowable as a "cost" by such regulation or by specific contractual agreement will not be allowed unless it is a proper Federal income tax deduction. Furthermore, a specific agreement that additional proper costs incurred in performing a contract will not be claimed as an addition to the contract price will not result in the non-recognition of such cost for renegotiation purposes.

(7) Conditional allowance of cost.--If an occasion should arise in which the Board is unable to make a reasonable estimate of whether or the extent to which a particular item is allowable as a deduction or exclusion under the Internal Revenue Code for the year under review and the item is material in relation to the excessive profits to be eliminated, the Board may allow the item as a cost in renegotiation, provided that the contractor agrees to refund as additional excessive profits the amount so allowed to the extent that such amount may finally be determined to be not allowable as a deduction or exclusion under the Internal Revenue Code for the year under review.

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(8) Costs previously allowed in renegotiation.--No item will be allowed as a cost of renegotiable business to the extent that such item has, in a previous renegotiation under the act or under any other renegotiation law, been allowed as a cost in determining excessive profits, notwithstanding that such item may be a deduction or exclusion under chapter 1 of the Internal Revenue Code in computing taxable net income for the taxable period corresponding to the fiscal period covered by the current renegotiation.

2. Subparagraph (8) is renumbered subparagraph (9).

PART 1470 INFORMATION REQUIRED OF CONTRACTORS

Section 1470.3 Filing of financial statement is amended as follows:

1. Paragraph (c) is amended by inserting after the heading Sufficiency of contents the following:

(1) General.--

2. Paragraph (c) is further amended by inserting immediately following paragraph (c)(1) the following new subparagraph (2):

(2) Cost accounting standards.--

The Board recognizes the Cost Accounting Standards promulgated by the Cost Accounting Standards Board. To the extent one or more such standards are applicable to a fiscal year, under the provisions of 50 U.S.C. App. § 2168 and § 1459.1(b)(2) of this subchapter, the Standard Form of Contractor's Report

shall be prepared in accordance therewith. Upon request there shall be filed with the Board copies of disclosure statements, if any, and other explanatory documents and information filed with the Cost Accounting Standards Board and procurement agencies.

(Sec. 109, 65 Stat. 22; 50 U.S.C.A., App. Sec. 1219)

THE RENEGOTIATION BOARD
UNITED STATES OF AMERICA

NEWS RELEASE

2000 M Street, N.W.
Washington, DC 20446

Information 254-8266

FOR IMMEDIATE RELEASE
May 31, 1974

74-3

A 15-YEAR RECORD

President Nixon has been informed by William S. Whitehead, Chairman of the Renegotiation Board, that during fiscal year 1974, excessive profits determinations rendered to defense and related contractors totaled over $70,000,000, after computing state tax credits.

The Renegotiation Board is charged under the law with the responsibility of recapturing excessive profits earned on contracts with the Department of Defense, Atomic Energy Commission, Maritime Commission, National Aeronautics and Space Administration, General Services Administration and the Federal Aviation Administration.

The amount of over $70,000,000 resulted from the issuance of unilateral orders by the Board, and from agreements which it entered into with contractors.

The Board's excessive profits recovery for the 1974 fiscal year is the best for any such previous period since 1958, a 15-year record.

- END RELEASE -

ADDITIONAL NOTES PREPARED BY W.S. WHITEHEAD,
CHAIRMAN OF THE RENEGOTIATION BOARD
pertaining to those submitted on July 25, 1974
before the

Senate Committee on Appropriations
Subcommittee on HUD, Space, Science, Veterans

In reference to remarks made by me as Chairman of the Renegotiation Board at the hearing on July 25, 1974 with regard to the method of renegotiating a contractor with renegotiable business in more than one division or subsidiary, I would like to submit the following for clarification purposes.

The remarks made were from information that was basically prepared at my request by Mr. Grenough, Director, Office of Accounting, who furnished a draft copy to Mr. Harrison, Acting Director, Office of Review, and which were reviewed by Dr. Lenches, Director, Office of Planning & Analysis. These are technical matters which, in my opinion, reflect the position of the Board for many years past.

At the hearings before the Subcommittee on Priorities and Economy in Government of the Congressional Joint Economic Committee on May 24 and 25, 1971, Honorable L. E. Hartwig, Chairman of the Renegotiation Board, testified as follows:

> Many large corporations market a variety of products or services through separate, subsidiary corporations bound together in a so-called conglomerate. Under the Renegotiation Act, as under the Internal Revenue Code, such corporations are entitled to be treated on a consolidated basis; and it is upon the totality of the profit that the Board's determination must be based.
>
> This does not mean, however, that the evaluation--the analytical process--preceding a Board determination is also conducted on aggregate lines. Quite the contrary. A conglomerate is required to provide the Board with a separate statement of the renegotiable sales, costs, and profits of each corporate entity in the group, together with information sufficient to enable the Board to evaluate the activities of each such entity separately under the statutory factors. If the profits of a member of the group are found to be excessive, they are considered as such in the overall determination and can be offset only by a showing of losses or deficient profits of other members of the group.

The House Committee on Government Operations' recommendation in "The Efficiency and Effectiveness of Renegotiation Board Operations," House Report No. 92-758, 92d Cong., 1st Sess. Dec. 16, 1971, was:

> (d)(4) Classify contractor sales according to individual commodity grouping and base renegotiation on product line sales, rather than basing renegotiation on total company sales. To facilitate renegotiation on a product line basis, contractors should be required to report costs and profits on defense contracts over $100,000 on a contract-by-contract basis. These cost and profit reports should be audited by Defense Department auditors prior to submittal.

On February 7, 1974, Chairman Whitehead and Members Mattingly, Chase and Houston adopted the following recommendation in response to the Committee's recommendation (d)(4):

> Amend the Act to provide statutory authority to conduct renegotiation separately by major industry groups or by such subdivisions thereof as the Board may by regulations determine.

In conclusion, it appears to me:

1. That the position of the former Chairman, Mr. Hartwig, was eminently clear and correct when he stated relative to conglomerates that corporations are entitled to be treated on a consolidated basis under the Renegotiation Act as under the Internal Revenue Code and that it is upon the totality of the profit that the Board's determination must be based;

2. That the majority of the Members of the Renegotiation Board believed it was necessary to obtain legislative action to accomplish the objective of recommendation (d)(4) in the report of the House Committee on Government Operations; and

3. That after 21 years experience in renegotiation work, the Board would violate the renegotiation statute if it did not examine conglomerates on the basis which Mr. Hartwig had stated.

I firmly believe that to treat conglomerates and contractors who produce a variety of products and file on a consolidated basis in any way other than what the Board has been treating them over many years, will require legislation.

SUBMISSION OF CHAIRMAN WHITEHEAD
FOR INTRODUCTION INTO THE RECORD
of the hearing on October 2, 1974
before the

Senate Committee on Appropriations
Subcommittee on HUD, Space, Science, Veterans

In the course of the hearings on July 25, 1974, I testified to the effect that the McDonnell Douglas case had been held up for at least four months in order to get Mr. Chase to write a dissent, so that we could send it together with the Board's Final Opinion to the contractor.

As Chairman of the Board, I am primarily concerned with the final positions of the Board and with the issuance of final documents relating to such decisions; I am not normally involved in the day-to-day processing of a case. Thus, in my testimony, notwithstanding the words I actually used, I was referring to the elapsed time of four months between February 20, 1974 when, at a Board meeting, Mr. Chase verbally dissented on the McDonnell Douglas case, noting that he would state his views in writing, and July 3, 1974, when his dissent was filed with the Secretary of the Board for transmittal to the contractor.

The foregoing is evidenced by the chronology prepared by Division Chairman, D. Eldred Rinehart,

McDonnell Douglas

Important Dates in the Proceedings

7/3/73	The 1967 year was reassigned to the Statutory Board and to a three-man division with Mr. Rinehart appointed as Chairman.
7/9/73	A letter was received from Mr. Forry of McDonnell Douglas requesting that 1968 and 1969 be added to the 1967 proceedings.
7/24/73	A letter was received from Mr. Forry containing reasons for the request made in the 7/9/73 letter.
7/31/73	A letter was sent from Mr. Rinehart to the contractor granting approval of the above request.
10/16/73	The possibility of a meeting in December was discussed with Mr. Forry by Mr. Girard.

10/31/73 The 1968 and 1969 years were assigned together with the 1967 year to a five-man division with Mr. Rinehart as Chairman.

11/20/73 A request was made by telephone by Mr. Forry for a Notice of Points letter.

11/27/73 A Notice of Points letter was mailed to the contractor and was given orally by telephone. (Tuesday)

11/28/73 A telephone conversation took place with the contractor in regard to the meeting; contractor indicated it might request a deferral to study its position on the issue raised in the Board's Notice of Points letter. (Wednesday)

11/30/73 Analysis was distributed by the Office of Review. (Friday)

12/3/73 A letter was received from Mr. Forry confirming the meeting and requesting removal of a request of the Board in the Notice of Points letter. (Monday)

12/6/73 A proposed letter to the contractor in regard to its request was not approved by Mr. Rinehart after a conference with Mr. Girard, Director, Office of Accounting (the request for the withdrawal of Notice of Points letter). (Thursday)

12/12/73 A refresher meeting was held in St. Louis after a tour of the contractor's facilities; the division decided to drop the request made in its Notice of Points letter. (Wednesday)

12/13/73 The contractor's meeting was held in St. Louis.

1/14/74 A decision meeting was held and resulted in the approval of $5,000,000 refund in 1967 and Clearances for 1968 and 1969. These findings were conveyed to the contractor by Mr. Rinehart.

1/31/74 The contractor agreed by letter to the division's findings.

2/20/74 The division report was submitted for Board action; notice of dissent was given by Mr. Chase.

3/26/74 The possibility of a dissent was made public by Mr. Whitehead during the hearing before the Appropriations Subcommittee.

4/4/74 A draft of the Memorandum of Decision was submitted for staff approval.

4/9/74 The proposed Memorandum of Decision was submitted to Board members for comments or corrections.

4/12/74 The dissent was filed for inclusion with the MOD.

4/17/74 The MOD was typed in final form.

4/29/74 A hold was put on the MOD by Mr. Rinehart; a meeting took place between Mr. Rinehart and Mr. Chase.

4/30/74 The Board requested Mr. Chick and Mr. Harrison to obtain information that had been originally requested in the Notice of Points letter.

4/30/74 A meeting was held by Mr. Rinehart and Mr. Chase with staff members concerning the information to be obtained.

4/30/74 The contractor was notified by telephone that the additional information would be required.

5/1/74 Messrs. Forry, Chick and Harrison met to discuss the information which would be required and to make arrangements for accountants to visit the plant and obtain the material.

5/8/74)
5/23-24/74)
5/28-29-31/74) Staff visited plant to obtain necessary information.

6/7/74 The report was filed by Mr. Moreland.

6/17/74 The revised Opinion (formerly MOD) was discussed with Mr. Chase by Mr. Rinehart.

6/17/74 The Final Opinion was drafted (included 1968 and 1969 years also).

6/18/74 The Opinions were submitted for Board action and were approved; the notice of dissent was given.

7/3/74 The dissent was filed.

THE RENEGOTIATION BOARD

DATE : September 23, 1974.

TO : William S. Whitehead, Chairman

FROM : D. Eldred Rinehart, Board Member

SUBJECT: Extension of Remarks at Hearing on Thursday, July 25th, 1974, before the Subcommittee on Housing and Urban Development, Space Science, Veterans and Certain Other Independent Agencies, Committee on Appropriations, United States Senate. (See transcript: page 1406, line 17 through page 1408, line 7.)

On several occasions during the Spring, I discussed with the Chairman my concern about what I felt was the misuse of our staff by Board members. At a later date, I brought this question to the attention of the Board at a regular Board meeting. I stated at that time that, in my opinion, the Board members were calling on staff - particularly Mr. Lambert, General Counsel; Mr. Chick, Director, Office of Review; and Mr. Grenough, Director, Office of Accounting - for information and assistance far in excess of that required for ordinary case work, thereby contributing to the delay in moving the backlog of cases.

Subsequent to the Board meeting, in regard to one of the cases on which I was serving as Chairman of the division, it was necessary for the division and the Office of Review to have a legal opinion in regard to salary disallowance before proceeding with the case. After what seemed to me an unusual delay, the matter was discussed with the Chairman, and I advised him that I was concerned about such delays in the Office of General Counsel. I suggested to the Chairman that he bring this matter to the attention of Mr. Lambert as I felt that I, as a Board member, individually, could not be issuing orders concerning the Office of General Counsel and the delegation of staff time. I told him I would support him in whatever steps were necessary in order to correct the situation.

D. Eldred Rinehart
Board Member

August 1, 1974

In June 1974, it came up in a discussion with the Chairman that the staff was spending so much time advising Mr. Chase that other work was being neglected. This was the most serious in connection with the involvement of the Office of General Counsel because we believed Mr. Lambert was personally spending an inordinate amount of his time in that area. We agreed that this was only one indication of the failure of Mr. Lambert to make adequate use of his staff.

We also discussed the problem of Mr. Lambert involving himself in Board policy matters without the authority of the Chairman.

It was agreed that the Chairman would discuss the above problems with Mr. Lambert and if not corrected the Chairman would have my support if he thought it necessary to make a replacement.

Rex M. Mattingly

Rex M. Mattingly, Board Member

INVESTIGATION ESSENTIAL

Senator PROXMIRE. I am told in the 1966 McDonnell case, the Board found the contractor had understated his profits by about $50 million; that was 1966. And this formed part of the basis for the final determination that McDonnell had taken $27 million in excess profits that year.

Do not these facts strongly suggest, Mr. Whitehead, that you cannot take the filings of the giant firms, such as Mobil, at face value? That it is necessary, at least, to investigate them to determine the accuracy of the figures you are given?

ACCURACY OF ACCOUNTING DATA

Mr. WHITEHEAD. Well, sir, we have increased our assignments to the field tremendously in the last year, or even since the spring. And we believe that we are doing a much more thorough job with respect to analyzing these things and screening them than we ever did before. But so far as the results are concerned, so far as money results are concerned, the extra screening has not brought out, or the extra assignment of cases to the field has not brought out, an appreciably higher amount of excessive profits than before the intense assignment to the field.

Senator PROXMIRE. Mr. Chase, would you like to make a final comment?

Mr. CHASE. Mr. Chairman, in my judgement—but Mr. Lambert should speak for himself—his second opinion, which he was instructed by the Chairman to write, strengthens the first opinion.

I would like to read a brief statement from a man I admire very much, Admiral Hyman Rickover. This being a part of his testimony on September 24, 1969, before the Government Operations Subcommittee of the Committee on Government Operations. He said:

> The Renegotiation Act should require renegotiation of contractors by individual commodity groupings, as the groupings described by the Federal Supply Catalogue, rather than basing renegotiation on total company sales. This would help prevent large corporations from hiding excessive profits in the average figures they report to the Renegotiation Board.

Admiral Rickover referring to those instances wherein they use so-called deficient profits. The Admiral continues:

> Today, large corporations possess a substantial advantage over small companies in renegotiation since the large corporation can average all of the various business and product lines into a profit figure.

Mr. Chairman, in the year I have been with the Renegotiation Board, I have seen the 100 Department of Defense largest contractors before the Board cleared or cleared without assignment about as fast as you could do it. Seldom does one go to the field. We take a defense contractor with a $2 million or $3 million volume and a single product line and we'll send people out in the field and examine them up one side and down the other and in many cases jeopardize their financial capability to continue as a defense contractor.

So to me all that this dialog today and at the July 25 hearing has done is to substantially stimulate confusion and complicate the issues on the record. I return to the proposition that in the case of McDonnell Douglas, and I would like to have anyone who looks into it thoroughly

say that this is not a valid position, that we left an enormous amount of excessive profits on the table in the years 1967 and 1968. We have no idea what it is in 1969, for the reason that we didn't have usable information.

They have as much sales, approximately $1 billion, in that year and I am confident that the same procedure is given many other large defense contractors who should be examined in more detail. They can talk and confuse the record from now until midnight but they can't find a scintilla of evidence that my position in the McDonnell Douglas case is not valid. I stand on it.

I have read to you the statements of our professionals. How we put that dissent together as well as we did, as effectively as we did, with the limitation of staff is beyond me. I think if we had had more time to examine in depth the elements of the costs of goods sold by product line in the field, we would have indeed found that excessive profits beyond the $31 million my dissent referred to. And I think the American people are getting fed up with all of this double talk that they hear not only from the Renegotiation Board but often from the Congress itself.

Mr. Chairman, your testimony in years past has supported the Renegotiation Board and you have been a champion of providing adequate staff, and so has Mr. Brooks and others in the Congress. And yet we continue to muddle through, and I'm getting sick and tired of it. I think I would not be fully meeting my responsibility as a member of this Board, if I did not speak out on this incredible process of my observation since I became knowledgable of what the problem really is.

Senator PROXMIRE. Thank you very much, Mr. Chase. And as you know and as you said, I have fought to provide more staffing for the Renegotiation Board and more personnel in the past, although I have tried to oppose most Government spending programs. But what the hearings held today show in my judgment is that we have a regulatory agency which is not only toothless but gumless, aimless, and not doing the job it is supposed to do. Tens of billions of dollars of defense contracts—in fact, 90 percent of defense contracts are made not by competition, but through negotiated bidding. The assumption is that any excesses allowed by regulation will be recaptured by renegotiation. So this function is absolutely vital. That excessive profits will be recaptured, however, is just not true; it is a myth.

We find today's profits of 90 percent or more return on equity, which is outrageous and shocking on any kind of a basis, are allowed. We find contracts where the basic facts needed to make a sound judgment are not asked for. And we find high profits on defense contracts are allowed to offset low profits on commercial business.

What we need is regulation in the public interest. What we have is a feeble, inept, soft regulation at best. The American people and especially the American taxpayer deserve far better from their public servants.

We have also had here not only that very sad result, but we have a most serious clash between the Commission and the Chairman of the Commission and the staff. We have what seemed to be a clear case of intimidation with respect to the Chairman's attitude toward the general counsel of the staff. We had a division that is not a healthy and wholesome division on policy between members of the Board, but

one that is more fundamental and seems to be based on a lack of respect and consideration and a lack of cooperation between the members of the Board.

I have asked the representatives of the General Accounting Office to attend the hearing today and to follow this as closely as they can, and we intend to take further steps. It seems to me that the conclusion that we must come to is either we have a drastic reform of this operation so it can do the job it ought to do, or the Board ought to be abolished and its functions transferred someplace where the job can be done. Whether that is the Defense Department or some other agency, we might have to determine. But obviously, it is not being done properly at the present time.

The committee will stand in recess, subject to the call of the Chair.

Mr. WHITEHEAD. May I say one word or two, Senator?

Senator PROXMIRE. All right.

Mr. WHITEHEAD. Roughly 30 percent of all 100 DOD's in the last 8 months have been assigned to the regions for review.

Senator PROXMIRE. Thirty percent?

Mr. WHITEHEAD. Thirty percent; yes, sir.

Senator PROXMIRE. Thank you.

Mr. WHITEHEAD. One other thing.

I would just like to close on the note that for fiscal 1974 we had the best year that we have had in the recovery of excessive profits in 15 years.

Thank you very much.

CONCLUSION OF HEARINGS

Senator PROXMIRE. This concludes the hearings on the Renegotiation Board. The subcommittee will stand in recess now, subject to to the call of the Chair.

[Whereupon, at 5:35 p.m., Wednesday, October 2, the hearings were concluded and the subcommittee was recessed to reconvene at the call of the Chair.]

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